FEDERAL RECEIPTS AND COLLECTIONS

17. FEDERAL RECEIPTS

Receipts (budget and off-budget) are taxes and other collections from the public that result from the exercise of the Federal Government's sovereign or governmental powers. The difference between receipts and outlays is the surplus or deficit.

The Federal Government also collects income from the public from market-oriented activities. Collections from these activities, which are subtracted from gross outlays, rather than added to taxes and other governmental receipts, are discussed in the next Chapter.

Total receipts in 2008 are estimated to be $2,662.5 billion, an increase of $122.4 billion or 4.8 percent relative to 2007. Receipts are projected to grow at an average annual rate of 5.6 percent between 2008 and 2012, rising to $3,307.3 billion. This growth in receipts is largely due to assumed increases in incomes resulting from both real economic growth and inflation.

As a share of Gross Domestic Product (GDP), receipts are projected to decline from 18.5 percent in 2007 to 18.3 percent in 2008, and to rise to 18.6 percent in 2012.

Table 17–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
Individual income taxes	1,043.9	1,168.8	1,246.6	1,331.1	1,428.3	1,517.3	1,636.6
Corporation income taxes	353.9	342.1	314.9	319.8	325.5	340.6	366.6
Social insurance and retirement receipts	837.8	873.4	927.2	974.2	1,029.3	1,085.7	1,138.8
(On-budget)	(229.4)	(239.2)	(253.1)	(262.8)	(276.0)	(289.9)	(303.4)
(Off-budget)	(608.4)	(634.1)	(674.1)	(711.4)	(753.3)	(795.8)	(835.3)
Excise taxes	74.0	57.1	68.1	63.1	63.6	68.6	71.3
Estate and gift taxes	27.9	25.3	25.7	27.4	21.7	1.7	0.5
Customs duties	24.8	26.8	29.2	30.7	32.7	34.3	35.7
Miscellaneous receipts	45.0	46.7	50.7	52.0	53.6	55.5	57.8
Total receipts	2,407.3	2,540.1	2,662.5	2,798.3	2,954.7	3,103.6	3,307.3
(On-budget)	(1,798.9)	(1,906.0)	(1,988.4)	(2,086.9)	(2,201.4)	(2,307.8)	(2,472.0)
(Off-budget)	(608.4)	(634.1)	(674.1)	(711.4)	(753.3)	(795.8)	(835.3)
Total receipts as a percentage of GDP	18.4	18.5	18.3	18.3	18.3	18.3	18.6

Table 17–2. EFFECT ON RECEIPTS OF CHANGES IN THE SOCIAL SECURITY TAXABLE EARNINGS BASE

(In billions of dollars)

	Estimate				
	2008	2009	2010	2011	2012
Social security (OASDI) taxable earnings base increases:					
$97,500 to $102,600 on Jan. 1, 2008	2.7	7.0	7.9	8.8	9.7
$102,600 to $107,700 on Jan. 1, 2009	....	2.7	7.0	7.9	8.8
$107,700 to $113,100 on Jan. 1, 2010	....	....	2.8	7.4	8.3
$113,100 to $118,500 on Jan. 1, 2011	....	....	....	2.8	7.5
$118,500 to $123,600 on Jan. 1, 2012	....	....	....	....	2.7

Chart 17–1. Major Provisions of the Tax Code Under the 2001, 2003, 2004, and 2006 Enacted Tax Relief

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
Individual Income Tax Rates	Rates reduced to 35, 33, 28, and 25 percent								Rates revert to 39.6, 36, 31, and 28 percent
10 Percent Bracket	Top of bracket increased to $7,000/$14,000 for single/joint filers and inflation-indexed								Bracket eliminated, lowest bracket reverts to 15 percent
15 Percent Bracket for Joint Filers	Top of bracket for joint filers increased to 200 percent of top of bracket for single filers								Top of bracket for joint filers reverts to 167 percent of top of bracket for single filers
Standard Deduction for Joint Filers	Standard deduction for joint filers increased to 200 percent of standard deduction for single filers								Standard deduction for joint filers reverts to 167 percent of standard deduction for single filers
Child Credit	Tax credit for each qualifying child under age 17 increased to $1,000 and refundability extended to families with 1 or 2 children								Tax credit for each qualifying child under age 17 reverts to $500 and refundability restricted to taxpayers with 3 or more children
Estate Taxes	Top rate reduced to 49 percent	Top rate reduced to 48 percent Exempt amount increased to $1.5 million	Top Rate reduced to 47 percent	Top rate reduced to 46 percent Exempt amount increased to $2 million	Top rate reduced to 45 percent		Exempt amount increased to $3.5 million	Estate tax repealed	Top rate reverts to 60 percent Exempt amount reverts to $1 million
Small Business Expensing	Deduction increased to $100,000, reduced by amount qualifying property exceeds $400,000, and both amounts inflation-indexed Includes software							Deduction reverts to $25,000, reduced by amount qualifying property exceeds $200,000 and amounts not inflation-indexed Does not apply to software	

Chart 17–1. Major Provisions of the Tax Code Under the 2001, 2003, 2004, and 2006 Enacted Tax Relief—Continued

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
Capital Gains	Tax rate on capital gains reduced to 5/15 percent					Tax on capital gains eliminated for taxpayers in 10/15 percent tax brackets			Tax rate on capital gains reverts to 10/20 percent (8/18 percent on assets held over 5 years)
Dividends	Tax rate on dividends reduced to 5/15 percent					Tax on dividends eliminated for taxpayers in 10/15 percent tax brackets			Dividends taxed at standard income tax rates
Bonus Depreciation	Bonus depreciation increased to 50 percent of qualified property aquired after 5/5/03		Bonus depreciation expires						
Alternative Minimum Tax	AMT exemption amount increased to $40,250/$58,000 for single/joint filers			AMT exemption amount increased to $42,500/$62,550 for single /joint filers	AMT exemption amount reverts to $33,750/ $45,000 for single /joint filers				

ENACTED LEGISLATION

Several laws were enacted in 2006 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

TAX INCREASE PREVENTION AND RECONCILIATION ACT OF 2005

The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), which was signed by President Bush on May 17, 2006, extended previously enacted tax cuts that helped spur investment and economic expansion, resulting in more jobs and higher wages for American workers. The provisions of this Act increased the Alternative Minimum Tax (AMT) exemption amount for 2006; temporarily extended increased expensing limits for small businesses; reduced tax rates on capital gains and dividends; and made other miscellaneous changes to tax law. The major provisions of this Act are described below.

Expiring Provisions

Extend increased expensing for small business.—Under prior law, business taxpayers were allowed to expense up to $100,000 in annual investment expenditures for qualifying property (expanded to include off-the-shelf computer software) placed in service in taxable years beginning in 2003 through 2007. The maximum amount that could be expensed was reduced by the amount by which the taxpayer's cost of qualifying property exceeded $400,000. Both the deduction and annual investment limits were indexed annually for inflation, effective for taxable years beginning after 2003 and before 2008. Also, with respect to a taxable year beginning after 2002 and before 2008, taxpayers were permitted to make or revoke expensing elections on amended returns without the consent of the Internal Revenue Service (IRS) Commissioner. This Act extended each of these temporary provisions, applicable for qualifying property (including off-the-shelf computer software) placed in service in taxable years beginning in 2008 and 2009.

Extend reductions in individual income taxes on capital gains and dividends.—Under prior law, the maximum individual income tax rate on net capital gains and dividends was 15 percent for taxpayers in individual income tax rate brackets above 15 percent and 5 percent (zero in 2008) for lower income taxpayers. This Act extended these reduced rates (15 percent and zero), which were scheduled to expire on December 31, 2008, through December 31, 2010.

Extend and modify exceptions provided under Subpart F.—Under the Subpart F rules, certain U.S. shareholders of a controlled foreign corporation (CFC) are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the Subpart F rules includes, among other things, "foreign personal holding company

income" and insurance income. Foreign personal holding company income generally includes many types of income derived by a financial service company, such as dividends; interest; royalties; rents; annuities; net gains from the sale of certain property, including securities, commodities and foreign currency; and income from notional principal contracts and securities lending activities. Under prior law, for taxable years beginning before January 1, 2007, certain income derived in the active conduct of a banking, financing, insurance, or similar business was provided an exception from Subpart F. This Act extended the exception for two years, to apply to taxable years beginning before January 1, 2009. This Act also provided an exception from Subpart F for dividends, interest, rents, and royalties received by one CFC from a related CFC to the extent attributable or properly allocable to non-Subpart F income of the payor, effective for taxable years beginning after December 31, 2005 and before January 1, 2009.

Estimated Tax Payments by Corporations

Modify the timing of estimated tax payments by corporations.—Corporations generally are required to pay their income tax liability in quarterly estimated payments. For corporations that keep their accounts on a calendar year basis, these payments are due on or before April 15, June 15, September 15, and December 15 (if these dates fall on a holiday or weekend, payment is due on the next business day). This Act increased the estimated tax payments due in July through September by corporations with assets of at least $1 billion to: 105 percent of the amount otherwise due in 2006, 106.25 percent of the amount otherwise due in 2012, and 100.75 percent of the amount otherwise due in 2013. For corporations affected by this provision, the next required estimated tax payment is reduced accordingly. This Act also allowed corporations to delay 20.5 percent of the estimated tax payment otherwise due on September 15, 2010 until October 1, 2010, and 27.5 percent of the estimated tax payment otherwise due on September 15, 2011 until October 1, 2011.

Alternative Minimum Tax (AMT) Relief for Individuals

Increase and extend AMT relief for individuals.—A temporary provision of prior law increased the AMT exemption amounts to $40,250 for single taxpayers, $58,000 for married taxpayers filing a joint return and surviving spouses, and $29,000 for married taxpayers filing a separate return and estates and trusts. These temporary increases were effective for taxable years beginning after December 31, 2002 and before January 1, 2006. This Act increased the AMT exemption amounts, effective for taxable years beginning after December 31, 2005 and before January 1, 2007, to $42,500 for single taxpayers, $62,550 for married taxpayers filing a joint return and surviving spouses, and $31,275 for married taxpayers filing a separate return and estates and trusts.

Under a temporary provision of prior law, taxpayers were permitted to offset both the regular tax and the AMT with nonrefundable personal tax credits, effective for taxable years beginning before January 1, 2006. This Act extended minimum tax relief for nonrefundable personal tax credits for one year, to apply to taxable year 2006. The extension does not apply to the child credit, the new saver's credit, the earned income credit (EITC) or the adoption credit, which were provided AMT relief through December 31, 2010 under the 2001 tax cut. The refundable portion of the child credit and the earned income tax credit are also allowed against the AMT through December 31, 2010.

Offsets

Repeal income limitations on Roth Individual Retirement Account (IRA) conversions.—Under prior law, taxpayers with adjusted gross income (AGI) of less than $100,000 were eligible to roll over or convert all or a portion of a traditional IRA to a Roth IRA. Amounts converted were treated as distributions for income tax purposes, but the 10-percent tax on early withdrawals did not apply. This Act repealed the income limitation on conversions from traditional IRAs to Roth IRAs, effective for conversions occurring after December 31, 2009. Unless a taxpayer elects otherwise (or converted amounts are distributed before 2012), none of the amount converted in 2010 will be included in gross income for that year; instead, half of the amount converted will be included in gross income in each year, 2011 and 2012. If converted amounts are distributed before 2012, the amount included in income in the year of the distribution is increased by the amount distributed, and the amount included in income in 2012 (or 2011 and 2012 if the distribution was made in 2010) is the lesser of: (1) half of the amount includible in income as a result of the conversion, and (2) the remaining portion of such amount not already included in income.

Repeal foreign sales corporation (FSC)/extraterritorial income (ETI) binding contract relief.—The FSC Repeal and ETI Exclusion Act of 2000 replaced the FSC tax provisions of prior law, which the World Trade Organization (WTO) had found to be a prohibited export subsidy in violation of international tax standards, with an exclusion from U.S. tax for extraterritorial income. Transition rules delayed the repeal of the FSC rules and the effective date of ETI for transactions in the ordinary course of a trade or business if such transactions were pursuant to a binding contract between the taxpayer and an unrelated person and the contract was in effect on September 30, 2000 and at all other times thereafter. The ETI provisions also were declared a prohibited export subsidy by the WTO and were repealed by the American Jobs Creation Act of 2004, effective for transactions after December 31, 2004. Certain transitional tax rules applied to transactions occurring in 2005 and 2006, providing taxpayers with 80 percent and 60 percent, re-

spectively, of the tax benefits that would have been otherwise allowed under the prior law ETI provisions. Moreover, the ETI provisions of prior law remained in effect for transactions in the ordinary course of a trade or business if such transactions were pursuant to a binding contract between the taxpayer and an unrelated person and the contract was in effect on September 17, 2003 and at all times thereafter. Both the FSC and ETI binding contract relief of prior law were repealed under this Act, effective for taxable years beginning after May 17, 2006.

Impose withholding on certain payments made by government entities.—This Act imposed withholding on certain payments made by government entities (the Government of the United States, every State, and every political subdivision or instrumentality thereof, including multi-State agencies) to persons providing property or services. The requirement applies regardless of whether the government entity making the payment is the recipient of the property or service. The rate of withholding is three percent and applies to payments made after December 31, 2010. Political subdivisions of States (or any instrumentality thereof) with less than $100 million of annual expenditures for property or services are exempt from the withholding requirement. In addition, the provision does not apply to: (1) payments made through a public assistance or public welfare program for which eligibility is determined by a needs or income test; (2) payments, such as wages, that were subject to mandatory or voluntary withholding under prior law; (3) payments of interest; (4) payments for real property; (5) payments to tax-exempt entities or foreign governments; (6) intra-governmental payments; (7) payments made pursuant to a classified or confidential contract; and (8) payments to government employees that are not otherwise excludable from the new withholding provision with respect to the employees' services as an employee.

Modify taxation of citizens living abroad.—U.S. citizens who earn income in a foreign country may be taxed on that income by the foreign country. Such individuals are allowed a credit against the U.S. income tax imposed on foreign-source income for foreign taxes paid on that income; the amount of the credit generally is limited to the amount of U.S. tax otherwise owed on that income.

A U.S. citizen or resident living abroad may be eligible to exclude from U.S. taxable income certain foreign earned income and foreign housing costs, regardless of whether any foreign tax is paid on the foreign earned income or housing costs. To qualify for these exclusions, the taxpayer must have his or her tax home in a foreign country and must be either: (1) a U.S. citizen who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire taxable year, or (2) a U.S. citizen or resident present in a foreign country or countries for at least 330 full days in any 12-consecutive-month period.

The foreign earned income exclusion generally is available for a qualified individual's non-U.S. source earned income attributable to personal services performed by that individual during the period of foreign residence or presence. Under prior law, the maximum amount of the foreign earned income exclusion was $80,000 in taxable years 2002 through 2007 and was indexed annually for inflation beginning in taxable year 2008. This Act accelerated the annual indexation of the maximum amount of the foreign earned income exclusion by two years, increasing the limitation for taxable year 2006 to $82,400.

The housing cost exclusion (or deduction for purposes of computing AGI, if the otherwise excludable housing costs are not paid or reimbursed by a taxpayer's employer) is equal to the excess of a taxpayer's "housing expenses" over a base housing amount. "Housing expenses" are the reasonable expenses paid or incurred during the taxable year for housing in a foreign country for the taxpayer, and, if they live with the taxpayer, the taxpayer's spouse and dependents. Housing expenses include costs attributable to housing, such as utilities and insurance, but do not include items that are separately deductible, such as mortgage interest and real estate taxes. If the taxpayer maintains a second household outside the United States for a spouse or dependents who do not reside with the taxpayer because of dangerous, unhealthful, or otherwise adverse living conditions, the housing expenses of the second household also are eligible for exclusion. Under prior law, the base housing amount above which costs were eligible for exclusion in a taxable year was 16 percent of the annual salary (computed on a daily basis) of a GS–14 step 1 Federal employee, multiplied by the number of days of foreign residence or presence in the taxable year. This Act modified the base housing amount used in calculating the foreign housing cost exclusion, effective for taxable years beginning after December 31, 2005, changing it to 16 percent of the maximum amount (computed on a daily basis) of the foreign earned income exclusion, multiplied by the number of days of foreign residence or presence in the taxable year. Reasonable housing expenses in excess of the base housing amount may still be excluded from gross income (or, if paid by the taxpayer, deductible in computing AGI), but the amount of the exclusion is limited to 30 percent of the taxpayer's foreign earned income exclusion. Under this Act, the Secretary of the Treasury has authority to adjust this 30-percent limitation upwards or downwards, based on geographic differences in housing costs relative to housing costs in the United States.

As provided under prior law, the combined foreign earned income exclusion and housing cost exclusion (including the amount deductible in computing AGI) may not exceed the taxpayer's total foreign earned income for the taxable year. Similarly, the taxpayer's foreign tax credit must be reduced by the amount of the credit attributable to excluded income.

Under prior law, a taxpayer eligible for the foreign earned income and housing cost exclusions was subject to tax on income in excess of the exclusion amounts (after deductions), starting in the lowest tax rate bracket. Under this Act, effective for taxable years beginning after December 31, 2005, a taxpayer eligible for the foreign earned income and housing exclusions is subject to tax on income in excess of the exclusion amounts at the income tax rates that would have been applicable had the individual not elected to take the exclusions.

Require partial payment with submission of offers-in-compromise.—Offers-in-compromise are offers to the IRS by a taxpayer to settle outstanding tax liability for less than the full amount due, generally based on doubt as to liability for, or collectibility of, the tax. There are two general categories of offers-in-compromise: (1) lump-sum offers, in which the taxpayer proposes to make one lump-sum payment of a specified dollar amount in settlement of the outstanding tax liability, and (2) periodic-payment offers, in which the taxpayer proposes to make a series of payments over time in settlement of the outstanding tax liability. The IRS imposes a user fee of $150 on most offers-in-compromise, payable upon submission of the offer to the IRS. Enforcement action generally is suspended during the period that the IRS evaluates an offer. Under prior law, taxpayers were permitted (but not required) to make a deposit with their offer; if the offer was rejected, the deposit generally was returned to the taxpayer. This Act made the following changes, effective with respect to offers-in-compromise submitted to the IRS on and after July 16, 2006: (1) Taxpayers making lump-sum offers (offers to pay in five or fewer installments) are required to make a down payment of 20 percent of the amount of the offer upon submission of the offer to the IRS. (2) Taxpayers making periodic-payment offers are required to comply with the payment schedule proposed in the offer while the offer is being considered. (3) Offers submitted to the IRS that do not comply with these payment requirements are returned to the taxpayer as unprocessable and immediate enforcement action is permitted. (4) The $150 user fee is applied to the taxpayer's outstanding tax liability. (5) An offer-in-compromise is deemed accepted if the IRS does not make a decision with respect to the offer within two years from the date the offer was submitted. (6) The Secretary of the Treasury is authorized to issue regulations providing exceptions to the partial payment requirements in the case of offers from certain low-income taxpayers and offers based on doubt as to liability.

Modify amortization for certain geological and geophysical expenditures.—Geological and geophysical expenditures (G&G costs) are costs incurred by a taxpayer for the purpose of obtaining and accumulating data that will serve as the basis for the acquisition and retention of mineral properties by taxpayers exploring for minerals. Under prior law, G&G costs paid or incurred in taxable years beginning after August 8, 2005, in connection with oil and gas exploration in the United States, could be amortized over two years. This Act increased the amortization period to five years for G&G costs paid or incurred by certain major integrated oil companies after May 17, 2006. This five-year amortization rule applies only to integrated oil companies that have an average daily worldwide production of crude oil of at least 500,000 barrels for the taxable year, have gross receipts in excess of $1 billion in the last taxable year ending during calendar year 2005, and either are a crude oil refiner or have an ownership interest in a crude oil refiner of 15 percent or more.

Modify taxation of unearned income of minors.—An unmarried individual eligible to be claimed as a dependent on another taxpayer's individual income tax return generally must file an individual income tax return if he or she has: (1) earned income only over $5,150 (for 2006); (2) unearned income only over the minimum standard deduction amount for dependents ($850 in 2006); or (3) both earned income and unearned income totaling more than the smaller of (a) $5,150 (for 2006) or (b) the larger of (i) $850 (for 2006) or (ii) earned income plus $300. Under prior law, unearned income of a child was taxed under special rules if: (1) the child had not reached the age of 14 by the close of the taxable year, (2) the child's unearned income (income other than wages, salaries, professional fees, or other amounts received as compensation for personal services actually rendered) was more than $1,700 (for 2006), and (3) the child was required to file a return for the year. These special rules (referred to as the "kiddie tax") applied if the child could have been claimed as a dependent on the parent's return, regardless of whether the parent actually claimed the child as a dependent. Under the kiddie tax, the child's net unearned income over $1,700 (for 2006) was taxed at the parent's tax rate if that rate was higher than the child's rate. The remainder of a child's taxable income was taxed at the child's tax rate, regardless of whether the kiddie tax applied. Effective for taxable years beginning after December 31, 2005, this Act increased the age to which the kiddie tax applies from under 14 years of age to under 18 years of age.

Provide other offsets.—Other offsets provided in this Act included: (1) application of earnings stripping rules to partners that are C corporations, (2) amendment of information reporting requirements to include interest paid on tax-exempt bonds, (3) modification of the scope of the application of the Foreign Investment in Real Property Tax Act of 1980 regime, (4) denial of tax-free treatment to certain corporate spin-off transactions, (5) imposition of new requirements on pooled financing bonds, (6) clarification of the domestic manufacturing deduction wage limitation, and (7) imposition of penalties on certain exempt entities for participation in prohibited tax shelter transactions as accommodation parties.

Other Provisions

Provide other changes.—Other changes provided in this Act included: (1) modification of the tax treatment of income earned by certain environmental cleanup funds, (2) modification of the rules relating to taxation of distributions of stock and securities of a controlled corporation, (3) expansion of eligibility for the qualified veterans' mortgage bond program, (4) treatment of the sale or exchange of certain self-created musical works as capital gains, (5) modification of the vessel tonnage tax, (6) extension of the exemption for a portion of the Permanent University Fund from the tax-exempt bond arbitrage rules, (7) election of five-year amortization for the costs of creating or acquiring a musical composition, (8) acceleration of the increased capital expenditure limitation on the issuance of qualified small issue tax-exempt bonds to apply to bonds issued after December 31, 2006, and (9) modification of the tax treatment of loans to qualified continuing care facilities.

PENSION PROTECTION ACT OF 2006

The Pension Protection Act of 2006, which was signed by President Bush on August 17, 2006, was the most sweeping reform of America's pension system enacted in 30 years. The provisions of this Act strengthened the private retirement system by making it more difficult for employers to underfund their pension plans and by preventing employers with underfunded plans from making promises to their employees that they cannot keep. Provisions of this Act also provided more incentives to individuals to save for retirement, modified tax provisions related to spending for health care, temporarily suspended certain customs duties, provided incentives for certain charitable contributions, and modified certain rules relating to activities of tax-exempt organizations. The major provisions of this Act that affect receipts are described below.

Pension Funding Rules

Reform funding rules for single-employer defined-benefit pension plans.—Under prior law, defined-benefit pension plans were subject to minimum funding requirements imposed under both the Internal Revenue Code and the Employee Retirement Income Security Act of 1974 (ERISA). In the case of a qualified plan, the Internal Revenue Code excluded such contributions from gross income and allowed a deduction for the contributions, subject to certain limits on the maximum deductible amount. The calculation of the minimum funding requirements and the limits on deductible contributions were determined under a series of complex rules and measures of assets and liability, many of which were manipulable and none of which entailed the use of an accurate measure of the plan's assets and its true liabilities. This Act replaced the funding rules of prior law, effective for plan years beginning after December 31, 2007, with a minimum funding requirement of 100 percent of plan liabilities, phased in over four years, as follows: 92 percent in 2008, 94 percent in 2009, 96 percent in 2010, and 100 percent in 2011 and subsequent years. Other funding rules provided in this Act: (1) changed the calculation of the value of credit balances and restricted the use of credit balances in lieu of cash to fund required contributions; (2) changed the method of calculating liabilities for plans considered to be at risk; (3) reduced the time period over which asset values can be averaged to two years, and limited averaged asset values to no less than 90 percent and to no more than 110 percent of current fair market value; (4) required amortization of unfunded liabilities over seven years, in most cases; (5) updated the mortality table used to project future benefits; (6) allowed plan sponsors to deduct from taxable income contributions of up to 150 percent of plan liability; and (7) modified the interest rate used to calculate pension liability, requiring the use of a yield curve based on 24-month averages of the rates on corporate bonds of relevant maturities in the top three rating categories (AAA, AA and A), phased in at 33⅓ percent in 2008, 66⅔ percent in 2009 and 100 percent beginning in 2010.

Reform funding rules for multiemployer defined-benefit plans.—Multiemployer plans are subject to the same general funding rules as the pre-2006 rules for single-employer plans, except that different rules apply in some cases. This Act modified the funding of multiemployer plans by: (1) providing additional funding rules for certain plans that are in endangered or critical status; and (2) allowing plan sponsors to deduct from taxable income contributions of up to 140 percent of plan liability. These changes were effective for plan years beginning after 2007; however, the additional funding rules for plans in endangered or critical status do no apply to plan years beginning after December 31, 2014.

Other Pension Provisions

Encourage automatic enrollment in pension plans.—Under current law, most defined-contribution plans may include a qualified cash or deferred arrangement under which employees may elect to receive cash or to have contributions made to the plan by the employer on behalf of the employee in lieu of receiving cash. Contributions made to the plan at the election of the employee are referred to as "elective deferrals." Such a plan may be designed so that the employee will receive cash unless an affirmative election to make contributions is made. Alternatively, a plan may provide that elective contributions are made at a specified rate unless the employee elects otherwise; such a plan is sometimes referred to as an "automatic enrollment" plan. In either case, the employee must have an opportunity to elect to receive cash in lieu of contributions.

This Act made changes to address employers' concerns about implementing automatic enrollment plans and to provide incentives for automatic enrollment, generally effective for plan years beginning after 2007. The

changes provided in the Act: (1) exempted such plans from State payroll withholding laws; (2) provided fiduciary relief for investment of participant account balances in certain default investments; (3) provided a 90-day period from the initial payroll reduction during which participants are allowed to opt out of automatic enrollment and receive a penalty-free return of their automatic elective contributions; and (4) provided that plans with "a qualified automatic enrollment feature" satisfy the nondiscrimination rules regarding elective deferrals and employer matching contributions, and are not subject to the top-heavy rules.

Allow certain small employers to establish combined defined-benefit plans and qualified cash or deferred arrangements.—Under prior law, a defined-benefit plan could not be combined with a qualified cash or deferred arrangement (Section 401(k) plan); they had to be structured as two separate plans. This Act allowed small employers to establish combined defined-benefit and 401(k) plans, effective for plan years beginning after December 31, 2009. A small employer is an employer with an average of at least two and no more than 500 employees on business days during the preceding calendar year and at least two employees on the first day of the plan year. The assets of the combined plan must be held in a single trust and they must be clearly identified and allocated to the defined-benefit plan and the 401(k) plan to the extent necessary for the separate application of the Internal Revenue Code and ERISA; in addition, the combined plan must meet certain benefit, contribution, vesting, and nondiscrimination requirements.

Make other miscellaneous changes affecting pension plans.—Other changes in pension plans that affect receipts: (1) permitted workers in publicly held companies to divest themselves of company stock attributable to employer contributions after three years of service and prohibited employers from requiring workers to invest their own retirement savings in company stock; (2) improved portability of retirement savings, such as allowing direct rollovers from retirement plans to Roth IRAs and faster vesting of employer non-elective contributions; (3) gave taxpayers the option to deposit part of their individual income tax refund directly into an IRA; and (4) allowed members of the National Guard and reservists called to active duty to withdraw money from their IRA or pension without penalty and to repay the money within two years.

Expiring Provisions

Extend permanently IRA maximum contribution limits and index income limitations on IRA contributions.—The maximum annual contribution that can be made to a traditional or Roth IRA by or on behalf of an individual varies depending on the particular circumstances, including the individual's income. However, under prior law, the maximum annual contribution that could be made to all of an Individual's IRAs was the lesser of: (1) the individual's compensation or (2) $4,000 for taxable years 2005 through 2007, and $5,000 for taxable year 2008, indexed thereafter in increments of $500. In the case of a married couple, contributions could be made up to the dollar limit for each spouse if the combined compensation of the spouses was at least equal to the contributed amount. Individuals who attained age 50 before the end of a taxable year were allowed to make additional "catch-up" contributions. For those individuals, the otherwise maximum contribution limit was increased by $1,000 for taxable years 2006 through 2010. These contribution limits, which had been scheduled to expire after December 31, 2010, were extended permanently under this Act.

An individual may make nondeductible contributions to a traditional IRA up to the IRA contribution limits specified above (to the extent the taxpayer cannot or does not make deductible contributions). An individual may make deductible contributions to a traditional IRA up to the IRA contribution limits specified above, if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan. If an individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the deduction is phased out for taxpayers with AGI above certain levels. Under prior law, the AGI phase-out ranges were: (1) $50,000 to $60,000 for single taxpayers; (2) $80,000 to $100,000 for married taxpayers filing a joint return for 2007 and subsequent years; and (3) $0 to $10,000 for married taxpayers filing a separate return. If an individual was not an active participant in an employer-sponsored retirement plan, but the individual's spouse was an active participant in such a plan, the deduction was phased out for taxpayers with AGI between $150,000 and $160,000. An individual may make nondeductible contributions to a Roth IRA subject to the IRA contribution limits specified above. However, the maximum annual contribution is phased out for taxpayers with AGI over certain levels. Under prior law, the AGI phase-out ranges were: (1) $95,000 to $110,000 for single taxpayers; (2) $150,000 to $160,000 for married taxpayers filing a joint return; and (3) $0 to $10,000 for married taxpayers filing a separate return. Under this Act, the income thresholds that determine eligibility to make IRA contributions are indexed for inflation in increments of $1,000 beginning in 2007.

Extend permanently maximum contribution and benefit limits under qualified pension plans.—Limits on contributions and benefits under qualified pension plans are based on the type of plan. Under prior law, annual contributions to a defined-contribution plan with respect to each plan participant were limited to the lesser of 100 percent of compensation or $40,000 (adjusted annually for inflation in $1,000 increments after 2002). The maximum annual benefit payable under a defined-benefit plan was generally the lesser of 100 percent of average compensation or $160,000 (adjusted annually for inflation for plans ending after

December 31, 2002, in increments of $1,000). The annual compensation of each participant that could be taken into account for purposes of determining contributions and benefits under a plan generally was limited to $200,000 in 2002 (indexed annually thereafter in $5,000 increments). The dollar limit on annual elective deferrals under section 401(k) plans, section 403(b) annuities and salary reduction SEPs was $15,000 in 2006, indexed annually thereafter in $500 increments. The dollar limit on annual elective deferrals to a SIMPLE plan was $10,000 in 2005 (adjusted for inflation in increments of $500 after 2006). The dollar limit on contributions to an eligible section 457 plan was the lesser of 100 percent of includable compensation or $15,000 in 2006, indexed annually thereafter in increments of $500. Individuals who attained age 50 before the end of a taxable year were allowed to make "catch-up" contributions to a 401(k) plan, section 403(b) annuity, SEP or SIMPLE plan, or section 457 plan. The amount of catch-up contributions permitted was the lesser of: (1) the applicable dollar amount or (2) the participant's compensation for the year after reduction by any other elective deferrals of the participant for the year. The applicable dollar amount under a 401(k) plan, section 403(b) annuity, SEP or section 457 plan was $5,000 for 2006, indexed annually thereafter in increments of $500. The applicable dollar amount under a SIMPLE plan was $2,500 in 2006, indexed annually thereafter in increments of $500. These contribution and benefit limits, which were scheduled to expire after December 31, 2010, were extended permanently under this Act.

Extend permanently the ability to make tax-free distributions from qualified tuition programs (section 529 of the Internal Revenue Code).—Qualified State tuition programs generally take two forms—prepaid tuition plans and savings plans. Under a prepaid tuition plan, an individual may purchase tuition credits or certificates on behalf of a designated beneficiary, which entitle the beneficiary to the waiver or payment of qualified higher education expenses at participating educational institutions. Under a savings plan, an individual may make contributions to an account established for the purpose of meeting the qualified higher education expenses of a designated beneficiary. Private educational institutions are also allowed to establish qualified prepaid tuition plans (but not savings plans), provided the institution is eligible to participate in Federal financial aid programs under Title IV of the Higher Education Act of 1965. Earnings in a qualified savings program accumulate tax free. Under current law, if a distribution is used to pay qualified higher education expenses, the distribution is tax free. Qualified expenses include: tuition and fees; certain expenses for room and board; certain expenses for books, supplies and equipment; and expenses for a special needs beneficiary that are necessary in connection with enrollment or attendance at an eligible education institution. This Act permanently extended the preferred tax treatment of the distributions, which was scheduled to expire with respect to withdrawals after December 31, 2010. This Act also granted broad authority to the Secretary of the Treasury to issue regulations to carry out the purposes of section 529 and to prevent abuse of those purposes.

Extend permanently the nonrefundable tax credit (saver's credit) for certain elective deferrals and IRA contributions.—Under prior law, effective for taxable years beginning after December 31, 2001 and before January 1, 2007, a nonrefundable tax credit was provided for up to $2,000 in contributions made by eligible taxpayers to a qualified plan or to a traditional or Roth IRA. The credit, which was in addition to any deduction or exclusion that would otherwise apply with respect to the contribution, was available to single taxpayers with AGI less than or equal to $25,000 ($37,500 for heads of household and $50,000 for married taxpayers filing a joint return). The credit was available to individuals who were 18 years of age or older (other than individuals who were full-time students or claimed as a dependent on another taxpayer's return) and was offset against both the regular and alternative minimum tax. The credit rate was 50 percent for single taxpayers with AGI less than or equal to $15,000 ($30,000 for married taxpayers filing a joint return and $22,500 for heads of household), 20 percent for single taxpayers with AGI between $15,000 and $16,250 (between $30,000 and $32,500 for married taxpayers filing a joint return and between $22,500 and $24,375 for heads of household), and 10 percent for single taxpayers with AGI between $16,250 and $25,000 (between $32,500 and $50,000 for married taxpayers filing a joint return and between $24,375 and $37,500 for heads of household). The saver's credit was extended permanently under this Act. In addition, this Act provided for annual indexing of the income limits applicable to the credit in increments of $500 beginning in 2007.

Health and Medical Benefits

Modify tax treatment of annuity and life insurance contracts with a long-term care insurance feature.—Under prior law, annuity contracts were not allowed to have a qualified long-term care insurance feature; however, long-term care insurance could be provided by a rider on or as a part of a life insurance contract. This Act allowed qualified long-term care insurance to be provided by a rider on or as a part of an annuity contract and provided special tax treatment for the long-term care component of a life insurance or annuity contract. Under this Act: (1) payments for a qualified long-term care insurance contract, which is a rider on or is part of a life insurance contract or annuity contract, that are charged against the cash value of the annuity contract or the cash surrender value of the life insurance contract are not includable in income and the investment in the contract is reduced (but not below zero) by the charge; (2) the rules for tax-free exchanges of certain insurance contracts are expanded to include exchanges of a life insurance con-

tract, an endowment contract, an annuity contract, or a qualified long-term care insurance contract for a qualified long-term care insurance contract; and (3) except as otherwise provided in regulations, the portion of an annuity or life insurance contract providing long-term care insurance coverage is treated as a separate contract for Federal tax purposes. These, and other rules concerning the taxation of long-term care insurance provided as a rider on or as part of an annuity or life insurance contract generally will be effective for taxable years beginning after December 31, 2009 for contracts issued after December 31, 1996.

Permit tax-free distributions from governmental retirement plans for premiums for health and long-term care insurance for public safety officers.—Under current law, a distribution from a qualified retirement plan, a tax-sheltered annuity (a 403(b) annuity), an eligible deferred compensation plan maintained by a State or local government (a governmental 457 plan), or an IRA generally is included in the taxpayer's gross income in the year of distribution, except to the extent the amount received constitutes a return of after-tax contributions or a qualified distribution from a Roth IRA. This Act provided an annual exclusion from gross income for up to $3,000 in otherwise taxable distributions from an eligible retirement plan of a qualified public safety officer for the payment of qualified health insurance premiums made directly to the insurer. Eligible retired public safety officers are individuals who, by reason of disability or attainment of normal retirement age, are separated from service with the employer who maintains the eligible retirement plan from which pension benefits are received. Qualified health insurance premiums include premiums for accident or health insurance or qualified long-term care insurance contracts covering the taxpayer and the taxpayer's spouse and dependents. Amounts excluded from income are not taken into account in determining the itemized deduction for medical expenses or the deduction for health insurance of self-employed individuals. The provision is effective for distributions in taxable years beginning after December 31, 2006.

Charitable Contributions and Tax-Exempt Organizations

Permit tax-free withdrawals from IRAs for charitable contributions.—Eligible individuals may make deductible or non-deductible contributions to a traditional IRA and nondeductible contributions to a Roth IRA. Pre-tax contributions and earnings in a traditional IRA are included in income when withdrawn. Qualified withdrawals from a Roth IRA are excluded from gross income; withdrawals that are not qualified are included in gross income to the extent attributable to earnings. This Act provided an exclusion from gross income for otherwise taxable distributions from a traditional or a Roth IRA made directly to a qualified charitable organization. The exclusion may not exceed $100,000 per taxpayer per taxable year, is applicable only to distributions made on or after the date the IRA owner attains age 70½, and is effective for distributions made in taxable years beginning after December 31, 2005 and before January 1, 2008. The exclusion applies only if a charitable contribution deduction for the entire distribution would otherwise be allowable under current law, determined without regard to the percentage-of-AGI limitation. No charitable deduction is allowed with respect to any amount excludable from income under this provision.

Expand enhanced charitable deduction for contributions of food inventory.—A taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically cost) in the inventory, or, if less, the fair market value of the inventory. However, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of: (1) basis plus one half of the fair market value in excess of basis or (2) two times basis. To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer contributed to a charitable organization and the donee must: (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants; (2) not transfer the property in exchange for money, other property, or services; and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis.

The Katrina Emergency Tax Relief Act of 2005 expanded the enhanced deduction to apply to qualified contributions of food inventory made after August 27, 2005 and before January 1, 2006 by all taxpayers (not just C corporations) engaged in a trade or business. This Act extended the enhanced charitable deduction for contributions of food inventory provided under the Katrina Emergency Tax Relief Act of 2005 to apply to contributions made after December 31, 2005 and before January 1, 2008. The donated food must meet certain quality and labeling standards, and, for taxpayers other than C corporations, the total deduction for donated food inventory may not exceed 10 percent of the taxpayer's net income from the related trade or business.

Modify basis adjustment to stock of S corporations contributing appreciated property.—Each shareholder of an S corporation must take into account his or her pro rata share of a charitable contribution by the S corporation in determining his or her income tax liability. For donations of property, this generally is the pro rata share of the property's fair market value. Under prior law, the shareholder's basis in the stock of the company was reduced by the amount of the charitable contribution that flowed through to the shareholder. Under this Act, effective for charitable contributions made by an S corporation in taxable years beginning after December 31, 2005 and before January 1,

2008, shareholders are allowed to adjust their basis in the stock of the company by their pro rata share of the adjusted basis of the contributed property instead of by their pro rata share of the market value of the contributed property.

Make other changes affecting charitable contributions and tax-exempt organizations.—Other incentives for charitable contributions or modifications in the tax treatment of tax-exempt organizations provided in this Act included: (1) extension of the enhanced deduction for contributions of books to public schools for two years; (2) modification of the tax treatment of certain payments to controlling exempt organizations; (3) modification of the deduction for qualified conservation contributions; (4) modification of the deduction for charitable contributions of clothing and household items that are not in good condition and for items of minimal monetary value; (5) expansion of the definition of gross investment income of private foundations; (6) increases in penalty excise taxes applicable to certain activities of charities, social welfare organizations, and private foundations; (7) modification of recordkeeping and substantiation requirements; and (8) provision of new rules governing donor advised funds and supporting organizations.

TAX RELIEF AND HEALTH CARE ACT OF 2006

The Tax Relief and Health Care Act of 2006, which was signed by President Bush on December 20, 2006, extended a number of expired or expiring tax provisions, modified health savings accounts, modified various trade measures, and made a number of other changes to tax law. This Act also authorized drilling for oil in the Gulf of Mexico, rolled back a cut in Medicare physician payments, and amended the Surface Mining Control and Reclamation Act. The major provisions of this Act that affect receipts are described below.

Expiring Provisions

Extend deduction for qualified tuition and related expenses.—An above-the-line deduction of up to $4,000 is provided for qualified higher education expenses paid by a qualified taxpayer during the taxable year. For a given taxable year, the deduction may not be claimed if an education tax credit is claimed for the same student. In addition, the deduction may not be claimed for amounts taken into account in determining the amount excludable from income due to a distribution from a Coverdell education IRA or the amount of interest excludable from income with respect to education savings bonds. A taxpayer may not claim a deduction for the amount of a distribution from a qualified tuition plan that is excludable from income; however, the deduction may be claimed for the amount of a distribution from a qualified tuition plan that is not attributable to earnings. This Act extended the deduction, which had expired with respect to expenses incurred in taxable years beginning after December 31, 2005, to apply to expenses incurred in taxable years beginning before January 1, 2008.

Extend and modify the new markets tax credit.—The new markets tax credit is provided for qualified equity investments made to acquire stock in a corporation or a capital interest in a partnership that is a qualified community development entity (CDE). A credit of five percent is provided to the investor for the first three years of investment. The credit increases to six percent for the next four years. The maximum amount of annual qualifying equity investment is capped at $2.0 billion for calendar years 2004 and 2005, and $3.5 billion for calendar years 2006 and 2007. This Act extended the new markets tax credit through 2008 and permitted up to $3.5 billion in qualified equity investment for that calendar year. This Act also required the Secretary of the Treasury to prescribe regulations to ensure that non-metropolitan counties receive a proportional allocation of qualified equity investments.

Extend optional deduction for State and local general sales taxes.—Under prior law, effective for taxable years beginning after December 31, 2003 and before January 1, 2006, a taxpayer was allowed to elect to take an itemized deduction for State and local general sales taxes in lieu of the itemized deduction for State and local income taxes. This Act extended this deduction for two years, effective for taxable years beginning before January 1, 2008.

Extend and modify the research and experimentation (R&E) tax credit.—The 20-percent tax credit for qualified research and experimentation expenditures above a base amount and the alternative incremental credit expired with respect to expenditures incurred after December 31, 2005. This Act: (1) extended the research credit for two years, to apply to expenditures incurred before January 1, 2008; (2) extended the alternative incremental credit for one year, without modification, to apply to expenditures incurred before January 1, 2007; and (3) modified the alternative incremental credit and established an alternative simplified credit, to apply to expenditures incurred after December 31, 2006 and before January 1, 2008.

Extend and modify the work opportunity tax credit and the welfare-to-work tax credit.—The work opportunity tax credit (WOTC) provides incentives for hiring individuals from certain targeted groups. The credit generally applies to the first $6,000 of wages paid to several categories of economically disadvantaged or handicapped workers. The credit rate is 25 percent of qualified wages for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours.

The welfare-to-work tax credit provides an incentive for hiring certain recipients of long-term family assistance. The credit is 35 percent of up to $10,000 of eligible wages in the first year of employment and 50 per-

cent of wages up to $10,000 in the second year of employment. Eligible wages include cash wages plus the cash value of certain employer-paid health, dependent care, and educational fringe benefits. The minimum employment period that employees must work before employers can claim the credit is 400 hours.

This Act extended both the WOTC and the welfare-to-work tax credit for one year without modification, effective for wages paid to qualified individuals who began work for the employer after December 31, 2005 and before January 1, 2007. For wages paid to individuals who begin work for the employer after December 31, 2006 and before January 1, 2008, this Act combined and modified the two credits. Modifications included: (1) use of the WOTC definition of wages; (2) repeal of the requirement that a qualified ex-felon be certified as a member of an economically disadvantaged family; (3) expansion of eligibility by increasing the age ceiling for the food stamp recipient category; and (4) extension of the paperwork filing deadline from 21 days to 28 days.

Extend treatment of combat pay for purposes of computing the EITC.—This Act extended for one year, through December 31, 2007, the prior law election that allowed combat pay, which is otherwise excluded from gross income, to be treated as earned income for purposes of calculating the EITC.

Extend and modify authority to issue Qualified Zone Academy Bonds.—State and local governments are allowed to issue "qualified zone academy bonds," the interest on which is effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of the bonds must be used for teacher training, purchases of equipment, curriculum development, or rehabilitation and repairs at certain public school facilities. Under prior law, a nationwide total of $400 million of qualified zone academy bonds were authorized to be issued in each of calendar years 1998 through 2005 and unused authority could be carried forward for up to two years. This Act authorized the issuance of an additional $400 million of qualified zone academy bonds in each of calendar years 2006 and 2007. This Act also: (1) extended the arbitrage requirements that apply to interest-bearing tax-exempt bonds to qualified zone academy bonds, (2) imposed new spending requirements on the issuers of these bonds, and (3) imposed new reporting requirements on the issuers of these bonds.

Extend the above-the-line deduction for qualified out-of-pocket classroom expenses.—Taxpayers who itemize deductions (do not use the standard deduction) and incur unreimbursed, job-related expenses may deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceed two percent of AGI. Through 2005, certain teachers and other elementary and secondary school professionals could deduct up to $250 in annual qualified out-of-pocket classroom expenses above-the-line. Expenses claimed as an above-the-line deduction could not be claimed as an itemized deduction. This Act extended this above-the-line deduction to apply to expenses incurred before January 1, 2008.

Extend and expand expensing of brownfields remediation costs.—Taxpayers may elect to treat certain environmental remediation expenditures that would otherwise be chargeable to a capital account as deductible in the year paid or incurred. This Act extended this provision, making it available for environmental remediation expenditures paid or incurred after December 31, 2005 and before January 1, 2008. In addition, this Act expanded the provision to apply to expenditures paid or incurred to abate contamination at sites contaminated by petroleum products, which include crude oil, crude oil condensates and natural gasoline.

Extend tax incentives for the District of Columbia (DC).—A one-time, nonrefundable $5,000 tax credit is available to purchasers of a principal residence in DC who have not owned a residence in DC during the year preceding the purchase. The credit phases out for taxpayers with modified AGI between $70,000 and $90,000 ($110,000 and $130,000 for joint returns). This Act extended the credit for two years, making it available with respect to purchases after December 31, 2005 and before January 1, 2008.

The DC Enterprise Zone includes the DC Enterprise Community and DC census tracts with a poverty rate of at least 20 percent. Businesses in the zone are eligible for: (1) A wage credit equal to 20 percent of the first $15,000 in annual wages paid to qualified employees who reside within DC; (2) $35,000 in increased section 179 expensing; and (3) in certain circumstances, tax-exempt bond financing. In addition, a capital gains exclusion is allowed for certain investments held more than five years and made within the DC Enterprise Zone, or within any DC census tract with a poverty rate of at least 10 percent. This Act extended the DC Enterprise Zone incentives for two years, through December 31, 2007.

Extend tax incentives for employment and investment on Indian reservations.—This Act extended for two years, through December 31, 2007, the employment tax credit for qualified workers employed on an Indian reservation and the accelerated depreciation rules for qualified property used in the active conduct of a trade or business within an Indian reservation. The employment tax credit is not available for employees involved in certain gaming activities or who work in a building that houses certain gaming activities. Similarly, property used to conduct or house certain gaming activities is not eligible for the accelerated depreciation recovery periods.

Extend modified recovery period for qualified leasehold improvements and qualified restaurant property.—A taxpayer generally must capitalize the cost of property used in a trade or business and recover

such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system (MACRS). Under this system, depreciation is determined by applying specified recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property. Depreciation allowances for improvements made on leased property are determined under MACRS, even if the recovery period assigned to the property is longer than the term of the lease. Under prior law, the recovery period for qualified leasehold improvement property and qualified restaurant property was temporarily reduced from 39 years to 15 years, effective for such property placed in service after October 22, 2004 and before January 1, 2006. This Act extended the 15-year recovery period applicable to qualified leasehold improvement property and qualified restaurant property, effective for such property placed in service before January 1, 2008.

Extend tax on failure to comply with mental health parity requirements applicable to group health plans.—Group health plans that provide both mental health benefits and medical and surgical benefits cannot impose aggregate lifetime or annual dollar limits on mental health benefits that are not imposed on substantially all medical and surgical benefits. An excise tax of $100 per day for each individual affected (during the period of noncompliance) is imposed on an employer sponsoring a group plan that fails to meet these requirements. For a given taxable year, the tax is limited to the lesser of 10 percent of the employer's group health insurance expenses for the prior taxable year or $500,000. This Act extended the mental health parity requirements and excise tax for failure to comply with these requirements, which had been scheduled to expire with respect to benefits furnished after December 31, 2006, through December 31, 2007.

Extend deduction for corporate donations of computer technology.—The charitable contribution deduction that may be claimed by corporations for donations of inventory property generally is limited to the lesser of fair market value or the corporation's basis in the property. However, corporations are provided enhanced deductions, not subject to this limitation, for: (1) a "qualified research contribution", or (2) a "qualified computer contribution." The enhanced deduction is equal to the lesser of: (1) basis plus one-half of the item's fair market value in excess of basis, or (2) two times basis. This Act extended the enhanced deduction for a qualified computer contribution, which expired with respect to donations made after December 31, 2005, to apply to donations made before January 1, 2008. (The enhanced deduction for "qualified research contributions" does not expire.) In addition, this Act expanded the definition of property eligible for either the enhanced deduction relating to research equipment or computers to property assembled by the taxpayer; under prior law the deduction was restricted to property constructed by the taxpayer.

Extend Archer Medical Savings Accounts (Archer MSAs).—Self-employed individuals and employees of small firms are allowed to establish Archer MSAs; the number of accounts is capped at 750,000. In addition to other requirements: (1) individuals who establish Archer MSAs must be covered by a high-deductible health plan (and no other plan) with a deductible of at least $1,750 but not greater than $2,650 for policies covering a single person and a deductible of at least $3,500 but not greater than $5,250 in all other cases (these amounts are indexed annually for inflation); (2) tax-preferred contributions are limited to 65 percent of the deductible for single policies and 75 percent of the deductible for other policies; and (3) either an individual or an employer, but not both, may make a tax-preferred contribution to an Archer MSA for a particular year. Under prior law, no new contributions could be made to an Archer MSA after December 31, 2005, except for the following: (1) those made by or on behalf of individuals who previously had Archer MSA contributions and (2) those made by individuals employed by a participating employer. This Act extended the Archer MSA program for two years, through December 31, 2007.

Extend suspension of net income limitation on percentage depletion for marginal oil and gas wells.—Taxpayers are allowed to recover their investment in oil and gas wells through depletion deductions. For certain properties, deductions may be determined using the percentage of depletion method; however, in any year, the amount deducted generally may not exceed 100 percent of the net income from the property. Under prior law, for taxable years beginning after December 31, 1997 and before January 1, 2006, domestic oil and gas production from "marginal" properties was exempt from the 100-percent-of-net-income limitation. This Act extended the exemption to apply to taxable years beginning after December 31, 2005 and before January 1, 2008.

Extend economic development credit for American Samoa.—Certain domestic corporations with business operations in the U.S. possessions are eligible for the possession tax credit, which offsets the U.S. tax imposed on certain income related to operations in the U.S. possessions (including, among other places, American Samoa). The possession tax credit is available only to a corporation that qualifies as an existing credit claimant; the determination of whether a corporation is an existing credit claimant is made separately for each possession. The credit is computed separately for each possession with respect to which the corporation is an existing claimant and the credit is subject to either an economic activity-based limitation or an income-based limit. Under prior law, the possession tax credit was repealed for new claimants for taxable years beginning after December 31, 1995, and was phased

out for existing credit claimants for taxable years beginning after December 31, 1995 and before December 31, 2006. This Act extended and modified the credit with respect to American Samoa. Under the provision, a domestic corporation that was an existing credit claimant with respect to American Samoa and that elected the application of the possession tax credit for its last taxable year beginning before January 1, 2006 is allowed to claim a possession tax credit based on the economic activity-based limitation rules for the first two taxable years beginning after December 31, 2005 and before January 1, 2008.

Extend placed-in-service deadline for certain Gulf Opportunity Zone property.—Taxpayers are allowed to recover the cost of certain property used in a trade or business or for the production of income through annual depreciation deductions. The amount of the allowable depreciation deduction for a taxable year generally is determined under MACRS, which assigns applicable recovery periods and depreciation methods to different types of property. Under the Gulf Opportunity Zone Act of 2005, qualifying Gulf Opportunity Zone (GO Zone) property was provided an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of the property. In order to qualify, property generally had to be tangible property with a recovery period of 20 years or less and included: (1) certain computer software; (2) water utility property; (3) leasehold improvement property; (4) nonresidential real property; and (5) residential rental property. In addition: (1) substantially all of the use of the property had to be in the GO Zone and in the active conduct of a trade or business by the taxpayer in the GO Zone; (2) the original use of the property in the GO Zone had to commence with the taxpayer on or after August 28, 2005; and (3) the property had to be acquired by purchase by the taxpayer on or after August 28, 2005 and placed in service on or before December 31, 2007 (December 31, 2008 in the case of nonresidential real property and residential rental property). This Act extended the placed-in-service deadline to December 31, 2010 for nonresidential real property and residential rental property located in those portions of the GO Zone in a county or parish in which hurricanes occurring in 2005 damaged more than 60 percent of the housing units. However, only the adjusted basis of such property attributable to manufacture, construction, or production before January 1, 2010 ("progress expenditures") is eligible for the additional first-year depreciation.

Extend IRS authority to fund undercover operations.—The IRS is permitted to fund certain necessary and reasonable expenses of undercover operations, which places it on equal footing with other Federal law enforcement agencies. These undercover operations include international and domestic money laundering and narcotics operations. This Act extended this funding authority, which expired on December 31, 2006, through December 31, 2007.

Extend provisions permitting disclosure of tax return information relating to terrorist activity.—The disclosure of tax return information relating to terrorism is permitted in two situations. The first is when an executive of a Federal law enforcement or intelligence agency has reason to believe that the return information is relevant to a terrorist incident, threat or activity and submits a written request. The second is when the IRS wishes to apprise a Federal law enforcement agency of a terrorist incident, threat or activity. This Act extended this disclosure authority, which expired on December 31, 2006, through December 31, 2007.

Extend provisions permitting disclosure of certain other tax return information.—Certain law permits disclosure of taxpayer identity information and signatures to any agency, body, or commission of any State for the purpose of carrying out with such agency, body or commission a combined Federal and State employment tax reporting program approved by the Secretary of the Treasury. This Act extended this disclosure authority, which expired on December 31, 2006, through December 31, 2007.

Energy Provisions

Extend placed-in-service date for tax credit for energy produced from certain renewable sources.—Taxpayers are allowed a tax credit for electricity produced from wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, and qualified hydropower. The credit rate is 1.5 cents per kilowatt hour for electricity produced from wind, closed-loop biomass, geothermal, and solar power, and 0.75 cent per kilowatt hour for electricity produced from open-loop biomass, small irrigation power, municipal solid waste, and qualified hydropower (both rates are adjusted for inflation since 1992). A credit is also provided for the production of refined coal and Indian coal at qualified facilities. The credit for refined coal is $4.375 per ton (adjusted for inflation since 1992) and the credit for Indian coal is $1.50 per ton for coal produced after December 31, 2005 and before January 1, 2010 and $2.00 per ton for coal produced after December 31, 2009 and before January 1, 2013. To qualify for the credit under prior law, electricity generally had to be produced at a facility placed in service before January 1, 2008 (January 1, 2006, in the case of solar facilities) and coal had to be produced at a facility placed in service before January 1, 2009. This Act extended the placed-in-service date by one year, through December 31, 2008, for all facilities except solar energy, refined coal, and Indian coal facilities. For these facilities the placed-in-service termination dates of prior law were not changed.

Extend and modify other energy tax provisions.—Other energy tax provisions provided in this Act: (1) authorized the issuance of an additional $400 million

of clean renewable energy bonds and extended the authority to issue such bonds through December 31, 2008; (2) modified the advanced coal credit with respect to sub-bituminous coal; (3) extended the deduction for expenditures associated with the installation of energy-efficient property in a commercial building; (4) extended the tax credit for the construction of qualified new energy-efficient homes to apply to homes the construction of which is substantially completed after December 31, 2005 and that are purchased after December 31, 2005 and before January 1, 2009; (5) extended the tax credit for the purchase of certain residential solar energy property to apply to property placed in service after December 31, 2005 and before January 1, 2009; and (6) extended the business energy tax credit for the cost of certain solar energy, microturbine, and fuel cell property to apply to property purchased before January 1, 2009.

Health Savings Accounts

Modify health savings accounts.—Individuals with a high-deductible health plan (and no other health plan other than a plan that provides certain permitted coverage) may establish a health savings account (HSA). Individuals who may be claimed as a dependent on another person's tax return cannot establish HSAs and individuals who enroll in Medicare cannot make contributions to an HSA. In general, HSAs provide tax-favored treatment for current medical expenses as well as the ability to save on a tax-favored basis for future medical expenses. Contributions to an HSA may be made by both an individual and the individual's employer, all contributions are aggregated for purposes of the maximum annual contribution limit, and contributions to Archer MSAs reduce the annual contribution limit for HSAs. Contributions to an HSA made by an employer are excluded from income and employment taxes and, within limits, contributions to an HSA made by or on behalf of an eligible individual are deductible by the individual in determining AGI (whether or not the individual itemizes deductions). Earnings on amounts in an HSA are not taxable and distributions for qualified medical expenses are not included in gross income; however, distributions from an HSA that are not used for qualified medical expenses are included in gross income and except in the case of death, disability or the attainment of age 65, are subject to an additional tax of 10 percent. Under prior law, the maximum aggregate annual contribution that could be made to an HSA was the lesser of: (1) 100 percent of the annual deductible under the high deductible health plan or (2) for 2007, $2,850 in the case of self-only coverage and $5,650 in the case of family coverage. In the case of policy holders and covered spouses who were age 55 or older, the HSA annual contribution limit was greater than the otherwise applicable limit by $700 in 2006, $800 in 2007, $900 in 2008, and $1,000 in 2009 and subsequent years. This Act modified HSAs by: (1) allowing one-time rollovers of certain amounts (not greater than the balance on September 21, 2006) from flexible spending arrangements (FSAs) and health reimbursement arrangements (HRAs) directly to HSAs, effective for distributions on or after December 20, 2006 and before January 1, 2012; (2) treating certain FSA coverage as disregarded coverage for purposes of determining if tax deductible contributions can be made to an HSA, effective for taxable years beginning after December 31, 2006; (3) repealing the provision that limited the maximum deductible contribution to the annual deductible under the high-deductible health plan, effective for taxable years beginning after December 31, 2006; (4) modifying the 12-month period over which the Consumer Price Index (CPI) for a calendar year is determined for purposes of making cost-of-living adjustments to HSA contribution limits and high-deductible health plan requirements, effective for adjustments for taxable years beginning after 2007; (5) allowing individuals who become eligible individuals in a month other than January to make the full deductible HSA contribution for the year, effective for taxable years beginning after December 31, 2006; (6) modifying employer comparable contribution requirements for contributions made to non-highly compensated employees; and (7) allowing one-time rollovers from IRAs directly to HSAs up to the annual HSA maximum contribution, effective for taxable years beginning after December 31 2006.

Trade Measures

Extend Generalized System of Preferences (GSP).—Under GSP, duty-free access is provided to approximately 3,400 products from eligible beneficiary developing countries that meet certain worker rights, intellectual property protection, and other statutory criteria. This Act extended this program, which was scheduled to expire after December 31, 2006, through December 31, 2008. This Act also provided that the President should revoke any existing competitive need limitation (CNL) waiver that has been in effect for at least five years, if a GSP-eligible product from a specific country has an annual trade level in the previous calendar year that exceeds 150 percent of the annual trade cap or 75 percent of all U.S. imports of that product.

Extend Andean Trade Preference Act (ATPA).—The ATPA, which was scheduled to expire after December 31, 2006, was designed to provide economic alternatives for Bolivia, Columbia, Ecuador, and Peru in their fight against narcotics production and trafficking. This Act extended the ATPA for six-months through June 30, 2007. An additional six-month extension, through December 31, 2007, was granted to any ATPA beneficiary country that concludes a trade promotion agreement with the United States, provided the Congress and that country's legislature both approve the agreement by June 30, 2007.

Modify African Growth and Opportunity Act (AGOA) and AGOA Acceleration Act.—The African Growth and Opportunity Act (AGOA) and the AGOA

Acceleration Act, enacted in 2000 and 2004, respectively, reduced barriers to trade, thereby increasing U.S.-Africa trade, creating jobs, and increasing opportunities for Africans and Americans alike. This Act modified previous AGOA legislation by: (1) extending the deadline for use of third country fabric benefits, which was scheduled to expire after September 30, 2007, through September 30, 2012, with a 3.5 percent cap; (2) providing an exception to the third country fabric benefit for apparel goods made from fabric or yarn components that are in "abundant supply" in Africa; and (3) providing duty-free treatment to certain textiles and textile articles (non-apparel) of wholly made African fabric imported from lesser-developed AGOA beneficiaries.

Other trade measures.—This Act also: (1) authorized the President to grant permanent normal trade relations status to Vietnam; (2) provided new rules of origin for duty-free apparel imports from Haiti, subject to meeting statutory criteria; (3) offered temporary duty reductions on a variety of items not manufactured in the United States; and (5) extended the period from 15 to 30 days before changes made in the Harmonized Tariff Schedule of the United States to implement certain international tariff nomenclature obligations become effective.

Other Provisions

Expand qualified mortgage bond program.—Under current law, State and local governments may issue mortgage revenue bond (MRBs) to provide low-interest rate financing to qualified individuals for the purchase, improvement, or rehabilitation of owner-occupied residences. Several restrictions, including purchase price limitations, mortgagor income, and the first-time homebuyer requirement (except with regard to residences in certain targeted areas) apply to the financing of mortgages with MRBs. Effective for bonds issued after December 20, 2006 and before January 1, 2008, this Act waived the first-time homebuyer requirement with respect to financing for veterans who served in the active military. The exception applies without regard to the date the veteran last served on active duty or the date on which the veteran applied for the loan after leaving active duty; however, each veteran may use the exception only one time.

Allow prepayment of premium liability for coal industry health benefits.—The United Mine Workers of America (UMWA) Combined Benefit Fund was established by the Coal Industry Retiree Health Benefit Act of 1992 to assume responsibility of payments for medical care expenses of certain retired miners and their dependents. The Combined Benefit Fund is financed by assessments on current and former signatories to labor agreements with the UMWA, past transfers from an overfunded United Mine Workers pension fund, and transfers from the Abandoned Mine Reclamation Fund. The Social Security Administration is responsible for assigning eligible retired miners and their dependents to current and former signatories to labor agreements with the UMWA and calculating annual contributions to be paid by each such signatory for each beneficiary assigned to the signatory. The term "assigned operator" is used to refer to the signatory to whom liability for a particular beneficiary of the Combined Benefit Fund has been assigned. Effective December 20, 2006, this Act allowed certain assigned operators to prepay their premium liability to the Combined Benefit Fund. Under this Act: (1) the payment by the assigned operator (or any related person on behalf of the assigned operator) must be no less than the present value of the total premium liability of the assigned operator, as determined by the operator's enrolled actuary, using actuarial methods and assumptions each of which is reasonable and which are reasonable in the aggregate; and (2) the enrolled actuary must file with the Department of Labor an actuarial report regarding the valuation made by the actuary.

Provide other changes.—Other provisions in this Act: (1) allowed U.S. businesses operating as branches in Puerto Rico to claim the domestic manufacturing deduction for two years; (2) allowed individuals to take advantage of a refundable credit with respect to certain long-term unused AMT credits existing prior to January 1, 2013; (3) allowed individuals to treat premiums paid or accrued before December 31, 2007 on qualified mortgage insurance contracts issued after January 1, 2007 as qualified mortgage interest (subject to income limits); (4) modified the excise tax on unrelated business taxable income of charitable remainder trusts; and (5) reformed the reward program for individuals who provide information regarding violations of the tax laws.

UNITED STATES-OMAN FREE TRADE AGREEMENT IMPLEMENTATION ACT

This Act, which was signed by President Bush on September 26, 2006, approved and provided for U.S implementation of the United States-Oman Free Trade Agreement, as signed by the United States and Oman on January 19, 2006. When this Agreement enters into force, it will level the playing field for U.S. workers and businesses, provide additional market access for U.S. goods, help Oman's leaders develop long-term opportunities for their people, and advance our shared goal of building a Middle East Free Trade Area. By strengthening our relations with a strategic friend and ally in the Middle East, this Agreement will also help protect America's national security interests.

ADMINISTRATION PROPOSALS

IMPROVE THE TAX SYSTEM TO MAKE THE U.S. MORE COMPETITIVE

Americans deserve a tax system that is simple, fair, and pro-growth—in tune with our dynamic, 21st century economy. The tax system should allow taxpayers to make decisions based on economic merit, free of tax-induced distortions. The tax system should promote the competitiveness of American workers and businesses in the global economy. The Report of the President's Advisory Panel on Federal Tax Reform has helped lay groundwork on ways to ensure that our tax system better meets the needs of today's economy.

The President's tax relief enacted in 2001 and 2003 helped move the tax code in this direction. The President has proposed changes that would move the tax code yet further in this direction. The Budget includes proposals to make health care more affordable and consumer-driven, to promote savings for all Americans, and to encourage investment by entrepreneurs. The Budget also recognizes that tax policy analysis needs to account fully for the economic benefits of policy changes on our economy. In the coming months, the Treasury Department will engage in a public dialogue on how our tax system can be improved to make the U.S. more competitive in the global economy.

MAKE PERMANENT CERTAIN TAX RELIEF ENACTED IN 2001 AND 2003

Extend permanently reductions in individual income taxes on capital gains and dividends.—The maximum individual income tax rate on net capital gains and dividends is 15 percent for taxpayers in individual income tax rate brackets above 15 percent and 5 percent (zero in 2008, 2009 and 2010) for lower income taxpayers. The Administration proposes to extend permanently these reduced rates (15 percent and zero), which are scheduled to expire on December 31, 2010.

Extend permanently increased expensing for small business.—Under current law, beginning in 2010, taxpayers may expense up to $25,000 in annual investment expenditures for qualifying property, and the maximum amount that may be expensed is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $200,000. Neither of these dollar amounts is indexed for inflation. However, under temporary provisions first enacted in 2003, business taxpayers are allowed to expense up to $100,000 in annual investment expenditures for qualifying property (expanded to include off-the-shelf computer software) placed in service in taxable years beginning in 2003 through 2009. The maximum amount that may be expensed is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $400,000. Both the temporary deduction and annual investment limits are indexed annually for inflation, effective for taxable years beginning after 2003 and before 2010. Also, with respect to a taxable year beginning after 2002 and before 2010, taxpayers are permitted to make or revoke expensing elections on amended returns without the consent of the IRS Commissioner. The Administration proposes to extend permanently each of these temporary provisions, applicable for qualifying property (including off-the-shelf computer software) placed in service in taxable years beginning after 2009.

Extend permanently provisions expiring in 2010.—Most of the provisions of the 2001 tax cut sunset on December 31, 2010. The Administration proposes to extend those provisions permanently.

TAX INCENTIVES

Simplify and Encourage Saving

Expand tax-free savings opportunities.—Under current law, individuals can contribute to traditional IRAs, nondeductible IRAs, and Roth IRAs, each subject to different sets of rules. For example, contributions to traditional IRAs are deductible, while distributions are taxed; contributions to Roth IRAs are taxed, but distributions are excluded from income. In addition, eligibility to contribute is subject to various age and income limits. While primarily intended for retirement saving, withdrawals for certain education, medical, and other non-retirement expenses are penalty free. The eligibility and withdrawal restrictions for these accounts complicate compliance and limit incentives to save.

The Administration proposes to replace current law IRAs with two new savings accounts: a Lifetime Savings Account (LSA) and a Retirement Savings Account (RSA). Regardless of age or income, individuals could make annual nondeductible contributions of $2,000 to an LSA and $5,000 (or earnings if less) to an RSA. Distributions from an LSA would be excluded from income and could be made at any time for any purpose without restriction. Distributions from an RSA would be excluded from income after attaining age 58 or in the event of death or disability. All other distributions would be included in income (to the extent they exceed basis) and subject to an additional tax. Distributions would be deemed to come from basis first. The proposal would be effective for contributions made after December 31, 2007 and future year contribution limits would be indexed for inflation.

Existing Roth IRAs would be renamed RSAs and would be subject to the new rules for RSAs. Existing traditional and nondeductible IRAs could be converted into an RSA by including the conversion amount (excluding basis) in gross income, similar to a current-law Roth conversion. However, no income limit would apply to the ability to convert. Taxpayers who convert IRAs to RSAs before January 1, 2009 could spread the included conversion amount over four years. Existing traditional or nondeductible IRAs that are not converted to RSAs could not accept new contributions. New traditional IRAs could be created to accommodate roll-

overs from employer plans, but they could not accept new individual contributions. Individuals wishing to roll an amount directly from an employer plan to an RSA could do so by including the rollover amount (excluding basis) in gross income (i.e., "converting" the rollover, similar to a current law Roth conversion).

Saving will be further simplified and encouraged by administrative changes already planned for the 2007 filing season that will allow taxpayers to have their tax refunds directly deposited into more than one account. Consequently, taxpayers will be able, for example, to direct that a portion of their tax refunds be deposited into an LSA or RSA.

Consolidate employer-based savings accounts.—Current law provides multiple types of tax-preferred employer-based savings accounts to encourage saving for retirement. The accounts have similar goals but are subject to different sets of rules regulating eligibility, contribution limits, tax treatment, and withdrawal restrictions. For example, 401(k) plans for private employers, SIMPLE 401(k) plans for small employers, 403(b) plans for 501(c)(3) organizations and public schools, and 457 plans for State and local governments are all subject to different rules. To qualify for tax benefits, plans must satisfy multiple requirements. Among the requirements, the plan generally may not discriminate in favor of highly compensated employees with regard either to coverage or to amount or availability of contributions or benefits. Rules covering employer-based savings accounts are among the lengthiest and most complicated sections of the tax code and associated regulations. This complexity imposes substantial costs on employers, participants, and the Government, and likely has inhibited the adoption of retirement plans by employers, especially small employers.

The Administration proposes to consolidate 401(k), SIMPLE 401(k), 403(b), and 457 plans, as well as SIMPLE IRAs and SARSEPs, into a single type of plan—Employee Retirement Savings Accounts (ERSAs) that would be available to all employers. ERSA non-discrimination rules would be simpler and include a new ERSA non-discrimination safe-harbor. Under one of the safe-harbor options, a plan would satisfy the nondiscrimination rules with respect to employee deferrals and employee contributions if it provided a 50-percent match on elective contributions up to six percent of compensation. By creating a simplified and uniform set of rules, the proposal would substantially reduce complexity. The proposal would be effective for taxable years beginning after December 31, 2007.

Encourage Entrepreneurship and Investment

Increase expensing for small business.—Business taxpayers are currently allowed to expense up to $100,000 in annual investment expenditures for qualifying property (expanded to include off-the-shelf computer software) placed in service in taxable years beginning in 2003 through 2009. The maximum amount that may be expensed is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $400,000. Both the deduction and annual investment limits are indexed annually for inflation, effective for taxable years beginning after 2003 and before 2010. Also, with respect to a taxable year beginning after 2002 and before 2010, taxpayers are permitted to make or revoke expensing elections on amended returns without the consent of the IRS Commissioner. The Administration proposes to increase the amount of annual investment expenditures that taxpayers are allowed to expense to $200,000, and to raise the amount of qualifying investment at which the phase-out begins to $800,000, effective for qualifying property placed in service in taxable years beginning after 2007. These higher amounts would be indexed for inflation, effective for taxable years beginning after 2008.

Invest in Health Care

Provide a flat $15,000 deduction for family coverage ($7,500 for individual coverage) for those with and who purchase health insurance.—The Administration proposes to provide a flat $15,000 deduction to all families who purchase health insurance ($7,500 for those purchasing individual coverage), whether directly or through an employer, that meets minimum requirements. The full deduction would apply regardless of how much a family or individual spends on health insurance; that is, a family or individual that spends less than the full deduction on health insurance would still receive the full deduction. The deduction would apply for purposes of both the income and payroll tax.

The new, flat deduction would replace the existing exclusion for employer-provided health insurance, the self-employed premium deduction, and the medical itemized deduction for those under 65 years of age. The current exclusion or deduction from income of health care spending, whether for insurance premiums or out-of-pocket expenses, except under a Health Savings Account (HSA), would also be repealed. Employers would be required to report the value of health insurance coverage to their employees on their annual Form W-2 and such amounts would be subject to withholding and employment taxes. Businesses would continue to deduct employer-provided health insurance as a business expense. In addition, the phase-out rate for the EITC for taxpayers with qualifying children would be reduced to 15 percent. These provisions would be effective for tax years beginning after December 31, 2008.

Expand and make health savings accounts (HSAs) more flexible.—Current law allows individuals to accumulate funds in an HSA or medical savings account (MSA) on a tax-preferred basis to pay for medical expenses, provided they are covered by an HSA-qualified high-deductible health plan (HDHP), and no other health plan. Under current law, individual contributions to HSAs are deductible for income tax purposes, while employer contributions to HSAs are excluded from both the income and payroll tax. The higher de-

ductible under HSA-qualified health plans increases the cost consciousness of health care consumers by increasing their exposure to the cost of health care.

In addition to higher deductibles, the Administration also recognizes that higher coinsurance levels encourage cost consciousness among health care consumers. Therefore, the Administration proposes to allow health plans to be considered HSA-eligible if they meet all the existing requirements of an HDHP except that, in lieu of satisfying the minimum deductible requirement, they have at least a 50 percent coinsurance requirement and a minimum out-of-pocket exposure that would result in the same (or lower) premium as coverage under a high-deductible health plan under the current requirements for the same family or individual.

The Administration also proposes that additional changes be made to HSAs to encourage the use of HSAs and coverage under the HSA-eligible high-deductible health plans including: (1) allowing family coverage to include coverage where each individual in the family can receive benefits once they have reached the minimum deductible for an individual HDHP; (2) allowing both spouses to contribute the catch-up contribution to a single HSA owned by one spouse if both spouses are eligible individuals; (3) allowing an individual to be covered by a flexible spending arrangement (FSA) or health reimbursement arrangement (HRA) with first dollar coverage and still contribute to an HSA, but offset the maximum allowable HSA contribution by the level of FSA or HRA coverage; (4) allowing qualified medical expenses to include any medical expense incurred on or after the first day of HDHP coverage if individuals have established an HSA by their return filing date for that year; and (5) excluding from the comparability rules extra employer contributions to HSAs on behalf of employees who are chronically ill or employees who have spouses or dependents who are chronically ill. All of the HSA-related proposals would be effective for years beginning after December 31, 2007.

Improve the Health Coverage Tax Credit.—The Health Coverage Tax Credit (HCTC) was created under the Trade Act of 2002 for the purchase of qualified health insurance. Eligible persons include certain individuals who are receiving benefits under the Trade Adjustment Assistance (TAA) or the Alternative TAA (ATAA) program and certain individuals between the ages of 55 and 64 who are receiving pension benefits from the Pension Benefit Guaranty Corporation (PBGC). The tax credit is refundable and can be claimed through an advance payment mechanism at the time the insurance is purchased.

To make the requirements for qualified State-based coverage under the HCTC more consistent with the rules applicable under the Health Insurance Portability and Accountability Act (HIPAA) and thus encourage more plans to participate in the HCTC program, the Administration proposes to allow State-based coverage to impose a pre-existing condition restriction for a period of up to 12 months, provided the plan reduces the restriction period by the length of the eligible individual's creditable coverage (as of the date the individual applied for the State-based coverage). This provision would be effective for eligible individuals applying for coverage after December 31, 2007. Also, in order to prevent an individual from losing the benefit of the HCTC just because his or her spouse becomes eligible for Medicare, the Administration proposes to permit spouses of HCTC-eligible individuals to claim the HCTC when the HCTC-eligible individual becomes entitled to Medicare coverage. The spouse, however, would have to be at least 55 years old and meet the other HCTC eligibility requirements. This provision would be effective for taxable years beginning after December 31, 2007.

To improve the administration of the HCTC, the Administration proposes to: (1) modify the definition of "other specified coverage" for "eligible ATAA recipients," to be the same as the definition applied to "eligible TAA recipients;" (2) clarify that certain PBGC pension recipients are eligible for the tax credit; (3) allow State-based continuation coverage to qualify without meeting the requirements for State-based qualified coverage; and (4) for purposes of the State-based coverage rules, permit the Commonwealths of Puerto Rico and Northern Mariana Islands, as well as American Samoa, Guam, and the U.S. Virgin Islands to be deemed as States.

Allow the orphan drug tax credit for certain pre-designation expenses.—Current law provides a 50-percent credit for expenses related to human clinical testing of drugs for the treatment of certain rare diseases and conditions ("orphan drugs"). A taxpayer may claim the credit only for expenses incurred after the Food and Drug Administration (FDA) designates a drug as a potential treatment for a rare disease or condition. This creates an incentive to defer clinical testing for orphan drugs until the taxpayer receives the FDA's approval and increases complexity for taxpayers by treating pre-designation and post-designation clinical expenses differently. The Administration proposes to allow taxpayers to claim the orphan drug credit for expenses incurred prior to FDA designation if designation occurs before the due date (including extensions) for filing the tax return for the year in which the FDA application was filed. The proposal would be effective for qualified expenses incurred after December 31, 2006.

Provide Incentives for Charitable Giving

Extend permanently tax-free withdrawals from IRAs for charitable contributions.—Under current law, eligible individuals may make deductible or non-deductible contributions to a traditional IRA and non-deductible contributions to a Roth IRA. Pre-tax contributions and earnings in a traditional IRA are included in income when withdrawn. Qualified withdrawals from a Roth IRA are excluded from gross income; withdrawals that are not qualified are included

in gross income to the extent attributable to earnings. The Pension Protection Act of 2006 provided an exclusion from gross income for otherwise taxable distributions from a traditional or a Roth IRA made directly to a qualified charitable organization. The exclusion may not exceed $100,000 per taxpayer per taxable year, is applicable only to distributions made on or after the date the IRA owner attains age 70½, and is effective for distributions made in taxable years beginning after December 31, 2005 and before January 1, 2008. The exclusion applies only if a charitable contribution deduction for the entire distribution would otherwise be allowable under current law, determined without regard to the percentage-of-AGI limitation. No charitable deduction is allowed with respect to any amount excludable from income under this provision.

The Administration proposes to permanently extend this exclusion, effective for distributions made in taxable years beginning after December 31, 2007.

Extend permanently the enhanced charitable deduction for contributions of food inventory.—A taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically cost) in the inventory, or, if less, the fair market value of the inventory. However, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of: (1) basis plus one half of the fair market value in excess of basis, or (2) two times basis. To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer contributed to a charitable organization and the donee must: (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants; (2) not transfer the property in exchange for money, other property, or services; and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis.

The Katrina Emergency Tax Relief Act of 2005 expanded the enhanced deduction to apply to qualified contributions of food inventory made after August 27, 2005 and before January 1, 2006 by all taxpayers (not just C corporations) engaged in a trade or business. The Pension Protection Act of 2006 extended the enhanced charitable deduction for contributions of food inventory provided under the Katrina Emergency Tax Relief Act of 2005 to apply to contributions made after December 31, 2005 and before January 1, 2008. The donated food must meet certain quality and labeling standards, and, for taxpayer's other than C corporations, the total deduction for donated food inventory may not exceed 10 percent of the taxpayer's net income from the related trade or business. The Administration proposes to permanently extend the enhanced charitable deduction for contributions of food inventory to apply to contributions made after December 31, 2007.

Extend permanently the deduction for corporate donations of computer technology.—The charitable contribution deduction that may be claimed by corporations for donations of inventory property generally is limited to the lesser of fair market value or the corporation's basis in the property. However, corporations are provided enhanced deductions, not subject to this limitation, for contributions of computer technology and equipment for education purposes. The enhanced deduction is equal to the lesser of: (1) basis plus one-half of the item's fair market value in excess of basis, or (2) two times basis. To qualify for the enhanced deduction, equipment contributed must have been constructed or assembled by the taxpayer and be donated no later than three years after completion. This provision expires with respect to donations made after December 31, 2007. The Administration proposes to permanently extend this deduction, effective for distributions made in taxable years beginning after December 31, 2007.

Permanently increase limits on contributions of property interests made for conservation purposes.—In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. Exceptions to these general rules are provided for certain types of contributions, including qualified conservation contributions. The special rules for qualified conservation contributions were enhanced under the Pension Reform Act of 2006, applicable for qualified conservation contributions made in taxable years beginning after December 31, 2005 and before January 1, 2008. These special rules: (1) increased the cap on deductions for qualified conservation contributions from 30 percent to 50 percent of the excess of the donor's contribution base over the amount of all other allowable charitable contributions, (2) increased the cap on deductions for qualified conservation contributions applicable to qualified ranchers and farmers to 100 percent of the excess of the donor's contribution base over the amount of all other allowable charitable contributions in the case of individuals and to 100 percent of the excess of taxable income over the amount of all other allowable charitable contributions in the case of corporations, and (3) increased the number of years qualified conservation contributions in excess of the 50- and 100-percent caps may be carried forward from five to 15 years. The Administration proposes to permanently extend these special rules, applicable for qualified conservation contributions made in taxable years beginning after December 31, 2007.

Extend permanently basis adjustment to stock of S corporations contributing appreciated property.—Each shareholder of an S corporation must take into account his or her pro rata share of a charitable contribution by the S corporation in determining his or her income tax liability. For donations of property, this generally is the pro rata share of the property's fair market value. Under prior law, the shareholder's

basis in the stock of the company was reduced by the amount of the charitable contribution that flowed through to the shareholder. Under the Pension Protection Act of 2006, effective for charitable contributions made by an S corporation in taxable years beginning after December 31, 2005 and before January 1, 2008, shareholders are allowed to adjust their basis in the stock of the company by their pro rata share of the adjusted basis of the contributed property instead of by their pro rata share of the market value of the contributed property. The Administration proposes to permanently extend this provision, effective for charitable contributions made by an S corporation in taxable years beginning after December 31, 2007.

Reform excise tax based on investment income of private foundations.—Under current law, private foundations that are exempt from Federal income tax are subject to a two-percent excise tax on their net investment income (one-percent if certain requirements are met). The excise tax on private foundations that are not exempt from Federal income tax, such as certain charitable trusts, is equal to the excess of the sum of the excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. To encourage increased charitable activity and simplify the tax laws, the Administration proposes to replace the two rates of tax on the net investment income of private foundations that are exempt from Federal income tax with a single tax rate of one percent. The excise tax on private foundations not exempt from Federal income tax would be equal to the excess of the sum of the one-percent excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. The proposed change would be effective for taxable years beginning after December 31, 2007.

Repeal the $150 million limitation on qualified 501(c)(3) bonds.—Current law contains a $150 million limitation on the volume of outstanding, non-hospital, tax-exempt bonds for the benefit of any one 501(c)(3) organization. The limitation was repealed in 1997 for bonds issued after August 5, 1997, at least 95 percent of the net proceeds of which are used to finance capital expenditures incurred after that date. However, the limitation continues to apply to bonds more than five percent of the net proceeds of which finance or refinance working capital expenditures, or capital expenditures incurred on or before August 5, 1997. In order to simplify the tax laws and provide consistent treatment of bonds for 501(c)(3) organizations, the Administration proposes to repeal the $150 million limitation in its entirety.

Repeal certain restrictions on the use of qualified 501(c)(3) bonds for residential rental property.—Tax-exempt, 501(c)(3) organizations generally may utilize tax-exempt financing for charitable purposes. However, existing law contains a special limitation under which 501(c)(3) organizations may not use tax-exempt financing to acquire existing residential rental property for charitable purposes unless the property is rented to low-income tenants or is substantially rehabilitated. In order to simplify the tax laws and provide consistent treatment of bonds for 501(c)(3) organizations, the Administration proposes to repeal the residential rental property limitation.

Strengthen Education

Extend permanently the above-the-line deduction for qualified out-of-pocket classroom expenses.—Under current law, teachers who itemize deductions (do not use the standard deduction) and incur unreimbursed, job-related expenses are allowed to deduct those expenses to the extent that, when combined with other miscellaneous itemized deductions, they exceeded two percent of AGI. Current law also allows certain teachers and other elementary and secondary school professionals to treat up to $250 in annual qualified out-of-pocket classroom expenses as a non-itemized deduction (deductible above-the-line). Unreimbrsed expenditures for certain books, supplies, and equipment related to classroom instruction qualify for the above-the-line deduction. Expenses claimed as an above-the-line deduction may not be claimed as an itemized deduction. This additional deduction is effective for expenses incurred in table years beginning after December 31, 2001 and before January 1, 2008. The Administration proposes to extend permanently the above-the-line deduction to apply to qualified out-of-pocket expenditures incurred in taxable years beginning after December 31, 2007.

Allow the saver's credit for contributions to qualified tuition programs (section 529 of the Internal Revenue Code).—Under current law, taxpayers age 18 or older who are not dependents or full-time students may receive a nonrefundable credit (the saver's credit) on up to $2,000 of their compensation contributed to employer-sponsored qualified retirement plans and IRAs. The credit ranges between 10 and 50 percent of the amount contributed, depending on the taxpayer's filing status and AGI (adjusted for inflation). In determining the credit, qualified contributions are reduced by distributions from qualified plans and IRAs during the current tax year, the two preceding tax years, and the following year, up to the due date of the return, including extensions.

Under current law, taxpayers may contribute to a section 529 qualified tuition program (QTP) to save for higher education expenses of a designated beneficiary. Contributions to a QTP are not deductible from income for Federal tax purposes, but earnings on contributions accumulate tax-free. Taxpayers may exclude from gross

income amounts distributed from a QTP and used for qualified higher education expenses, provided the distribution is not used for the same educational expenses for which another tax benefit is claimed. Nonqualified distributions are subject to an additional tax.

The Administration proposes to allow the saver's credit for qualified contributions to QTPs controlled by the taxpayer. AGI would be modified to include the excludable portion of the taxpayer's Social Security benefits in determining the applicable rate for the saver's credit. The credit would apply to an annual aggregate contribution of up to $2,000 (or earnings includible in gross income, if less) to the taxpayer's elective deferral plans, IRAs, and QTPs. For an individual who is married filing a joint return, the earnings limitation would be binding only if the combined includible compensation of the spouses was less than $4,000. Qualified contributions would be reduced by distributions from elective deferral plans, IRAs, and QTPs during the current tax year, the two preceding tax years, and the following tax year up to the due date of the return, including extensions. The credit would be effective for years beginning after December 31, 2007.

Protect the Environment

Extend permanently expensing of brownfields remediation costs.—Taxpayers may elect, with respect to expenditures paid or incurred before January 1, 2008, to treat certain environmental remediation expenditures that would otherwise be chargeable to a capital account as deductible in the year paid or incurred. The Administration proposes to extend this provision permanently, making it available for expenditures paid or incurred after December 31, 2007, and facilitating its use by businesses to undertake projects that may be uncertain in overall duration.

Eliminate the volume cap for private activity bonds for water infrastructure.—Bonds are classified as private activity bonds if they meet a private business use test and a private payments test. Private activity bonds may be issued on a tax-exempt basis only if they meet specified requirements, including targeting requirements that limit such bond financing to specifically defined facilities and programs. For example, qualified private activity bonds can be used to finance facilities for the furnishing of water and for sewer facilities. Qualified private activity bonds are subject to the same general rules applicable to governmental bonds. Most qualified private activity bonds are also subject to a number of additional rules and limitations, in particular an annual State volume cap limitation.

The Administration proposes to remove from the annual State volume cap limitation qualified private activity bonds issued to finance water and sewage facilities. Municipalities that use these bonds for wastewater and drinking water systems must implement (if they have not already) full-cost pricing for services, to help their systems become self-financing like the electric and gas utilities and minimize the need for future Federal financing. The volume cap would be removed for obligations issued after December 31, 2007.

Restructure Assistance to New York City for Continued Recovery from the Attacks of September 11th

Provide tax incentives for transportation infrastructure.—The Administration proposes to restructure the tax benefits for New York recovery that were enacted in 2002. Some of the tax benefits that were provided to New York following the attacks of September 11, 2001, likely will not be usable in the form in which they were originally provided. As such, the Administration proposed in the Mid-Session Review of the 2005 Budget to sunset certain existing New York Liberty Zone tax benefits and in their place provide tax credits to New York State and New York City for expenditures incurred in building or improving transportation infrastructure in or connecting with the New York Liberty Zone. The tax credit would be available as of the date of enactment, subject to an annual limit of $200 million ($2 billion in total over 10 years), evenly divided between the State and the City. Any unused credit limit in a given year would be added to the $200 million allowable in the following year, including years beyond the 10-year period of the credit. Similarly, expenditures that could not be credited in a given year because of the credit limit would be carried forward and used against the next year's limitation. The credit would be allowed against any payments (e.g., income tax withholding) made by the City and State under any provision of the Internal Revenue Code, other than Social Security and Medicare payroll taxes and excise taxes. The Secretary of the Treasury may prescribe such rules as are necessary to ensure that the expenditures are made for the intended purpose. The Administration also proposes to terminate the additional first-year depreciation deduction for certain real property, which was provided to eligible property within the New York Liberty Zone under the 2002 economic stimulus act.

SIMPLIFY THE TAX LAWS FOR FAMILIES

Clarify uniform definition of a child.—The 2004 tax relief act created a uniform definition of a child, allowing, in many circumstances, a taxpayer to claim the same child for five different child-related tax benefits. Under the new rules, a qualifying child must meet relationship, residency, and age tests. While the new rules simplify the determination of eligibility for many child-related tax benefits, the elimination of certain complicated factual tests to determine if siblings and certain other family members are eligible to claim a qualifying child may have some unintended consequences. The new rules effectively deny the EITC to some young taxpayers who are the sole guardians of their younger siblings. Yet some taxpayers are able to avoid income limitations on child-related tax benefits by allowing other family members, who have lower in-

comes, to claim the taxpayers' sons or daughters as qualifying children. The 2004 tax relief act had other unintended consequences, which made some of the eligibility rules less uniform. For example, it allowed dependent filers to claim the child tax credit, even though they are generally ineligible for most other child-related tax benefits. It also allowed taxpayers to claim the child tax credit on behalf of a married child who files a joint return with his or her spouse, even though the taxpayer generally cannot claim other benefits for the married child. These exceptions create confusion and add complexity to the tax code.

To ensure that deserving taxpayers receive child-related tax benefits, the Administration proposes to clarify the uniform definition of a child. First, the definition of a qualifying child would be further simplified. A taxpayer would not be a qualifying child of another individual if the taxpayer is older than that individual. However, an individual could be a qualifying child of a younger sibling if the individual is permanently and totally disabled. Also, under the proposal, an individual who is married and filing jointly (for any reason other than to obtain a refund of overwithheld taxes) would not be considered a qualifying child for the child-related tax benefits, including the child tax credit. Second, the proposal clarifies when a taxpayer is eligible to claim child-related tax benefits. If a parent resides with his or her child for over half the year, the parent would be the only individual eligible to claim the child as a qualifying child. The parent could waive the child-related tax benefits to another member of the household who has higher AGI and is otherwise eligible for the tax benefits. In addition, dependent filers would not be allowed to claim qualifying children. The proposal is effective for taxable years beginning after December 31, 2007.

Simplify EITC eligibility requirement regarding filing status, presence of children, and work and immigrant status.—To qualify for the EITC, taxpayers must satisfy requirements regarding filing status, the presence of children in their households, and their work and immigration status in the United States. These rules are confusing, require significant record-keeping, and are costly to administer. Under the proposal, married taxpayers who reside with children could claim the EITC without satisfying a complicated household maintenance test if they live apart from their spouse for the last six months of the year. In addition, certain taxpayers who live with children but do not qualify for the larger child-related EITC could claim the smaller EITC for very low-income childless workers. The simplification of the filing status and residency requirements would be effective for taxable years beginning after December 31, 2007. Effective January 1, 2008, the proposal would also improve the administration of the EITC with respect to eligibility requirements for undocumented workers.

Reduce computational complexity of refundable child tax credit.—Taxpayers with earned income in excess of $11,750 may qualify for a refundable (or "additional") child tax credit even if they do not have any income tax liability. Over 70 percent of additional child tax credit claimants also claim the EITC. However, the two credits have a different definition of earned income and different U.S. residency requirements. In addition, some taxpayers have to perform multiple computations to determine the amount of the additional child tax credit they can claim. First, they must compute the additional child tax credit using a formula based on earned income. Then, if they have three or more children, they may recalculate the credit using a formula based on social security taxes and claim the higher of the two amounts.

Under the proposal, the additional child tax credit would use the same definition of earned income as is used for the EITC. Taxpayers (other than members of the Armed Forces stationed overseas) would be required to reside with a child in the United States to claim the additional child tax credit (as they are currently required to do for the EITC). Taxpayers with three or more children would do only one computation based on earned income to determine the credit amount. The proposal would be effective for taxable years beginning after December 31, 2007.

IMPROVE TAX COMPLIANCE

The Federal tax system is based on voluntary compliance with the tax laws. Under this system, taxpayers report and pay their taxes voluntarily with minimal interaction with the IRS. While the vast majority of American taxpayers pay their taxes timely and accurately, there remains in aggregate a difference between what taxpayers should pay and what they actually pay on a timely basis. In 2001, the overall compliance rate was 86 percent, after including late payments and recoveries from IRS enforcement activities. While this rate of compliance is high, a large amount of the tax that should be paid is not, resulting in the so-called "tax gap".[1]

In September 2006, the Treasury Department released a comprehensive strategy to improve tax compliance.[2] The strategy builds upon the demonstrated experience and current efforts of the Treasury Department and IRS to improve compliance.

Four key principles guided development of the strategy:

- Unintentional taxpayer errors and intentional taxpayer evasion should both be addressed.
- Sources of non-compliance should be targeted with specificity.
- Enforcement activities should be combined with a commitment to taxpayer service.
- Tax policy and compliance proposals should be sensitive to taxpayer rights and maintain an appropriate balance between enforcement activity and imposition of taxpayer burden.

[1] See Chapter 13, Stewardship, in the *Analytical Perspectives* volume.

[2] Comprehensive Strategy for Reducing the Tax Gap, U.S. Treasury Department, September 26, 2006.

These principles point to the need for a comprehensive, integrated, multi-year strategy to improve tax compliance. Components of this strategy must include: (1) legislative proposals to reduce opportunities for evasion; (2) a multi-year commitment to compliance research; (3) continued improvements in information technology; (4) improvements in IRS compliance activities; (5) enhancements of taxpayer service; (6) simplification of the tax law; and (7) coordination between the government and its partners and stakeholders.

The IRS has taken a number of steps to improve compliance. To enhance the IRS' efforts, the Administration's Budget includes a number of legislative proposals intended to improve tax compliance with minimum taxpayer burden. The Administration proposes to expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties.

Expand information reporting.—Compliance with the tax laws is highest when payments are subject to information reporting to the IRS. Specific information reporting proposals would: (1) require information reporting on payments to corporations; (2) require basis reporting on security sales; (3) expand broker information reporting; (4) require information reporting on merchant payment card reimbursements; (5) require a certified tax identification number (TIN) from non-employee service providers; (6) require increased information reporting for certain government payments for property and services; and (7) increase information return penalties.

Improve compliance by businesses.—Improving compliance by businesses of all sizes is important. Specific proposals to improve compliance by businesses would: (1) require electronic filing by certain large businesses; (2) implement standards clarifying when employee leasing companies can be held liable for their clients' Federal employment taxes; and (3) amend collection due process procedures applicable to employment tax liabilities.

Strengthen tax administration.—The IRS has taken a number of steps under existing law to improve compliance. These efforts would be enhanced by specific tax administration proposals that would: (1) expand IRS access to information in the National Directory of New Hires database; (2) permit the IRS to disclose to prison officials return information about tax violations; and (3) make repeated failure to file a tax return a felony.

Expand penalties.—Penalties play an important role in discouraging intentional non-compliance. Specific proposals to expand penalties would: (1) expand preparer penalties; (2) impose a penalty on failure to comply with electronic filing requirements; and (3) create an erroneous refund claim penalty.

IMPROVE TAX ADMINISTRATION AND OTHER MISCELLANEOUS PROPOSALS

Implement IRS administrative reforms.—The Administration has four proposals relating to administrative reforms. The first proposal modifies employee infractions subject to mandatory termination and permits a broader range of available penalties. It strengthens taxpayer privacy while reducing employee anxiety resulting from unduly harsh discipline or unfounded allegations. The second proposal allows the IRS to terminate installment agreements when taxpayers fail to make timely tax deposits and file tax returns on current liabilities. The third proposal eliminates the requirement that the IRS Chief Counsel provide an opinion for any accepted offer-in-compromise of unpaid tax (including interest and penalties) equal to or exceeding $50,000. This proposal requires that the Secretary of the Treasury establish standards to determine when an opinion is appropriate. The fourth proposal modifies the way that Financial Management Services (FMS) recovers its transaction fees for processing IRS levies by permitting FMS to add the fee to the liability being recovered thereby shifting the cost of collection to the delinquent taxpayer. The offset amount would be included as part of the 15-percent limit on continuous levies against income.

Extend IRS authority to fund undercover operations.—The IRS is permitted to fund certain necessary and reasonable expenses of undercover operations, placing it on equal footing with other Federal law enforcement agencies. These undercover operations include international and domestic money laundering and narcotics operations. The Administration proposes to extend this funding authority, which expires on December 31, 2007, through December 31, 2010.

Eliminate the special exclusion from unrelated business taxable income for gain or loss on the sale or exchange of certain brownfields.—In general, an organization that is otherwise exempt from Federal income tax is taxed on income from any trade or business regularly carried on by the organization that is not substantially related to the organization's exempt purposes. In addition, income derived from property that is debt-financed generally is subject to unrelated business income tax. The 2004 job creation act created a special exclusion from unrelated business taxable income of gain or loss from the sale or exchange of certain qualifying brownfield properties. The exclusion applies regardless of whether the property is debt-financed. The new provision adds considerable complexity to the Internal Revenue Code and, because there is no limit on the amount of tax-free gain, could exempt from tax real estate development considerably beyond mere environmental remediation. The proposal would eliminate this special exclusion effective for taxable years beginning after December 31, 2007.

Limit related party interest deductions.—Current law (section 163(j) of the Internal Revenue Code) denies U.S. tax deductions for certain interest expenses paid to a related party where: (1) the corporation's debt-to-equity ratio exceeds 1.5 to 1, and (2) net interest expenses exceed 50 percent of the corporation's adjusted taxable income (computed by adding back net interest expense, depreciation, amortization, depletion, and any net operating loss deduction). If these thresholds are exceeded, no deduction is allowed for interest in excess of the 50-percent limit that is paid to a related party or paid to an unrelated party but guaranteed by a related party, and that is not subject to U.S. tax. Any interest that is disallowed in a given year is carried forward indefinitely and may be deductible in a subsequent taxable year. A three-year carryforward for any excess limitation (the amount by which interest expense for a given year falls short of the 50-percent limit) is also allowed. Because of the opportunities available under current law to reduce inappropriately U.S. tax on income earned on U.S. operations through the use of foreign related-party debt, the Administration proposes to tighten the interest disallowance rules of section 163(j) as follows: (1) the current law 1.5 to 1 debt-to-equity safe harbor would be eliminated; (2) the adjusted taxable income threshold for the limitation would be reduced from 50 percent to 25 percent of adjusted taxable income with respect to disqualified interest other than interest paid to unrelated parties on debt that is subject to a related-party guarantee, which generally would remain subject to the current law 50 percent threshold; and (3) the indefinite carryforward for disallowed interest would be limited to ten years and the three-year carryforward of excess limitation would be eliminated. The Department of Treasury also is conducting a study of these rules and the potential for further modifications to ensure the prevention of inappropriate income-reduction opportunities.

Repeal telephone tax on local telephone service.—Under prior law, a three-percent Federal excise tax was imposed on amounts paid for local telephone service, toll telephone service (essentially long distance telephone service), and teletypewriter exchange service. In accordance with multiple court decisions that concluded that the tax did not apply to long distance services sold at flat per-minute rates for interstate, intrastate, and international calls, the IRS is no longer collecting tax on telephone service other than local-only telephone service. The Administration proposes to repeal the tax on local telephone service effective for amounts paid pursuant to bills first rendered more than 90 days after enactment of legislation repealing the tax.

Modify financing of the Airport and Airway trust fund.—The Administration supports a reauthorization proposal that would make the Federal Aviation Administration's (FAA's) financing system more cost-based. The FAA's current excise tax system, largely based on taxes on the price of airline tickets, does not have a direct relationship between the taxes paid by users and the air traffic control services provided by the FAA. Under the reauthorization proposal, FAA would collect user fees from commercial aviation operators for air traffic control services starting in 2009. For non-commercial users, FAA would continue to recover its costs for air traffic control services via a fuel tax. Both commercial and non-commercial users would continue to pay fuel taxes to support FAA's Airport Improvement Program.

Anticipated receipt of donations to the National Park Service through the National Park Centennial Challenge Fund.—The President's National Parks Centennial Challenge encourages the public to increase donations to national parks by proposing to match contributions for signature projects and programs on a dollar-for-dollar basis up to $100 million a year for ten years. As part of a broader initiative to prepare for the National Park Service Centennial in 2016, this Challenge continues the National Park Service's legacy of leveraging philanthropic investment for the benefit of our national parks.

Transition from the non-foreign cost-of-living adjustment (COLA) to locality pay for employees in non-foreign areas.—Federal employees working outside the continental United States in Alaska, Hawaii or the US territories presently receive a COLA, which is an untaxed annual pay adjustment that is not creditable for retirement. By transitioning to locality pay, Federal employees in the non-foreign areas will contribute a larger percentage of their pay into the Federal retirement fund as locality pay is retirement-creditable. The proposal would establish a yearly reduction in the COLA, offset by a yearly increase in applicable locality pay, with the intent of eliminating the COLA over seven years.

IMPROVE UNEMPLOYMENT INSURANCE

Strengthen the financial integrity of the unemployment insurance system by reducing improper benefit payments and tax avoidance.—The Administration has a multi-part proposal to strengthen the financial integrity of the unemployment insurance (UI) system and to encourage the early reemployment of UI beneficiaries. The Administration's proposal will boost States' ability to recover benefit overpayments and deter tax evasion schemes by permitting them to use a portion of recovered funds to expand enforcement efforts in these areas. In addition, the proposal would require States to impose a monetary penalty on UI benefit fraud, which would be used to reduce overpayments; make it easier for States to use private collection agencies in the recovery of hard-to-collect overpayments and delinquent employer taxes; require States to charge employers found to be at fault when their actions lead to overpayments; permit collection of delinquent UI overpayments and employer taxes through garnishment of Federal tax refunds; and improve the

accuracy of hiring data in the National Directory of New Hires, which would reduce benefit overpayments. The Administration's proposal would also permit States to request waivers of certain Federal requirements in order to carry out demonstration projects that improve the administration of the UI program, such as speeding reemployment of UI beneficiaries. These efforts to strengthen the financial integrity of the UI system and encourage early reemployment of UI beneficiaries will keep State UI taxes down and improve the solvency of the State trust funds.

Extend unemployment insurance surtax.—The Federal unemployment tax on employers is scheduled to drop from 0.8 percent to 0.6 percent with respect to wages paid after December 31, 2007. The 0.8 percent rate is proposed to be extended for five years, through December 31, 2012.

MODIFY ENERGY PROVISIONS

Repeal reduced recovery period for natural gas distribution lines.—The Energy Policy Act of 2005 reduced the recovery period for new natural gas distribution lines that are placed in service before January 1, 2011 from 20 years to 15 years. The Administration proposes to repeal this provision for natural gas distribution lines placed in service after December 31, 2007.

Modify amortization for certain geological and geophysical expenditures.—Geological and geophysical expenditures (G&G costs) are costs incurred by a taxpayer for the purpose of obtaining and accumulating data that will serve as the basis for the acquisition and retention of mineral properties by taxpayers exploring for minerals. Under the Energy Policy Act of 2005, G&G costs paid or incurred in taxable years beginning after August 8, 2005, in connection with oil and gas exploration in the United States, could be amortized over two years. The Tax Increase Prevention and Reconciliation Act of 2006 increased the amortization period to five years for G&G costs paid or incurred by certain major integrated oil companies after May 17, 2006. This five-year amortization rule applies only to integrated oil companies that have an average daily worldwide production of crude oil of at least 500,000 barrels for the taxable year, have gross receipts in excess of $1 billion in the last taxable year ending during calendar year 2005, and either are a crude oil refiner or have an ownership interest in a crude oil refiner of 15 percent or more. The Administration proposes to increase the amortization period to five years for all companies, effective for amounts paid or incurred in taxable years beginning after December 31, 2007.

PROMOTE TRADE

Implement free trade agreements.—Free trade agreement negotiations with Panama were completed, with the expectation that implementation could begin as early as FY 2008. The FTA signed with Peru and the recently completed agreement with Colombia could also begin implementation in FY 2008. Free trade agreements are expected to be completed with Korea, Malaysia, and the United Arab Emirates (UAE), with implementation to begin in FY 2009. These agreements will continue the Administration's effort to use free trade agreements to benefit U.S. consumers and producers as well as strengthen the economies of our partner countries.

Establish Reconstruction Opportunity Zones (ROZs) in Pakistan and Afghanistan.—In March 2006, the President announced his intention to establish ROZs in Afghanistan and the border regions of Pakistan. ROZs are a critical part of the Administration's broader counterterrorism strategy in these areas, designed to connect isolated regions to the global economy and create vital employment opportunities in territories prone to extremism. The creation of ROZs will encourage investment and economic development in these areas by granting duty-free entry to the United States for certain goods produced in designated territories. By stimulating economic activity in remote and underdeveloped regions, ROZs can also serve as a powerful catalyst for peace, prosperity, stability, growth and good governance. In early 2007, the Administration will work closely with Congress and private sector stakeholders to implement this important initiative.

EXTEND EXPIRING PROVISIONS

Extend AMT relief for individuals.—A temporary provision of current law increased the AMT exemption amounts to $42,500 for single taxpayers, $62,550 for married taxpayers filing a joint return and surviving spouses, and $31,275 for married taxpayers filing a separate return and estates and trusts. Effective for taxable years beginning after December 31, 2006, the AMT exemption amounts decline to $33,750 for single taxpayers, $45,000 for married taxpayers filing a joint return and surviving spouses, and $22,500 for married taxpayers filing a separate return and estates and trusts. A temporary provision of current law permits nonrefundable personal tax credits to offset both the regular tax and the AMT for taxable years beginning before January 1, 2007.

The Administration proposes to increase the AMT exemption amounts to $43,900 for single taxpayers, $65,350 for married taxpayers filing a joint return, and $32,675 for married taxpayers filing a separate return and estates and trusts through taxable year 2007 to prevent the number of AMT taxpayers from increasing. Non-refundable personal tax credits also would be allowed to offset both the regular tax and the AMT through taxable year 2007.

Extend permanently the research and experimentation (R&E) tax credit.—The Administration proposes to extend permanently the tax credits for research and experimentation expenditures, which are

scheduled to expire with respect to expenditures incurred after December 31, 2007.

Extend the work opportunity tax credit.—The work opportunity tax credit provides incentives for hiring individuals from certain targeted groups. The credit applies to wages paid to qualified individuals who begin work for the employer before January 1, 2008. The Administration proposes to extend the credit for one year, making it applicable to wages paid to qualified individuals who begin work after December 31, 2007 and before January 1, 2009.

Extend the first-time homebuyer credit for the District of Columbia.—A one-time nonrefundable $5,000 credit is available to purchasers of a principal residence in the District of Columbia who have not owned a residence in the District during the year preceding the purchase. The credit phases out for taxpayers with modified adjusted gross income between $70,000 and $90,000 ($110,000 and $130,000 for joint returns). The credit does not apply to purchases after December 31, 2007. The Administration proposes to extend the credit for one year, making the credit available with respect to purchases after December 31, 2007 and before January 1, 2009.

Extend authority to issue Qualified Zone Academy Bonds.—Current law allows State and local governments to issue "qualified zone academy bonds," the interest on which is effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of the bonds have to be used for teacher training, purchases of equipment, curriculum development, or rehabilitation and repairs at certain public school facilities. A nationwide total of $400 million of qualified zone academy bonds were authorized to be issued in each of calendar years 1998 through 2007. In addition, unused authority arising in 1998 and 1999 can be carried forward for up to three years and unused authority arising in 2000 through 2007 can be carried forward for up to two years. The Administration proposes to authorize the issuance of an additional $400 million of qualified zone academy bonds in calendar year 2008; unused authority could be carried forward for up to two years. Reporting of issuance would be required.

Extend deferral of gains from sales of electric transmission property.—Generally, the gain on the sale of business assets is subject to current income tax unless a special rule provides for nonrecognition or deferral of the gain. One such special rule applies to qualifying electric transmission transactions. Under this rule, a taxpayer may elect to recognize the gain from a qualifying electric transmission transaction ratably over the eight-year period beginning with the year of the transaction. Deferral is allowed only with respect to proceeds that are used to purchase other gas or electric utility property during the four-year period beginning on the date of the transaction (the reinvestment period). A sale or other disposition of property is a qualifying electric transmission transaction if: (1) the property is used in the trade or business of providing electric transmission services or is an ownership interest in a entity whose principal trade or business is providing electric transmission services, and (2) the sale or other disposition is to an independent transmission company and occurs before January 1, 2008. In general, whether the purchaser qualifies as an independent transmission company depends on determinations by the Federal Energy Regulatory Commission (FERC) or, in the case of facilities subject to the jurisdiction of the Public Utility Commission of Texas, by that Commission. The special rule allowing the deferral of tax on the gain from the sale or disposition of electric transmission property would be extended for one year, allowing taxpayers to elect deferral with respect to sales or dispositions that occur before January 1, 2009.

Extend provisions permitting disclosure of tax return information relating to terrorist activity.—The disclosure of tax return information relating to terrorism is permitted in two situations. The first is when an executive of a Federal law enforcement or intelligence agency has reason to believe that the return information is relevant to a terrorist incident, threat or activity and submits a written request. The second is when the IRS wishes to apprise a Federal law enforcement agency of a terrorist incident, threat or activity. The Administration proposes to extend this disclosure authority, which expires on December 31, 2007, through December 31, 2008.

Extend excise tax on coal at current rates.—Excise taxes levied on coal mined and sold for use in the United States are deposited in the Black Lung Disability Trust Fund. Amounts deposited in the Fund are used to cover the cost of program administration and compensation, medical, and survivor benefits to eligible miners and their survivors, when mine employment terminated prior to 1970 or when no mine operator can be assigned liability. Current tax rates on coal sold by a producer are $1.10 per ton of coal from underground mines and $0.55 per ton of coal from surface mines; however, these rates may not exceed 4.4 percent of the price at which the coal is sold. Effective for coal sold after December 31, 2013, the tax rates on coal from underground mines and surface mines will decline to $0.50 per ton and $0.25 per ton, respectively, and will be capped at 2 percent of the price at which the coal is sold. The Administration proposes to repeal the reduction in these tax rates effective for sales after December 31, 2013, and keep current rates in effect until the Black Lung Disability Trust Fund debt is repaid.

Extend the exception for retirement plan distributions provided individuals called to active duty for at least 179 days.—Under current law, a taxpayer who receives a distribution from a qualified retirement plan prior to age 59½, death or disability is subject to a 10-percent early withdrawal tax unless a specific exception to the tax applies. One of the exceptions to the tax applies to qualified reservist distributions. An individual who receives a qualified reservist distribution may, at any time during a two-year period beginning on the day after the end of the active duty period, make contributions to an IRA in an amount not exceeding the amount of the qualified reservist distribution. Such contributions are not subject to the dollar limitations otherwise applicable to contributions to IRAs. The exception to the tax for qualified reservist distributions applies to individuals ordered or called to active duty after September 11, 2001 and before December 31, 2007. The Administration proposes to extend the exception to individuals ordered or called to active duty before December 31, 2008.

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS

(In millions of dollars)

	2007	2008	2009	2010	2011	2012	2008–12	2008–17
Make Permanent Certain Tax Relief Enacted in 2001 and 2003 (assumed in the baseline):								
Dividends tax rate structure	344	683	695	–3,595	–13,789	1,491	–14,515	–89,973
Capital gains tax rate structure	....	....	....	–3,405	–17,477	–7,269	–28,151	–79,059
Expensing for small business	....	....	....	–3,728	–4,947	–3,376	–12,051	–20,158
Marginal individual income tax rate reductions	....	....	....	....	–71,892	–113,251	–185,143	–793,780
Child tax credit [1]	....	....	....	....	–5,265	–21,128	–26,393	–135,380
Marriage penalty relief [1]	....	....	....	....	–5,380	–7,971	–13,351	–41,317
Education incentives	....	....	....	....	–739	–1,336	–2,075	–9,673
Repeal of estate and generation-skipping transfer taxes, and modification of gift taxes	–156	–1,373	–2,290	–3,067	–26,845	–57,652	–91,227	–442,490
Other incentives for families and children	....	....	....	6	–179	–866	–1,039	–5,341
Total, make permanent certain tax relief enacted in 2001 and 2003	188	–690	–1,595	–13,789	–146,513	–211,358	–373,945	–1,617,171
Tax Incentives:								
Simplify and encourage saving:								
Expand tax-free savings opportunities	....	1,527	3,545	3,023	1,075	–1,314	7,856	–592
Consolidate employer-based savings accounts	....	–80	–120	–132	–141	–150	–623	–1,484
Total, simplify and encourage saving	....	1,447	3,425	2,891	934	–1,464	7,233	–2,076
Encourage entrepreneurship and investment:								
Increase expensing for small business	....	–1,597	–2,180	–1,541	–1,135	–847	–7,300	–10,095
Invest in health care:								
Provide a flat $15,000 deduction for family coverage ($7,500 for individual coverage) for those with and who purchase health insurance [1]	....	....	–31,433	–38,892	–30,843	–20,033	–121,201	5,150
Expand and make health savings accounts (HSAs) more flexible	....	–318	–593	–784	–937	–1,037	–3,669	–10,366
Improve the Health Coverage Tax Credit [1]	....	–1	–3	–4	–5	–5	–18	–51
Allow the orphan drug tax credit for certain pre-designation expenses	....	....	....	....	....	....	....	–1
Total, invest in health care	....	–319	–32,029	–39,680	–31,785	–21,075	–124,888	–5,268
Provide incentives for charitable giving:								
Extend permanently tax-free withdrawals from IRAs for charitable contributions	....	–120	–255	–235	–171	–147	–928	–1,867
Extend permanently the enhanced charitable deduction for contributions of food inventory	....	–44	–96	–106	–116	–127	–489	–1,345
Extend permanently the deduction for corporate donations of computer technology	....	–50	–118	–147	–154	–162	–631	–1,570
Permanently increase limits on contributions of property interests made for conservation purposes	....	–48	–35	–22	–18	–21	–144	–265
Extend permanently basis adjustment to stock of S corporations contributing appreciated property	....	–3	–15	–21	–25	–28	–92	–301
Reform excise tax based on investment income of private foundations	....	–61	–91	–97	–103	–110	–462	–1,163
Repeal the $150 million limitation on qualified 501(c)(3) bonds	....	–2	–3	–9	–13	–14	–41	–104
Repeal certain restrictions on the use of qualified 501(c)(3) bonds for residential rental property	....	–2	–5	–10	–17	–24	–58	–286
Total, provide incentives for charitable giving	....	–330	–618	–647	–617	–633	–2,845	–6,901
Strengthen education:								
Extend permanently the above-the-line deduction for qualified out-of-pocket classroom expenses	....	–18	–180	–183	–185	–188	–754	–1,739

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

	2007	2008	2009	2010	2011	2012	2008–12	2008–17
Allow the saver's credit for contributions to qualified tuition programs	....	–63	–163	–176	–189	–200	–791	–1,966
Total, strengthen education	....	–81	–343	–359	–374	–388	–1,545	–3,705
Protect the environment:								
Extend permanently expensing of brownfields remediation costs	61	–244	–400	–352	–342	–331	–1,669	–2,851
Eliminate the volume cap for private activity bonds for water infrastructure	....	–1	–3	–5	–9	–13	–31	–184
Total, protect the environment	61	–245	–403	–357	–351	–344	–1,700	–3,035
Restructure assistance to New York City for continued recovery from the attacks of September 11th:								
Provide tax incentives for transportation infrastructure	....	–200	–200	–200	–200	–200	–1,000	–2,000
Total, tax incentives	61	–1,325	–32,348	–39,893	–33,528	–24,951	–132,045	–33,080
Simplify the Tax Laws for Families:								
Clarify uniform definition of a child [1]	17	64	48	31	40	15	198	350
Simplify EITC eligibility requirement regarding filing status, presence of children, and work and immigration status [1]	....	31	–25	–22	–22	–21	–59	–164
Reduce computational complexity of refundable child tax credit [1]	....	....	....	....	....	....	....	....
Total, simplify the tax laws for families	17	95	23	9	18	–6	139	186
Improve Tax Compliance: [5]								
Expand information reporting	....	232	1,075	1,848	2,488	2,903	8,546	28,849
Improve compliance by businesses	....	143	91	38	21	20	313	421
Strengthen tax administration	....	....	....	1	1	1	3	17
Expand penalties	....	3	5	11	18	20	57	178
Total, improve tax compliance	....	378	1,171	1,898	2,528	2,944	8,919	29,465
Improve Tax Administration and Other Miscellaneous Proposals:								
Implement IRS administrative reforms and extend IRS authority to fund undercover operations [4]	....	....	....	....	....	....	....	....
Eliminate the special exclusion from unrelated business taxable income for gain or loss on the sale or exchange of certain brownfields	....	2	14	28	28	23	95	126
Limit related party interest deductions	86	148	155	163	171	180	817	1,859
Repeal excise tax on local telephone service [2]	–552	–463	–148	–74	–74	–74	–833	–1,211
Modify financing of the Airport and Airway trust fund [2]	....	....	–6,407	–6,705	–7,005	–7,326	–27,443	–69,732
Anticipated receipt of donations to the National Park Service through the National Park Centennial Challenge Fund	....	100	100	100	100	100	500	1,000
Transition from the non-foreign COLA to locality pay for employees in non-foreign areas	....	1	2	3	4	5	15	50
Total, improve tax administration and other miscellaneous proposals [2]	–466	–212	–6,284	–6,485	–6,776	–7,092	–26,849	–67,908
Improve Unemployment Insurance:								
Strengthen the financial integrity of the unemployment insurance system by reducing improper benefit payments and tax avoidance [2]	....	....	29	29	–16	–64	–22	–1,469
Extend unemployment insurance surtax [2]	....	1,073	1,542	1,580	1,617	1,633	7,445	1,526
Total, improve unemployment insurance [2]	....	1,073	1,571	1,609	1,601	1,569	7,423	57
Modify Energy Provisions:								
Repeal reduced recovery period for natural gas distribution lines	....	52	88	107	119	106	472	906
Modify amortization for certain geological and geophysical expenditures	....	15	55	81	67	56	274	582
Indirect effect of energy proposals [3]	....	–45	–93	–163	–92	–98	–491	–1,019
Total, modify energy provisions	....	22	50	25	94	64	255	469
Promote Trade:								
Implement free trade agreements and modify other trade-related provisions [2]	....	–241	–502	–760	–994	–1,240	–3,737	–13,072
Extend Expiring Provisions:								
AMT relief for individuals	–9,123	–47,922	11,431	....	....	....	–36,491	–36,491
Research & Experimentation (R&E) tax credit	....	–3,221	–7,071	–9,145	–10,601	–11,799	–41,837	–117,309
Work opportunity tax credit	....	–71	–192	–162	–80	–51	–556	–582
First-time homebuyer credit for DC	....	–1	–19	....	....	....	–20	–20
Authority to issue Qualified Zone Academy Bonds	....	–3	–8	–13	–18	–20	–62	–162
Deferral of gains from sales of electric transmission property	–63	–48	–52	–65	–39	5	–199	41
Disclosure of tax return information related to terrorist activity [4]	....	....	....	....	....	....	....	....
Excise tax on coal [2]	....	....	....	....	....	....	....	1,081

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

	2007	2008	2009	2010	2011	2012	2008–12	2008–17
Exception for retirement plan distributions provided individuals called to active duty for at least 179 days	–*	–*	–*	–*	–*	–*	–*	–*
Total, extend expiring provisions [2]	–9,186	–51,266	4,089	–9,385	–10,738	–11,865	–79,165	–153,442
Total budget proposals, including proposals assumed in the baseline [2]	–9,386	–52,166	–33,825	–66,771	–194,308	–251,935	–599,005	–1,854,496
Total budget proposals, excluding proposals assumed in the baseline [2]	–9,574	–51,476	–32,230	–52,982	–47,795	–40,577	–225,060	–237,325

* $500,000 or less.
[1] Affects both receipts and outlays. Only the receipt effect is shown here. For the outlay effect, see summary Table S–5 of the *Budget* volume.
[2] Net of income offsets.
[3] Indirect effect on receipts of proposed alternative fuels and fuel efficiency standards. These proposals are discussed in the Energy chapter of the *Budget* volume.
[4] No net budgetary impact.
[5] "Tax gap"-related proposals.

Table 17–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	2006 Actual	Estimate 2007	2008	2009	2010	2011	2012
Individual income taxes (federal funds):							
Existing law	1,043,908	1,177,703	1,294,636	1,349,248	1,476,448	1,673,666	1,819,724
Proposed legislation	....	–8,857	–48,022	–18,111	–48,131	–156,377	–183,157
Total individual income taxes	**1,043,908**	**1,168,846**	**1,246,614**	**1,331,137**	**1,428,317**	**1,517,289**	**1,636,567**
Corporation income taxes:							
Federal funds:							
Existing law	353,914	341,867	318,385	326,647	334,665	350,891	377,546
Proposed legislation	....	190	–3,444	–6,837	–9,206	–10,314	–10,910
Total Federal funds corporation income taxes	353,914	342,057	314,941	319,810	325,459	340,577	366,636
Trust funds:							
Hazardous substance superfund	1	....	....	....	....	....	....
Total corporation income taxes	**353,915**	**342,057**	**314,941**	**319,810**	**325,459**	**340,577**	**366,636**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	520,069	542,098	576,237	608,106	643,935	680,272	714,061
Disability insurance (Off-budget)	88,313	92,032	97,848	103,264	109,347	115,518	121,256
Hospital insurance	177,429	185,163	198,726	208,700	221,160	233,811	245,766
Railroad retirement:							
Social Security equivalent account	1,894	1,993	2,073	2,137	2,203	2,258	2,319
Rail pension and supplemental annuity	2,338	2,364	2,441	2,529	2,473	2,507	2,712
Total employment and general retirement	790,043	823,650	877,325	924,736	979,118	1,034,366	1,086,114
On-budget	181,661	189,520	203,240	213,366	225,836	238,576	250,797
Off-budget	608,382	634,130	674,085	711,370	753,282	795,790	835,317
Unemployment insurance:							
Deposits by States [1]	35,938	37,574	37,584	36,792	37,203	38,150	39,352
Proposed legislation	....	....	....	36	36	–20	–108
Federal unemployment receipts [1]	7,394	7,323	6,183	5,785	5,925	6,065	6,207
Proposed legislation	....	....	1,341	1,928	1,975	2,022	2,069
Railroad unemployment receipts [1]	88	88	95	106	112	114	122
Total unemployment insurance	43,420	44,985	45,203	44,647	45,251	46,331	47,642
Other retirement:							
Federal employees' retirement—employee share	4,308	4,704	4,633	4,798	4,909	4,964	4,972
Proposed legislation	....	....	1	2	3	4	5
Non-Federal employees retirement [2]	50	38	33	31	28	26	23
Total other retirement	4,358	4,742	4,667	4,831	4,940	4,994	5,000
Total social insurance and retirement receipts	**837,821**	**873,377**	**927,195**	**974,214**	**1,029,309**	**1,085,691**	**1,138,756**
On-budget	229,439	239,247	253,110	262,844	276,027	289,901	303,439
Off-budget	608,382	634,130	674,085	711,370	753,282	795,790	835,317
Excise taxes:							
Federal funds:							
Alcohol taxes	8,484	8,614	8,798	8,953	9,109	9,318	9,524
Proposed legislation	....	....	–76	–26	....	....	....
Tobacco taxes	7,710	7,605	7,496	7,393	7,298	7,208	7,123
Transportation fuels tax	–2,386	–2,960	–3,459	–4,101	–4,798	–1,227	234
Proposed legislation	....	....	–74	–139	–190	–57	....
Telephone and teletype services	4,897	–10,892	–1,712	197	100	100	100
Proposed legislation	....	–736	–616	–197	–100	–100	–100
Other Federal fund excise taxes	3,755	1,493	1,932	1,987	2,057	2,128	2,208
Proposed legislation	....	....	15	–121	–155	–163	–172
Total Federal fund excise taxes	22,460	3,124	12,304	13,946	13,321	17,207	18,917

Table 17–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	2006 Actual	Estimate 2007	2008	2009	2010	2011	2012
Trust funds:							
Highway	38,378	39,707	40,858	41,911	42,696	43,402	44,045
Proposed legislation	....	....	12	14	–27	–65	–131
Airport and airway	10,590	11,426	12,094	12,808	13,556	14,341	15,162
Proposed legislation	....	....	....	–8,485	–8,882	–9,279	–9,706
Sport fish restoration and boating safety	519	547	564	581	600	619	638
Tobacco assessments	891	960	960	960	960	960	960
Black lung disability insurance	607	624	629	640	659	679	692
Inland waterway	81	84	85	86	87	88	89
Oil spill liability	54	199	205	214	225	233	244
Vaccine injury compensation	184	195	196	198	199	202	203
Leaking underground storage tank	197	196	199	204	206	210	212
Total trust funds excise taxes	51,501	53,938	55,802	49,131	50,279	51,390	52,408
Total excise taxes	**73,961**	**57,062**	**68,106**	**63,077**	**63,600**	**68,597**	**71,325**
Estate and gift taxes:							
Federal funds	27,877	25,260	26,786	28,757	22,920	20,407	48,691
Proposed legislation	....	17	–1,081	–1,318	–1,179	–18,733	–48,170
Total estate and gift taxes	**27,877**	**25,277**	**25,705**	**27,439**	**21,741**	**1,674**	**521**
Customs duties:							
Federal funds	23,533	25,430	28,105	29,786	32,066	33,837	35,501
Proposed legislation	....	....	–322	–671	–1,015	–1,326	–1,655
Trust funds	1,277	1,336	1,440	1,536	1,637	1,740	1,849
Total customs duties	**24,810**	**26,766**	**29,223**	**30,651**	**32,688**	**34,251**	**35,695**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	423	534	542	549	558	567	577
Exercise of warrants	118	....	....	....	....	....	....
United Mine Workers of America combined benefit fund	119	72	65	44	24	5	3
Deposit of earnings, Federal Reserve System	29,945	32,638	36,115	37,625	39,040	40,680	42,804
Defense cooperation	12	8	8	8	8	8	8
Fees for permits and regulatory and judicial services	10,226	10,083	10,468	10,600	10,806	11,020	11,213
Fines, penalties, and forfeitures	3,796	3,243	3,254	2,910	2,929	2,948	2,969
Gifts and contributions	378	189	194	199	201	203	206
Proposed legislation	....	....	100	100	100	100	100
Refunds and recoveries	–55	–56	–56	–56	–56	–56	–56
Total miscellaneous receipts	**44,962**	**46,711**	**50,690**	**51,979**	**53,610**	**55,475**	**57,824**
Total budget receipts	**2,407,254**	**2,540,096**	**2,662,474**	**2,798,307**	**2,954,724**	**3,103,554**	**3,307,324**
On-budget	1,798,872	1,905,966	1,988,389	2,086,937	2,201,442	2,307,764	2,472,007
Off-budget	608,382	634,130	674,085	711,370	753,282	795,790	835,317
MEMORANDUM							
Federal funds	1,517,453	1,635,493	1,681,337	1,774,042	1,874,190	1,965,503	2,115,280
Trust funds	616,863	653,127	692,062	709,365	747,034	789,414	827,684
Interfund transactions	–335,444	–382,654	–385,010	–396,470	–419,782	–447,153	–470,957
Total on-budget	**1,798,872**	**1,905,966**	**1,988,389**	**2,086,937**	**2,201,442**	**2,307,764**	**2,472,007**
Off-budget (trust funds)	**608,382**	**634,130**	**674,085**	**711,370**	**753,282**	**795,790**	**835,317**
Total	**2,407,254**	**2,540,096**	**2,662,474**	**2,798,307**	**2,954,724**	**3,103,554**	**3,307,324**

[1] Deposits by States cover the benefit part of the program. Federal unemployment receipts cover administrative costs at both the Federal and State levels. Railroad unemployment receipts cover both the benefits and adminstrative costs of the program for the railroads.
[2] Represents employer and employee contributions to the civil service retirement and disability fund for covered employees of Government-sponsored, privately owned enterprises and the District of Columbia municipal government.
[3] Includes both Federal and trust funds.

18. USER CHARGES AND OTHER COLLECTIONS

In addition to collecting taxes and other receipts by the exercise of its sovereign powers, which is discussed in the previous chapter, the Federal Government collects income from the public from market-oriented activities and the financing of regulatory expenses. These collections are classified as user charges, and they include the sale of postage stamps and electricity, charges for admittance to national parks, premiums for deposit insurance, and proceeds from the sale of assets, such as rents and royalties for the right to extract oil from the Outer Continental Shelf.

Depending on the laws that authorize the user charges, most are credited to expenditure accounts as "offsetting collections," or to receipt accounts as "offsetting receipts." The budget refers to these amounts as "offsetting" because they are subtracted from gross outlays rather than added to taxes on the receipts side of the budget. The purpose of this treatment is to produce budget totals for receipts, outlays, and budget authority in terms of the amount of resources allocated governmentally, through collective political choice, rather than through the market.[1] In addition, some regulatory fees therefore are classified as governmental receipts and are on the receipts side of the budget.

Usually offsetting collections are authorized to be spent for the purposes of the account without further action by the Congress. Offsetting receipts may or may not be earmarked for a specific purpose, depending on the legislation that authorizes them. When earmarked, the authorizing legislation may either authorize them to be spent without further action by the Congress, or require them to be appropriated in annual appropriations acts before they can be spent.

Offsetting collections and receipts include most user charges, which are discussed below, as well as some amounts that are not user charges. Table 18–1 summarizes these transactions. For 2008, total offsetting collections and receipts from the public are estimated to be $319.3 billion, and total user charges are estimated to be $244.6 billion.

The following section discusses user charges and the Administration's user charge proposals. The subsequent section displays more information on offsetting collections and receipts. The offsetting collections and receipts by agency are displayed in Table 21–1, which appears in Chapter 21, "Outlays to the Public, Gross and Net," of this volume. Collections specifically related to credit programs are discussed in Chapter 7, "Credit and Insurance."

Table 18–1. GROSS OUTLAYS, USER CHARGES, OTHER OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, AND NET OUTLAYS

(In billions)

	Actual 2006	Estimate	
		2007	2008
Gross outlays	2,935.5	3,100.3	3,221.1
Offsetting collections and receipts from the public:			
User charges [1]	–197.8	–226.8	–241.2
Other	–82.2	–89.2	–78.1
Subtotal, offsetting collections and receipts from the public	–280.1	–316.0	–319.3
Net outlays	2,655.4	2,784.3	2,901.9

[1] Total user charges are shown below. They include user charges that are classified on the receipts side of the budget in addition to the amounts shown on this line. For additional details of total user charges, see Table 18–2, "Total User Charge Collections."

Total user charges:			
Offsetting collections and receipts from the public	197.8	226.8	241.2
Receipts	3.5	3.5	3.4
Total, User charges	201.4	230.3	244.6

[1] Showing collections from business-type transactions as offsets on the spending side of the budget follows the concept recommended by the *Report of the President's Commission on Budget Concepts* in 1967. The concept is discussed in Chapter 26: "The Budget System and Concepts" in this volume.

USER CHARGES

I. Introduction and Background

The Federal Government often charges those who benefit directly from a particular activity or those subject to regulation. Based on the definition used in this chapter, Table 18–2 shows that user charges were $201.4 billion in 2006, and are estimated to increase to $230.3 billion in 2007 and to $244.6 billion in 2008, growing to an estimated $275.5 billion in 2012, including the user charges proposals that are shown in Table 18–3. This table shows that the Administration's user charge proposals, including extension of expiring charges, would increase user charges by an estimated $4.5 billion in 2008, growing to an estimated $19.1 billion in 2012.

Definition. User charges are fees, charges, and assessments levied on individuals or organizations directly benefiting from, or subject to regulation by, a Government program or activity. In addition, the payers of the charge must be limited to those benefiting from, or subject to regulation by, the program or activity, and may not include the general public, and generally does not apply to a broad segment of the public (such as those who pay income taxes or customs duties).

- Examples of business-type or market-oriented user charges include charges for the sale of postal services (the sale of stamps), electricity (e.g., sales by the Tennessee Valley Authority), proceeds from the sale of goods by defense commissaries, payments for Medicare voluntary supplemental medical insurance, life insurance premiums for veterans, recreation fees for parks, and proceeds from the sale of assets (property, plant, and equipment) and natural resources (such as timber, oil, and minerals).
- Examples of regulatory and licensing user charges include charges for regulating the nuclear energy industry, bankruptcy filing fees, immigration fees, food inspection fees, passport fees, and patent and trademark fees.

The "user charges" concept used here aligns these estimates with the concept that establishes policy for charging prices to the public for the sale or use of goods, services, property, and resources (see OMB Circular No. A–25, "User Charges," July 8, 1993).

User charges do not include all offsetting collections and receipts from the public, such as repayments received from credit programs; interest, dividends, and other earnings; payments from one part of the Federal Government to another; or cost sharing contributions. Nor do they include earmarked taxes (such as taxes paid to social insurance programs or excise taxes on gasoline), or customs duties, fines, penalties, and forfeitures.

Alternative definitions. The definition used in this chapter is useful because it is similar to the definition used in OMB Circular No. A–25, "User Charges," which provides policy guidance to Executive Branch agencies on setting prices for user charges. Alternative definitions may be used for other purposes. Much of the discussion of user charges below—their purpose, when they should be levied, and how the amount should be set—applies to these alternatives as well.

Other definitions of user charges could, for example:

- be narrower than the one used here, by limiting the definition to proceeds from the sale of goods and services (and excluding the sale of assets), and by limiting the definition to include only proceeds that are earmarked to be used specifically to finance the goods and services being provided. This definition is similar to one the House of Representatives uses as a guide for purposes of committee jurisdiction. (See the *Congressional Record*, January 3, 1991, p. H31, item 8.)
- be even narrower than the user fee concept described above, by excluding regulatory fees and focusing solely on business-type transactions.
- be broader than the one used in this chapter by including beneficiary- or liability-based excise taxes, such as gasoline taxes. [2]

What is the purpose of user charges? The purpose of user charges is to improve the efficiency and equity of certain Government activities, and to reduce the burden on taxpayers to finance activities whose benefits accrue to a relatively limited number of people, or to impose a charge on activities that impose a cost on the public.

User charges that are set to cover the costs of production of goods and services can provide efficiency in the allocation of resources within the economy. They allocate goods and services to those who value them the most, and they signal to the Government how much of the goods or services it should provide. Prices in private, competitive markets serve the same purposes.

User charges for goods and services that do not have special social benefits improve equity, or fairness, by requiring that those who benefit from an activity are the same people who pay for it. The public often perceives user charges as fair because those who benefit from the good or service pay for it in whole or in part, and those who do not benefit do not pay.

When should the Government charge a fee? Discussions of whether to finance spending with a tax or a fee often focus on whether the benefits of the activity are to the public in general or to a limited group of people. In general, if the benefits accrue broadly to the public, then the program should be financed by taxes paid by the public; in contrast, if the benefits accrue to a limited number of private individuals or organizations, then the program should be financed by charges paid by the private beneficiaries. For Federal

[2] Beneficiary- and liability-based taxes are terms taken from the Congressional Budget Office, *The Growth of Federal User Charges*, August 1993, and updated in October 1995. In addition to gasoline taxes, examples of beneficiary-based taxes include taxes on airline tickets, which finance air traffic control activities and airports. An example of a liability-based tax is the excise tax that formerly helped fund the hazardous substance superfund in the Environmental Protection Agency. This tax was paid by industry groups to finance environmental cleanup activities related to the industry activity but not necessarily caused by the payer of the fee.

programs where the benefits are entirely public or entirely private, applying this principle is relatively easy. For example, according to this principle, the benefits from national defense accrue to the public in general and should be (and are) financed by taxes. In contrast, the benefits of electricity sold by the Tennessee Valley Authority accrue exclusively to those using the electricity, and should be (and are) financed by user charges.

In many cases, however, an activity has benefits that accrue to both public and to private groups, and it may be difficult to identify how much of the benefits accrue to each. Because of this, it can be difficult to know how much of the program should be financed by taxes and how much by fees. For example, the benefits from recreation areas are mixed. Fees for visitors to these areas are appropriate because the visitors benefit directly from their visit, but the public in general also benefits because these areas protect the Nation's natural and historic heritage now and for posterity.

As a further complication, where a fee may be appropriate to finance all or part of an activity, some consideration must be given to the ease of administering the fee.

What should be the amount of the fee? For programs that have private beneficiaries, the amount of the charge should depend on the costs of producing the goods or services and the portion of the program that is for private benefits. If the benefit is primarily private and any public benefits are incidental, current policies support charges that cover the full cost to the Government, including both direct and indirect costs. When the Government is not acting in its capacity as sovereign and engages in a business-type transaction (i.e., leasing or selling goods, services, or resources), market price should be the basis for establishing the fee. [3]

The Executive Branch is working to put cost accounting systems in place across the Government that would make the calculation of full cost more feasible. The difficulties in measuring full cost are associated in part with allocating to an activity the full costs of capital, retirement benefits, and insurance, as well as other Federal costs that may appear in other parts of the budget. Guidance in the Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Standards" for the Federal Government (July 31, 1995), should underlie cost accounting in the Federal Government.

Classification of user charges in the budget. As shown in Table 18–1, most user charges are classified as offsets to outlays on the spending side of the budget, but a few are classified on the receipts side of the budget. An estimated $3.4 billion in 2008 are classified on the receipts side and are included in the totals described in Chapter 17. "Federal Receipts." They are classified as receipts because they are regulatory charges collected by the Federal Government by the exercise of its sovereign powers. Examples include filing fees in the United States courts, agricultural quarantine inspection fees, and passport fees. These regulatory charges are unlike user fees classified as offsets to outlays, which are normally for identifiable goods or services whose benefits primarily fall to the party paying the fee and for which alternatives may exist in the private sector or State and local sector.

The remaining user charges, an estimated $241.2 billion in 2008, are classified as offsetting collections and receipts on the spending side of the budget. Some of these are collected by the Federal Government by the exercise of its sovereign powers and conceptually would appear on the receipts side of the budget, but are required by law to be classified on the spending side as offsetting collections or receipts. Examples of these fees include immigration examination fees, U. S. customs processing fees, and nuclear regulatory fees.

An estimated $141.8 billion of user charges for 2008 are credited directly to expenditure accounts, and are generally available for expenditure when they are collected, without further action by the Congress. An estimated $99.4 billion of user charges for 2008 are deposited in offsetting receipt accounts, and are available to be spent only according to the legislation that established the charges.

As a further classification, the accompanying Tables 18–2 and 18–3 identify the user charges as discretionary or mandatory. These classifications are terms from the Budget Enforcement Act of 1990 as amended and are used frequently in the analysis of the budget. "Discretionary" in this chapter refers to user charges generally controlled through annual appropriations acts and under the jurisdiction of the appropriations committees in the Congress. "Mandatory" refers to user charges controlled by permanent laws and under the jurisdiction of the authorizing committees.

These and other classifications are discussed further in this volume in Chapter 26, "The Budget System and Concepts."

II. TOTAL USER CHARGES

As shown in Table 18–2, total user charge collections (including those proposed in this Budget) are estimated to be $244.6 billion in 2008, increasing to $275.5 billion in 2012. User charge collections by the Postal Service and for Medicare premiums are the largest and are estimated to be more than half of total user charge collections in 2008.

[3] Policies for setting user charges are promulgated in OMB Circular No. A–25: "User Charges" (July 8, 1993).

Table 18–2. TOTAL USER CHARGE COLLECTIONS

(In millions of dollars)

	Actual 2006	Estimates 2007	2008	2009	2010	2011	2012
Receipts							
Judicial Branch: Filing fees, U.S. courts	221	144	172	157	153	159	164
Department of Agriculture: Agricultural quarantine inspection fees	418	455	494	502	509	517	524
Department of the Interior: Abandoned mine reclamation fund	303	301	295	270	275	282	286
Department of State: Immigration, passport, and consular fees	861	719	732	731	730	729	728
Corps of Engineers: Harbor maintenance fees	1,207	1,264	1,367	1,461	1,561	1,663	1,770
Other	538	567	357	304	306	309	312
Subtotal, receipts	3,548	3,450	3,417	3,425	3,534	3,659	3,784
Offsetting Collections and Receipts from the Public							
Discretionary							
Department of Agriculture: Food safety inspection and other charges	316	312	309	305	304	309	312
Department of Commerce: Patent and trademark, fees for weather services, and other charges	1,779	1,892	2,034	2,182	2,368	2,574	2,757
Department of Defense: Commissary and other charges	10,079	10,564	10,417	10,393	10,392	10,392	10,392
Department of Energy: Federal Energy Regulation Commission, power marketing, and other charges	982	1,131	1,345	1,323	1,319	1,349	1,361
Department of Health and Human Services: Food and Drug Administration, Centers for Medicare and Medicaid Services, and other charges	1,247	972	1,193	1,104	1,100	1,124	1,134
Department of Homeland Security: Border and Transportation Security and other charges	2,051	2,431	2,761	2,842	2,937	3,035	3,136
Department of the Interior: Minerals Management Service and other charges	736	721	843	826	811	848	850
Department of Justice: Charges for bankruptcy oversight and other charges	301	329	364	358	357	365	368
Department of State: Passport and other charges	948	1,308	1,576	1,622	1,670	1,719	1,769
Department of Transportation: FAA user fee proposal, pipeline safety, and other charges	188	105	252	8,422	8,908	9,344	9,766
Department of the Treasury: Sale of commemorative coins and other charges	1,606	1,992	1,948	1,916	1,909	1,954	1,970
Department of Veterans Affairs: Medical care and other charges	2,082	2,274	2,431	2,518	2,607	2,703	2,801
General Services Administration: Acquisition services fund and other charges	87	452	470	481	491	501	511
Social Security Administration, State supplemental fees, supplemental security income	116	119	135	133	132	135	137
Federal Communications Commission: Regulatory fees	383	374	397	391	389	398	402
Federal Trade Commission: Regulatory fees	133	153	165	162	162	165	167
Nuclear Regulatory Commission: Regulatory fees	624	641	765	756	756	774	783
Securities and Exchange Commission: Regulatory fees	1,904	1,379	1,147	1,332	1,520	1,740	1,742
All other agencies, discretionary user charges	–3,036	305	255	249	246	247	248
Subtotal, discretionary user charges	22,526	27,454	28,807	37,315	38,378	39,676	40,606
Mandatory							
Department of Agriculture: Crop insurance and other charges	1,941	1,829	2,648	2,457	2,405	2,444	2,374
Department of Defense: Commissary surcharge and other charges	1,036	742	784	791	770	703	515
Department of Energy: Proceeds from the sale of energy, nuclear waste disposal, and other charges	4,491	4,680	4,553	4,769	4,608	4,670	4,594
Department of Health and Human Services: Medicare Part B and Part D insurance premiums and other charges	47,250	54,956	59,578	64,404	69,320	74,660	80,728
Department of Homeland Security: Customs, immigration, and other charges	7,024	7,478	8,428	8,345	8,782	9,222	9,646
Department of the Interior: Recreation and other charges	6,156	4,778	5,148	5,654	5,497	5,383	5,866
Department of Justice: Federal Prison Commissary fees and other charges	435	516	549	561	575	588	602
Department of Labor: Insurance premiums to guaranty private pensions and other charges	3,160	3,756	3,607	6,575	7,532	7,943	8,561
Department of the Treasury: Bank regulation, and other charges	956	1,048	1,120	1,146	1,186	1,228	1,272
Department of Veterans Affairs: Veterans life insurance and other charges	2,468	2,499	2,207	2,291	2,258	2,230	2,239
Office of Personnel Management: Federal employee health and life insurance fees	11,164	11,560	12,207	13,001	13,947	14,991	15,978
Federal Deposit Insurance Corporation: Deposit insurance fees and other charges	252	865	2,526	5,318	6,946	8,105	6,330
National Credit Union Administration: Credit union share insurance and other charges	353	401	453	477	434	461	487
Postal Service: Fees for postal services	70,348	73,672	76,733	70,273	70,533	70,865	71,312
Tennessee Valley Authority: Proceeds from the sale of energy	9,051	9,136	9,410	8,428	8,708	8,987	9,354
Undistributed Offsetting Receipts:							
Department of Commerce: Digital television transition and public safety fund	....	....	11,800	2,058	....	....	....
Department of the Interior: Arctic National Wildlife Refuge, lease bonuses	....	....	....	7,004	4	1,006	6
Executive Office of the President: Spectrum relocation receipts	....	6,850	....	....	....	....	....
Federal Communications Commission: Auction receipts	111	6,900	50	100	100	100	....
Outer Continental Shelf receipts and other collections	7,283	6,940	9,621	10,662	9,558	10,166	10,208
All other agencies, mandatory user charges	1,815	765	957	957	973	1,018	1,004
Subtotal, mandatory user charges	175,294	199,371	212,379	215,271	214,136	224,770	231,076
Subtotal, user charges that are offsetting collections and receipts from the public	197,820	226,825	241,186	252,586	252,514	264,446	271,682
TOTAL, User charges	**201,368**	**230,275**	**244,603**	**256,011**	**256,048**	**268,105**	**275,466**

III. USER CHARGE PROPOSALS

As shown in Table 18–3, the Administration is proposing new or increased user charges, including proposed extensions of expiring charges, that would increase collections by an estimated $4.5 billion in 2008, increasing to $19.1 billion in 2012. These amounts are collections and receipts only. They do not include related spending.

A. Discretionary User Charge Proposals

1. Offsetting collections

Department of Commerce: Minority Business Development Agency

Conference fees. The Budget proposed to give the Minority Business Development Agency (MBDA) the authority to collect and retain fees to offset the costs of conducting conferences. MBDA conducts the annual Minority Enterprise Development (MED) Week conference and estimated fees are less than $500 thousand per year.

Department of Defense (DOD)

Medical care enrollment fees and deductible. The Budget gives DOD the authority to increase enrollment fees and deductibles for military retirees under age 65 (and families). The new cost shares differ for officer and enlisted retirees and for those in the different types of plans. The Budget also assumes that retail pharmacy co-payments for all military retirees will increase. None of these changes apply to active-duty members and their dependents. DOD will take into account the recommendations of the DOD Task Force on the Future of Military Health Care before final implementation. The total 2008 savings for these proposals is estimated to be $1,862 million.

Department of Health and Human Services

Food and Drug Administration (FDA)

Generic drug review activities fee. Generic drugs play an important role in reducing the cost of pharmaceuticals. The Budget proposes a new user fee to generate additional resources to support FDA's generic drug review activities. Similar to the purpose of FDA's current prescription drug user fees, the proposed generic drug user fee would be targeted towards improving review times and reducing the backlog of applications.

Expiring user fees. The Prescription Drug User Fee Act, the Medical Devices User Fee and Modernization Act, and the Mammography Quality Standards Act will expire on September 30, 2007. These laws authorize the FDA to assess and collect fees associated with the pre-market review of prescription drugs, medical devices, and activities related to ensuring mammography quality. The Administration supports reauthorizing the collection and spending of these fees.

Centers for Medicare and Medicaid Services

Survey and certification user fee. The Budget proposes a new user fee for the survey and certification program within the Centers for Medicare and Medicaid Services. The agency would charge facilities participating in Medicare and Medicaid a fee for conducting follow-up surveys, which verify that they have taken appropriate action to correct identified deficiencies in compliance with specific Federal health, safety, and quality standards.

Table 18–3. USER FEE AND OTHER USER CHARGE PROPOSALS [1]

(Estimated collections in millions of dollars)

	2007	2008	2009	2010	2011	2012	2008–2012
DISCRETIONARY:							
1. Offsetting collections							
Department of Commerce: Minority Business Development Agency							
Conference fees	....	*	*	*	*	*	2
Department of Defense							
Medical care enrollment fees and deductible	....	1,862	2,322	2,815	3,424	4,061	14,484
Department of Health and Human Services							
Food and Drug Administration:							
Generic drug review activities fee	....	16	16	16	16	16	80
Prescription drug user fee	....	339	333	332	340	343	1,687
Medical devices user fee	....	48	47	47	48	49	239
Mammography standards user fee	....	18	18	18	18	18	90
Centers for Medicare and Medicaid Services: Survey and certification user fee	....	35	34	34	35	35	173
Department of Transportation							
Federal Aviation Administration: User fee proposal	....	....	8,173	8,660	9,092	9,511	35,436
Federal Election Commission							
Registration fees	....	*	*	*	*	*	1
2. Offsetting receipts							
Department of Homeland Security: U.S. Citizenship and Immigration Services							
Systematic alien verification for entitlements program	....	3	3	3	3	3	15
Department of Housing and Urban Development							
Office of Federal Housing Enterprise Oversight	....	–66	–65	–65	–66	–67	–329
Department of the Interior							
Repeal Energy Act fee prohibition	....	21	21	21	21	21	105
Subtotal, discretionary user charge proposals	....	2,277	10,903	11,882	12,932	13,991	51,983
MANDATORY:							
1. Offsetting collections							
Department of Labor							
Pension Benefit Guaranty Corporation premiums	....	....	1,390	1,387	1,400	1,295	5,472
Federal Housing Enterprise Regulator							
Government-Sponsored Enterprises regulatory fee	....	101	105	105	107	109	527
Federal Housing Finance Board							
Federal Home Loan Bank fees	....	–35	–39	–40	–41	–42	–197
2. Offsetting receipts							
Department of Agriculture							
Food Safety and Inspection Service user fees	....	96	98	100	102	104	500
Grain, Inspection, Packers, and Stockyards Administration user fees	....	22	22	23	23	24	115
Animal and Plant Health Inspection Service user fees	....	9	13	13	14	14	63
Federal crop insurance fees	....	....	15	15	15	15	60
Forest county safety net payments	....	467	264	180	137	....	1,048
Department of Defense							
National defense stockpile asset sales: Authorization for additional sales	....	69	145	198	145	25	582
Department of Health and Human Services							
Food and Drug Administration: Re-inspection fees and export certification fees	....	27	28	28	29	30	142
Centers for Medicare and Medicaid Services: Additional Medicare premiums	....	403	804	1,116	1,432	1,792	5,547
Department of Housing and Urban Development							
Ginnie Mae premium increase	....	46	46	46	46	46	230
Government-Sponsored Enterprises oversight fee	....	6	6	6	6	6	30
Department of the Interior							
Amend Bureau of Land Management Federal land sale authority	....	5	10	14	53	53	135
Require upfront payment of coal bonus bid receipts	....	2	121	115	54	134	426
Arctic National Wildlife Refuge lease bonuses:							
Collections for payment to Alaska	....	....	3,502	2	503	3	4,010
Collections deposited in the Treasury	....	....	3,502	2	503	3	4,010
Department of Labor							
Foreign labor certification fees	....	65	65	65	65	65	325
Department of Veterans Affairs							
Pharmacy co-pay increase	....	311	304	306	307	342	1,570
Income-based medical care enrollment fee	....	....	138	134	129	125	526
Third-party insurance co-payment offset	....	44	44	44	43	43	218
Corps of Engineers—Civil Works							
Additional recreation fees	....	7	10	13	16	19	65

Table 18–3. USER FEE AND OTHER USER CHARGE PROPOSALS [1]—Continued

(Estimated collections in millions of dollars)

	2007	2008	2009	2010	2011	2012	2008–2012
Environmental Protection Agency							
Pesticide user fees	....	66	57	60	66	57	306
Pre-manufacture notice user fees	....	4	8	8	8	8	36
Commodity Futures Trading Commission							
Transaction fees	....	86	89	92	95	99	461
Federal Communications Commission							
Spectrum license fee authority	....	50	150	300	300	400	1,200
Extend spectrum auction authority	....	....	....	....	....	200	200
Prospective ancillary terrestrial component spectrum auctions	....	150	150	150	150	150	750
Domestic satellite spectrum auctions	130	252	105	100	100	75	632
Subtotal, mandatory user charge proposals	130	2,253	11,152	4,582	5,807	5,194	28,989
GOVERNMENTAL RECEIPTS							
Department of Transportation							
Federal Aviation Administration: Aviation overflight fees	....	....	–56	–58	–60	–62	–236
Total, user charge proposals	**130**	**4,530**	**21,999**	**16,406**	**18,679**	**19,123**	**80,736**

[1] A negative sign indicates a decrease in collections.
*$500 thousand or less

Department of Transportation: Federal Aviation Administration (FAA)

User fee proposal. The Budget includes a reauthorization proposal that would make the Federal Aviation Administration's financing system more cost-based. The FAA's current excise tax system, which generated $10.6 billion in 2006, largely based on taxes on the price of airline tickets, does not have a direct relationship between the taxes paid by users and the air traffic control services provided by the FAA. Under its reauthorization proposal, FAA would collect user fees from commercial aviation operators for air traffic control services. Implementing user fees for services provided should create incentives to make the system more efficient and responsive to user needs. FAA would have the authority to collect the user fees that directly offset the cost of its operations; expenditure of the proceeds from these fees would be subject to the appropriations process. The Budget assumes FAA will implement its new financing system starting in 2009, and estimates FAA will collect $8 billion in user fees during the first year.

Federal Election Commission

Registration fees. The Federal Election Commission hosts public conferences on subjects related to campaign finance. The Administration proposes to grant the FEC authority to collect registration fees from attendees to cover the cost of these events.

2. Offsetting receipts

Department of Homeland Security: U.S. Citizenship and Immigration Services (USCIS)

Systematic alien verification for entitlements program. The Budget requests authority for the Secretary of the Department of Homeland Security (DHS) to deposit fees collected from the Systematic Alien Verification for Entitlements (SAVE) Program into the USCIS immigration examinations fee account. This program is an intergovernmental information-sharing intiative that aids organizations in determining an applicant's/recipient's immigration status, and thereby ensure that only entitled applicants/recipients receive Federal, State, or local public benefits as required by the Immigration Reform and Control Act. The proposed language will clarify DHS authority to collect these fees and provide them the authority to deposit those fees in their mandatory fee account.

Department of Housing and Urban Development

Office of Federal Housing Enterprise Oversight. This proposal is discussed below in the section on the Federal Housing Enterprise Regulator.

Department of the Interior

Repeal Energy Act fee prohibition. A last-minute addition to the 2005 Energy Policy Act prohibited the Bureau of Land Management from implementing new user fees for oil and gas permit processing and instead diverted existing rental receipts to make up for the lost program funding. The Budget proposes to repeal these changes and substitute new user fees for the mandatory funding provided by the Act. The proposal would also repeal a mandatory geothermal program fund drawn from Federal geothermal royalties and return to the traditional 50/50 Federal-State revenue sharing arrangement for geothermal revenues. The proposed fees are expected to generate at least $20 million per year beginning in 2008, thereby reducing the cost to taxpayers for operating these programs. Additional savings will be generated by discontinuing the Act's mandatory spending provisions related to geothermal receipts.

B. Mandatory User Charge Proposals

1. Offsetting collections

Department of Labor

Pension Benefit Guaranty Corporation (PBGC) premiums. The Budget re-proposes increases to the premiums paid to the PBGC for single-employer defined benefit pension insurance. Despite improvements in the recently enacted Pension Protection Act, further premium increases are needed to reduce PBGC's $19 billion deficit.

Federal Housing Enterprise Regulator

Government-Sponsored Enterprises (GSE) regulatory fee. The Administration will again propose broad reform of the supervisory system for GSEs in the housing market. Fees currently collected by the Office of Federal Housing Enterprise Oversight in the Department of Housing and Development and the Federal Housing Finance Board would instead be collected by a new housing GSE safety and soundness regulator. For additional information, see the "Credit and Insurance" chapter in this volume.

Federal Housing Finance Board

Federal Home Loan Bank fees. This proposal is discussed above in the section on the Federal Housing Enterprise Regulator.

2. Offsetting receipts

Department of Agriculture

Food Safety and Inspection Service (FSIS) user fees. This Budget proposes two new user fees, a licensing fee and a performance fee. These two fees are different from those proposed in recent budgets and do not try to completely offset a portion of the Food Safety and Inspection Services operational expenses. The recommended fees, estimated to be $96 million in the first year, include:

- $92 million for a licensing fee scaled to the size of the operation, and
- $4 million for a performance fee. Plants that have resampling and retesting due to positive samples, recalls, or are linked to outbreaks would pay a fee to FSIS for each incident.

Grain Inspection, Packers, and Stockyards Administration (GIPSA) user fees. The Administration proposes to establish a fee to cover the cost associated with GIPSA's standardization activities and a licensing fee to cover the cost associated with administering meat packers and stockyards activities.

Animal and Plant Health Inspection Service user fees. The Administration proposes to establish user fees for animal welfare inspections, for animal research facilities, carriers, and in-transit handlers of animals.

Federal crop insurance fees. The Administration proposes to implement a participation fee in the Federal crop insurance program to fund modernization and future maintenance of the existing information technology (IT) system. The fee would be charged to insurance companies participating in the Federal crop insurance program based on a rate of about one-half cent per dollar of premium sold. Because it is the companies that will most benefit from better, more advanced computer systems, it is reasonable that they contribute to the modernization and maintenance of these systems.

Forest county safety net payments. The Budget includes a legislative proposal that authorizes the Secretary of Agriculture to dispose of certain Forest Service lands, up to $800 million, identified in National Forest plans as suitable for exchange since they are isolated or inefficient to manage. Along with additional proceeds, these receipts will finance payments to the most affected areas and for national forest land acquisition in States where parcels are sold. For the 2007 payment (to be made in 2008), the Administration will continue to work with Congress to identify mutually agreeable offsets.

Department of Defense

National Defense stockpile asset sales: Authorization for additional sales. The Administration proposes legislation to permit the sale of the remaining government-owned industrial commodities in the National Defense Stockpile that are not needed for national defense requirements. Sales of these commodities are expected to result in mandatory sales receipts of an estimated $69 million in 2008. Sales receipts are subject to fluctuation based on commodity price changes.

Department of Health and Human Services

Food and Drug Administration (FDA)

Re-inspection fees. FDA conducts post-market inspections of food, human drug, biologic, animal drug and feed, and medical device manufacturers to assess their compliance with Good Manufacturing Practice requirements. The Administration proposes new fees that would be assessed for repeat inspections due to violations found during the first inspection.

Food and animal feed export certification fees. FDA collects user fees for the issuance of export certifications for human and animal drugs, and medical devices as authorized by the Federal Food, Drug, and Cosmetic Act. The Administration proposes to expand FDA's authority to collect user fees for the issuance of export certificates for foods and animal feed. Timely issuance of food/feed export certificates funded through user fees would improve the ability of food and animal feed producers to export their products.

Centers for Medicare and Medicaid Services

Additional Medicare premiums. Medicare beneficiaries share in the costs of their health services through premiums, deductibles, and co-insurance. The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) began to limit the growth in subsidies for certain higher-income beneficiaries. Beneficiaries who are most able to contribute to the costs of their coverage have more responsibility and ownership over their health care utilization and costs.

To help improve Medicare's long-term sustainability, the Budget proposes to broaden the application of reduced subsidies for certain higher-income beneficiaries.

Department of Housing and Urban Development (HUD)

Ginnie Mae premium increase. This proposal will create an upfront premium of 6 basis points on new mortgage-backed securities that will be charged to security issuers. This will generate receipts to cover the total cost of administrating the Government National Mortgage Association (Ginnie Mae) and promote oversight of such spending.

Government-Sponsored Enterprises (GSE) oversight fee. Upon enactment of the Administration's proposal for a strengthened regulator for GSEs, the cost of HUD's responsibilities under the Federal Housing Enterprise Safety and Soundness Act of 1992, and amendments as proposed, would be assessed on Fannie Mae and Freddie Mac. These responsibilities include the establishment and enforcement of affordable housing goals for the GSEs, ensuring GSE compliance with fair housing laws, and providing consultation to the safety and soundness regulator on the GSEs' new activities. The cost of these regulatory responsibilities is currently in the HUD salaries and expenses account as a non-reimbursable expense.

Department of the Interior

Amend Bureau of Land Management (BLM) Federal land sale authority. The Administration will propose legislation to amend BLM's land sale authority under the Federal Land Transaction Facilitation Act (FLTFA) to: (1) allow BLM to use updated management plans to identify areas suitable for disposal; (2) allow a portion of the receipts to be used by BLM for restoration projects; (3) return 70 percent of land sale proceeds to the Treasury; and (4) cap receipt retention at $60 million per year. BLM is currently limited to selling lands that had been identified for disposal in land use plans that were in effect prior to enactment of FLTFA. Use of the receipts is currently limited to the purchase of other lands for conservation purposes. The new receipts shown in this chapter reflect only a portion of the savings from this proposal; additional savings will be generated by redirecting receipts under the existing FLFTA authority to the Treasury. The amounts shown in Table 18–3 reflect receipts only and do not include related spending.

Require upfront payment of coal bonus bid receipts. The Budget proposes to amend the Mineral Leasing Act to change the current practice of allowing bonus bid payments for coal lease sales to be made over a five-year period, instead requiring the full payment to be made in the sale year. This proposal would increase near-term revenues, but would reduce revenues in later years when deferred payments under the current system would otherwise be collected.

Arctic National Wildlife Refuge lease bonuses. The Budget includes a proposal to authorize the Department of the Interior to conduct environmentally responsible oil and gas exploration and development within a small area of the Arctic National Wildlife Refuge, sometimes referred to as the "1002 Area," located in northern Alaska. The Department of the Interior estimates that recoverable oil from this area is between 5.7 and 16 billion barrels. The Budget assumes that the first oil and gas lease sale would be held in 2009 and would result in an estimated $7 billion in new revenues. All oil and gas revenues from the 1002 Area would be shared fifty percent with the State of Alaska, including the estimated $6 million in annual rental payments. The Federal share of revenues would be deposited in the Treasury.

Department of Labor

Foreign labor certification fees. The 2008 Budget re-proposes legislation to establish a cost-based user fee for new applications under the permanent foreign labor certification program. Fee proceeds would offset the costs of administering the program. Upon enactment of the fee, funding for these activities now included in the program administration account will be reviewed and adjusted.

Department of Veterans Affairs

Medical care fees. The President's Budget includes legislation to implement new or higher fees for non-disabled higher-income veterans (PL 7/8 veterans). These veterans will pay higher drug co-pays (from $8 to $15) and new income-based annual enrollment fees that start at $250 for those with household incomes of $50,000 and rise to $750 for those with incomes of $100,000 or greater. These proposals do not pertain to veterans who are considered among VA's core mission and the highest priority—those with service disabilities, lower incomes, or special needs. The Budget also includes technical correction language to ensure that current co-pays are charged to all eligible veterans equally and not reduced if a veteran has health insurance. These proposals will result in an additional $355 million in estimated receipts for 2008.

Corps of Engineers—Civil Works

Additional recreation fees. The Corps of Engineers manages 4,300 recreation areas at 465 Corps projects (mostly lakes and reservoirs) on 12 million acres in 43 States at an annual cost of about $267 million. The Administration re-proposes a recreation modernization ("RecMod") initiative that would encourage the collection of entrance fees (not currently authorized) and the creation of public/private partnerships to improve Corps recreation facilities and services at little or no cost to the Federal Government. The Corps would implement user fees and private/public partnerships selectively, at recreation areas where fees would be appropriate. Some Corps recreation areas are isolated and remote; raising fees there might not be productive. But others are integral parts of prosperous urban communities with valuable lake-front property. Those communities may decide to help upgrade the Corps recreation areas that their

citizens enjoy to provide amenities that might not otherwise be available.

Environmental Protection Agency (EPA)

Pesticide user fees. EPA presently collects fees from entities seeking to register their pesticides and from entities with existing pesticides registered for use in the United States. The Administration proposes to better cover the costs of EPA's pesticide services by increasing collections of currently authorized, but soon to expire, pesticide user fees. Furthermore, the Federal Food, Drug, and Cosmetic Act requires EPA to collect fees for the establishment and reassessment of pesticide tolerances. However, collection of these fees has been blocked through 2008. The Administration proposes to eliminate the prohibition and collect the tolerance fee in 2008. In addition, amendments to the Federal Insecticide, Fungicide, and Rodenticide Act require EPA to implement a new program to review all registered pesticides on a 15 year cycle to ensure that registrations reflect current science. EPA initiated this new Registration Review program in 2007. If EPA determines that a pesticide adversely impacts an endangered species during registration review, additional work is required to ensure adequate protections are implemented. The new registration review fee structure is designed to cover the incremental cost of this work.

Pre-manufacture notice user fees. EPA presently collects fees from chemical manufacturers seeking to bring new chemicals into commerce. These fees are authorized by the Toxic Substances Control Act and are subject to an outdated statutory cap. The Administration proposes to eliminate the cap so that EPA can recover a greater portion of the cost of the program.

Commodity Futures Trading Commission (CFTC)

Transaction fees. The CFTC is the only Federal financial regulator that does not derive its funding from the specialized entities it regulates. The Administration will propose legislation to collect a new transaction fee on commodity futures and option contracts traded on approved exchanges. The fees would be set at a level to equal the costs to the taxpayer of funding CFTC's Market Oversight and Clearing and Intermediary Oversight functions, an estimated $86 million in 2008. Such fees are already imposed on futures exchanges to fund the programs of the futures industry's self-regulatory organization, and will help to offset the deficit impact of general taxpayer funding of the CFTC's activities.

Federal Communications Commission

Spectrum license fee authority. To continue to promote efficient spectrum use, the Administration proposes legislation to provide the Federal Communications Commission (FCC) with new authority to use other economic mechanisms, such as fees, as a spectrum management tool. The Commission would be authorized to set user fees on unauctioned spectrum licenses based on public-interest and spectrum-management principles. Fees would be phased in over time as part of an ongoing rulemaking process to determine the appropriate application and level for fees. Fee collections are proposed to begin in 2008 and are estimated to total more than $3.6 billion through 2017.

Extend spectrum auction authority. The Administration proposes legislation to extend indefinitely the authority of the FCC to auction spectrum licenses, which expires on September 30, 2011. The additional receipts associated with this permanent extension are estimated to total $1.2 billion through 2017.

Prospective ancillary terrestrial component spectrum auctions. The Administration proposes legislation to bring greater competition to the assignment of the land-based component of hybrid terrestrial-satellite communications networks, such as the Ancillary Terrestrial Component to Mobile Satellite Services, subject to technical feasibility as determined by the FCC. The use of auctions to assign the land-based component for any future satellite licenses for these hybrid networks will help to ensure that the radio spectrum is assigned efficiently and effectively. The additional receipts associated with this policy are estimated to total $1.5 billion through 2017.

Domestic satellite spectrum auctions. The Administration proposes legislation to ensure that spectrum licenses for predominantly domestic satellite services are assigned efficiently and effectively through competitive bidding. Services such as Direct Broadcast Satellite and Satellite Digital Audio Radio Services were assigned by auction prior to a 2005 court decision that questioned this practice on technical grounds. By clarifying through legislation that auctions of licenses for these domestic satellite services are authorized, prior policy of the FCC will be restored. The additional receipts associated with this policy are estimated to total $690 million through 2017.

C. User Charge Proposals that are Governmental Receipts

Federal Aviation Administration (FAA): Aviation overflight fees. This proposal is part of the proposal discussed above for the FAA user fees.

OTHER OFFSETTING COLLECTIONS AND RECEIPTS

Table 18–4 shows the distribution of user charges and other offsetting collections and receipts from the public according to whether they are offsetting collections credited to expenditure accounts or offsetting receipts. The table shows that total offsetting collections and receipts from the public are estimated to be $319.3 billion in 2008. Of these, an estimated $169.9 billion are offsetting collections credited to expenditure accounts and an estimated $149.4 billion are deposited in offsetting receipt accounts.

Information on the user charges presented in Table 18–4 is available in Tables 18–2 and 18–3 and the

discussion that accompanies those tables. Major offsetting collections deposited in expenditure accounts that are not user charges include collections by the Commodity Credit Corporation fund in the Department of Agriculture, which are related to loans; collections from States to supplement payments in the supplemental security income program; and pre-credit reform loan repayments. Major offsetting receipts that are not user charges include military assistance program sales and interest income.

Table 18–5 includes all offsetting receipts deposited in receipt accounts. These include offsetting receipts from the public (as summarized in Table 18–4) and also payments from one part of the Government to another, called intragovernmental transactions. These receipts are offset (deducted) from outlays in the Federal budget. In total, offsetting receipts are estimated to be $737.0 billion in 2008: $587.6 billion are intragovernmental transactions; and $149.4 billion are from the public. The $149.4 billion in offsetting receipts from the public consist of proprietary receipts from the public ($129.9 billion) and offsetting governmental receipts ($19.5 billion).

As noted above, offsetting collections and receipts by agency are also displayed in Table 21–1, which appears in Chapter 21, "Outlays to the Public, Gross and Net," of this volume.

Table 18–4. OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC

(In billions of dollars)

	Actual 2006	Estimate	
		2007	2008
Offsetting collections (credited to expenditure accounts):			
User charges:			
Postal service stamps and other postal fees (off-budget)	70.3	73.7	76.7
Defense Commissary Agency	5.5	5.4	5.4
Employee contributions for employees and retired employees health benefits funds	9.1	9.4	10.0
Sale of energy:			
Tennessee Valley Authority	9.1	9.1	9.4
Bonneville Power Administration	3.3	3.3	3.3
All other user charges	29.6	34.5	36.9
Subtotal, user charges	126.8	135.5	141.8
Other collections credited to expenditure accounts:			
Commodity Credit Corporation fund	10.2	13.7	13.2
Supplemental security income (collections from the States)	4.2	4.4	4.6
Other collections	14.8	10.5	10.4
Subtotal, other collections	29.1	28.6	28.1
Subtotal, offsetting collections	156.0	164.1	169.9
Offsetting receipts (deposited in receipt accounts):			
User charges:			
Medicare premiums	45.1	52.8	57.3
Outer Continental Shelf rents, bonuses, and royalties	7.3	6.8	9.2
All other user charges	18.6	31.7	32.9
Subtotal, user charges deposited in receipt accounts	71.0	91.3	99.4
Other collections deposited in receipt accounts:			
Military assistance program sales	14.2	15.1	13.1
Interest income	14.7	16.1	16.2
All other collections deposited in receipt accounts	24.2	29.4	20.7
Subtotal, other collections deposited in receipt accounts	53.1	60.5	49.9
Subtotal, offsetting receipts	124.1	151.8	149.4
Total, offsetting collections and receipts from the public	**280.1**	**316.0**	**319.3**
Total, offsetting collections and receipts excluding off-budget	**209.7**	**242.3**	**242.5**
ADDENDUM:			
User charges that are offsetting collections and receipts [1]	197.8	226.8	241.2
Other offsetting collections and receipts from the public	82.2	89.2	78.1
Total, offsetting collections and receipts from the public	**280.1**	**316.0**	**319.3**

[1] Excludes user charges that are classified on the receipts side of the budget. For total user charges, see Table 18.1 or Table 18.2.

Table 18–5. OFFSETTING RECEIPTS BY TYPE

(In millions of dollars)

Source	2006 Actual	Estimate 2007	2008	2009	2010	2011	2012
INTRAGOVERNMENTAL TRANSACTIONS							
On-budget receipts:							
Federal intrafund transactions:							
Distributed by agency:							
Interest from the Federal Financing Bank	391	765	1,023	1,077	1,174	1,272	1,450
Interest on Government capital in enterprises	1,208	1,716	1,654	846	838	850	862
Interest received by retirement and health benefits funds	198	169	176	183	198	215	235
General fund payments to retirement and health benefits funds:							
Employees health benefits fund	....	5,400	5,400	5,400	5,500	5,500	5,600
DoD retiree health care fund	20,391	19,415	21,185	23,101	25,196	27,461	29,887
Miscellaneous Federal retirement funds	285	345	362	427	524	487	489
Other	1,998	5,723	4,291	4,741	4,726	5,175	5,694
Undistributed by agency:							
Employing agency contributions:							
DoD retiree health care fund	11,138	11,550	11,212	12,216	12,993	13,897	14,691
Total Federal intrafunds	35,609	45,083	45,303	47,991	51,149	54,857	58,908
Trust intrafund transactions:							
Distributed by agency:							
Payments to railroad retirement	4,793	5,211	5,298	5,392	5,710	6,163	5,959
Total trust intrafunds	4,793	5,211	5,298	5,392	5,710	6,163	5,959
Total intrafund transactions	40,402	50,294	50,601	53,383	56,859	61,020	64,867
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Contributions to insurance programs:							
Military retirement fund	23,180	26,048	27,025	28,039	29,090	30,181	31,313
Supplementary medical insurance	162,602	175,657	187,749	197,816	212,353	231,110	246,821
Proposed Legislation (non-PAYGO)	....	....	–1,649	–3,594	–5,409	–7,063	–8,916
Hospital insurance	10,973	11,572	13,248	14,410	16,037	17,775	19,699
Railroad social security equivalent fund	129	132	144	159	168	186	205
Rail industry pension fund	337	325	339	355	370	386	401
Civilian supplementary retirement contributions	28,430	32,388	33,831	35,470	37,199	38,969	41,180
Unemployment insurance	828	830	807	806	812	800	781
Other contributions	782	850	882	831	898	777	767
Subtotal	227,261	247,802	262,376	274,292	291,518	313,121	332,251
Miscellaneous payments	1,870	1,762	1,775	1,751	1,731	1,749	1,758
Proposed Legislation (non-PAYGO)	....	....	2,752	....	....	....	....
Subtotal	229,131	249,564	266,903	276,043	293,249	314,870	334,009
Trust fund payments to Federal funds:							
Quinquennial adjustment for military service credits	350	....	....	....	....	....	....
Other	1,757	24,804	1,840	1,894	1,946	2,000	2,201
Proposed Legislation (non-PAYGO)	....	....	2,315	–437	–432	–424	–424
Subtotal	2,107	24,804	4,155	1,457	1,514	1,576	1,777
Total interfunds distributed by agency	231,238	274,368	271,058	277,500	294,763	316,446	335,786
Undistributed by agency:							
Employer share, employee retirement (on-budget):							
Civil service retirement and disability insurance	13,819	14,072	15,714	16,623	18,141	19,723	21,342
Proposed Legislation (non-PAYGO)	....	....	2	8	15	23	31
CSRDI from Postal Service	4,429	3,382	3,596	3,817	4,063	4,327	4,609
Hospital insurance (contribution as employer) [1]	2,722	2,839	2,965	3,053	3,180	3,344	3,439
Postal employer contributions to FHI	682	694	720	752	788	827	868
Military retirement fund	16,240	16,115	17,249	18,356	19,046	19,806	20,430

Table 18–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2006 Actual	Estimate 2007	2008	2009	2010	2011	2012
Other Federal employees retirement	201	193	195	198	200	202	204
Total employer share, employee retirement (on-budget)	38,093	37,295	40,441	42,807	45,433	48,252	50,923
Interest received by on-budget trust funds	71,574	75,067	77,710	80,363	83,658	86,270	87,640
Proposed Legislation (non-PAYGO)	....	....	117	369	779	1,339	2,085
Total interfund transactions undistributed by agency	109,667	112,362	118,268	123,539	129,870	135,861	140,648
Total interfund transactions	340,905	386,730	389,326	401,039	424,633	452,307	476,434
Total on-budget receipts	381,307	437,024	439,927	454,422	481,492	513,327	541,301
Off-budget receipts:							
Trust intrafund transactions:							
Distributed by agency:							
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Old-age, survivors, and disability insurance	22,056	19,358	19,962	22,034	24,227	27,110	30,069
Undistributed by agency:							
Employer share, employee retirement (off-budget)	11,625	12,289	13,108	13,848	14,739	15,788	16,560
Interest received by off-budget trust funds	97,722	106,249	114,618	124,802	136,492	149,278	162,901
Proposed Legislation (non-PAYGO)	....	....	....	....	....	....	–775
Total off-budget receipts:	131,403	137,896	147,688	160,684	175,458	192,176	208,755
Total intragovernmental transactions	**512,710**	**574,920**	**587,615**	**615,106**	**656,950**	**705,503**	**750,056**
PROPRIETARY RECEIPTS FROM THE PUBLIC							
Distributed by agency:							
Interest:							
Interest on foreign loans and deferred foreign collections	285	210	210	210	210	210	210
Interest on deposits in tax and loan accounts	924	1,022	871	834	797	769	767
Proposed Legislation (non-PAYGO)	....	....	10	10	10	10	10
Other interest (domestic—civil) [2]	11,264	12,494	13,632	14,681	16,041	17,554	19,047
Total interest	12,473	13,726	14,723	15,735	17,058	18,543	20,034
Dividends and other earnings	2,177	2,382	1,446	1,490	1,511	1,486	1,464
Royalties and rents	4,337	3,955	4,271	4,452	4,384	4,392	4,671
Proposed Legislation (PAYGO)	....	....	–44	192	177	58	216
Sale of products:							
Sale of timber and other natural land products	393	272	279	288	296	305	314
Proposed Legislation (PAYGO)	....	....	67	64	60	57	....
Sale of minerals and mineral products	671	74	39	37	36	35	36
Sale of power and other utilities	725	705	674	644	660	628	630
Proposed Legislation (PAYGO)	....	....	17	17	17	17	17
Other	102	99	115	112	99	119	115
Proposed Legislation (PAYGO)	....	....	14	14	14	14	14
Total sale of products	1,891	1,150	1,205	1,176	1,182	1,175	1,126
Fees and other charges for services and special benefits:							
Medicare premiums and other charges (trust funds)	45,108	52,785	57,202	61,923	66,864	72,138	78,222
Proposed Legislation (PAYGO)	....	....	78	82	–43	–78	–95
Nuclear waste disposal revenues	752	760	770	771	773	774	775
Veterans life insurance (trust funds)	154	141	128	116	104	92	82
Other [2]	7,908	12,002	12,060	12,672	13,338	14,130	15,025
Proposed Legislation (non-PAYGO)	....	....	21	21	21	21	21
Proposed Legislation (PAYGO)	....	....	762	1,091	1,306	1,561	1,900
Total fees and other charges	53,922	65,688	71,021	76,676	82,363	88,638	95,930
Sale of Government property:							
Sale of land and other real property [2]	984	191	229	197	195	160	160
Proposed Legislation (PAYGO)	....	....	376	177	102	99	19
Military assistance program sales (trust funds)	14,233	15,053	13,054	11,446	11,651	11,861	12,074

Table 18–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
Other	214	147	164	130	106	99	47
Proposed Legislation (PAYGO)	....	....	69	145	198	145	25
Total sale of Government property	15,431	15,391	13,892	12,095	12,252	12,364	12,325
Realization upon loans and investments:							
Negative subsidies and downward reestimates	8,600	11,752	713	629	611	609	534
Proposed Legislation (non-PAYGO)	....	....	–21	–21	–21	–21	–21
Proposed Legislation (PAYGO)	....	....	2,859	46	46	46	46
Repayment of loans to foreign nations	328	....	....	....	....	....	....
Other	475	70	67	80	80	80	80
Total realization upon loans and investments	9,403	11,822	3,618	734	716	714	639
Recoveries and refunds [2]	8,169	8,782	8,562	8,935	9,385	9,131	9,276
Proposed Legislation (non-PAYGO)	....	....	....	58	122	126	130
Proposed Legislation (PAYGO)	....	....	2	492	507	373	379
Miscellaneous receipt accounts [2]	2,980	2,008	1,949	1,961	1,972	1,983	1,994
Proposed Legislation (PAYGO)	....	....	14	14	14	14	14
Total proprietary receipts from the public distributed by agency	110,783	124,904	120,659	124,010	131,643	138,997	148,198
Undistributed by agency:							
Other interest: Interest received from Outer Continental Shelf escrow account	2	....	....	....	....	....	....
Rents, bonuses, and royalties:							
Outer Continental Shelf rents and bonuses	967	662	2,404	1,169	875	532	474
Outer Continental Shelf royalties	6,316	6,148	6,740	8,759	8,087	9,035	8,860
Proposed Legislation (PAYGO)	....	....	50	50	50	50	50
Arctic National Wildlife Refuge:							
Proposed Legislation (PAYGO)	....	....	....	7,004	4	1,006	6
Sale of major assets	....	....	....	323	....	....	....
Other undistributed offsetting receipts	....	6,850	....	....	....	....	....
Total proprietary receipts from the public undistributed by agency	7,285	13,660	9,194	17,305	9,016	10,623	9,390
Total proprietary receipts from the public	**118,068**	**138,564**	**129,853**	**141,315**	**140,659**	**149,620**	**157,588**
OFFSETTING GOVERNMENTAL RECEIPTS							
Distributed by agency:							
Regulatory fees	5,759	6,108	7,032	7,235	7,527	7,866	8,158
Proposed Legislation (non-PAYGO)	....	....	–63	–62	–62	–63	–64
Proposed Legislation (PAYGO)	....	....	65	65	65	65	65
Other	159	143	144	144	145	124	125
Proposed Legislation (PAYGO)	....	....	27	28	28	29	30
Undistributed by agency:							
Spectrum auction proceeds	111	6,900	11,850	2,158	100	100	....
Proposed Legislation (PAYGO)	....	130	452	405	550	550	825
Total offsetting governmental receipts	**6,029**	**13,281**	**19,507**	**9,973**	**8,353**	**8,671**	**9,139**
Total offsetting receipts	**636,807**	**726,765**	**736,975**	**766,394**	**805,962**	**863,794**	**916,783**

[1] Includes provision for covered Federal civilian employees and military personnel.
[2] Includes both Federal funds and trust funds.

19. TAX EXPENDITURES

The Congressional Budget Act of 1974 (Public Law 93–344) requires that a list of "tax expenditures" be included in the budget. Tax expenditures are defined in the law as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability." These exceptions may be viewed as alternatives to other policy instruments, such as spending or regulatory programs.

Identification and measurement of tax expenditures depends importantly on the baseline tax system against which the actual tax system is compared. In general, the tax expenditure estimates presented in this chapter are patterned on a comprehensive income tax, which defines income as the sum of consumption and the change in net wealth in a given period of time. An alternative approach would be to pattern the tax expenditure estimates on a comprehensive consumption tax. Which approach is used is perhaps the most important factor determining what is included as a tax expenditure. For example, because a consumption tax does not tax the return to saving or investment, using a comprehensive consumption tax as the normative baseline for determining tax expenditures would exclude current tax exemptions related to retirement and education saving accounts. Similarly, business provisions that provide accelerated depreciation or expensing of investment would also be excluded as tax expenditures because investment is generally deducted immediately under a comprehensive consumption tax.

The choice of the baseline—a comprehensive income or a comprehensive consumption tax—is arbitrary when viewed from the perspective of the current so-called income tax system, which includes elements of both income and consumption taxes. According to Treasury Department analysis, roughly 35 percent of household financial assets receive consumption tax treatment because assets are held in tax-preferred accounts such as individual retirement accounts (IRAs), defined-contribution retirement plans (401(k) type plans), defined-benefit pension plans, and tax-preferred annuities and various life insurance products. The balance of household financial assets reflecting most other saving vehicles receive income tax treatment.

The ambiguities in the tax expenditure concept are reviewed in greater detail in Appendix A. This review focuses on defining tax expenditures relative to a comprehensive income tax baseline and a consumption tax baseline, and defining negative tax expenditures, i.e., provisions of current law that over-tax certain items or activities.

The tax expenditure estimates presented below differ from a comprehensive income tax in a number of other important respects. While under a comprehensive income tax all income is taxed once, the U.S. income tax system generally taxes corporate income twice, first at the corporate level through the corporate income tax and then again when the income is received by investors as dividends or capital gains. This "double tax" is accounted for in some of the tax expenditure estimates, such as those related to retirement savings, but not in the corporate tax expenditures. Indeed, the tax expenditure estimates, in large part, view the individual and corporation income taxes separately, rather than as an integrated system as appropriate under comprehensive income tax principles. Other areas of divergence from a comprehensive income tax are detailed below.

An important assumption underlying each tax expenditure estimate reported below is that other parts of the tax code remain unchanged. The estimates would be different if tax expenditures were changed simultaneously because of potential interactions among provisions. For that reason, this chapter does not present a grand total for the estimated tax expenditures.

Tax expenditures relating to the individual and corporate income taxes are estimated for fiscal years 2006–2012 using two methods of accounting: current revenue effects and present value effects. The present value approach provides estimates of the revenue effects for tax expenditures that generally involve deferrals of tax payments into the future.

A discussion of performance measures and economic effects related to the assessment of the effect of tax expenditures on the achievement of program performance goals is presented in Appendix B. This section is a complement to the Government-wide performance plan required by the Government Performance and Results Act of 1993.

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

All tax expenditure estimates presented here are based upon current tax law enacted as of December 31, 2006. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 2006. Due to the time required to estimate the large number of tax expenditures, the estimates are based on Mid-Session economic assumptions; exceptions are the earned income tax credit and child credit provisions, which involve outlay

components and hence are updated to reflect the economic assumptions used elsewhere in the Budget.

The total revenue effects for tax expenditures for fiscal years 2006–2012 are displayed according to the Budget's functional categories in Table 19–1. Descriptions of the specific tax expenditure provisions follow the tables of estimates and the discussion of general features of the tax expenditure concept.

Two baseline concepts—the normal tax baseline and the reference tax law baseline—are used to identify and estimate tax expenditures. [1] For the most part, the two concepts coincide. However, items treated as tax expenditures under the normal tax baseline, but not the reference tax law baseline, are indicated by the designation "normal tax method" in the tables. The revenue effects for these items are zero using the reference tax rules. The alternative baseline concepts are discussed in detail following the tables.

Table 19–2 reports the respective portions of the total revenue effects that arise under the individual and corporate income taxes separately. The location of the estimates under the individual and corporate headings does not imply that these categories of filers benefit from the special tax provisions in proportion to the respective tax expenditure amounts shown. Rather, these breakdowns show the specific tax accounts through which the various provisions are cleared. The ultimate beneficiaries of corporate tax expenditures could be shareholders, employees, customers, or other providers of capital, depending on economic forces.

Table 19–3 ranks the major tax expenditures by the size of their 2008–2012 revenue effect. The first column provides the number of the provision in order to cross reference this table to Tables 19–1 and 19–2 as well as to the descriptions below. Outlay Equivalent Estimates of Income Tax Expenditures, which were included in prior volumes of Analytical Perspectives, are no longer included in this chapter. [2]

Interpreting Tax Expenditure Estimates

The estimates shown for individual tax expenditures in Tables 19–1, 19–2, and 19–3 do not necessarily equal the increase in Federal revenues (or the change in the budget balance) that would result from repealing these special provisions, for the following reasons:

First, eliminating a tax expenditure may have incentive effects that alter economic behavior. These incentives can affect the resulting magnitudes of the activity or of other tax provisions or Government programs. For example, if capital gains were taxed at ordinary rates, capital gain realizations would be expected to decline, potentially resulting in a decline in tax receipts. Such behavioral effects are not reflected in the estimates.

Second, tax expenditures are interdependent even without incentive effects. Repeal of a tax expenditure provision can increase or decrease the tax revenues associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the revenue costs from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the revenue cost from other deductions if taxpayers are led to claim the standard deduction instead of itemizing. Similarly, if two provisions were repealed simultaneously, the increase in tax liability could be greater or less than the sum of the two separate tax expenditures, because each is estimated assuming that the other remains in force. In addition, the estimates reported in Table 19–1 are the totals of individual and corporate income tax revenue effects reported in Table 19–2 and do not reflect any possible interactions between individual and corporate income tax receipts. For this reason, the estimates in Table 19–1 should be regarded as approximations.

[1] These baseline concepts are thoroughly discussed in Special Analysis G of the 1985 Budget, where the former is referred to as the pre-1983 method and the latter the post-1982 method.

[2] The Administration has dropped the estimates of the outlay equivalents because they were often the same as the normal tax expenditure estimates, and the criteria for applying the concepts as to when they should differ were often judgmental and hard to apply with consistency across time and across tax expenditure items.

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES

(in millions of dollars)

		Total from corporations and individuals							
		2006	2007	2008	2009	2010	2011	2012	2008–12
	National Defense								
1	Exclusion of benefits and allowances to armed forces personnel	3,100	3,220	3,350	3,480	3,620	3,780	3,930	18,160
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	2,500	2,630	2,760	2,900	3,050	3,200	3,360	15,270
3	Exclusion of certain allowances for Federal employees abroad	800	840	880	920	970	1,020	1,070	4,860
4	Extraterritorial income exclusion	4,400	1,630	....	....	....	....	....	....
5	Inventory property sales source rules exception	1,730	1,890	2,120	2,330	2,510	2,704	2,913	12,577
6	Deferral of income from controlled foreign corporations (normal tax method)	11,160	11,940	12,770	13,650	14,600	15,620	16,710	73,350
7	Deferred taxes for financial firms on certain income earned overseas	2,260	2,370	2,490	1,060	....	....	....	3,550
	General science, space, and technology:								
8	Expensing of research and experimentation expenditures (normal tax method)	7,920	5,680	5,280	4,060	5,030	6,230	6,000	26,600
9	Credit for increasing research activities	2,180	10,320	4,960	2,100	920	360	70	8,410
	Energy:								
10	Expensing of exploration and development costs, fuels	680	860	840	710	600	450	310	2,910
11	Excess of percentage over cost depletion, fuels	760	790	790	790	780	760	740	3,860
12	Alternative fuel production credit	2,980	2,370	780	10	10	....	....	800
13	Exception from passive loss limitation for working interests in oil and gas properties	30	30	30	30	30	30	30	150
14	Capital gains treatment of royalties on coal	160	170	170	170	190	180	130	840
15	Exclusion of interest on energy facility bonds	40	40	50	50	50	50	50	250
16	New technology credit	510	690	960	1,120	1,150	1,150	1,150	5,530
17	Alcohol fuel credits [1]	50	50	60	70	80	30	....	240
18	Tax credit and deduction for clean-fuel burning vehicles	110	260	150	130	–20	–50	–60	150
19	Exclusion of utility conservation subsidies	110	110	110	110	110	110	100	540
20	Credit for holding clean renewable energy bonds	20	60	80	100	100	100	100	480
21	Deferral of gain from dispositions of transmission property to implement FERC restructuring policy	620	530	230	–100	–360	–510	–540	–1,280
22	Credit for investment in clean coal facilities	....	30	50	80	130	180	250	690
23	Temporary 50% expensing for equipment used in the refining of liquid fuels	10	30	120	240	260	180	–50	750
24	Natural gas distribution pipelines treated as 15–year property	20	50	90	120	150	150	120	630
25	Amortize all geological and geophysical expenditures over 2 years	10	60	90	70	40	10	10	220
26	Allowance of deduction for certain energy efficient commercial building property	80	190	170	90	30	–10	–10	270
27	Credit for construction of new energy efficient homes	10	20	30	20	10	....	....	60
28	Credit for energy efficiency improvements to existing homes	230	380	150	....	....	....	....	150
29	Credit for energy efficient appliances	120	80	....	....	....	....	....	....
30	30% credit for residential purchases/installations of solar and fuel cells	10	10	10	....	....	....	....	10
31	Credit for business installation of qualified fuel cells and stationary microturbine power plants	80	90	130	50	–10	–10	–10	150
32	Partial expensing for advanced mine safety equipment	....	10	20	....	....	....	....	20
	Natural resources and environment:								
33	Expensing of exploration and development costs, nonfuel minerals	10	10	10	10	10	10	10	50
34	Excess of percentage over cost depletion, nonfuel minerals	450	480	490	510	530	550	570	2,650
35	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	510	580	600	630	640	670	680	3,220
36	Capital gains treatment of certain timber income	160	170	170	170	190	180	130	840
37	Expensing of multiperiod timber growing costs	290	310	320	330	350	360	370	1,730
38	Tax incentives for preservation of historic structures	390	400	430	440	470	490	520	2,350
39	Expensing of capital costs with respect to complying with EPA sulfur regulations	10	10	30	50	30	....	....	110
40	Exclusion of gain or loss on sale or exchange of certain brownfield sites	....	10	30	40	40	40	30	180
	Agriculture:								
41	Expensing of certain capital outlays	130	130	130	140	140	150	150	710
42	Expensing of certain multiperiod production costs	70	70	80	80	80	90	90	420
43	Treatment of loans forgiven for solvent farmers	20	20	20	20	20	30	30	120
44	Capital gains treatment of certain income	880	940	950	950	1,010	980	700	4,590
45	Income averaging for farmers	60	60	60	60	60	70	70	320
46	Deferral of gain on sale of farm refiners	10	20	20	20	20	20	20	100
47	Bio-Diesel and small agri-biodiesel producer tax credits	90	180	200	30	20	10	10	270
	Commerce and housing:								
	Financial institutions and insurance:								
48	Exemption of credit union income	1,320	1,400	1,480	1,570	1,660	1,750	1,850	8,310
49	Excess bad debt reserves of financial institutions	20	10	10	10	10	....	....	30
50	Exclusion of interest on life insurance savings	19,380	20,150	21,925	25,060	27,830	30,090	32,100	137,005
51	Special alternative tax on small property and casualty insurance companies	50	50	50	50	50	60	60	270
52	Tax exemption of certain insurance companies owned by tax-exempt organizations	220	230	240	250	260	270	280	1,300
53	Small life insurance company deduction	60	60	60	60	60	50	50	280
54	Exclusion of interest spread of financial institutions	1,350	1,330	1,400	1,480	1,550	1,950	2,050	8,430
	Housing:								
55	Exclusion of interest on owner-occupied mortgage subsidy bonds	1,170	1,300	1,390	1,430	1,470	1,510	1,560	7,360
56	Exclusion of interest on rental housing bonds	970	1,090	1,150	1,180	1,220	1,260	1,300	6,110

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(in millions of dollars)

		Total from corporations and individuals							
		2006	2007	2008	2009	2010	2011	2012	2008–12
57	Deductibility of mortgage interest on owner-occupied homes	68,330	79,940	89,430	96,250	103,540	111,440	119,600	520,260
58	Deductibility of State and local property tax on owner-occupied homes	21,260	15,540	12,620	12,590	12,580	22,440	27,770	88,000
59	Deferral of income from installment sales	1,190	1,210	1,230	1,250	1,370	1,500	1,650	7,000
60	Capital gains exclusion on home sales	35,270	37,030	38,890	40,830	42,870	45,010	47,270	214,870
61	Exclusion of net imputed rental income	28,780	32,110	35,680	39,440	43,596	48,190	53,269	220,176
62	Exception from passive loss rules for $25,000 of rental loss	6,590	7,150	7,520	7,790	7,990	8,150	8,300	39,750
63	Credit for low-income housing investments	4,420	4,660	4,940	5,250	5,570	5,870	6,170	27,800
64	Accelerated depreciation on rental housing (normal tax method)	10,340	11,240	12,300	13,480	14,560	15,790	17,190	73,320
	Commerce:								
65	Cancellation of indebtedness	90	100	90	60	30	30	30	240
66	Exceptions from imputed interest rules	50	50	50	50	50	50	50	250
67	Capital gains (except agriculture, timber, iron ore, and coal)	48,610	51,770	51,960	52,230	55,400	53,870	38,420	251,880
68	Capital gains exclusion of small corporation stock	240	270	320	340	370	490	540	2,060
69	Step-up basis of capital gains at death	29,600	32,600	35,900	36,750	37,950	39,450	41,010	191,060
70	Carryover basis of capital gains on gifts	590	650	760	800	1,270	6,340	1,500	10,670
71	Ordinary income treatment of loss from small business corporation stock sale	50	50	50	50	60	60	60	280
72	Accelerated depreciation of buildings other than rental housing (normal tax method)	–970	–740	–310	260	870	1,550	2,280	4,650
73	Accelerated depreciation of machinery and equipment (normal tax method)	36,470	51,030	64,670	78,390	85,250	92,630	100,850	421,790
74	Expensing of certain small investments (normal tax method)	5,000	5,330	5,330	4,740	–1,090	80	850	9,910
75	Graduated corporation income tax rate (normal tax method)	4,050	4,270	4,240	4,320	4,420	4,530	4,690	22,200
76	Exclusion of interest on small issue bonds	510	580	600	630	640	670	680	3,220
77	Deduction for US production activities	9,950	10,700	13,810	14,500	19,550	23,890	25,360	97,110
78	Special rules for certain film and TV production	110	90	70	–40	–90	–60	–50	–170
	Transportation:								
79	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
80	Exclusion of reimbursed employee parking expenses	2,740	2,890	3,040	3,190	3,350	3,430	3,540	16,550
81	Exclusion for employer-provided transit passes	560	630	710	790	880	960	1,030	4,370
82	Tax credit for certain expenditures for maintaining railroad tracks	140	160	130	60	30	10	10	240
83	Exclusion of interest on bonds for Financing of Highway Projects and rail-truck transfer facilities	25	50	75	95	95	100	100	465
	Community and regional development:								
84	Investment credit for rehabilitation of structures (other than historic)	40	40	40	40	40	40	40	200
85	Exclusion of interest for airport, dock, and similar bonds	1,130	1,250	1,320	1,360	1,400	1,440	1,480	7,000
86	Exemption of certain mutuals' and cooperatives' income	80	80	80	80	80	90	90	420
87	Empowerment zones and renewal communities	1,210	1,340	1,480	1,740	1,130	420	570	5,340
88	New markets tax credit	590	810	990	970	860	730	590	4,140
89	Expensing of environmental remediation costs	150	300	130	–40	–20	–20	–30	20
90	Credit to holders of Gulf Tax Credit Bonds	10	10	10	10	10	10	10	50
	Education, training, employment, and social services:								
	Education:								
91	Exclusion of scholarship and fellowship income (normal tax method)	1,780	1,870	1,960	2,050	2,150	2,250	2,360	10,770
92	HOPE tax credit	3,900	3,330	3,350	3,600	3,710	4,350	4,730	19,740
93	Lifetime Learning tax credit	2,490	2,190	2,200	2,310	2,390	2,780	3,020	12,700
94	Education Individual Retirement Accounts	10	10	10	20	20	20	30	100
95	Deductibility of student-loan interest	800	810	820	830	840	780	530	3,800
96	Deduction for higher education expenses	1,420	1,450	1,180	....	....	....	....	1,180
97	State prepaid tuition plans	690	830	1,000	1,210	1,470	1,820	2,000	7,500
98	Exclusion of interest on student-loan bonds	500	550	590	600	630	640	670	3,130
99	Exclusion of interest on bonds for private nonprofit educational facilities	2,140	2,380	2,530	2,610	2,690	2,770	2,850	13,450
100	Credit for holders of zone academy bonds	130	140	160	170	170	170	160	830
101	Exclusion of interest on savings bonds redeemed to finance educational expenses	....	20	20	20	20	20	20	100
102	Parental personal exemption for students age 19 or over	4,030	2,500	1,590	1,480	1,410	2,620	3,040	10,140
103	Deductibility of charitable contributions (education)	4,200	4,550	5,120	5,520	5,900	6,320	6,770	29,630
104	Exclusion of employer-provided educational assistance	590	620	660	690	720	40	....	2,110
105	Special deduction for teacher expenses	160	170	160	....	....	....	....	160
106	Discharge of student loan indebtedness	20	20	20	20	20	20	20	100
	Training, employment, and social services:	....	....	....	....	....	....	....	....
107	Work opportunity tax credit	210	360	370	250	140	70	40	870
108	Welfare-to-work tax credit	80	80	80	50	20	10	10	170
109	Employer provided child care exclusion	660	890	1,030	1,080	1,140	1,160	1,210	5,620
110	Employer-provided child care credit	10	10	10	20	20	10	....	60
111	Assistance for adopted foster children	320	350	400	440	480	530	570	2,420
112	Adoption credit and exclusion	540	560	570	580	600	540	170	2,460
113	Exclusion of employee meals and lodging (other than military)	890	930	970	1,010	1,060	1,110	1,170	5,320
114	Child credit [2]	30,377	32,556	32,341	32,096	31,909	24,719	13,598	134,666
115	Credit for child and dependent care expenses	3,190	2,810	1,740	1,650	1,570	1,500	1,430	7,890
116	Credit for disabled access expenditures	20	30	30	30	30	30	30	150

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(in millions of dollars)

		Total from corporations and individuals							
		2006	2007	2008	2009	2010	2011	2012	2008–12
117	Deductibility of charitable contributions, other than education and health	37,120	40,400	45,760	49,360	52,840	56,610	60,740	265,310
118	Exclusion of certain foster care payments	440	450	460	470	480	490	500	2,400
119	Exclusion of parsonage allowances	480	510	550	580	610	640	670	3,050
120	Employee retention credit for employers affected by Hurricane Katrina, Rita, and Wilma	....	40	....	....	....	....	....	....
	Health:								
121	Exclusion of employer contributions for medical insurance premiums and medical care	125,000	141,270	160,190	179,580	200,510	221,880	243,820	1,005,980
122	Self-employed medical insurance premiums	3,970	4,370	3,730	4,180	4,670	5,230	5,810	23,620
123	Medical Savings Accounts/Health Savings Accounts	280	990	1,980	2,600	2,830	2,910	2,850	13,170
124	Deductibility of medical expenses	3,770	4,240	4,920	5,820	6,840	9,250	10,780	37,610
125	Exclusion of interest on hospital construction bonds	3,420	3,770	4,010	4,130	4,260	4,380	4,510	21,290
126	Deductibility of charitable contributions (health)	4,190	4,560	5,160	5,570	5,960	6,380	6,850	29,920
127	Tax credit for orphan drug research	230	260	290	320	360	410	460	1,840
128	Special Blue Cross/Blue Shield deduction	620	680	740	610	660	690	740	3,440
129	Tax credit for health insurance purchased by certain displaced and retired individuals [3]	....	10	10	10	10	10	10	50
130	Distributions from retirement plans for premiums for health and long-term care insurance	....	250	240	280	310	340	380	1,550
	Income security:								
131	Exclusion of railroad retirement system benefits	390	380	380	380	370	360	350	1,840
132	Exclusion of workers' compensation benefits	5,660	5,740	5,830	5,920	6,010	6,110	6,200	30,070
133	Exclusion of public assistance benefits (normal tax method)	450	470	490	510	530	550	580	2,660
134	Exclusion of special benefits for disabled coal miners	50	50	40	40	40	40	40	200
135	Exclusion of military disability pensions	110	110	120	130	130	140	150	670
	Net exclusion of pension contributions and earnings:								
136	Employer plans	49,040	49,510	48,480	48,030	46,350	43,700	42,790	229,350
137	401(k) plans	40,760	42,410	43,970	45,980	48,550	54,230	57,690	250,420
138	Individual Retirement Accounts	3,970	5,700	6,650	7,130	7,200	7,460	7,840	36,280
139	Low and moderate income savers credit	700	690	670	630	610	590	580	3,080
140	Keogh plans	10,130	10,860	11,890	13,010	14,230	15,550	16,970	71,650
	Exclusion of other employee benefits:								
141	Premiums on group term life insurance	2,280	2,310	2,350	2,380	2,420	2,450	2,490	12,090
142	Premiums on accident and disability insurance	290	300	310	320	330	340	350	1,650
143	Income of trusts to finance supplementary unemployment benefits	20	30	30	30	40	40	50	190
144	Special ESOP rules	1,760	1,890	2,030	2,170	2,330	2,490	2,670	11,690
145	Additional deduction for the blind	40	40	40	40	40	50	60	230
146	Additional deduction for the elderly	1,920	1,830	1,830	1,910	2,010	2,890	3,480	12,120
147	Tax credit for the elderly and disabled	20	10	10	10	10	10	10	50
148	Deductibility of casualty losses	260	280	300	310	320	350	370	1,650
149	Earned income tax credit [4]	5,050	5,360	5,340	5,490	5,660	5,890	7,900	30,280
150	Additional exemption for housing Hurricane Katrina displaced individuals	110	20	....	....	....	....	....	....
	Social Security:								
	Exclusion of social security benefits:								
151	Social Security benefits for retired workers	17,890	18,100	18,930	19,110	20,230	21,320	23,260	102,850
152	Social Security benefits for disabled	4,730	5,120	5,620	5,890	6,240	6,690	7,220	31,660
153	Social Security benefits for dependents and survivors	3,360	3,340	3,400	3,330	3,420	3,490	3,700	17,340
	Veterans benefits and services:								
154	Exclusion of veterans death benefits and disability compensation	3,580	3,770	3,890	4,030	4,200	4,590	5,030	21,740
155	Exclusion of veterans pensions	150	180	180	180	190	200	230	980
156	DExclusion of GI bill benefits	210	260	280	300	320	360	420	1,680
157	Exclusion of interest on veterans housing bonds	40	40	40	50	50	50	50	240
	General purpose fiscal assistance:								
158	Exclusion of interest on public purpose State and local bonds	22,980	25,430	27,150	27,960	28,800	29,670	30,560	144,140
159	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	43,120	33,680	27,900	27,790	28,570	48,560	59,850	192,670
160	Tax credit for corporations receiving income from doing business in U.S. possessions	200	20	....	....	....	....	....	....
	Interest:								
161	Deferral of interest on U.S. savings bonds	1,260	1,330	1,340	1,360	1,370	1,420	1,520	7,010
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	21,260	15,540	12,620	12,590	12,580	22,440	27,770	88,000
	Nonbusiness State and local taxes other than on owner-occupied homes	43,120	33,680	27,900	27,790	28,570	48,560	59,850	192,670
	Exclusion of interest on State and local bonds for:								
	Public purposes	22,980	25,430	27,150	27,960	28,800	29,670	30,560	144,140
	Energy facilities	40	40	50	50	50	50	50	250
	Water, sewage, and hazardous waste disposal facilities	510	580	600	630	640	670	680	3,220
	Small-issues	510	580	600	630	640	670	680	3,220
	Owner-occupied mortgage subsidies	1,170	1,300	1,390	1,430	1,470	1,510	1,560	7,360

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(in millions of dollars)

	Total from corporations and individuals							
	2006	2007	2008	2009	2010	2011	2012	2008–12
Rental housing	970	1,090	1,150	1,180	1,220	1,260	1,300	6,110
Airports, docks, and similar facilities	1,130	1,250	1,320	1,360	1,400	1,440	1,480	7,000
Student loans	500	550	590	600	630	640	670	3,130
Private nonprofit educational facilities	2,140	2,380	2,530	2,610	2,690	2,770	2,850	13,450
Hospital construction	3,420	3,770	4,010	4,130	4,260	4,380	4,510	21,290
Veterans' housing	40	40	40	50	50	50	50	240
Credit for holders of zone academy bonds	130	140	160	170	170	170	160	830

[1] In addition, the alcohol fuel credit results in a reduction in excise tax receipts (in millions of dollars) as follows: 2006 $2,570; 2007 $2,990; 2008 $3,460; 2009 $4,280; 2010 $4,990; 2011 $1,440; 0 in 2012.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2006 $15,473; 2007 $14,931; 2008 $14,367; 2009 $14,019; 2010 $13,651; 2011 $13,410; and 2012 $1,275.

[3] The figures in the table indicate the effect of the health insurance tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2006 $90; 2007 $100; 2008 $110; 2009 $120; 2010 $130; 2011 $140; and 2012 $150.

[4] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2006 $36,166;2007 $36,461; 2008 $37,573; 2009 $38,237; 2010 $38,994; 2011 $40,289; and 2012 $36,982.

Note: Provisions with estimates denoted normal tax method have no revenue loss under the reference tax law method.

All estimates have been rounded to the nearest $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Present-Value Estimates

The annual value of tax expenditures for tax deferrals is reported on a cash basis in all tables except Table 19–4. Cash-based estimates reflect the difference between taxes deferred in the current year and incoming revenues that are received due to deferrals of taxes from prior years. Although such estimates are useful as a measure of cash flows into the Government, they do not accurately reflect the true economic cost of these provisions. For example, for a provision where activity levels have changed, so that incoming tax receipts from past deferrals are greater than deferred receipts from new activity, the cash-basis tax expenditure estimate can be negative, despite the fact that in present-value terms current deferrals have a real cost to the Government. Alternatively, in the case of a newly enacted deferral provision, a cash-based estimate can overstate the real effect on receipts to the Government because the newly deferred taxes will ultimately be received. Present-value estimates, which are a useful complement to the cash-basis estimates for provisions involving deferrals, are discussed below.

Discounted present-value estimates of revenue effects are presented in Table 19–4 for certain provisions that involve tax deferrals or other long-term revenue effects. These estimates complement the cash-based tax expenditure estimates presented in the other tables.

The present-value estimates represent the revenue effects, net of future tax payments that follow from activities undertaken during calendar year 2006 which cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 2006 would cause a deferral of tax payments on wages in 2006 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 2006 pension contribution and accrued earnings will be paid out and taxes will be due; these receipts are included in the present-value estimate. In general, this conceptual approach is similar to the one used for reporting the budgetary effects of credit programs, where direct loans and guarantees in a given year affect future cash flows.

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES

(in millions of dollars)

		Corporations								Individuals							
		2006	2007	2008	2009	2010	2011	2012	2008–12	2006	2007	2008	2009	2010	2011	2012	2008–12
	National Defense																
1	Exclusion of benefits and allowances to armed forces personnel									3,100	3,220	3,350	3,480	3,620	3,780	3,930	18,160
	International affairs:																
2	Exclusion of income earned abroad by U.S. citizens									2,500	2,630	2,760	2,900	3,050	3,200	3,360	15,270
3	Exclusion of certain allowances for Federal employees abroad									800	840	880	920	970	1020	1070	4,860
4	Extraterritorial income exclusion	4,400	1,630														
5	Inventory property sales source rules exception	1,730	1,890	2,120	2,330	2,510	2,704	2,913	12,577								
6	Deferral of income from controlled foreign corporations (normal tax method)	11,160	11,940	12,770	13,650	14,600	15,620	16,710	73,350								
7	Deferred taxes for financial firms on certain income earned overseas	2,260	2,370	2,490	1,060				3,550								
	General science, space, and technology:																
8	Expensing of research and experimentation expenditures (normal tax method)	7,770	5,570	5,170	3,980	4,920	6,100	5,880	26,050	150	110	110	80	110	130	120	550
9	Credit for increasing research activities	2,120	10,260	4,910	2,100	920	360	70	8,360	60	60	50					50
	Energy:																
10	Expensing of exploration and development costs, fuels	590	750	730	620	520	390	270	2,530	90	110	110	90	80	60	40	380
11	Excess of percentage over cost depletion, fuels	680	710	710	710	700	680	670	3,470	80	80	80	80	80	80	70	390
12	Alternative fuel production credit	2,860	2,270	750	10	10			770	120	100	30					30
13	Exception from passive loss limitation for working interests in oil and gas properties									30	30	30	30	30	30	30	150
14	Capital gains treatment of royalties on coal									160	170	170	170	190	180	130	840
15	Exclusion of interest on energy facility bonds	10	10	10	10	10	10	10	50	30	30	40	40	40	40	40	200
16	New technology credit	470	640	900	1060	1090	1090	1090	5,230	40	50	60	60	60	60	60	300
17	Alcohol fuel credits [1]	40	40	50	50	60	20		180	10	10	10	20	20	10		60
18	Tax credit and deduction for clean-fuel burning vehicles	40	30		–30	–30	–40	–50	–150	70	230	150	160	10	–10	–10	300
19	Exclusion of utility conservation subsidies									110	110	110	110	110	110	100	540
20	Credit for holding clean renewable energy bonds	10	30	40	50	50	50	50	240	10	30	40	50	50	50	50	240
21	Deferral of gain from dispositions of transmission property to implement FERC restructuring policy	620	530	230	–100	–360	–510	–540	–1,280								
22	Credit for investment in clean coal facilities		30	50	80	130	180	250	690								
23	Temporary 50% expensing for equipment used in the refining of liquid fuels	10	30	120	240	260	180	–50	750								
24	Natural gas distribution pipelines treated as 15–year property	20	50	90	120	150	150	120	630								
25	Amortize all geological and geophysical expenditures over 2 years	10	50	70	60	30	10	10	180		10	20	10	10			40
26	Allowance of deduction for certain energy efficient commercial building property	60	140	130	70	20	–10	–10	200	20	50	40	20	10			70
27	Credit for construction of new energy efficient homes	10	20	20	20	10			50			10					10
28	Credit for energy efficiency improvements to existing homes									230	380	150					150
29	Credit for energy efficient appliances	120	80														
30	30% credit for residential purchases/installations of solar and fuel cells									10	10	10					10
31	Credit for business installation of qualified fuel cells and stationary microturbine power plants	60	70	100	40	–10	–10	–10	110	20	20	30	10				40
32	Partial expensing for advanced mine safety equipment		10	20					20								
	Natural resources and environment:																
33	Expensing of exploration and development costs, nonfuel minerals	10	10	10	10	10	10	10	50								
34	Excess of percentage over cost depletion, nonfuel minerals	430	460	470	480	500	520	540	2,510	20	20	20	30	30	30	30	140
35	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	120	140	140	150	150	160	160	760	390	440	460	480	490	510	520	2,460
36	Capital gains treatment of certain timber income									160	170	170	170	190	180	130	840
37	Expensing of multiperiod timber growing costs	200	220	230	240	250	260	270	1,250	90	90	90	90	100	100	100	480
38	Tax incentives for preservation of historic structures	300	310	330	340	360	380	400	1,810	90	90	100	100	110	110	120	540
39	Expensing of capital costs with respect to complying with EPA sulfur regulations	10	10	30	50	30			110								
40	Exclusion of gain or loss on sale or exchange of certain brownfield sites		10	20	30	30	30	20	130			10	10	10	10	10	50
	Agriculture:																
41	Expensing of certain capital outlays	20	20	20	20	20	30	30	120	110	110	110	120	120	120	120	590

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2006	2007	2008	2009	2010	2011	2012	2008–12	2006	2007	2008	2009	2010	2011	2012	2008–12
42	Expensing of certain multiperiod production costs	10	10	10	10	10	20	20	70	60	60	70	70	70	70	70	350
43	Treatment of loans forgiven for solvent farmers									20	20	20	20	20	30	30	120
44	Capital gains treatment of certain income									880	940	950	950	1,010	980	700	4,590
45	Income averaging for farmers									60	60	60	60	60	70	70	320
46	Deferral of gain on sale of farm refiners	10	20	20	20	20	20	20	100								
47	Bio-Diesel and small agri-biodiesel producer tax credits									90	180	200	30	20	10	10	270
	Commerce and housing:																
	Financial institutions and insurance:																
48	Exemption of credit union income	1320	1400	1480	1570	1660	1750	1850	8,310								
49	Excess bad debt reserves of financial institutions	20	10	10	10	10			30								
50	Exclusion of interest on life insurance savings	1780	1850	2020	2310	2560	2770	2950	12,610	17600	18300	19905	22750	25270	27320	29150	124,395
51	Special alternative tax on small property and casualty insurance companies	50	50	50	50	50	60	60	270								
52	Tax exemption of certain insurance companies owned by tax-exempt organizations	220	230	240	250	260	270	280	1,300								
53	Small life insurance company deduction	60	60	60	60	60	50	50	280								
54	Exclusion of interest spread of financial institutions									1,350	1,330	1,400	1,480	1,550	1,950	2,050	8,430
	Housing:																
55	Exclusion of interest on owner-occupied mortgage subsidy bonds	280	310	330	340	350	360	370	1,750	890	990	1,060	1,090	1,120	1,150	1,190	5,610
56	Exclusion of interest on rental housing bonds	230	260	270	280	290	300	310	1,450	740	830	880	900	930	960	990	4,660
57	Deductibility of mortgage interest on owner-occupied homes									68,330	79,940	89,430	96,250	103,540	111,440	119,600	520,260
58	Deductibility of State and local property tax on owner-occupied homes									21,260	15,540	12,620	12,590	12,580	22,440	27,770	88,000
59	Deferral of income from installment sales	310	310	310	320	320	320	330	1,600	880	900	920	930	1,050	1,180	1,320	5,400
60	Capital gains exclusion on home sales									35,270	37,030	38,890	40,830	42,870	45,010	47,270	214,870
61	Exclusion of net imputed rental income									28,780	32,110	35,680	39,440	43,596	48,190	53,269	220,176
62	Exception from passive loss rules for $25,000 of rental loss									6,590	7,150	7,520	7,790	7,990	8,150	8,300	39,750
63	Credit for low-income housing investments	3,980	4,200	4,440	4,730	5,010	5,280	5,550	25,010	440	460	500	520	560	590	620	2,790
64	Accelerated depreciation on rental housing (normal tax method)	640	680	720	770	820	870	930	4,110	9,700	10,560	11,580	12,710	13,740	14,920	16,260	69,210
	Commerce:																
65	Cancellation of indebtedness									90	100	90	60	30	30	30	240
66	Exceptions from imputed interest rules									50	50	50	50	50	50	50	250
67	Capital gains (except agriculture, timber, iron ore, and coal)									48,610	51,770	51,960	52,230	55,400	53,870	38,420	251,880
68	Capital gains exclusion of small corporation stock									240	270	320	340	370	490	540	2,060
69	Step-up basis of capital gains at death									29,600	32,600	35,900	36,750	37,950	39,450	41,010	191,060
70	Carryover basis of capital gains on gifts									590	650	760	800	1,270	6,340	1,500	10,670
71	Ordinary income treatment of loss from small business corporation stock sale									50	50	50	50	60	60	60	280
72	Accelerated depreciation of buildings other than rental housing (normal tax method)	230	290	450	680	910	1,170	1,440	4,650	–1,200	–1,030	–760	–420	–40	380	840	
73	Accelerated depreciation of machinery and equipment (normal tax method)	23,730	34,650	44,780	55,310	62,620	68,490	74,110	305,310	12,740	16,380	19,890	23,080	22,630	24,140	26,740	116,480
74	Expensing of certain small investments (normal tax method)	1,150	1,130	1,070	890	–800	–360	–70	730	3,850	4,200	4,260	3,850	–290	440	920	9,180
75	Graduated corporation income tax rate (normal tax method)	4,050	4,270	4,240	4,320	4,420	4,530	4,690	22,200								
76	Exclusion of interest on small issue bonds	120	140	140	150	150	160	160	760	390	440	460	480	490	510	520	2,460
77	Deduction for US production activities	8,180	8,690	11,380	12,000	16,220	19,100	19,770	78,470	1,770	2,010	2,430	2,500	3,330	4,790	5,590	18,640
78	Special rules for certain film and TV production	90	70	60	–30	–70	–50	–40	–130	20	20	10	–10	–20	–10	–10	–40
	Transportation:																
79	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100								
80	Exclusion of reimbursed employee parking expenses									2,740	2,890	3,040	3,190	3,350	3,430	3,540	16,550
81	Exclusion for employer-provided transit passes									560	630	710	790	880	960	1,030	4,370
82	Tax credit for certain expenditures for maintaining railroad tracks	140	160	130	60	30	10	10	240								
83	Exclusion of interest on bonds for Financing of Highway Projects and rail-truck transfer facilities	10	15	20	25	25	25	25	120	15	35	55	70	70	75	75	345
	Community and regional development:																
84	Investment credit for rehabilitation of structures (other than historic)	20	20	20	20	20	20	20	100	20	20	20	20	20	20	20	100

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued
(in millions of dollars)

		Corporations								Individuals							
		2006	2007	2008	2009	2010	2011	2012	2008–12	2006	2007	2008	2009	2010	2011	2012	2008–12
85	Exclusion of interest for airport, dock, and similar bonds	270	300	310	320	330	340	350	1,650	860	950	1,010	1,040	1,070	1,100	1,130	5,350
86	Exemption of certain mutuals' and co-operatives' income	80	80	80	80	80	90	90	420								
87	Empowerment zones and renewal communities	310	340	370	420	190	60	90	1,130	900	1,000	1,110	1,320	940	360	480	4,210
88	New markets tax credit	150	210	250	240	210	180	140	1,020	440	600	740	730	650	550	450	3,120
89	Expensing of environmental remediation costs	120	250	110	–30	–20	–20	–30	10	30	50	20	–10				10
90	Credit to holders of Gulf Tax Credit Bonds									10	10	10	10	10	10	10	50
	Education, training, employment, and social services:																
	Education:																
91	Exclusion of scholarship and fellowship income (normal tax method)									1,780	1,870	1,960	2,050	2,150	2,250	2,360	10,770
92	HOPE tax credit									3,900	3,330	3,350	3,600	3,710	4,350	4,730	19,740
93	Lifetime Learning tax credit									2,490	2,190	2,200	2,310	2,390	2,780	3,020	12,700
94	Education Individual Retirement Accounts									10	10	10	20	20	20	30	100
95	Deductibility of student-loan interest									800	810	820	830	840	780	530	3,800
96	Deduction for higher education expenses									1,420	1,450	1,180					1,180
97	State prepaid tuition plans									690	830	1,000	1,210	1,470	1,820	2,000	7,500
98	Exclusion of interest on student-loan bonds	120	130	140	140	150	150	160	740	380	420	450	460	480	490	510	2,390
99	Exclusion of interest on bonds for private nonprofit educational facilities	510	570	600	620	640	660	680	3,200	1630	1810	1930	1990	2050	2110	2170	10,250
100	Credit for holders of zone academy bonds	130	140	160	170	170	170	160	830								
101	Exclusion of interest on savings bonds redeemed to finance educational expenses										20	20	20	20	20	20	100
102	Parental personal exemption for students age 19 or over									4,030	2,500	1,590	1,480	1,410	2,620	3,040	10,140
103	Deductibility of charitable contributions (education)	570	600	630	670	710	750	790	3,550	3,630	3,950	4,490	4,850	5,190	5,570	5,980	26,080
104	Exclusion of employer-provided educational assistance									590	620	660	690	720	40		2,110
105	Special deduction for teacher expenses									160	170	160					160
106	Discharge of student loan indebtedness									20	20	20	20	20	20	20	100
	Training, employment, and social services:																
107	Work opportunity tax credit	180	320	340	220	120	60	30	770	30	40	30	30	20	10	10	100
108	Welfare-to-work tax credit	70	70	60	40	20	10	10	140	10	10	20	10				30
109	Employer provided child care exclusion									660	890	1030	1080	1140	1160	1210	5,620
110	Employer-provided child care credit	10	10	10	20	20	10		60								
111	Assistance for adopted foster children									320	350	400	440	480	530	570	2,420
112	Adoption credit and exclusion									540	560	570	580	600	540	170	2,460
113	Exclusion of employee meals and lodging (other than military)									890	930	970	1,010	1,060	1,110	1,170	5,320
114	Child credit[2]									30,377	32,556	32,341	32,096	31,909	24,719	13,601	134,666
115	Credit for child and dependent care expenses									3,190	2,810	1,740	1,650	1,570	1,500	1,430	7,890
116	Credit for disabled access expenditures	10	10	10	10	10	10	10	50	10	20	20	20	20	20	20	100
117	Deductibility of charitable contributions, other than education and health	1,300	1,370	1,440	1,510	1,580	1,650	1720	7,900	35,820	39,030	44,320	47,850	51,260	54,960	59,020	257,410
118	Exclusion of certain foster care payments									440	450	460	470	480	490	500	2,400
119	Exclusion of parsonage allowances									480	510	550	580	610	640	670	3,050
120	Employee retention credit for employers affected by Hurricane Katrina, Rita, and Wilma		40														
	Health:																
121	Exclusion of employer contributions for medical insurance premiums and medical care									125,000	141,270	160,190	179,580	200,510	221,880	243,820	1,005,980
122	Self-employed medical insurance premiums									3,970	4,370	3,730	4,180	4,670	5,230	5,810	23,620
123	Medical Savings Accounts / Health Savings Accounts									280	990	1,980	2,600	2,830	2,910	2,850	13,170
124	Deductibility of medical expenses									3,770	4,240	4,920	5,820	6,840	9,250	10,780	37,610
125	Exclusion of interest on hospital construction bonds	820	900	950	980	1,010	1,040	1,070	5,050	2,600	2,870	3,060	3,150	3,250	3,340	3,440	16,240
126	Deductibility of charitable contributions (health)	170	180	190	200	210	220	230	1,050	4,020	4,380	4,970	5,370	5,750	6,160	6,620	28,870
127	Tax credit for orphan drug research	230	260	290	320	360	410	460	1,840								
128	Special Blue Cross/Blue Shield deduction	620	680	740	610	660	690	740	3,440								
129	Tax credit for health insurance purchased by certain displaced and retired individuals[3]										10	10	10	10	10	10	50

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2006	2007	2008	2009	2010	2011	2012	2008–12	2006	2007	2008	2009	2010	2011	2012	2008–12
130	Distributions from retirement plans for premiums for health and long-term care insurance	....	....	....	....	....	....	....	....	....	250	240	280	310	340	380	1,550
	Income security:																
131	Exclusion of railroad retirement system benefits	....	....	....	....	....	....	....	....	390	380	380	380	370	360	350	1,840
132	Exclusion of workers' compensation benefits	....	....	....	....	....	....	....	....	5,660	5,740	5,830	5,920	6,010	6,110	6,200	30,070
133	Exclusion of public assistance benefits (normal tax method)	....	....	....	....	....	....	....	....	450	470	490	510	530	550	580	2,660
134	Exclusion of special benefits for disabled coal miners	....	....	....	....	....	....	....	....	50	50	40	40	40	40	40	200
135	Exclusion of military disability pensions	....	....	....	....	....	....	....	....	110	110	120	130	130	140	150	670
	Net exclusion of pension contributions and earnings:																
136	Employer plans	....	....	....	....	....	....	....	....	49,040	49,510	48,480	48,030	46,350	43,700	42,790	229,350
137	401(k) plans	....	....	....	....	....	....	....	....	40,760	42,410	43,970	45,980	48,550	54,230	57,690	250,420
138	Individual Retirement Accounts	....	....	....	....	....	....	....	....	3,970	5,700	6,650	7,130	7,200	7,460	7,840	36,280
139	Low and moderate income savers credit	....	....	....	....	....	....	....	....	700	690	670	630	610	590	580	3,080
140	Keogh plans	....	....	....	....	....	....	....	....	10,130	10,860	11,890	13,010	14,230	15,550	16,970	71,650
	Exclusion of other employee benefits:																
141	Premiums on group term life insurance	....	....	....	....	....	....	....	....	2280	2310	2350	2380	2420	2450	2490	12,090
142	Premiums on accident and disability insurance	....	....	....	....	....	....	....	....	290	300	310	320	330	340	350	1,650
143	Income of trusts to finance supplementary unemployment benefits	....	....	....	....	....	....	....	....	20	30	30	30	40	40	50	190
144	Special ESOP rules	1420	1540	1660	1780	1940	2100	2280	9,760	340	350	370	390	390	390	390	1,930
145	Additional deduction for the blind	....	....	....	....	....	....	....	....	40	40	40	40	40	50	60	230
146	Additional deduction for the elderly	....	....	....	....	....	....	....	....	1,920	1,830	1,830	1,910	2,010	2,890	3,480	12,120
147	Tax credit for the elderly and disabled	....	....	....	....	....	....	....	....	20	10	10	10	10	10	10	50
148	Deductibility of casualty losses	....	....	....	....	....	....	....	....	260	280	300	310	320	350	370	1,650
149	Earned income tax credit [4]	....	....	....	....	....	....	....	....	5,050	5,360	5,340	5,490	5,660	5,890	7,900	30,280
150	Additional exemption for housing Hurricane Katrina displaced individuals	....	....	....	....	....	....	....	....	110	20	....	....	....	....	....	....
	Social Security:																
	Exclusion of Social Security benefits:																
151	Social Security benefits for retired workers	....	....	....	....	....	....	....	....	17,890	18,100	18,930	19,110	20,230	21,320	23,260	102,850
152	Social Security benefits for disabled	....	....	....	....	....	....	....	....	4,730	5,120	5,620	5,890	6,240	6,690	7,220	31,660
153	Social Security benefits for dependents and survivors	....	....	....	....	....	....	....	....	3,360	3,340	3,400	3,330	3,420	3,490	3,700	17,340
	Veterans benefits and services:																
154	Exclusion of veterans death benefits and disability compensation	....	....	....	....	....	....	....	....	3,580	3,770	3,890	4,030	4,200	4,590	5,030	21,740
155	Exclusion of veterans pensions	....	....	....	....	....	....	....	....	150	180	180	180	190	200	230	980
156	Exclusion of GI bill benefits	....	....	....	....	....	....	....	....	210	260	280	300	320	360	420	1,680
157	Exclusion of interest on veterans housing bonds	10	10	10	10	10	10	10	50	30	30	30	40	40	40	40	190
	General purpose fiscal assistance:																
158	Exclusion of interest on public purpose State and local bonds	7,230	8,000	8,460	8,710	8,970	9,240	9,520	44,900	15,750	17,430	18,690	19,250	19,830	20,430	21,040	99,240
159	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	....	....	....	....	....	....	....	....	43,120	33,680	27,900	27,790	28,570	48,560	59,850	192,670
160	Tax credit for corporations receiving income from doing business in U.S. possessions	200	20	....	....	....	....	....	....	....	....	....	....	....	....	....	....
	Interest:																
161	Deferral of interest on U.S. savings bonds	....	....	....	....	....	....	....	....	1,260	1,330	1,340	1,360	1,370	1,420	1,520	7,010
	Addendum: Aid to State and local governments:																
	Deductibility of:																
	Property taxes on owner-occupied homes	....	....	....	....	....	....	....	....	21,260	15,540	12,620	12,590	12,580	22,440	27,770	88,000
	Nonbusiness State and local taxes other than on owner-occupied homes	....	....	....	....	....	....	....	....	43,120	33,680	27,900	27,790	28,570	48,560	59,850	192,670
	Exclusion of interest on State and local bonds for:																
	Public purposes	7,230	8,000	8,460	8,710	8,970	9,240	9,520	44,900	15,750	17,430	18,690	19,250	19,830	20,430	21,040	99,240
	Energy facilities	10	10	10	10	10	10	10	50	30	30	40	40	40	40	40	200
	Water, sewage, and hazardous waste disposal facilities	120	140	140	150	150	160	160	760	390	440	460	480	490	510	520	2,460
	Small-issues	120	140	140	150	150	160	160	760	390	440	460	480	490	510	520	2,460
	Owner-occupied mortgage subsidies	280	310	330	340	350	360	370	1,750	890	990	1,060	1,090	1,120	1,150	1,190	5,610
	Rental housing	230	260	270	280	290	300	310	1,450	740	830	880	900	930	960	990	4,660
	Airports, docks, and similar facilities	270	300	310	320	330	340	350	1,650	860	950	1,010	1,040	1,070	1,100	1,130	5,350
	Student loans	120	130	140	140	150	150	160	740	380	420	450	460	480	490	510	2,390
	Private nonprofit educational facilities	510	570	600	620	640	660	680	3,200	1,630	1,810	1,930	1,990	2,050	2,110	2,170	10,250
	Hospital construction	820	900	950	980	1010	1040	1070	5,050	2,600	2,870	3,060	3,150	3,250	3,340	3,440	16,240
	Veterans' housing	10	10	10	10	10	10	10	50	30	30	30	40	40	40	40	190

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2006	2007	2008	2009	2010	2011	2012	2008–12	2006	2007	2008	2009	2010	2011	2012	2008–12
	Credit for holders of zone academy bonds ..	130	140	160	170	170	170	160	830	....	....	....	....	....	....	....	....

[1] In addition, the alcohol fuel credit results in a reduction in excise tax receipts (in millions of dollars) as follows: 2006 $2,570; 2007 $2,990; 2008 $3,460; 2009 $4,280; 2010 $4,990; 2011 $1,440; 0 in 2012.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2006 $15,473; 2007 $14,931; 2008 $14,367; 2009 $14,019; 2010 $13,651; 2011 $13,410; and 2012 $1,275.

[3] The figures in the table indicate the effect of the health insurance tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2006 $90; 2007 $100; 2008 $110; 2009 $120; 2010 $130; 2011 $140; and 2012 $150.

[4] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2006 $36,166;2007 $36,461; 2008 $37,573; 2009 $38,237; 2010 $38,994; 2011 $40,289; and 2012 $36,982.

Note: Provisions with estimates denoted normal tax method have no revenue loss under the reference tax law method.

All estimates have been rounded to the nearest $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Tax Expenditure Baselines

A tax expenditure is an exception to baseline provisions of the tax structure that usually results in a reduction in the amount of tax owed. The 1974 Congressional Budget Act, which mandated the tax expenditure budget, did not specify the baseline provisions of the tax law. As noted previously, deciding whether provisions are exceptions, therefore, is a matter of judgment. As in prior years, most of this year's tax expenditure estimates are presented using two baselines: the normal tax baseline and the reference tax law baseline. An exception is provided for the lower tax rate on dividends and capital gains on corporate shares as discussed below.

The normal tax baseline is patterned on a comprehensive income tax, which defines income as the sum of consumption and the change in net wealth in a given period of time. The normal tax baseline allows personal exemptions, a standard deduction, and deduction of expenses incurred in earning income. It is not limited to a particular structure of tax rates, or by a specific definition of the taxpaying unit.

In the case of income taxes, the reference tax law baseline is also patterned on a comprehensive income tax, but it is closer to existing law. Tax expenditures under the reference law baseline are generally tax expenditures under the normal tax baseline, but the reverse is not always true.

Both the normal and reference tax baselines allow several major departures from a pure comprehensive income tax. For example, under the normal and reference tax baselines:

- Income is taxable only when it is realized in exchange. Thus, neither the deferral of tax on unrealized capital gains nor the tax exclusion of imputed income (such as the rental value of owner-occupied housing or farmers' consumption of their own produce) are regarded as tax expenditures. Both accrued and imputed income would be taxed under a comprehensive income tax.
- A comprehensive income tax would generally not exclude from the tax base amounts for personal exemptions or a standard deduction, except perhaps to ease tax administration.
- A separate corporate income tax is not part of a comprehensive income tax.
- Tax rates vary by level of income. Multiple tax rates exist as a means to facilitate the redistribution of income.
- Tax rates are allowed to vary with marital status.
- Values of assets and debt are not generally adjusted for inflation. A comprehensive income tax would adjust the cost basis of capital assets and debt for changes in the price level during the time the assets or debt are held. Thus, under a comprehensive income tax baseline, the failure to take account of inflation in measuring depreciation, capital gains, and interest income would be regarded as a negative tax expenditure (i.e., a tax penalty), and failure to take account of inflation in measuring interest costs would be regarded as a positive tax expenditure (i.e., a tax subsidy).

Although the reference law and normal tax baselines are generally similar, areas of difference include:

Tax rates. The separate schedules applying to the various taxpaying units are included in the reference law baseline. Thus, corporate tax rates below the maximum statutory rate do not give rise to a tax expenditure. The normal tax baseline is similar, except that, by convention, it specifies the current maximum rate as the baseline for the corporate income tax. The lower tax rates applied to the first $10 million of corporate income are thus regarded as a tax expenditure. Again, by convention, the Alternative Minimum Tax is treated as part of the baseline rate structure under both the reference and normal tax methods.

Income subject to the tax. Income subject to tax is defined as gross income less the costs of earning that income. The Federal income tax defines gross income to include: (1) consideration received in the exchange of goods and services, including labor services or property; and (2) the taxpayer's share of gross or net income earned and/or reported by another entity (such as a partnership). Under the reference tax rules, therefore, gross income does not include gifts defined as receipts of money or property that are not consideration in an exchange nor does gross income include most transfer payments which can be thought of as gifts from the

Government.[3] The normal tax baseline also excludes gifts between individuals from gross income. Under the normal tax baseline, however, all cash transfer payments from the Government to private individuals are counted in gross income, and exemptions of such transfers from tax are identified as tax expenditures. The costs of earning income are generally deductible in determining taxable income under both the reference and normal tax baselines.[4]

Capital recovery. Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. Under the normal tax baseline, the depreciation allowance for property is computed using estimates of economic depreciation. The latter represents a change in the calculation of the tax expenditure under normal law first made in the 2004 Budget. Appendix A provides further details on the new methodology and how it differs from the prior methodology.

Treatment of foreign income. Both the normal and reference tax baselines allow a tax credit for foreign income taxes paid (up to the amount of U.S. income taxes that would otherwise be due), which prevents double taxation of income earned abroad. Under the normal tax method, however, controlled foreign corporations (CFCs) are not regarded as entities separate from their controlling U.S. shareholders. Thus, the deferral of tax on income received by CFCs is regarded as a tax expenditure under this method. In contrast, except for tax haven activities, the reference law baseline follows current law in treating CFCs as separate taxable entities whose income is not subject to U.S. tax until distributed to U.S. taxpayers. Under this baseline, deferral of tax on CFC income is not a tax expenditure because U.S. taxpayers generally are not taxed on accrued, but unrealized, income.

In addition to these areas of difference, the Joint Committee on Taxation considers a somewhat broader set of tax expenditures under its normal tax baseline than is considered here.

Table 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2008–2012 PROJECTED REVENUE EFFECT

(in millions of dollars)

	Provision	2008	2008–12
121	Exclusion of employer contributions for medical insurance premiums and medical care	160,190	1,005,980
57	Deductibility of mortgage interest on owner-occupied homes	89,430	520,260
73	Accelerated depreciation of machinery and equipment (normal tax method)	64,670	421,790
117	Deductibility of charitable contributions, other than education and health	45,760	265,310
67	Capital gains (except agriculture, timber, iron ore, and coal)	51,960	251,880
137	401(k) plans	43,970	250,420
136	Employer plans	48,480	229,350
61	Exclusion of net imputed rental income	35,680	220,176
60	Capital gains exclusion on home sales	38,890	214,870
159	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	27,900	192,670
69	Step-up basis of capital gains at death	35,900	191,060
158	Exclusion of interest on public purpose State and local bonds	27,150	144,140
50	Exclusion of interest on life insurance savings	21,925	137,005
114	Child tax credit	32,341	134,666
151	Social Security benefits for retired workers	18,930	102,850
77	Deduction for U.S. production activities	13,810	97,110
58	Deductibility of State and local property tax on owner-occupied homes	12,620	88,000
6	Deferral of income from controlled foreign corporations (normal tax method)	12,770	73,350
64	Accelerated depreciation on rental housing (normal tax method)	12,300	73,320
140	Keogh plans	11,890	71,650
62	Exception from passive loss rules for $25,000 of rental loss	7,520	39,750
124	Deductibility of medical expenses	4,920	37,610
138	Individual Retirement Accounts	6,650	36,280
152	Social Security benefits for disabled	5,620	31,660
149	Earned income tax credit	5,340	30,280
132	Exclusion of workers' compensation benefits	5,830	30,070
126	Deductibility of charitable contributions (health)	5,160	29,920
103	Deductibility of charitable contributions (education)	5,120	29,630
63	Credit for low-income housing investments	4,940	27,800
8	Expensing of research and experimentation expenditures (normal tax method)	5,280	26,600
122	Self-employed medical insurance premiums	3,730	23,620
75	Graduated corporation income tax rate (normal tax method)	4,240	22,200
154	Exclusion of veterans death benefits and disability compensation	3,890	21,740
125	Exclusion of interest on hospital construction bonds	4,010	21,290
92	HOPE tax credit	3,350	19,740

[3] Gross income does, however, include transfer payments associated with past employment, such as Social Security benefits.

[4] In the case of individuals who hold "passive" equity interests in businesses, however, the pro-rata shares of sales and expense deductions reportable in a year are limited. A passive business activity is defined to be one in which the holder of the interest, usually a partnership interest, does not actively perform managerial or other participatory functions. The taxpayer may generally report no larger deductions for a year than will reduce taxable income from such activities to zero. Deductions in excess of the limitation may be taken in subsequent years, or when the interest is liquidated. In addition, costs of earning income may be limited under the Alternative Minimum Tax.

Table 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2008–2012 PROJECTED REVENUE EFFECT—Continued

(in millions of dollars)

	Provision	2008	2008–12
1	Exclusion of benefits and allowances to armed forces personnel	3,350	18,160
153	Social Security benefits for dependents and survivors	3,400	17,340
80	Exclusion of reimbursed employee parking expenses	3,040	16,550
2	Exclusion of income earned abroad by U.S. citizens	2,760	15,270
99	Exclusion of interest on bonds for private nonprofit educational facilities	2,530	13,450
123	Medical Savings Accounts / Health Savings Accounts	1,980	13,170
93	Lifetime Learning tax credit	2,200	12,700
5	Inventory property sales source rules exception	2,120	12,577
146	Additional deduction for the elderly	1,830	12,120
141	Premiums on group term life insurance	2,350	12,090
144	Special ESOP rules	2,030	11,690
91	Exclusion of scholarship and fellowship income (normal tax method)	1,960	10,770
70	Carryover basis of capital gains on gifts	760	10,670
102	Parental personal exemption for students age 19 or over	1,590	10,140
74	Expensing of certain small investments (normal tax method)	5,330	9,910
54	Exclusion of interest spread of financial institutions	1,400	8,430
9	Credit for increasing research activities	4,960	8,410
48	Exemption of credit union income	1,480	8,310
115	Credit for child and dependent care expenses	1,740	7,890
97	State prepaid tuition plans	1,000	7,500
55	Exclusion of interest on owner-occupied mortgage subsidy bonds	1,390	7,360
161	Deferral of interest on U.S. savings bonds	1,340	7,010
59	Deferral of income from installment sales	1,230	7,000
85	Exclusion of interest for airport, dock, and similar bonds	1,320	7,000
56	Exclusion of interest on rental housing bonds	1,150	6,110
109	Employer provided child care exclusion	1,030	5,620
16	New technology credit	960	5,530
87	Empowerment zones, Enterprise communities, and Renewal communities	1,480	5,340
113	Exclusion of employee meals and lodging (other than military)	970	5,320
3	Exclusion of certain allowances for Federal employees abroad	880	4,860
72	Accelerated depreciation of buildings other than rental housing (normal tax method)	–310	4,650
44	Capital gains treatment of certain income	950	4,590
81	Exclusion for employer-provided transit passes	710	4,370
88	New markets tax credit	990	4,140
11	Excess of percentage over cost depletion, fuels	790	3,860
95	Deductibility of student-loan interest	820	3,800
7	Deferred taxes for financial firms on certain income earned overseas	2,490	3,550
128	Special Blue Cross/Blue Shield deduction	740	3,440
35	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	600	3,220
76	Exclusion of interest on small issue bonds	600	3,220
98	Exclusion of interest on student-loan bonds	590	3,130
139	Low and moderate income savers credit	670	3,080
119	Exclusion of parsonage allowances	550	3,050
10	Expensing of exploration and development costs, fuels	840	2,910
133	Exclusion of public assistance benefits (normal tax method)	490	2,660
34	Excess of percentage over cost depletion, nonfuel minerals	490	2,650
112	Adoption credit and exclusion	570	2,460
111	Assistance for adopted foster children	400	2,420
118	Exclusion of certain foster care payments	460	2,400
38	Tax incentives for preservation of historic structures	430	2,350
104	Exclusion of employer-provided educational assistance	660	2,110
68	Capital gains exclusion of small corporation stock	320	2,060
127	Tax credit for orphan drug research	290	1,840
131	Exclusion of railroad retirement system benefits	380	1,840
37	Expensing of multiperiod timber growing costs	320	1,730
156	Exclusion of GI bill benefits	280	1,680
142	Premiums on accident and disability insurance	310	1,650
148	Deductibility of casualty losses	300	1,650
130	Distributions from retirement plans for premiums for health and long-term care insurance	240	1,550
52	Tax exemption of certain insurance companies owned by tax-exempt organizations	240	1,300
96	Deduction for higher education expenses	1,180	1,180
155	Exclusion of veterans pensions	180	980
107	Work opportunity tax credit	370	870
14	Capital gains treatment of royalties on coal	170	840
36	Capital gains treatment of certain timber income	170	840
100	Credit for holders of zone academy bonds	160	830
12	Alternative fuel production credit	780	800
23	Temporary 50% expensing for equipment used in the refining of liquid fuels	120	750

Table 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2008–2012 PROJECTED REVENUE EFFECT—Continued

(in millions of dollars)

	Provision	2008	2008–12
41	Expensing of certain capital outlays	130	710
22	Credit for investment in clean coal facilities	50	690
135	Exclusion of military disability pensions	120	670
24	Natural gas distribution pipelines treated as 15–year property	90	630
19	Exclusion of utility conservation subsidies	110	540
20	Credit for holding clean renewable energy bonds	80	480
83	Exclusion of interest on bonds for Financing of Highway Projects and rail-truck transfer facilities	75	465
42	Expensing of certain multiperiod production costs	80	420
86	Exemption of certain mutuals' and cooperatives' income	80	420
45	Income averaging for farmers	60	320
53	Small life insurance company deduction	60	280
71	Ordinary income treatment of loss from small business corporation stock sale	50	280
26	Allowance of deduction for certain energy efficient commercial building property	170	270
47	Bio-Diesel tax credit	200	270
51	Special alternative tax on small property and casualty insurance companies	50	270
15	Exclusion of interest on energy facility bonds	50	250
66	Exceptions from imputed interest rules	50	250
17	Alcohol fuel credits	60	240
65	Cancellation of indebtedness	90	240
82	Tax credit for certain expenditures for maintaining railroad tracks	130	240
157	Exclusion of interest on veterans housing bonds	40	240
145	Additional deduction for the blind	40	230
25	Amortize all geological and geophysical expenditures over 2 years	90	220
84	Investment credit for rehabilitation of structures (other than historic)	40	200
134	Exclusion of special benefits for disabled coal miners	40	200
143	Income of trusts to finance supplementary unemployment benefits	30	190
40	Exclusion of gain or loss on sale or exchange of certain brownfield sites	30	180
108	Welfare-to-work tax credit	80	170
105	Special deduction for teacher expenses	160	160
13	Exception from passive loss limitation for working interests in oil and gas properties	30	150
18	Tax credit and deduction for clean-fuel burning vehicles	150	150
28	Credit for energy efficiency improvements to existing homes	150	150
31	Credit for business installation of qualified fuel cells and stationary microturbine power plants	130	150
116	Credit for disabled access expenditures	30	150
43	Treatment of loans forgiven for solvent farmers	20	120
39	Expensing of capital costs with respect to complying with EPA sulfur regulations	30	110
46	Deferral of gain on sale of farm refiners	20	100
79	Deferral of tax on shipping companies	20	100
94	Education Individual Retirement Accounts	10	100
101	Exclusion of interest on savings bonds redeemed to finance educational expenses	20	100
106	Discharge of student loan indebtedness	20	100
27	Credit for construction of new energy efficient homes	30	60
110	Employer-provided child care credit	10	60
33	Expensing of exploration and development costs, nonfuel minerals	10	50
90	Credit to holders of Gulf Tax Credit Bonds	10	50
129	Tax credit for health insurance purchased by certain displaced and retired individuals	10	50
147	Tax credit for the elderly and disabled	10	50
49	Excess bad debt reserves of financial institutions	10	30
32	Partial expensing for advanced mine safety equipment	20	20
89	Expensing of environmental remediation costs	130	20
30	30% credit for residential purchases/installations of solar and fuel cells	10	10
4	Extraterritorial income exclusion	....	....
29	Credit for energy efficient appliances	....	....
120	Employee retention credit for employers affected by Hurricane Katrina, Rita, and Wilma	....	....
150	Additional exemption for housing Hurricane Katrina displaced individuals	....	....
160	Tax credit for corporations receiving income from doing business in U.S. possessions	....	....
78	Special rules for certain film and TV production	70	–170
21	Deferral of gain from dispositions of transmission property to implement FERC restructuring policy	230	–1,280

Table 19–4. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 2006

(in millions of dollars)

	Provision	2006 Present Value of Revenue Loss
1	Deferral of income from controlled foreign corporations (normal tax method)	10,520
2	Deferred taxes for financial firms on income earned overseas	2,380
3	Expensing of research and experimentation expenditures (normal tax method)	2,690
4	Expensing of exploration and development costs—fuels	260
5	Expensing of exploration and development costs—nonfuels	10
6	Expensing of multiperiod timber growing costs	160
7	Expensing of certain multiperiod production costs—agriculture	140
8	Expensing of certain capital outlays—agriculture	180
9	Deferral of income on life insurance and annuity contracts	19,750
10	Accelerated depreciation on rental housing	16,240
11	Accelerated depreciation of buildings other than rental	10,510
12	Accelerated depreciation of machinery and equipment	68,430
13	Expensing of certain small investments (normal tax method)	860
14	Deferral of tax on shipping companies	20
15	Credit for holders of zone academy bonds	210
16	Credit for low-income housing investments	4,530
17	Deferral for state prepaid tuition plans	4,730
18	Exclusion of pension contributions—employer plans	75,660
19	Exclusion of 401(k) contributions	110,000
20	Exclusion of IRA contributions and earnings	4,100
21	Exclusion of contributions and earnings for Keogh plans	7,640
22	Exclusion of interest on public-purpose bonds	20,420
23	Exclusion of interest on non-public purpose bonds	6,900
24	Deferral of interest on U.S. savings bonds	420
25	Exclusion of Roth earnings and distributions	8,380
26	Exclusion of non-deductible IRA earnings	400

Double Taxation of Corporate Profits

In a gradual transition to a more economically neutral tax system under which all income is taxed no more than once, the lower tax rates on dividends and capital gains on corporate equity under current law have not been considered tax preferences since the 2005 Budget. Thus, the difference between ordinary tax rates and the lower tax rates on dividends, introduced by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), does not give rise to a tax expenditure. Similarly, the lower capital gains tax rates applied to gains realized from the disposition of corporate equity do not give rise to a tax expenditure. As a consequence, tax expenditure estimates for the lower tax rates on capital, step-up in basis, and the inside build-up on pension assets, 401k plans, IRAs, among others, are limited to capital gains from sources other than corporate equity. Appendix A provides a greater discussion of alternative baselines.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported on in this chapter follow. These descriptions relate to current law as of December 31, 2006, and do not reflect proposals made elsewhere in the Budget. Legislation enacted in 2006, such as the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), the Pension Protection Act of 2006 (PPA), and the Tax Relief and Health Care Act of 2006 (TRHCA) extended and expanded the scope of many existing provisions.

TIPRA extended the 15 percent tax rate for dividends and capital gains through December 31, 2010, and the higher limit for certain investment that can be expensed through December 31, 2009.

Provisions extended or expanded by the PPA include:

- the low-income saver's credit (made permanent)
- Section 529 education savings provisions (made permanent)
- the maximum contribution and benefit limits under qualified pension plans (made permanent)
- the enhanced charitable deduction for food and book inventories
- the indexation of the IRA contribution limits (and higher limits made permanent)
- allowing for tax-free distributions from retirement plans for premiums for health and long-term care insurance for public safety officers
- tax-free distributions from IRAs to public charities

Provisions extended or expanded by the TRHCA include:

- the deduction for tuition and teaching related expenses
- the new markets tax credit
- the deduction for State and local sales taxes
- the research and experimentation tax credit
- the work opportunity and welfare to work tax credits
- qualified zone academy bonds

- expensing of remediation costs
- charitable contributions of computers and scientific property
- credit for clean renewable energy bonds
- credits for construction of new energy efficient homes and commercial buildings
- credits for alternative technologies
- select empowerment zone incentives

Chapter 17 on Federal Receipts has more detailed descriptions of the provisions of these three bills.

National Defense

1. ***Benefits and allowances to armed forces personnel.***—The housing and meals provided military personnel, either in cash or in kind, as well as certain amounts of pay related to combat service, are excluded from income subject to tax.

International Affairs

2. ***Income earned abroad.***—U.S. citizens who lived abroad, worked in the private sector, and satisfied a foreign residency requirement may exclude up to $80,000 in foreign earned income from U.S. taxes. In addition, if these taxpayers receive a specific allowance for foreign housing from their employers, then they may also exclude the value of that allowance. If they do not receive a specific allowance for housing expenses, they may deduct against their U.S. taxes that portion of such expenses that exceeds one-sixth the salary of a civil servant at grade GS–14, step 1 ($77,793 in 2006).

3. ***Exclusion of certain allowances for Federal employees abroad.***—U.S. Federal civilian employees and Peace Corps members who work outside the continental United States are allowed to exclude from U.S. taxable income certain special allowances they receive to compensate them for the relatively high costs associated with living overseas. The allowances supplement wage income and cover expenses like rent, education, and the cost of travel to and from the United States.

4. ***Extraterritorial income exclusion*** [5].—The exclusion for extraterritorial income was repealed by the American Jobs Creation Act of 2004. Under the transition rules, taxpayers retain 80 percent of ETI benefits for 2005, 60 percent of ETI benefits for 2006, and no ETI benefits thereafter. The exclusion for extraterritorial income remains in effect for certain transactions which occur pursuant to a binding contract entered into on or before September 17, 2003.

5. ***Sales source rule exceptions.***—The worldwide income of U.S. persons is taxable by the United States and a credit for foreign taxes paid is allowed. The amount of foreign taxes that can be credited is limited to the pre-credit U.S. tax on the foreign source income. The sales source rules for inventory property allow U.S. exporters to use more foreign tax credits by allowing the exporters to attribute a larger portion of their earnings abroad than would be the case if the allocation of earnings was based on actual economic activity.

6. ***Income of U.S.-controlled foreign corporations.***—The income of foreign corporations controlled by U.S. shareholders is not subject to U.S. taxation. The income becomes taxable only when the controlling U.S. shareholders receive dividends or other distributions from their foreign stockholding. Under the normal tax method, the currently attributable foreign source pre-tax income from such a controlling interest is considered to be subject to U.S. taxation, whether or not distributed. Thus, the normal tax method considers the amount of controlled foreign corporation income not yet distributed to a U.S. shareholder as tax-deferred income.

7. ***Exceptions under subpart F for active financing income.***—Financial firms can defer taxes on income earned overseas in an active business. Taxes on income earned through December 31, 2006 can be deferred.

General Science, Space, and Technology

8. ***Expensing R&E expenditures.***—Research and experimentation (R&E) projects can be viewed as investments because, if successful, their benefits accrue for several years. It is often difficult, however, to identify whether a specific R&E project is successful and, if successful, what its expected life will be. Under the normal tax method, the expensing of R&E expenditures is viewed as a tax expenditure. The baseline assumed for the normal tax method is that all R&E expenditures are successful and have an expected life of five years.

9. ***R&E credit.***—The research and experimentation (R&E) credit is 20 percent of qualified research expenditures in excess of a base amount. The base amount is generally determined by multiplying a "fixed-base percentage" by the average amount of the company's gross receipts for the prior four years. The taxpayer's fixed base percentage generally is the ratio of its research expenses to gross receipts for 1984 through 1988. Taxpayers may also elect an alternative incremental credit regime. Under the alternative incremental credit regime the taxpayer is assigned a three-tiered fixed-base percentage that is lower than the fixed-base percentage that would otherwise apply, and the credit rate is reduced (the rates range from 2.65 percent to 3.75 percent). Beginning in 2007, the rates for the alternative incremental credit increases to a range of 3 percent to 5 percent. An alternative simplified credit is also allowed which is equal to 12 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years. A 20-percent credit with a separate threshold is provided for a taxpayer's payments to universities for basic research. A 20-percent "flat" credit with no threshold base amount is available for energy research expenditures paid to certain research consortia. The credit applies to research conducted before January 1, 2008 and extends to research conducted in Puerto Rico and the U.S. possessions.

[5] The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of "income" that is larger in scope than is "income" as defined under general U.S. income tax principles. For that reason, the tax expenditure estimates include, for example, estimates related to the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation.

Energy

10. ***Exploration and development costs.***—For successful investments in domestic oil and gas wells, intangible drilling costs (e.g., wages, the costs of using machinery for grading and drilling, the cost of unsalvageable materials used in constructing wells) may be expensed rather than amortized over the productive life of the property. Integrated oil companies may deduct only 70 percent of such costs and must amortize the remaining 30 percent over five years. The same rule applies to the exploration and development costs of surface stripping and the construction of shafts and tunnels for other fuel minerals.

11. ***Percentage depletion.***—Independent fuel mineral producers and royalty owners are generally allowed to take percentage depletion deductions rather than cost depletion on limited quantities of output. Under cost depletion, outlays are deducted over the productive life of the property based on the fraction of the resource extracted. Under percentage depletion, taxpayers deduct a percentage of gross income from mineral production at rates of 22 percent for uranium; 15 percent for oil, gas and oil shale; and 10 percent for coal. The deduction is limited to 50 percent of net income from the property, except for oil and gas where the deduction can be 100 percent of net property income. Production from geothermal deposits is eligible for percentage depletion at 65 percent of net income, but with no limit on output and no limitation with respect to qualified producers. Unlike depreciation or cost depletion, percentage depletion deductions can exceed the cost of the investment.

12. ***Alternative fuel production credit.***—A credit of $3 per oil-equivalent barrel of production (in 1979 dollars) is provided for gas produced from biomass and liquid, gaseous, or solid synthetic fuels produced from coal. The credit is generally available if the price of oil stays below $29.50 (in 1979 dollars). The credit applies only to fuel (1) produced at a facility placed in service before July 1, 1998, and (2) sold before January 1, 2008. A credit is also available for the production of coke or coke gas from a qualified facility. Qualified facilities must have been placed in service before January 1, 1993, or after June 30, 1998, and before January 1, 2010.

13. ***Oil and gas exception to passive loss limitation.***—Owners of working interests in oil and gas properties are exempt from the "passive income" limitations. As a result, the working interest-holder, who manages on behalf of himself and all other owners the development of wells and incurs all the costs of their operation, may aggregate negative taxable income from such interests with his income from all other sources.

14. ***Capital gains treatment of royalties on coal.***—Sales of certain coal under royalty contracts can be treated as capital gains rather than ordinary income.

15. ***Energy facility bonds.***—Interest earned on State and local bonds used to finance construction of certain energy facilities is taxexempt. These bonds are generally subject to the State private-activity bond annual volume cap.

16. ***New technology, refined coal, Indian coal and coke and coke gas credits.***—A credit is provided equal to 10 percent of the basis of solar property (30 percent for purchases beginning in 2006 through 2008) and 10 percent of the basis of geothermal property placed in service during the taxable year. A credit is also available for certain electricity produced from wind energy, biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, or qualified hydropower and sold to an unrelated party. The credit rate in 2006 is 1.9 cents per kilowatt hour (0.9 cents per kilowatt hour for open-loop biomass, small irrigation power, municipal solid waste and qualified hydropower) and the rate is indexed in subsequent years. Another credit is available for refined coal. The credit rate in 2006 is $5.679 per ton and the rate is indexed in subsequent years. An additional credit is available for the production of Indian coal. The value of the credit is $1.50 per ton in 2006 and indexed for inflation in subsequent years.

17. ***Alcohol fuel credits.***—An income tax credit is provided for ethanol that is derived from renewable sources and used as fuel. The credit equals 51 cents per gallon through 2010. In lieu of the alcohol mixture credit, the taxpayer may claim a refundable excise tax credit. In addition, small ethanol producers are eligible for a separate 10 cents per gallon credit.

18. ***Credit and deduction for clean-fuel vehicles and property and alternative motor vehicle credits.***—A tax credit of 10 percent (not to exceed $4,000) is provided for purchasers of electric vehicles. The credit is reduced by 75 percent for vehicles placed in service in 2006 and is not available for vehicles placed in service after December 31, 2006. No deduction is available to taxpayers for vehicles placed in service after December 31, 2005. The deduction for clean-fuel property is available for costs incurred before January 1, 2007. A taxpayer may claim a 30 percent credit for the cost of installing clean-fuel vehicle refueling property for property placed in service after December 31, 2005 and before January 1, 2008. The taxpayer may not claim deductions with respect to property for which the credit is claimed. A tax credit is also available for the purchase of hybrid vehicles, fuel cell vehicles, alternative fuel vehicles and advanced lean burn vehicles. The provision applies to vehicles placed in service after December 31, 2005, in the case of qualified fuel cell motor vehicles, before January 1, 2015; in the case of qualified hybrid motor vehicles that are automobiles and light trucks and in the case of advanced lean-burn technology vehicles, before January 1, 2011; in the case of qualified hybrid motor vehicles that are medium and heavy trucks, before January 1, 2010; and in the case of qualified alternative fuel motor vehicles, before January 1, 2011.

19. ***Exclusion of utility conservation subsidies.***—Non-business customers can exclude from gross income

subsidies received from public utilities for expenditures on energy conservation measures.

20. ***Credit to holders of clean renewable energy bonds.***—This provision provides for up to $800 million in aggregate issuance of Clean Renewable Energy Bonds (CREBs) through December 31, 2008. Taxpayers holding CREBs on a credit allowance date are entitled to a tax credit in lieu of interest.

21. ***Deferral of gain from dispositions of transmission property to implement FERC restructuring policy.***—Utilities that sell their transmission assets to a FERC-approved independent transmission company are allowed a longer recognition period for their gains from sale. Rather than paying tax on any gain from the sale in the year that the sale is completed, utilities will have 8 years to pay the tax on any gain from the sale. The rule expires at the end of 2007.

22. ***Credit for investment in clean coal facilities.***—Three investment tax credits for clean coal facilities are available: a 15 percent and 20 percent investment tax credit for clean coal facilities producing electricity; and a 20 percent credit for industrial gasification projects. Integrated gasification combined cycle (IGCC) projects get a 20 percent investment tax credit and other advanced coal-based projects that produce electricity get a 15 percent credit. The Secretary of the Treasury may allocate up to $800 million for IGCC projects and up to $500 million for other advanced coal-based technologies and up to $350 million for industrial gasification.

23. ***Temporary 50 percent expensing for equipment used in the refining of liquid fuels.***—Taxpayers may expense 50 percent of the cost of refinery investments which increase the capacity of an existing refinery by at least 5 percent or increase the throughput of qualified fuels by at least 25 percent. Qualified fuels include oil from shale and tar sands. Investments must be placed in service before January 1, 2012.

24. ***Natural gas distribution pipelines treated as 15-year property.***—The depreciation period is shortened to 15 years for any gas distribution lines the original use of which occurred after April 11, 2004 and before January 1, 2011. The provision does not apply to any property which the taxpayer or a related party had entered into a binding contract for the construction thereof or self-constructed on or before April 11, 2005.

25. ***Amortize all geological and geophysical expenditures over 2 years.***—Geological and geophysical amounts incurred in connection with oil and gas exploration in the United States may be amortized over two years for non-integrated oil companies and five years for certain major integrated oil companies. In the case of abandoned property, any remaining basis may no longer be recovered in the year of abandonment of a property as all basis is recovered over the two-year amortization period.

26. ***Allowance of deduction for certain energy efficient commercial building property.***—A deduction for energy efficient commercial buildings that reduce annual energy and power consumption by 50 percent compared to the American Society of Heating, Refrigerating, and Air Conditioning Engineers (ASHRAE) standard is allowed. The provision is effective for property placed in service after December 31, 2005 and prior to January 1, 2008.

27. ***Credit for construction of new energy efficient homes.***—A credit is available to eligible contractors for construction of a qualified new energy-efficient home. The credit applies to homes whose construction is substantially completed after December 31, 2005 and which are purchased after December 31, 2005 and prior to January 1, 2009.

28. ***Credit for energy efficiency improvements to existing homes.***—A 10 percent investment tax credit up to $500 is available for expenditures on insulation, exterior windows and doors that improve the energy efficiency of homes and meet certain standards. Credits for purchases of advanced main air circulating fans, natural gas, propane, or oil furnaces or hot water boilers, and other qualified energy efficient property are also available. Credit applies to property placed in service after December 31, 2005 and prior to January 1, 2008.

29. ***Credit for energy efficient appliances.***—Tax credits for the manufacture of efficient dishwashers, clothes washers, and refrigerators are available. Credits vary depending on the efficiency of the unit. The provision is effective for appliances manufactured in 2006 and 2007.

30. ***Credit for residential purchases/installations of solar and fuel cells.***—A credit, equal to 30 percent of qualifying expenditures, for purchase for qualified photovoltaic property and solar water heating property is available. A 30 percent credit for the purchase of qualified fuel cell power plants is also allowed and applies to property placed in service after December 31, 2005 and prior to January 1, 2009.

31. ***Credit for business installation of qualified fuel cells and stationary microturbine power plants.***—A 30 percent business energy credit for purchase of qualified fuel cell power plants for businesses and a 10 percent credit for purchase of qualifying stationary microturbine power plants are allowed.

32. ***Partial expensing for advanced mine safety equipment.***—Qualified mine safety equipment may me expensed rather depreciated over time. Provision limited to property placed in service on or before December 31, 2008.

Natural Resources and Environment

33. ***Exploration and development costs.***—Certain capital outlays associated with exploration and development of nonfuel minerals may be expensed rather than depreciated over the life of the asset.

34. ***Percentage depletion.***—Most nonfuel mineral extractors may use percentage depletion rather than cost depletion, with percentage depletion rates ranging from 22 percent for sulfur to 5 percent for sand and gravel.

35. ***Sewage, water, solid and hazardous waste facility bonds.***—Interest earned on State and local bonds used to finance the construction of sewage, water, or hazardous waste facilities is tax-exempt. These bonds are generally subject to the State private-activity bond annual volume cap.

36. ***Capital gains treatment of certain timber.***—Certain timber sales can be treated as a capital gain rather than ordinary income.

37. ***Expensing multi-period timber growing costs.***—Most of the production costs of growing timber may be expensed rather than capitalized and deducted when the timber is sold. In most other industries, these costs are capitalized under the uniform capitalization rules.

38. ***Historic preservation.***—Expenditures to preserve and restore historic structures qualify for a 20-percent investment tax credit, but the depreciable basis must be reduced by the full amount of the credit taken.

39. ***Expensing of capital costs with respect to complying with EPA sulfur regulations.***—Small refiners are allowed to deduct 75 percent of qualified capital costs incurred by the taxpayer during the taxable year.

40. ***Exclusion of gain or loss on sale or exchange of certain brownfield sites.***—In general, an organization that is otherwise exempt from federal income tax is taxed on income from any trade or business regularly carried on by the organization that is not substantially related to the organization's exempt purpose. The AJCA of 2004 created a special exclusion from unrelated business taxable income of the gain or loss from the sale or exchange of certain qualifying brownfield properties. The exclusion applies regardless of whether the property is debt-financed. In order to qualify, a minimum amount of remediation expenditures must be incurred by the organization.

Agriculture

41. ***Expensing certain capital outlays.***—Farmers, except for certain agricultural corporations and partnerships, are allowed to expense certain expenditures for feed and fertilizer, as well as for soil and water conservation measures. Expensing is allowed, even though these expenditures are for inventories held beyond the end of the year, or for capital improvements that would otherwise be capitalized.

42. ***Expensing multi-period livestock and crop production costs.***—The production of livestock and crops with a production period of less than two years is exempt from the uniform cost capitalization rules. Farmers establishing orchards, constructing farm facilities for their own use, or producing any goods for sale with a production period of two years or more may elect not to capitalize costs. If they do, they must apply straight-line depreciation to all depreciable property they use in farming.

43. ***Loans forgiven solvent farmers.***—Farmers are forgiven the tax liability on certain forgiven debt. Normally, debtors must include the amount of loan forgiveness as income or reduce their recoverable basis in the property to which the loan relates. If the debtor elects to reduce basis and the amount of forgiveness exceeds the basis in the property, the excess forgiveness is taxable. For insolvent (bankrupt) debtors, however, the amount of loan forgiveness reduces carryover losses, then unused credits, and then basis; any remainder of the forgiven debt is excluded from tax. Farmers with forgiven debt are considered insolvent for tax purposes, and thus qualify for income tax forgiveness.

44. ***Capital gains treatment of certain income.***—Certain agricultural income, such as unharvested crops, can be treated as capital gains rather than ordinary income.

45. ***Income averaging for farmers.***—Taxpayers can lower their tax liability by averaging, over the prior three-year period, their taxable income from farming and fishing.

46. ***Deferral of gain on sales of farm refiners.***—A taxpayer who sells stock in a farm refiner to a farmers' cooperative can defer recognition of gain if the taxpayer reinvests the proceeds in qualified replacement property.

47. ***Bio-Diesel tax credit.***—An income tax credit of $0.50, similar to Ethanol benefits, is available for each gallon of biodiesel used or sold. Biodiesel derived from virgin sources (agri-biodiesel) receives an increased credit of $1.00 per gallon. The Energy Tax Incentives Act of 2005 extends the income tax credit, excise tax credit, and payment provisions through December 31, 2008 and adds a credit for small agri-biodiesel producers. The conference agreement also creates a similar income tax credit, excise tax credit and payment system for renewable diesel, however there is no credit for small producers of renewable diesel. Renewable diesel means diesel fuel derived form biomass using thermal depolymerization process.

Commerce and Housing

This category includes a number of tax expenditure provisions that also affect economic activity in other functional categories. For example, provisions related to investment, such as accelerated depreciation, could be classified under the energy, natural resources and environment, agriculture, or transportation categories.

48. ***Credit union income.***—The earnings of credit unions not distributed to members as interest or dividends are exempt from income tax.

49. ***Bad debt reserves.***—Small (less than $500 million in assets) commercial banks, mutual savings banks, and savings and loan associations may deduct additions to bad debt reserves in excess of actually experienced losses.

50. ***Deferral of income on life insurance and annuity contracts.***—Favorable tax treatment is provided for investment income within qualified life insurance and annuity contracts. Investment income earned on qualified life insurance contracts held until death is permanently exempt from income tax. Investment income distributed prior to the death of the insured is

tax-deferred, if not tax-exempt. Investment income earned on annuities is treated less favorably than income earned on life insurance contracts, but it benefits from tax deferral without annual contribution or income limits generally applicable to other tax-favored retirement income plans.

51. ***Small property and casualty insurance companies.***—For taxable years beginning before January 1, 2004, insurance companies that were not life insurance companies and which had annual net premiums of less than $350,000 were exempt from tax; those with $350,000 to $1.2 million of annual net premiums could elect to pay tax only on the income earned by their taxable investment portfolio. For taxable years beginning after December 31, 2003, stock non-life insurance companies are generally exempt from tax if their gross receipts for the taxable year do not exceed $600,00 and more than 50 percent of such gross receipts consists of premiums. Mutual non-life insurance companies are generally tax-exempt if their annual gross receipts do not exceed $150,000 and more than 35 percent of gross receipts consist of premiums. Also, for taxable years beginning after December 31, 2003, non-life insurance companies with no more than $1.2 million of annual net premiums may elect to pay tax only on their taxable investment income.

52. ***Insurance companies owned by exempt organizations.***—Generally, the income generated by life and property and casualty insurance companies is subject to tax, albeit by special rules. Insurance operations conducted by such exempt organizations as fraternal societies and voluntary employee benefit associations, however, are exempt from tax.

53. ***Small life insurance company deduction.***—Small life insurance companies (gross assets of less than $500 million) can deduct 60 percent of the first $3 million of otherwise taxable income. The deduction phases out for otherwise taxable income between $3 million and $15 million.

54. ***Exclusion of interest spread of financial institutions.***—Consumers and non-profit organizations pay for some deposit-linked services, such as check cashing, by accepting a below-market interest rate on their demand deposits. If they received a market rate of interest on those deposits and paid explicit fees for the associated services, they would pay taxes on the full market rate and (unlike businesses) could not deduct the fees. The government thus foregoes tax on the difference between the risk-free market interest rate and below-market interest rates on demand deposits, which under competitive conditions should equal the value added of deposit services.

55. ***Mortgage housing bonds.***—Interest earned on State and local bonds used to finance homes purchased by first-time, low-to-moderate-income buyers is tax-exempt. The amount of State and local tax-exempt bonds that can be issued to finance these and other private activity is limited. The combined volume cap for private activity bonds, including mortgage housing bonds, rental housing bonds, student loan bonds, and industrial development bonds was $62.50 per capita ($187.5 million minimum) per State in 2001, and $75 per capita ($225 million minimum) in 2002. The Community Renewal Tax Relief Act of 2000 accelerated the scheduled increase in the state volume cap and indexed the cap for inflation, beginning in 2003. States may issue mortgage credit certificates (MCCs) in lieu of mortgage revenue bonds. MCCs entitle home buyers to income tax credits for a specified percentage of interest on qualified mortgages. The total amount of MCCs issued by a State cannot exceed 25 percent of its annual ceiling for mortgage-revenue bonds.

56. ***Rental housing bonds.***—Interest earned on State and local government bonds used to finance multifamily rental housing projects is tax-exempt. At least 20 percent (15 percent in targeted areas) of the units must be reserved for families whose income does not exceed 50 percent of the area's median income; or 40 percent for families with incomes of no more than 60 percent of the area median income. Other tax-exempt bonds for multifamily rental projects are generally issued with the requirement that all tenants must be low or moderate income families. Rental housing bonds are subject to the volume cap discussed in the mortgage housing bond section above.

57. ***Interest on owner-occupied homes.***—Owner-occupants of homes may deduct mortgage interest on their primary and secondary residences as itemized nonbusiness deductions. The mortgage interest deduction is limited to interest on debt no greater than the owner's basis in the residence and, for debt incurred after October 13, 1987; it is limited to no more than $1 million. Interest on up to $100,000 of other debt secured by a lien on a principal or second residence is also deductible, irrespective of the purpose of borrowing, provided the debt does not exceed the fair market value of the residence. Mortgage interest deductions on personal residences are tax expenditures because the value of owner-occupied housing services is not included in a taxpayer's taxable income.

58. ***Taxes on owner-occupied homes.***—Owner-occupants of homes may deduct property taxes on their primary and secondary residences even though they are not required to report the value of owner-occupied housing services as gross income.

59. ***Installment sales.***—Dealers in real and personal property (i.e., sellers who regularly hold property for sale or resale) cannot defer taxable income from installment sales until the receipt of the loan repayment. Nondealers (i.e., sellers of real property used in their business) are required to pay interest on deferred taxes attributable to their total installment obligations in excess of $5 million. Only properties with sales prices exceeding $150,000 are includable in the total. The payment of a market rate of interest eliminates the benefit of the tax deferral. The tax exemption for nondealers with total installment obligations of less than $5 million is, therefore, a tax expenditure.

60. ***Capital gains exclusion on home sales.***—A homeowner can exclude from tax up to $500,000

($250,000 for singles) of the capital gains from the sale of a principal residence. The exclusion may not be used more than once every two years.

61. ***Imputed net rental income on owner-occupied housing.***—The implicit rental value of home ownership, net of expenses such as mortgage interest and depreciation, is excluded from income. Appendix A provides a fuller explanation of this new addition to the tax expenditure budget.

62. ***Passive loss real estate exemption.***—In general, passive losses may not offset income from other sources. Losses up to $25,000 attributable to certain rental real estate activity, however, are exempt from this rule.

63. ***Low-income housing credit.***—Taxpayers who invest in certain low-income housing are eligible for a tax credit. The credit rate is set so that the present value of the credit is equal to 70 percent for new construction and 30 percent for (1) housing receiving other Federal benefits (such as tax-exempt bond financing), or (2) substantially rehabilitated existing housing. The credit is allowed in equal amounts over 10 years. State agencies determine who receives the credit; States are limited in the amount of credit they may authorize annually. The Community Renewal Tax Relief Act of 2000 increased the per-resident limit to $1.50 in 2001 and to $1.75 in 2002 and indexed the limit for inflation, beginning in 2003. The Act also created a $2 million minimum annual cap for small States beginning in 2002; the cap is indexed for inflation, beginning in 2003.

64. ***Accelerated depreciation of rental property.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under the reference method. Under the normal tax method, however, economic depreciation is assumed. This calculation is described in more detail in Appendix A.

65. ***Cancellation of indebtedness.***—Individuals are not required to report the cancellation of certain indebtedness as current income. If the canceled debt is not reported as current income, however, the basis of the underlying property must be reduced by the amount canceled.

66. ***Imputed interest rules.***—Holders (issuers) of debt instruments are generally required to report interest earned (paid) in the period it accrues, not when paid. In addition, the amount of interest accrued is determined by the actual price paid, not by the stated principal and interest stipulated in the instrument. In general, any debt associated with the sale of property worth less than $250,000 is excepted from the general interest accounting rules. This general $250,000 exception is not a tax expenditure under reference law but is under normal law. Exceptions above $250,000 are a tax expenditure under reference law; these exceptions include the following: (1) sales of personal residences worth more than $250,000, and (2) sales of farms and small businesses worth between $250,000 and $1 million.

67. ***Capital gains (other than agriculture, timber, iron ore, and coal***).—Capital gains on assets held for more than 1 year are taxed at a lower rate than ordinary income. Under the revised reference law baseline used for the 2005 Budget, the lower rate on capital gains is considered a tax expenditure under the reference law method, but only for capital gains that have not been previously taxed under the corporate income tax. As discussed above, this treatment partially adjusts for the double tax on corporate income and is more consistent with a comprehensive income tax base.

The Jobs Growth Tax Relief Reconciliation Act (JGTRRA) lowered the top tax rate on capital gains from 20 percent to 15 percent, which is effective through 2010. For taxpayers in the 15 percent or below ordinary tax bracket, JGTRRA lowered the tax rate on capital gains to 5 percent (0 percent in 2008). These lower rates apply to assets held for more than one year.

Previously, for assets acquired after December 31, 2000, the top capital gains tax rate for assets held for more than 5 years was 18 percent. Since January 1, 2001, taxpayers may mark-to-market existing assets to start the 5-year holding period. Losses from the mark-to-market are not recognized. For assets held for more than 1 year by taxpayers in the 15-percent ordinary tax bracket, the top capital gains tax rate was 10 percent. After December 31, 2000, the top capital gains tax rate for assets held by these taxpayers for more than 5 years was 8 percent.

68. ***Capital gains exclusion for small business stock.***—An exclusion of 50 percent is provided for capital gains from qualified small business stock held by individuals for more than 5 years. A qualified small business is a corporation whose gross assets do not exceed $50 million as of the date of issuance of the stock.

69. ***Step-up in basis of capital gains at death.***—Capital gains on assets held at the owner's death are not subject to capital gains taxes. The cost basis of the appreciated assets is adjusted upward to the market value at the owner's date of death. After repeal of the estate tax for 2010 under the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001, the basis for property acquired from a decedent will be the lesser of fair market value or the decedent's basis. Certain types of additions to basis will be allowed so that assets in most estates that are not currently subject to estate tax will not be subject to capital gains tax in the hands of the heirs.

70. ***Carryover basis of capital gains on gifts.***—When a gift is made, the donor's basis in the transferred property (the cost that was incurred when the transferred property was first acquired) carries-over to the donee. The carryover of the donor's basis allows a continued deferral of unrealized capital gains.

71. ***Ordinary income treatment of losses from sale of small business corporate stock shares.***—Up to $100,000 in losses from the sale of small business corporate stock (capitalization less than $1 million) may

be treated as ordinary losses. Such losses would, thus, not be subject to the $3,000 annual capital loss write-off limit.

72. ***Accelerated depreciation of non-rental-housing buildings.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under reference law. Under normal law, however, economic depreciation is assumed. This calculation is described in more detail in Appendix A.

73. ***Accelerated depreciation of machinery and equipment.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under reference law. Under the normal tax baseline, this tax depreciation allowance is measured relative to economic depreciation. This calculation is described in more detail in Appendix A.

74. ***Expensing of certain small investments.***—As of 2003, under prior law, qualifying investments in tangible property up to $25,000 could have been expensed rather than depreciated over time. The amount eligible for expensing was decreased to the extent the taxpayer's qualifying investment during the year exceeded $200,000. For 2003, however, the expensing limit was temporarily increased to $100,000, the phase-out limit was temporarily increased to $400,000, and computer software became temporarily eligible for expensing treatment. For 2004 through 2009, these higher limits are indexed for inflation, and computer software continues to be an eligible investment. In all years, the amount expensed cannot exceed the taxpayer's taxable income for the year. The prior rules will apply for taxable years beginning after 2009.

75. ***Graduated corporation income tax rate schedule.***—The corporate income tax schedule is graduated, with rates of 15 percent on the first $50,000 of taxable income, 25 percent on the next $25,000, and 34 percent on the next $9.925 million. Compared with a flat 34-percent rate, the lower rates provide an $11,750 reduction in tax liability for corporations with taxable income of $75,000. This benefit is recaptured for corporations with taxable incomes exceeding $100,000 by a 5-percent additional tax on corporate incomes in excess of $100,000 but less than $335,000.

The corporate tax rate is 35 percent on income over $10 million. Compared with a flat 35-percent tax rate, the 34-percent rate provides a $100,000 reduction in tax liability for corporations with taxable incomes of $10 million. This benefit is recaptured for corporations with taxable incomes exceeding $15 million by a 3-percent additional tax on income over $15 million but less than $18.33 million. Because the corporate rate schedule is part of reference tax law, it is not considered a tax expenditure under the reference method. A flat corporation income tax rate is taken as the baseline under the normal tax method; therefore the lower rate is considered a tax expenditure under this concept.

76. ***Small issue industrial development bonds.***—Interest earned on small issue industrial development bonds (IDBs) issued by State and local governments to finance manufacturing facilities is tax exempt. Depreciable property financed with small issue IDBs must be depreciated, however, using the straight-line method. The annual volume of small issue IDBs is subject to the unified volume cap discussed in the mortgage housing bond section above.

77. ***Deduction for U.S. production activities.***—This provision was introduced by the AJCA in 2004 and allows for a deduction equal to a portion of taxable income attributable to domestic production. For taxable years beginning in 2004, 2005, 2006, 2007, and 2008, the amount of the deduction is 5, 5, 5, 6, and 7 percent, respectively. For taxable years beginning after 2008, the amount of the deduction is 9 percent.

78. ***Special rules for certain film and TV production.***—Taxpayers may deduct up to $15 million ($15 million in certain distressed areas) per production expenditures in the year incurred. Excess expenditures may be deducted over three years using the straight line method. This provision was introduced by the AJCA enacted in 2004. Under prior law, production expenses were depreciated.

Transportation

79. ***Deferral of tax on U.S. shipping companies.***—Certain companies that operate U.S. flag vessels can defer income taxes on that portion of their income used for shipping purposes, primarily construction, modernization and major repairs to ships, and repayment of loans to finance these investments. Once indefinite, the deferral has been limited to 25 years since January 1, 1987.

80. ***Exclusion of employee parking expenses.***—Employee parking expenses that are paid for by the employer or that are received in lieu of wages are excludable from the income of the employee. In 2006, the maximum amount of the parking exclusion is $250 (indexed) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

81. ***Exclusion of employee transit pass expenses.***—Transit passes, tokens, fare cards, and vanpool expenses paid for by an employer or provided in lieu of wages to defray an employee's commuting costs are excludable from the employee's income. In 2006, the maximum amount of the exclusion is $105 (indexed) per month.

82. ***Tax credit for certain expenditures for maintaining railroad tracks.***—Eligible taxpayers may claim a credit equal to the lesser of 50 percent of maintenance expenditures and the product of $3,500 and the number of miles of track owned or leased.

83. ***Exclusion of interest on bonds for Financing of Highway Projects and Rail-Truck Transfer Facilities.***—This provision provides for $15 billion of tax-exempt bond authority to finance qualified highway or surface freight transfer facilities. The authority to issue these bonds expires on December 31, 2015.

Community and Regional Development

84.***Rehabilitation of structures.***—A 10-percent investment tax credit is available for the rehabilitation of buildings that are used for business or productive activities and that were erected before 1936 for other than residential purposes. The taxpayer's recoverable basis must be reduced by the amount of the credit.

85. ***Airport, dock, and similar facility bonds.***—Interest earned on State and local bonds issued to finance high-speed rail facilities and government-owned airports, docks, wharves, and sport and convention facilities is tax-exempt. These bonds are not subject to a volume cap.

86. ***Exemption of income of mutuals and cooperatives.***—The incomes of mutual and cooperative telephone and electric companies are exempt from tax if at least 85 percent of their revenues are derived from patron service charges.

87. ***Empowerment zones and renewal communities.***—Qualifying businesses in designated economically depressed areas can receive tax benefits such as an employer wage credit, increased expensing of investment in equipment, special tax-exempt financing, accelerated depreciation, and certain capital gains incentives. Empowerment zone and renewal community designations expire at the end of 2009. The Job Creation and Worker Assistance Act of 2002 expanded the existing provisions by adding the "New York City Liberty Zone." In addition, the Working Families Tax Relief Act of 2004 extended the District of Columbia Enterprise Zone and the District of Columbia first time homebuyer credit by two years through 2007.

The Gulf Opportunity Zone Act of 2005 added several provisions targeted to encourage the redevelopment of areas affected by hurricanes Katrina, Rita and Wilma, including some provisions that have already been listed elsewhere in this table. Gulf Opportunity Zone Act provisions not listed elsewhere include additional tax-exempt bond financing authority, accelerated depreciation of investment in both structures and equipment, partial expensing for certain demolition and clean-up costs, increased carryback of certain net operating losses, increased authority to allocate low-income housing tax credits and new markets tax credits within the affected areas and other provisions.

88. ***New markets tax credit.***—Taxpayers who make qualified equity investments in a community development entity (CDE), which then makes qualified investments in low-income communities, are eligible for a tax credit received over 7 years. The amount of the credit equals (1) 5 percent in the year of purchase and the following 2 years, and (2) 6 percent in the following 4 years. A CDE is any domestic firm the primary mission of which is to serve or provide investment capital for low-income communities/individuals; a CDE must be accountable to residents of low-income communities. The total equity investment available for the credit across all CDEs is $1.0 billion in 2001, $1.5 billion in 2002 and 2003, $2.0 billion in 2004 and 2005, and $3.5 billion in 2006 and 2008. Credit authority is allocated to CDEs through a competitive application process.

89. ***Expensing of environmental remediation costs.***—Taxpayers who clean up certain hazardous substances at a qualified site may expense the clean-up costs, even though the expenses will generally increase the value of the property significantly or appreciably prolong the life of the property. The Working Families Tax Relief Act of 2004 extended this provision for two years, allowing remediation expenditures incurred before December 31, 2007 to be eligible for expensing.

90. ***Credit to holders of Gulf Tax Credit Bonds.***—Taxpayers that own Gulf Tax Credit bonds receive a non-refundable tax credit (at a rate set by the Treasury Department) rather than interest. The credit is included in gross income. The maximum amount that can be issued is $200 million in the case of Louisiana, $100 million in the case of Mississippi, and $50 million in the case of Alabama.

Education, Training, Employment, and Social Services

91.***Scholarship and fellowship income.***—Scholarships and fellowships are excluded from taxable income to the extent they pay for tuition and course-related expenses of the grantee. Similarly, tuition reductions for employees of educational institutions and their families are not included in taxable income. From an economic point of view, scholarships and fellowships are either gifts not conditioned on the performance of services, or they are rebates of educational costs. Thus, under the reference law method, this exclusion is not a tax expenditure because this method does not include either gifts or price reductions in a taxpayer's gross income. The exclusion, however, is considered a tax expenditure under the normal tax method, which includes gift-like transfers of Government funds in gross income (many scholarships are derived directly or indirectly from Government funding).

92. ***HOPE tax credit.***—The non-refundable HOPE tax credit allows a credit for 100 percent of an eligible student's first $1,100 of tuition and fees and 50 percent of the next $1,100 of tuition and fees. The credit only covers tuition and fees paid during the first two years of a student's post-secondary education. In 2006, the credit is phased out ratably for taxpayers with modified AGI between $90,000 and $110,000 ($45,000 and $55,000 for singles), indexed.

93. ***Lifetime Learning tax credit.***—The non-refundable Lifetime Learning tax credit allows a credit for 20 percent of an eligible student's tuition and fees, up to a maximum credit per return is $2,000. The credit is phased out ratably for taxpayers with modified AGI between $90,000 and $110,000 ($45,000 and $55,000 for singles) (indexed beginning in 2002). The credit applies to both undergraduate and graduate students.

94. ***Education Individual Retirement Accounts.***—Contributions to an education IRA are not tax-deductible. Investment income earned by education IRAs is not taxed when earned, and investment income from

an education IRA is tax-exempt when withdrawn to pay for a student's tuition and fees. The maximum contribution to an education IRA in 2006 is $2000 per beneficiary. The maximum contribution is phased down ratably for taxpayers with modified AGI between $190,000 and $220,000 ($95,000 and $110,000 for singles).

95. ***Student-loan interest.***—Taxpayers may claim an above-the-line deduction of up to $2,500 on interest paid on an education loan. Interest may only be deducted for the first five years in which interest payments are required. In 2006, the maximum deduction is phased down ratably for taxpayers with modified AGI between $105,000 and $135,000 ($50,000 and $65,000 for singles), indexed.

96. ***Deduction for Higher Education Expenses.***—The maximum annual deduction for qualified higher education expenses is $4,000 in 2007 for taxpayers with adjusted gross income up to $130,000 on a joint return ($65,000 for singles). Taxpayers with adjusted gross income up to $160,000 on a joint return ($80,000 for singles) may deduct up to $2,000 beginning in 2004. No deduction is allowed for expenses paid after December 31, 2007.

97. ***State prepaid tuition plans.***—Some States have adopted prepaid tuition plans and prepaid room and board plans, which allow persons to pay in advance for college expenses for designated beneficiaries. In 2001 taxes on the earnings from these plans are paid by the beneficiaries and are deferred until tuition is actually paid. Beginning in 2002, investment income is not taxed when earned, and is tax-exempt when withdrawn to pay for qualified expenses.

98. ***Student-loan bonds.***—Interest earned on State and local bonds issued to finance student loans is tax-exempt. The volume of all such private activity bonds that each State may issue annually is limited.

99. ***Bonds for private nonprofit educational institutions.***—Interest earned on State and local Government bonds issued to finance the construction of facilities used by private nonprofit educational institutions is not taxed.

100. ***Credit for holders of zone academy bonds.***—Financial institutions that own zone academy bonds receive a non-refundable tax credit (at a rate set by the Treasury Department) rather than interest. The credit is included in gross income. Proceeds from zone academy bonds may only be used to renovate, but not construct, qualifying schools and for certain other school purposes. The total amount of zone academy bonds that may be issued is limited to $1.6 billion—$400 million in each year from 1998 to 2007.

101. ***U.S. savings bonds for education.***—Interest earned on U.S. savings bonds issued after December 31, 1989 is tax-exempt if the bonds are transferred to an educational institution to pay for educational expenses. The tax exemption is phased out for taxpayers with AGI between $94,700 and $124,700 ($63,100 and $78,100 for singles) in 2006.

102. ***Dependent students age 19 or older.***—Taxpayers may claim personal exemptions for dependent children who are over the age of 18 or under the age of 24 and who (1) reside with the taxpayer for over half the year (with exceptions for temporary absences from home, such as for school attendance), (2) are full-time students, and (3) do not claim a personal exemption on their own tax returns.

103. ***Charitable contributions to educational institutions.***—Taxpayers may deduct contributions to nonprofit educational institutions. Taxpayers who donate capital assets to educational institutions can deduct the asset's current value without being taxed on any appreciation in value. An individual's total charitable contribution generally may not exceed 50 percent of adjusted gross income; a corporation's total charitable contributions generally may not exceed 10 percent of pre-tax income.

104. ***Employer-provided educational assistance.***—Employer-provided educational assistance is excluded from an employee's gross income even though the employer's costs for this assistance are a deductible business expense.

105. ***Special deduction for teacher expenses.***—Educators in both public and private elementary and secondary schools, who work at least 900 hours during a school year as a teacher, instructor, counselor, principal or aide, may subtract up to $250 of qualified expenses when figuring their adjusted gross income (AGI). Provision expires at end of December 31, 2007.

106. ***Discharge of student loan indebtedness.***—Certain professionals who perform in underserved areas, and as a consequence get their student loans discharged, may not recognize such discharge as income. This provision was expanded by the AJCA to include health professionals.

107. ***Work opportunity tax credit.***—Employers can claim a tax credit for qualified wages paid to individuals who begin work on or before December 31, 2007 and who are certified as members of various targeted groups. The amount of the credit that can be claimed is 25 percent for employment of less than 400 hours and 40 percent for employment of 400 hours or more. The maximum credit per employee is $2,400 and can only be claimed on the first year of wages an individual earns from an employer. Employees must work at least 120 hours to be eligible for the credit. Employers must reduce their deduction for wages paid by the amount of the credit claimed. The Katrina Emergency Tax Relief Act of 2005 expanded WOTC eligibility to Hurricane Katrina Employees, defined as persons whose principal places of abode on August 28, 2005 were in the core disaster area and who beginning on such date and through August 28, 2007, are hired for a position principally located in the core disaster area; and beginning on such date and through December 31, 2005, are hired for a position regardless of its location. The usual certification process rules are waived for Hurricane Katrina employees. The Tax Relief and Health Care Act of 2006 modified the Work opportunity tax credit

by changing definitions of the Food Stamp and Ex-Convict target groups and adding persons eligible for the Welfare-to-work credit as a new WOTC target group with a $10,000 ceiling on qualified first year wages and a 50 percent credit on qualified second year wages up to $10,000. Under the 2006 Act, qualified employees hired through December 31, 2007, are eligible for the modified WOTC credit..

108. ***Welfare-to-work tax credit.***—An employer is eligible for a tax credit on the first $20,000 of eligible wages paid to qualified long-term family assistance recipients during the first two years of employment. The credit is 35 percent of the first $10,000 of wages in the first year of employment and 50 percent of the first $10,000 of wages in the second year of employment. Employees must work at least 400 hours to be eligible for the credit. The maximum credit is $8,500 per employee. The credit applies to wages paid to employees who are hired on or before December 31, 2006. The Tax Relief and Health Care Act of 2006 modified the Welfare to Work credit by making qualified long-term family assistance recipients a WOTC target group after December 31, 2007.

109. ***Employer-provided child care exclusion.***—Up to $5,000 of employer-provided child care is excluded from an employee's gross income even though the employer's costs for the child care are a deductible business expense.

110. ***Employer-provided child care credit.***—The credit is equal to 25 percent of qualified expenses for employee child care and 10 percent of qualified expenses for child care resource and referral services. Employer deductions for such expenses are reduced by the amount of the credit. The maximum total credit is limited to $150,000 per taxable year.

111. ***Assistance for adopted foster children.***—Taxpayers who adopt eligible children from the public foster care system can receive monthly payments for the children's significant and varied needs and a reimbursement of up to $2,000 for nonrecurring adoption expenses. These payments are excluded from gross income.

112. ***Adoption credit and exclusion.***—Taxpayers can receive a nonrefundable tax credit for qualified adoption expenses. The maximum credit is $10,960 per child for 2006, and is phased-out ratably for taxpayers with modified AGI between $164,410 and $204,410. The credit amounts and the phase-out thresholds are indexed for inflation beginning in 2003. Unused credits may be carried forward and used during the five subsequent years. Taxpayers may also exclude qualified adoption expenses from income, subject to the same maximum amounts and phase-out as the credit. The same expenses cannot qualify for tax benefits under both programs; however, a taxpayer may use the benefits of the exclusion and the tax credit for different expenses. Stepchild adoptions are not eligible for either benefit.

113. ***Employer-provided meals and lodging.***—Employer-provided meals and lodging are excluded from an employee's gross income even though the employer's costs for these items are a deductible business expense.

114. ***Child credit.***—Taxpayers with children under age 17 can qualify for a $1,000 partially refundable per child credit. The maximum credit declines to $500 in 2011 and later years. The credit is phased out for taxpayers at the rate of $50 per $1,000 of modified AGI above $110,000 ($75,000 for singles).

115. ***Child and dependent care expenses.***—Married couples with child and dependent care expenses may claim a tax credit when one spouse works full time and the other works at least part time or goes to school. The credit may also be claimed by single parents and by divorced or separated parents who have custody of children. In 2006, expenditures up to a maximum $3,000 for one dependent and $6,000 for two or more dependents are eligible for the credit. The credit is equal to 35 percent of qualified expenditures for taxpayers with incomes of $15,000. The credit is reduced to a minimum of 20 percent by one percentage point for each $2,000 of income in excess of $15,000.

116. ***Disabled access expenditure credit.***—Small businesses (less than $1 million in gross receipts or fewer than 31 full-time employees) can claim a 50-percent credit for expenditures in excess of $250 to remove access barriers for disabled persons. The credit is limited to $5,000.

117. ***Charitable contributions, other than education and health.***—Taxpayers may deduct contributions to charitable, religious, and certain other nonprofit organizations. Taxpayers who donate capital assets to charitable organizations can deduct the assets' current value without being taxed on any appreciation in value. An individual's total charitable contribution generally may not exceed 50 percent of adjusted gross income; a corporation's total charitable contributions generally may not exceed 10 percent of pre-tax income.

118. ***Foster care payments.***—Foster parents provide a home and care for children who are wards of the State, under contract with the State. Compensation received for this service is excluded from the gross incomes of foster parents; the expenses they incur are nondeductible.

119. ***Parsonage allowances.***—The value of a minister's housing allowance and the rental value of parsonages are not included in a minister's taxable income.

120. ***Provide an employee retention credit to employers affected by hurricane Katrina, Rita, and Wilma.***—Businesses located within the Gulf Opportunity (GO) Zone on August 28, 2005 are eligible for a 40 percent tax credit on the first $6,000 in qualified wages paid to qualified employees employed within the GO Zone. Qualified wages are those paid by an eligible employer to an eligible employee on any day after August 28, 2005 and before January 1, 2006 during the period beginning on the date on which the trade or business first became inoperable at the principal place of employment of the employee by reason of hurricane Katrina and ending on the date on which such trade or business resumed significant operations at such prin-

cipal place of employment. Similar rules apply to the Rita GO Zone and the Wilma GO Zone with initial effective dates of September 23, 2005, and October 23, 2005, respectively.

Health

121. ***Employer-paid medical insurance and expenses.***—Employer-paid health insurance premiums and other medical expenses (including long-term care) are deducted as a business expense by employers, but they are not included in employee gross income. The self-employed also may deduct part of their family health insurance premiums.

122. ***Self-employed medical insurance premiums.***—Self-employed taxpayers may deduct a percentage of their family health insurance premiums. Taxpayers without self-employment income are not eligible for the special percentage deduction. The deductible percentage is 60 percent in 2001, 70 percent in 2002, and 100 percent in 2003 and thereafter.

123. ***Medical and health savings accounts.***—Individual contributions to Archer Medical Savings Accounts (Archer MSAs) and Health Savings Accounts (HSAs) are allowed as a deduction in determining adjusted gross income whether or not the individual itemizes deductions. Employer contributions to Archer MSAs and HSAs are excluded from income and employment taxes. Archer MSAs and HSAs require that the individual have coverage by a qualifying high deductible health plan. Earnings from the accounts are excluded from taxable income. Distributions from the accounts used for medical expenses are not taxable. The rules for HSAs are generally more flexible than for Archer MSAs and the deductible contribution amounts are greater (in 2007, $2850 for taxpayers with individual coverage and $5,650 for taxpayers with family coverage). Thus, HSAs have largely replaced MSAs.

124. ***Medical care expenses.***—Personal expenditures for medical care (including the costs of prescription drugs) exceeding 7.5 percent of the taxpayer's adjusted gross income are deductible.

125. ***Hospital construction bonds.***—Interest earned on State and local government debt issued to finance hospital construction is excluded from income subject to tax.

126. ***Charitable contributions to health institutions.***—Individuals and corporations may deduct contributions to nonprofit health institutions. Tax expenditures resulting from the deductibility of contributions to other charitable institutions are listed under the education, training, employment, and social services function.

127. ***Orphan drugs.***—Drug firms can claim a tax credit of 50 percent of the costs for clinical testing required by the Food and Drug Administration for drugs that treat rare physical conditions or rare diseases.

128. ***Blue Cross and Blue Shield.***—Blue Cross and Blue Shield health insurance providers in existence on August 16, 1986 and certain other nonprofit health insurers are provided exceptions from otherwise applicable insurance company income tax accounting rules that substantially reduce (or even eliminate) their tax liabilities.

129. ***Tax credit for health insurance purchased by certain displaced and retired individuals.***—The Trade Act of 2002 provided a refundable tax credit of 65 percent for the purchase of health insurance coverage by individuals eligible for Trade Adjustment Assistance and certain PBGC pension recipients.

130. ***Distributions for premiums for health and long-term care insurance.***—This provision provides for tax-free distributions of up to $3,000 from governmental retirement plans for premiums for health and long term care premiums of public safety officers.

Income Security

131. ***Railroad retirement benefits.***—Railroad retirement benefits are not generally subject to the income tax unless the recipient's gross income reaches a certain threshold. The threshold is discussed more fully under the Social Security function.

132. ***Workers' compensation benefits.***—Workers compensation provides payments to disabled workers. These benefits, although income to the recipients, are not subject to the income tax.

133. ***Public assistance benefits.***—Public assistance benefits are excluded from tax. The normal tax method considers cash transfers from the Government as taxable and, thus, treats the exclusion for public assistance benefits as a tax expenditure.

134. ***Special benefits for disabled coal miners.***—Disability payments to former coal miners out of the Black Lung Trust Fund, although income to the recipient, are not subject to the income tax.

135. ***Military disability pensions.***—Most of the military pension income received by current disabled retired veterans is excluded from their income subject to tax.

136. ***Employer-provided pension contributions and earnings.***—Certain employer contributions to pension plans are excluded from an employee's gross income even though the employer can deduct the contributions. In addition, the tax on the investment income earned by the pension plans is deferred until the money is withdrawn.

137. ***401(k) plans.***—Individual taxpayers can make tax-preferred contributions to certain types of employer-provided 401(k) plans (and 401(k)-type plans like 403(b) plans and the Federal government's Thrift Savings Plan). In 2006, an employee could exclude up to $15,000 (indexed) of wages from AGI under a qualified arrangement with an employer's 401(k) plan. The tax on the investment income earned by 401(k)-type plans is deferred until withdrawn.

Employees are allowed to make after-tax contributions to 401(k) and 401(k)-type plans. These contributions are not excluded from AGI, but the investment income of such after-tax contributions is not taxed when earned or withdrawn.

138. ***Individual Retirement Accounts.***—Individual taxpayers can take advantage of several different Individual Retirement Accounts (IRAs): deductible IRAs, non-deductible IRAs, and Roth IRAs. The annual contributions limit applies to the total of a taxpayer's deductible, non-deductible, and Roth IRAs contributions. The IRA contribution limit is $4,000 in 2006, and $5,000 in 2008 (indexed thereafter) and allows taxpayers over age 50 to make additional "catch-up" contributions of $1,000.

Taxpayers whose AGI is below $85,000 ($65,000 for non-joint filers) in 2006 can claim a deduction for IRA contributions. The IRA deduction is phased out for taxpayers with AGI between $75,000 and $85,000 ($50,000 and $60,000 for non-joint). The phase-out range increases annually until it reaches $80,000 to $100,000 in 2007. Taxpayers whose AGI is above the phase-out range can also claim a deduction for their IRA contributions depending on whether they (or their spouse) are an active participant in an employer-provided retirement plan. The tax on the investment income earned by 401(k) plans, non-deductible IRAs, and deductible IRAs is deferred until the money is withdrawn.

Taxpayers with incomes below $160,000 ($110,000 for nonjoint filers) can make contributions to Roth IRAs. The maximum contribution to a Roth IRA is phased out for taxpayers with AGI between $150,000 and $160,000 ($95,000 and $110,000 for singles). Investment income of a Roth IRA is not taxed when earned nor when withdrawn. Withdrawals from a Roth IRA are penalty free if: (1) the Roth IRA was opened at least 5 years before the withdrawal, and (2) the taxpayer either (a) is at least 591/2, (b) dies, (c) is disabled, or (d) purchases a first-time house.

Taxpayers can contribute to a non-deductible IRA regardless of their income and whether they are an active participant in an employer-provided retirement plan. The tax on investment income earned by non-deductible IRAs is deferred until the money is withdrawn.

139. ***Low and moderate-income savers' credit.***—The Tax Code provides an additional incentive for lower-income taxpayers to save through a nonrefundable credit of up to 50 percent on IRA and other retirement contributions of up to $2,000. This credit is in addition to any deduction or exclusion. The credit is completely phased out by $50,000 for joint filers and $25,000 for single filers.

140. ***Keogh plans.***—Self-employed individuals can make deductible contributions to their own retirement (Keogh) plans equal to 25 percent of their income, up to a maximum of $44,000 in 2006. Total plan contributions are limited to 25 percent of a firm's total wages. The tax on the investment income earned by Keogh plans is deferred until withdrawn.

141. ***Employer-provided life insurance benefits.***—Employer-provided life insurance benefits are excluded from an employee's gross income even though the employer's costs for the insurance are a deductible business expense, but only to the extent that the employer's share of the total costs does not exceed the cost of $50,000 of such insurance.

142. ***Employer-provided accident and disability benefits.***—Employer-provided accident and disability benefits are excluded from an employee's gross income even though the employer's costs for the benefits are a deductible business expense.

143. ***Employer-provided supplementary unemployment benefits.***—Employers may establish trusts to pay supplemental unemployment benefits to employees separated from employment. Interest payments to such trusts are exempt from taxation.

144. ***Employer Stock Ownership Plan (ESOP) provisions.***—ESOPs are a special type of tax-exempt employee benefit plan. Employer-paid contributions (the value of stock issued to the ESOP) are deductible by the employer as part of employee compensation costs. They are not included in the employees' gross income for tax purposes, however, until they are paid out as benefits. The following special income tax provisions for ESOPs are intended to increase ownership of corporations by their employees: (1) annual employer contributions are subject to less restrictive limitations; (2) ESOPs may borrow to purchase employer stock, guaranteed by their agreement with the employer that the debt will be serviced by his payment (deductible by him) of a portion of wages (excludable by the employees) to service the loan; (3) employees who sell appreciated company stock to the ESOP may defer any taxes due until they withdraw benefits; and (4) dividends paid to ESOP-held stock are deductible by the employer.

145. ***Additional deduction for the blind.***—Taxpayers who are blind may take an additional $1,250 standard deduction if single, or $1,000 if married in 2006.

146. ***Additional deduction for the elderly.***—Taxpayers who are 65 years or older may take an additional $1,250 standard deduction if single, or $1,000 if married in 2006.

147. ***Tax credit for the elderly and disabled.***—Individuals who are 65 years of age or older, or who are permanently disabled, can take a tax credit equal to 15 percent of the sum of their earned and retirement income. Income is limited to no more than $5,000 for single individuals or married couples filing a joint return where only one spouse is 65 years of age or older, and up to $7,500 for joint returns where both spouses are 65 years of age or older. These limits are reduced by one-half of the taxpayer's adjusted gross income over $7,500 for single individuals and $10,000 for married couples filing a joint return.

148. ***Casualty losses.***—Neither the purchase of property nor insurance premiums to protect its value are deductible as costs of earning income; therefore, reimbursement for insured loss of such property is not reportable as a part of gross income. Taxpayers, however, may deduct uninsured casualty and theft losses of more than $100 each, but only to the extent that total losses during the year exceed 10 percent of AGI.

149. ***Earned income tax credit (EITC***).—The EITC may be claimed by low-income workers. For a family with one qualifying child, the credit is 34 percent of the first $8,080 of earned income in 2006. The credit is 40 percent of the first $11,340 of income for a family with two or more qualifying children. The credit is phased out beginning when the taxpayer's income exceeds $14,810 at the rate of 15.98 percent (21.06 percent if two or more qualifying children are present). It is completely phased out when the taxpayer's modified adjusted gross income reaches $32,001 ($36,348 if two or more qualifying children are present), $34,001 (or $38,348) for those married.

The credit may also be claimed by workers who do not have children living with them. Qualifying workers must be at least age 25 and may not be claimed as a dependent on another taxpayer's return. The credit is not available to workers age 65 or older. In 2006, the credit is 7.65 percent of the first $5,380 of earned income. When the taxpayer's income exceeds $6,740 (8,740 if married), the credit is phased out at the rate of 7.65 percent. It is completely phased out at $12,120 ($14,120 for married) of modified adjusted gross income.

For workers with or without children, the income levels at which the credit begins to phase-out and the maximum amounts of income on which the credit can be taken are adjusted for inflation. For married taxpayers filing a joint return, the base amount for the phase-out increases by $2,000 in 2006 through 2007, and $3,000 in 2008 (indexed thereafter).

Earned income tax credits in excess of tax liabilities owed through the individual income tax system are refundable to individuals. This portion of the credit is shown as an outlay, while the amount that offsets tax liabilities is shown as a tax expenditure.

150. ***Additional exemption for housing Hurricane Katrina displaced individuals.***—This provision, introduced by the Katrina Emergency Tax Relief Act of 2005, provides an additional exemption of $500 for each Hurricane Katrina displaced individual for whom the taxpayer is providing shelter in his or her home, for a maximum additional exemption amount is $2,000.

Social Security

151. ***Social Security benefits for retired workers.***—The non-taxation of Social Security benefits that exceed the beneficiary's contributions out of taxed income is a tax expenditure. These additional retirement benefits are paid for partly by employers' contributions that were not included in employees' taxable compensation. Portions (reaching as much as 85 percent) of recipients' Social Security and Tier 1 Railroad Retirement benefits are included in the income tax base, however, if the recipient's provisional income exceeds certain base amounts. Provisional income is equal to adjusted gross income plus foreign or U.S. possession income and tax-exempt interest, and one half of Social Security and tier 1 railroad retirement benefits. The tax expenditure is limited to the portion of the benefits received by taxpayers who are below the base amounts at which 85 percent of the benefits are taxable.

152. ***Social Security benefits for the disabled.***—Benefit payments from the Social Security Trust Fund for disability are partially excluded from a beneficiary's gross incomes.

153. ***Social Security benefits for dependents and survivors.***—Benefit payments from the Social Security Trust Fund for dependents and survivors are partially excluded from a beneficiary's gross income.

Veterans Benefits and Services

154. ***Veterans death benefits and disability compensation.***—All compensation due to death or disability paid by the Veterans Administration is excluded from taxable income.

155. ***Veterans pension payments.***—Pension payments made by the Veterans Administration are excluded from gross income.

156. ***G.I. Bill benefits.***—G.I. Bill benefits paid by the Veterans Administration are excluded from gross income.

157. ***Tax-exempt mortgage bonds for veteran.***—Interest earned on general obligation bonds issued by State and local governments to finance housing for veterans is excluded from taxable income. The issuance of such bonds is limited, however, to five pre-existing State programs and to amounts based upon previous volume levels for the period January 1, 1979 to June 22, 1984. Furthermore, future issues are limited to veterans who served on active duty before 1977.

General Government

158. ***Public purpose State and local bonds.***—Interest earned on State and local government bonds issued to finance public-purpose construction (e.g., schools, roads, sewers), equipment acquisition, and other public purposes is tax-exempt. Interest on bonds issued by Indian tribal governments for essential governmental purposes is also tax-exempt.

159. ***Deductibility of certain nonbusiness State and local taxes.***—Taxpayers may deduct State and local income taxes and property taxes even though these taxes primarily pay for services that, if purchased directly by taxpayers, would not be deductible.

160. ***Business income earned in U.S. possessions.***—U.S. corporations operating in a U.S. possession (e.g., Puerto Rico) can claim a credit against some or all of their U.S. tax liability on possession business income. The credit expires December 31, 2005.

Interest

161. ***U.S. savings bonds.***—Taxpayers may defer paying tax on interest earned on U.S. savings bonds until the bonds are redeemed.

Appendix A

TREASURY REVIEW OF THE TAX EXPENDITURE PRESENTATION

This appendix provides a presentation of the Treasury Department's continuing review of the tax expenditure budget. The review focuses on three issues: (1) using comprehensive income as a baseline tax system; (2) using a consumption tax as a baseline tax system; and (3) defining negative tax expenditures (provisions that cause taxpayers to pay too much tax).

The first section of this appendix compares major tax expenditures in the current budget to those implied by a comprehensive income baseline. This comparison includes a discussion of negative tax expenditures. The second section compares the major tax expenditures in the current budget to those implied by a consumption tax baseline, and also discusses negative tax expenditures. The final section addresses concerns that have been raised over the measurement of some current tax expenditures by describing new estimates of the tax expenditure caused by accelerated depreciation and by the tax exemption of the return earned on owner-occupied housing, and an alternative estimate of the tax expenditure for the preferential treatment of capital gains. The final section also provides an estimate of the negative tax expenditure caused by the double tax on corporate profits.

DIFFERENCES BETWEEN OFFICIAL TAX EXPENDITURES AND THOSE BASED ON COMPREHENSIVE INCOME

As discussed in the main body of the chapter, tax expenditures are measured relative to normal law or reference law baselines that deviate from a comprehensive concept of income. Consequently, tax expenditures identified in the Budget can differ from those that would be identified under a comprehensive income tax baseline. This appendix compares major tax expenditures listed in the tax expenditure budget with those implied by a comprehensive income baseline.

Current budgetary practice excludes from the list of tax expenditures those provisions that over-tax certain items of income because the original motivation for the analysis was to identify tax provisions that substitute for direct Government spending programs. However, this treatment gives a one-sided picture of how current law deviates from the baseline tax system. Relative to comprehensive income, a number of current tax provisions would be negative tax expenditures. Some of these also might be negative tax expenditures under the reference law or normal law baselines, expanded to admit negative tax expenditures.

Major Tax Expenditures from the Traditional Budget under a Comprehensive Income Tax Baseline

Comprehensive income, also called Haig-Simons income, is the real, inflation-adjusted accretion to one's economic power arising between two points in time, e.g., the beginning and ending of the year. It includes all accretions to wealth, whether or not realized, whether or not related to a market transaction, and whether a return to capital or labor. Inflation-adjusted capital gains (and losses) would be included in comprehensive income as they accrue. Business investment and casualty losses, including losses caused by depreciation, would be deducted. Implicit returns, such as those accruing to homeowners, also would be included in comprehensive income. A comprehensive income tax baseline would tax all sources of income once and only once. Thus, it would not levy a separate tax on corporate income leading to the double taxation of corporate profits.

Comprehensive income is widely held to be the idealized base for an income tax even though it is not a perfectly defined concept.[6] It suffers from conceptual ambiguities, some of which are discussed below, as well as practical problems in measurement and tax administration, e.g., how to implement a practicable deduction for economic depreciation or include in income the return earned on consumer durable goods such as housing, automobiles, and major appliances.

Furthermore, comprehensive income does not necessarily represent an ideal tax base; economic efficiency would be improved by deviating from comprehensive income as a tax base by reducing the tax on capital income to spur economic growth further or by subsidizing certain types of activities to correct for market failures. In addition, some elements of comprehensive income would be difficult or impossible to include in a tax system that is administrable.

Classifying individual tax provisions relative to a comprehensive income baseline is difficult in part because of the ambiguity of the baseline. It also is difficult because of interactions between tax provisions (or their absence). These interactions mean that it may not always be appropriate to consider each provision in isolation. Nonetheless, Appendix Table 1 attempts such a classification for each of the thirty largest tax expenditures from the Budget.

Table 1 classifies fifteen of the thirty items as tax expenditures under a comprehensive tax base (those in panel A). Most of these give preferential tax treatment to the return on certain types of savings or investment. They reflect the hybrid nature of the existing tax system and arise out of policy decisions to reduce the high tax rate on capital income that would otherwise arise. Even these relatively clear-cut items, how-

[6] See, e.g., David F. Bradford, Untangling the Income Tax (Cambridge, MA: Harvard University Press, 1986), pp. 15–31, and Richard Goode, "The Economic Definition of Income" in Joseph Pechman, ed., Comprehensive Income Taxation (Washington, D.C.: The Brookings Institution, 1977), pp. 1–29.

ever, can raise ambiguities in light of the absence of integration of the corporate and individual tax systems. For example, the reduction or elimination of individual level tax on income from investment in corporate equities might not be a tax expenditure relative to a comprehensive income baseline because the income is taxed first at the corporate level. A similar line of reasoning suggests that in the case of corporations, expensing[7] of R&E or accelerated depreciation are not tax expenditures because they offset the corporate tax penalty.

Because net rental income (gross rents minus depreciation, interest, taxes, and other expenses) would be in the homeowner's tax base under a comprehensive income tax baseline, this item would continue to be a tax expenditure relative to a comprehensive income baseline.

The exclusion of worker's compensation benefits also would be a tax expenditure under comprehensive income tax principles; if the worker were to buy the insurance himself, he would be able to deduct the premium (since it represents a reduction in net worth) but should include in income the benefits when paid (since it represents an increase in net worth).[8] If the employer pays the premium, the proper treatment would allow the employer a deduction and allow the employee to disregard the premium, but he would take any proceeds into income. Current law allows the employer to deduct the premium and excludes both the premium and the benefits from the employee's tax base.

Panel B displays items that probably are tax expenditures, but that raise additional issues. Current law, for instance, allows deductions for home mortgage interest and for property taxes on owner-occupied housing. The tax expenditure budget includes both of these provisions. A comprehensive tax base would allow both deductions, but it would also include imputed gross rental income. Current law does not include gross rental income, however, and so on this basis the home mortgage interest deduction and the deduction for property taxes on owner-occupied housing are properly tax expenditures under a comprehensive income tax base.[9] Indeed, the sum of the tax expenditure for these two deductions, plus the tax expenditure for the failure to include net rental income, sums to the tax expenditure for owner-occupied housing relative to a comprehensive income tax base.

The deduction of nonbusiness State and local taxes other than on owner-occupied homes also is included in Panel B. The justification for this tax expenditure is that "Taxpayers may deduct State and local income taxes and property taxes even though these taxes primarily pay for services that, if purchased directly by taxpayers, would not be deductible.[10] The difficulty is that this presumes that one's consumption of State and local services relates directly to the amount of State and local taxes paid. Such a presumption is difficult to sustain when taxes are levied inconsistently across taxpayers.[11]

In contrast to the view in the official Budget, however, the deduction for State and local taxes might not be a tax expenditure if the baseline were comprehensive income. Properly measured comprehensive income would include the value of State and local government benefits received, but would allow a deduction for State and local taxes paid.[12] Thus, in this sense the deductibility of State and local taxes is consistent with comprehensive income tax principles; it should not be a tax expenditure. Nonetheless, imputing the value of State and local services is difficult and is not done under current law. Consequently, a deduction for taxes might sensibly be viewed as a (roughly measured) tax expenditure relative to a comprehensive income baseline.[13]

The comprehensive income tax base is an objective measure of income. Traditionally, this measure is modified to reflect a subjective or social economic policy concern regarding the financial ability of an individual to pay tax. Absent this modification, provisions such as the personal exemption and the child tax credit would be treated as tax expenditures. However, once the definition of income is modified to reflect the ability of an individual to pay tax, then these and similar provisions are typically dropped from the list of tax expenditures.

The step-up of basis at death lowers the tax on capital gains for those who inherit assets. From that perspective it would be a tax expenditure under a comprehensive income baseline. Nonetheless, there are ambiguities. Under a comprehensive income baseline, all inflation-adjusted gains would be taxed as accrued, so there would be no deferred unrealized gains on assets held at death.

The partial exclusion of Social Security benefits from tax is also listed in panel B. To the extent Social Security is viewed as a pension, comprehensive income would include all contributions to Social Security retirement funds (payroll taxes) and tax accretions to value as they arise.[14] Benefits paid out of contributions and the inside build-up in value, however, would not be

[7] Expensing means immediate deduction. Proper income tax treatment requires capitalization followed by annual depreciation allowances reflecting the decay in value of the associated R&E spending.

[8] Suppose a taxpayer buys a one year term unemployment insurance policy at the beginning of the year. At that time he exchanges one asset, cash, for another, the insurance policy, so there is no change in net worth. But, at the end of the year, the policy expires and so is worthless, hence the taxpayer has a reduction in net worth equal to the premium. If the policy pays off during the year (i.e., the taxpayer has a work related injury), then the taxpayer would include the proceeds in income because they represent an increase in his net worth.

[9] If there were no deduction for interest and property taxes, the tax expenditure base (i.e., the proper tax base minus the actual tax base) for owner-occupied housing would equal the homeowner's net rental income: gross rents minus(depreciation+interest+property taxes+other expenses). With the deduction for interest and property taxes, the tax expenditure base rises to gross rents minus (depreciation+other expenses).

[10] Fiscal Year 2003 Budget of the United States Government, Analytical Perspectives (Washington, D.C.: U.S. Government Printing Office, 2002) p. 127.

[11] Property taxes on owner-occupied housing also might serve as a proxy for the value of untaxed local services provided to homeowners. As such, they would be listed in the tax expenditure budget (as configured, i.e., building on the estimate for the failure to tax net rents) twice, once because current law does not tax rental income and again as a proxy for government services received. Property taxes on other consumer durables such as automobiles also might be included twice, owing to current law's exclusion from income of the associated service flow.

[12] U.S. Treasury, Blueprints for Basic Tax Reform (Washington, D.C.: U.S. Government Printing Office, 1977) p. 92.

[13] Under the normal tax method employed by the Joint Committee on Taxation, the value of some public assistance benefits provided by State Governments is included as a tax expenditure, thereby raising a potential double counting issue.

[14] As a practical matter, this may be impossible to do. Valuing claims subject to future contingencies is very difficult, as discussed in Bradford, Untangling the Income Tax, pp. 23–24.

included because the fall in the value of the individual's Social Security account would be offset by an increase in cash. In contrast, to the extent that Social Security is viewed as a transfer program, all contributions should be deductible from income and all benefits received should be included.

In contrast to any of these treatments, current law excludes one-half of Social Security contributions (employer-paid payroll taxes) from the base of the income tax, makes no attempt to tax accretions, and subjects some, but not all, benefits to taxation. The difference between current law's treatment of Social Security benefits and their treatment under a comprehensive income tax would qualify as a tax expenditure, but such a tax expenditure differs in concept from that included in the official Budget.

The tax expenditures in the official Budget[15] reflect exemptions for lower-income beneficiaries from the tax on 85 percent of Social Security benefits.[16] Historically, payroll taxes paid by the employee represented no more than 15 percent of the expected value of the retirement benefits received by a lower-earning Social Security beneficiary. The 85 percent inclusion rate is intended to tax upon distribution the remaining amount of the retirement benefit payment—the portion arising from the payroll tax contributions made by employers and the implicit return on the employee and employer contributions. Thus, the tax expenditure conceived and measured in the current budget is not intended to capture the deviation from a comprehensive income baseline, which would additionally account for the deferral of tax on the employer's contributions and on the rate of return (less an inflation adjustment attributable to the employee's payroll tax contributions). Rather, it is intended to approximate the taxation of private pensions with employee contributions made from after-tax income[17] . Hence, the tax expenditure budget understates the tax advantage accorded Social Security retirement benefits relative to a comprehensive income baseline.

The deduction for U.S. production activities also raises problems. To the extent it is viewed as a tax break for certain qualifying businesses ("manufacturers"), it would be a tax expenditure. In contrast, the deduction may prove to be so broad that it is available to most U.S. businesses, in which case it might not be seen as a tax expenditure. Rather, it would then represent a feature of the baseline tax rate system because the deduction is equivalent to a lower tax rate. In addition, it might not be a tax expenditure to the extent it is viewed as providing relief from the double tax on corporate profits.

The next category (panel C) includes items whose treatment is less certain. The proper treatment of some of these items under a comprehensive income tax is ambiguous, while others may serve as proxies for provisions that would be a tax expenditure under a comprehensive income base.[18]

For example, under existing law charitable contributions are deductible, and this deduction is considered on its face a tax expenditure in the current budget.[19] The treatment of charitable donations, however, is ambiguous under a comprehensive income tax. If charitable contributions are a consumption item for the giver, then they are properly included in his taxable income and a deduction for contributions would be a tax expenditure under a comprehensive income tax base. In contrast, charitable contributions could represent a transfer of purchasing power from the giver to the receiver. As such, they would represent a reduction in the giver's net worth, not an item of consumption, and so properly would be deductible, implying that the charitable deduction is not a tax expenditure. At the same time, however, the value of the charitable benefits received is income to the recipient. Under current law, such income is not taxed.[20]

Medical expenditures may or may not be an element of income. These expenditures may be viewed as a reduction of net worth (e.g. cost of earning income) rather than as discretionary spending, and so are not really consumption and should be excluded from the tax base. However, expenditures for medical care may be considered as indistinguishable from other consumption items which are not excluded from a comprehensive income base.

The exemption of full taxation of Social Security benefits paid to the disabled also raises issues. Social Security benefits for the disabled most closely resemble either Government transfers or insurance. From either perspective, a comprehensive income tax would require that the benefit be included in income and would allow a deduction for associated Social Security taxes. If viewed as insurance, an equivalent treatment would allow the taxpayer to include the premium (i.e., tax) and exclude the benefit. The deviation between either of these treatments and current law's treatment (described above) would be a tax expenditure under a comprehensive income baseline.

In contrast, as described above, the tax expenditure budget displays the benefit of exempting low-income beneficiaries from the tax on 85 percent of Social Security benefits. This measurement does not correspond closely to that required under a comprehensive income base. If the payment of the benefit is viewed as a transfer and divorced from the treatment of Social Security taxes, then the current tax expenditure understates the tax expenditure measured relative to a comprehensive

[15] This includes the tax expenditure for benefits paid to workers, that for benefits paid to survivors and dependents, and that for benefits paid to dependents.

[16] The current Budget does not include as a tax expenditure the absence of income taxation on the employer's contributions (payroll taxes) to Social Security retirement at the time these contributions are made.

[17] Private pensions allow the employee to defer tax on all inside build-up. They also allow the employee to defer tax on contributions made by the employer, but not on contributions made directly by the employee. Applying these tax rules to Social Security would require the employee to include in his taxable income benefits paid out of inside build-up and out of the employer's contributions, but would allow the employee to exclude from his taxable income benefits paid out of his own contributions.

[18] See, for example, Goode, The Economic Definition of Income, pp. 16–17, and Bradford, Untangling the Income Tax, pp. 19–21, and pp.30–31.

[19] The item also includes gifts of appreciated property, at least part of which represents a tax expenditure relative to an ideal income tax, even if one assumes that charitable donations are not consumption.

[20] If recipients tend to be in lower tax brackets, then the tax expenditure is smaller than when measured at the donor's tax rates..

income baseline. If the payment of the benefit is viewed as a transfer but the inability to deduct the employee's share of the Social Security tax is simultaneously considered, then it is less likely that the current tax expenditure overstates the tax expenditure relative to a comprehensive income baseline, and in some cases it may generate a negative tax expenditure. If the benefit is viewed as insurance and the tax as a premium, then the current tax expenditure overstates the tax expenditure relative to a comprehensive income baseline. Indeed, in the insurance model, the ability to exclude from tax only half of the premium might suggest that half of the payout should be taxed, so that the current tax rules impose a greater tax burden than that implied by a comprehensive income tax, i.e., a negative tax expenditure.

The final category (panel D) includes items that would not be tax expenditures under a comprehensive income tax base. A tax based on comprehensive income would allow all losses to be deducted. Hence, the exception from the passive loss rules would not be a tax expenditure.[21]

Major Tax Expenditures under a Comprehensive Income Tax That Are Excluded from the Current Budget

While most of the major tax expenditures in the current budget also would be tax expenditures under a comprehensive income base, there also are tax expenditures relative to a comprehensive income base that are not found on the existing tax expenditure list. These additional tax expenditures include the imputed return from certain consumer durables (e.g., automobiles), the difference between capital gains (and losses) as they accrue and capital gains as they are realized, private gifts and inheritances received, in-kind benefits from such Government programs as food-stamps, Medicaid, and public housing, the value of payouts from insurance policies,[22] and benefits received from private charities. Under some theories of comprehensive income, the value of leisure and of household production of goods and services also would be included as tax expenditures. The personal exemption and standard deduction also might be considered tax expenditures, although they can be viewed differently, e.g., as elements of the basic tax rate schedule. The foreign tax credit also might be a tax expenditure since a deduction for foreign taxes, rather than a credit, might measure the income of U.S. residents properly.

Negative Tax Expenditures

The passive loss rules, restrictions on the deductibility of capital losses, and net operating loss (NOL) carry-forward requirements each would generate a negative tax expenditure, since a comprehensive income tax would allow full deductibility of losses.

Human capital is generally considered a productive asset, and so its cost (e.g., certain education and training expenses, including perhaps the cost of college and professional school) should be amortizable under a comprehensive income tax, but it is not under current law.[23]

Some restricted deductions under the individual AMT might be negative tax expenditures as might the phase-out of personal exemptions and of itemized deductions. The inability to deduct consumer interest also might be a negative tax expenditure, as an interest deduction may be required to measure income properly, as seen by the equivalence between borrowing and reduced lending.[24] As discussed above, the current treatment of Social Security payments to the disabled also might represent a negative tax expenditure if viewed as payments on an insurance policy.

Current tax law also fails to index for inflation interest receipts, capital gains, depreciation, and inventories. This failure leads to negative tax expenditures because comprehensive income would be indexed for inflation. Current law, however, also fails to index for inflation the deduction for interest payments and so this represents a (positive) tax expenditure.

The issue of indexing also highlights that even if one wished to focus only on tax policies that are similar to spending programs, accounting for some negative tax expenditures may be required. For example, the net subsidy created by accelerated depreciation is properly measured by the difference between depreciation allowances specified under existing tax law and economic depreciation, which is indexed for inflation.[25]

DIFFERENCES BETWEEN OFFICIAL TAX EXPENDITURES AND TAX EXPENDITURES RELATIVE TO A CONSUMPTION TAX BASE

This section compares tax expenditures listed in the tax expenditure budget with those implied by a comprehensive consumption tax baseline. It first discusses some of the difficulties encountered in contemplating current tax provisions as part of a comprehensive consumption tax. Next, it assesses which of the thirty largest income tax expenditures would be tax expenditures under the consumption tax baseline, concluding that about half would remain under a consumption tax baseline. Most that fall off the list are incentives for saving and investment.

The section next discusses some major differences between current law and a comprehensive consumption tax baseline. These differences include the consumption

[21] In contrast, the passive loss rules themselves, which restrict the deduction of losses, would be a negative tax expenditure when compared to a comprehensive tax base.

[22] To the extent that premiums are deductible.

[23] Current law offers favorable treatment to some education costs, thereby creating (positive) tax expenditures. Current law allows expensing of that part of the cost of education and career training that is related to foregone earnings and this would be a tax expenditure under a comprehensive income baseline.

[24] See Bradford, Untangling the Income Tax, p. 41.

[25] Accelerated depreciation can be described as the equivalent of an interest free loan from the Government to the taxpayer. Under federal budget accounting principles, such a loan would be treated as an outlay equal to the present value of the foregone interest.

value of owner-occupied housing and other consumer durables, benefits from in-kind Government transfers, and gifts. It concludes with a discussion of negative tax expenditures relative to a consumption tax baseline.

Ambiguities in Determining Tax Expenditures Relative to a Consumption Baseline

A broad-based consumption tax can be viewed as a combination of an income tax plus a deduction for net saving. This follows from the definition of comprehensive income as consumption plus the change in net worth. It therefore seems straightforward to say that current law's deviations from a consumption base are the sum of (a) tax expenditures on an income base associated with exemptions and deductions for certain types of income, plus (b) overpayments of tax, or negative tax expenditures, to the extent net saving is not deductible from the tax base. In reality, however, the situation is more complicated. Some issues arise which are also problems in defining a comprehensive income tax, but seem more severe, or at least only more obvious, for the consumption tax baseline.

It is not always clear how to treat certain items under a consumption tax. One problem discussed earlier in the context of the comprehensive income tax is determining whether a particular expenditure, such as spending on medical care and charitable donations, is an item of consumption.

Also, there may be more than one way to treat various items under a consumption tax. For example, a consumption tax might ignore borrowing and lending by excluding from the borrower's tax base the proceeds from loans, denying the borrower a deduction for payments of interest and principal, and excluding interest and principal payments received from the lender's tax base. On the other hand, a consumption tax might include borrowing and lending in the tax base by requiring the borrower to add the proceeds from loans in his tax base, allowing the lender to deduct loans from his tax base, allowing the borrower to deduct payments of principal and interest, and requiring the lender to include receipt of principal and interest payments. In present value terms, the two approaches are equivalent for both the borrower and the lender; in particular both allow the tax base to measure consumption and both impose a zero effective tax rate on interest income. But which approach is taken obviously has different implications (at least on an annual flow basis) for the treatment of many important items of income and expense such as the home mortgage interest deduction. The classification below suggests that the deduction for home mortgage interest could well be a tax expenditure, but takes note of alternative views.

Some exclusions of income are equivalent in many respects to consumption tax treatment that immediately deducts the cost of an investment while taxing the future cash flow. For example, exempting an investment's income (or yield) is equivalent to consumption tax treatment with respect to the normal rate of return on new investment; expensing generates a tax reduction that offsets in present value terms the tax paid on the investment's future normal returns. Because of this equivalence, in the context of consumption taxes, a yield exemption approach is sometimes called a tax prepayment approach. That is, tax is paid on an asset's purchase price rather than on the consumption flow that it generates.

However, a yield exemption approach differs from a pure consumption tax with respect to the distribution of income and Government revenue. Pure profits in excess of the normal rate of return would be taxed under a consumption tax because pure profits are an element of cash flow; however, pure profits would not be taxed under a yield exemption tax system. The question arises whether an exemption of certain kinds of investment income, and certain investment tax credits, should be regarded as the equivalent of consumption tax treatment. The classification that follows takes a fairly broad view of this equivalence and considers many tax provisions that reduce or eliminate the tax on capital income to be roughly consistent with a broad-based consumption tax.

Considering provisions individually can be misleading. The hybrid character of the existing tax system reflects many provisions that might be good policy in the context of a consumption tax, but that generate inefficiencies because of the problem of the "uneven playing field" when evaluated within the context of the existing tax rules. It is not clear how these should be classified. For example, many saving incentives are targeted to specific tax-favored sources of capital income. The inability to save on a similar tax-favored basis irrespective of the ultimate purpose to which the saving is applied potentially distorts economic choices in ways that would not occur under a broad-based consumption tax.

In addition, provisions can interact even once an appropriate treatment is determined. For example, if financial flows are excluded from the tax base, then the deduction for home mortgage interest would be a tax expenditure except that current law generally taxes interest income. When combined with the mortgage interest deduction, this offsets the inclusion of the interest flow, consistent with consumption tax treatment.

Capital gains would not be a part of a comprehensive consumption tax base. Proceeds from asset sales and sometimes borrowing would be part of the cash-flow tax base, but, for transactions between domestic investors at a flat tax rate, the effects of these transactions would cancel out in the economy as a whole. The classification below generally views available capital gains tax relief as consistent with a broad-based consumption tax because they lower tax rate on capital income is consistent with a consumption-based tax.

Such considerations suggest that, as with an income tax, computing the current tax's deviations from "the" base of a consumption tax is difficult because deviations cannot always be uniquely determined, making it problematic to do a consistent accounting of the differences between the current tax base and a consumption tax

base. Nonetheless, Appendix Table 2 attempts a classification based on the judgments outlined above.

Treatment of Major Tax Expenditures under a Comprehensive Consumption Baseline

As noted above, the major difference between a comprehensive consumption tax and a comprehensive income tax is in the treatment of saving, or in the taxation of capital income. Consequently, many current tax expenditures related to preferential taxation of capital income would not be tax expenditures under a consumption tax. However, preferential treatment of items of income that is unrelated to saving or investment incentives would remain tax expenditures under a consumption baseline. In addition, several official tax expenditures relating to items of income and expense are difficult to classify properly, while others may serve as proxies for properly measured tax expenditures.

Appendix Table 2 shows thirty large tax expenditures from the Budget classified according to whether they would be considered a tax expenditure under a consumption tax. One of the thirty items clearly would be a tax expenditure (shown in panel A) under a consumption tax, while an additional six (those in panel B) probably would be tax expenditures.

Exclusion of workers' compensation benefits allows an exclusion from income that is unrelated to investment, and so should be included in the base of a comprehensive consumption tax.

In one respect the deductibility of home mortgage interest is a strong candidate for inclusion as a tax expenditure. A consumption tax would seek to tax the entire value of the flow of services from housing, and so would not allow a deduction for home mortgage interest. This would be the case regardless of whether the tax base included the annual flow of housing services, or instead used a tax-prepayment or yield exemption approach (discussed more completely below) to taxing housing services. A deduction for interest would be allowed under a consumption tax applied to both real and financial cash flows, but current law does not require the homeowner to take into income the proceeds of a home loan, nor does it allow a deduction for principal repayments.

From another perspective, however, the home mortgage interest deduction would not be a tax expenditure under a consumption tax. Under a consumption tax, the interest income accruing to the mortgage lender generally would not be taxed (at least in present value terms). As interest income is subject to tax under current law, the homeowner's mortgage interest deduction could be viewed as counterbalancing the lender's inclusion, eliminating interest flows from the tax base, as would be appropriate under many types of consumption taxes.[26]

The deductibility of property taxes on owner-occupied housing also is a strong candidate for inclusion as a tax expenditure under a consumption tax baseline, although there is a bit of ambiguity. Property taxes would be deducted under a consumption tax under which the base allowed expensing of the cost of the house and included the rental value of the house in the annual tax base. But, as discussed above in the income tax section, this deduction nonetheless is a strong candidate for inclusion as a tax expenditure because the current tax system does not impute the consumption value of housing services to the homeowner's tax base.

Under a consumption tax based on the yield exemption or tax prepayment approach to housing, property taxes would not be deducted by the homeowner because the cash flows (positive and negative) related to the investment are simply ignored for tax purposes—they are outside the tax base. Their deduction under current law would represent a tax expenditure. As discussed below, current law's taxation of housing approximates a yield exemption approach; no deduction of the purchase price of the house, no tax on the house's service flow. Consequently, the deduction for property taxes probably would be a tax expenditure relative to a consumption base.

As discussed in the section on comprehensive income, whether the deduction for State and local income taxes gives rise to a tax expenditure under a consumption tax depends on whether the services paid for with these taxes constitute consumption value to the taxpayer. If there is not a firm relationship between the taxes paid and the services received, then the deduction may not be viewed as a tax expenditure.

Property taxes on assets other than housing would seem to be best thought of using the model discussed above for housing. These taxes typically are paid on assets, such as automobiles and boats, yielding a stream of services that current federal tax law fails to impute to income.

The tax expenditures for Social Security benefits discussed in the section on comprehensive income measure a tax benefit relative to a baseline that is somewhere between a comprehensive income tax and a consumption tax. The properly measured tax expenditure relative to a consumption tax baseline would include only those Social Security benefits that are accorded treatment more favorable than that implied by a consumption tax, which would correspond to including 50 percent of Social Security benefits in the recipient's tax base.[27] Thus, the existing tax expenditure is correct conceptually, but is not measured properly relative to a comprehensive income tax. A similar analysis would

[26] One must guard against double counting here, however, to the extent that current law's general taxation of capital income is calculated elsewhere in the tax expenditure budget as a negative tax expenditure..

[27] The current tax expenditure estimates reflect exceptions for low-income taxpayers from the general rule that 85 percent of Social Security benefits are included in the recipient's tax base. The 85 percent inclusion is intended as a simplified mechanism for taxing Social Security benefits as if the Social Security program were a private pension with employee contributions made from after-tax income. Under these tax rules, income earned on contributions made by both employers and employees benefits from tax deferral, but employer contributions also benefit because the employee may exclude them from his taxable income, while the employee's own contributions are included in his taxable income. These tax rules give the equivalent of consumption tax treatment, a zero effective tax rate on the return, to the extent that the original pension contributions are made by the employer, but give less generous treatment to the extent that the original contributions are made by the employee. Income earned on employee contributions is taxed at a low, but positive, effective tax rate. Based on historical calculations, the 85 percent inclusion reflects roughly the outcome of applying these tax rules to a lower-income earner when one-half of the contributions are from the employer and one-half from the employee.

apply to the exclusion of Social Security benefits of dependents and retirees.

There is a strong case for viewing the child tax credit and the earned income tax credit as social welfare programs (transfers). As such, they would be tax expenditures relative to a consumption baseline. These credits could alternatively be viewed as relieving tax on "nondiscretionary" consumption, and so not properly considered a tax expenditure.

The treatment of the items in panel C is less uncertain. Several of these items relate to the costs of medical care or to charitable contributions. As discussed in the previous section of the appendix, there is disagreement within the tax policy community over the extent to which medical care and charitable giving represent consumption items.

There also is the issue of how to tax medical insurance premiums. Under current law, employees may exclude insurance premiums paid for by employers from their income. The self-employed also may exclude (via a deduction) medical insurance premiums from their taxable income. From some perspectives, these premiums should be included in the tax base because they represent consumption. Yet an alternative perspective would support excluding the premium from the tax base as long as the value of any medical services paid for by the insurance policy were included. But even from this alternative perspective, the official tax expenditure might continue to be a tax expenditure under a consumption tax baseline because current law excludes the value of medical services paid with insurance benefits from the employee's taxable income.

Current law does not tax the annual rental value of owner-occupied housing. In contrast, the annual rental value of the housing would be taxed under a consumption tax. Hence, from one perspective, the exclusion of the net annual rental value of owner-occupied housing would be a tax expenditure relative to a consumption tax baseline.

However, a consumption tax that included in its base the annual rental value of housing also would allow the homeowner a deduction for the price of the house in the year it was purchased; the investment in housing would be expensed. Current law fails to allow such a deduction, raising doubt about classifying as a tax expenditure the exclusion of net rental income from owner-occupied housing. Indeed, it is possible to interpret current law as applying the tax pre-payment or yield exemption method to housing, so it is not clear whether the failure to tax the rental income from housing represents a tax expenditure.

The taxation of Social Security benefits for the disabled also is difficult to classify. As discussed in this appendix above, these benefits generally ought to be taxed because they represent purchasing power. However, the associated Social Security taxes ought to be fully deductible, but they are not. Hence the proper treatment is unclear. Moreover, if the insurance model is applied, the taxation of Social Security benefits might be a negative tax expenditure.

The credit for low-income housing acts to lower the tax burden on qualified investment, and so from one perspective would not be a tax expenditure under a consumption tax baseline. However, in some cases the credit is too generous; it can give a negative tax on income from qualified investment rather than the zero tax called for under consumption tax principles. In addition, the credit is very narrowly targeted. Consequently, it could be considered a tax expenditure relative to a consumption tax baseline.

The final panel (D) shows items that are not tax expenditures under a consumption base. Most of these relate to tax provisions that eliminate or reduce the tax on various types of capital income because a zero tax on capital income is consistent with consumption tax principles.

The deduction for U.S. production activities is not classified as a tax expenditure. This reflects the view that it represents a widespread reduction in taxes on capital income or an offset to the corporate income tax. The exception from the passive loss rules probably would not be a tax expenditure because proper measurement of income, and hence of consumption, requires full deduction of losses.

Major Tax Expenditures under a Consumption Tax That Are Excluded from the Current Budget

Several differences between current law and a consumption tax are left off the official tax expenditure list. Additional possible tax expenditures include benefits paid by insurance policies, in-kind benefits from such Government programs as food-stamps, Medicaid, and public housing, and benefits received from charities. Under some theories of a comprehensive consumption tax, the value of leisure and of household production of goods and services would be included as a tax expenditure.

A consumption tax implemented as a tax on gross cash flows would tax all proceeds from sales of capital assets when consumed, rather than just capital gains; because of expensing, taxpayers effectively would have a zero basis. The proceeds from borrowing would be in the base of a consumption tax that also allowed a deduction for repayment of principal and interest, but are excluded from the current tax base. The deduction of business interest expense might be a tax expenditure, since under some forms of consumption taxation interest is neither deducted from the borrower's tax base nor included in the lender's tax base. The personal exemption and standard deduction also might be considered tax expenditures, although they can be viewed differently, e.g., as elements of the basic tax rate schedule.

Negative Tax Expenditures

Importantly, current law also deviates from a consumption tax norm in ways that increase, rather than decrease, tax liability. These provisions are called negative tax expenditures.

A large item on this list would be the inclusion of capital income in the current individual income tax

base, including the income earned on inside-build up in Social Security accounts. The revenue from the corporate income tax, or more generally a measure of the double tax on corporate profits, also would be a negative tax expenditure. Depreciation allowances, even if accelerated, would be a negative tax expenditure since consumption tax treatment generally requires expensing. Depending on the treatment of loans, the borrower's inability to deduct payments of principal and the lender's inability to deduct loans might be a negative tax expenditure. The passive loss rules and net operating loss carry-forward provisions also might generate negative tax expenditures, because the change in net worth requires a deduction for losses (consumption = income—the change in net worth). Human capital is a productive asset, and so its cost (e.g., certain education and training expenses, including perhaps costs of college and professional school) should be expensed, but it is not under current law. Certain restrictions under the individual Alternative Minimum Tax as well as the phase-out of personal exemptions and of itemized deductions also might be considered negative tax expenditures. Under some views, the current tax treatment of Social Security benefits paid to the disabled would be a negative tax expenditure.

REVISED ESTIMATES OF SELECTED TAX EXPENDITURES

Accelerated Depreciation

Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. In the past, tax expenditure estimates of accelerated depreciation under the normal tax law baseline compared tax allowances based on the historic cost of an asset with allowances calculated using the straight-line method over relatively long recovery periods. Normal law allowances also were determined by the historical cost of the asset and so did not adjust for inflation, although such an adjustment is required when measuring economic depreciation, the age related fall in the real value of the asset.

Beginning with the 2004 Budget, the tax expenditures for accelerated depreciation under the normal law concept have been recalculated using as a baseline depreciation rates and replacement cost indexes from the National Income and Product Accounts.[28] The revised estimates are intended to approximate the degree of acceleration provided by current law over a baseline determined by real, inflation adjusted, and economic depreciation. Current law depreciation allowances for machinery and equipment include the benefits of a temporary expensing provision.[29] The estimates are shown in tables in the body of the main text, e.g., Table 19–1.

Owner-Occupied Housing

A homeowner receives a flow of housing services equal in gross value to the rent that could have been earned had the owner chosen to rent the house to others. Comprehensive income would include in the homeowner's tax base this gross rental flow, and would allow the homeowner a deduction for expenses such as interest, depreciation, property taxes, and other costs associated with earning the rental income. Thus, a comprehensive tax base would include in its base the homeowner's implicit net rental income (gross income minus deductions) earned on investment in owner-occupied housing.

In contrast to a comprehensive income tax, current law makes no imputation for gross rental income and allows no deduction for depreciation or for other expenses, such as utilities and maintenance. Current law does, however, allow a deduction for home mortgage interest and for property taxes. Consequently, relative to a comprehensive income baseline, the total tax expenditure for owner-occupied housing is the sum of tax on net rental income plus the tax saving from the deduction for property taxes and for home mortgage interest.[30]

Prior to 2006, the official list of tax expenditures did not include the exclusion of net implicit rental income on owner-occupied housing. Instead, it included as tax expenditures deductions for home mortgage interest and for property taxes. While these deductions are legitimately considered tax expenditures, given current law's failure to impute rental income, they are highly flawed as estimates of the total income tax advantage to housing; they overlook the additional exclusion of implicit net rental income. To the extent a homeowner owns his house outright, unencumbered by a mortgage, he would have no home mortgage interest deduction, yet he still would enjoy the benefits of receiving tax free the implicit rental income earned on his house. On the other hand, a homeowner with a mortgage approximately matching the value of the house might make interest payments that exceed the implicit rental income. The treatment of owner-occupied housing has been revised beginning in the 2006 budget, which now includes an item for the exclusion of net rental income of homeowners.[31]

[28] See Barbara Fraumeni, "The Measurement of Depreciation in the U.S. National Income and Product Accounts," in Survey of Current Business 77 No. 7 (Washington, D.C.: Department of Commerce, Bureau of Economic Analysis, July, 1997), pp. 7–42, and the National Income and Product Accounts of the United States, Table 7.6, "Chain-type Quantity and Price Indexes for Private Fixed Investment by Type," U.S. Department of Commerce, Bureau of Economic Analysis.

[29] The temporary provision allows 30 percent of the cost of a qualifying investment to be deducted immediately rather than capitalized and depreciated over time. It is generally effective for qualifying investments made after September 10, 2001 and before September 11, 2004. The Jobs and Growth Tax Relief Reconciliation Act of 2003 raised the deduction to 50 percent depreciation (up from 30 percent) of the cost new equipment purchased after May 5, 2003 and placed into service before January 1, 2005. Qualifying investments generally are limited to tangible property with depreciation recovery periods of 20 years or less, certain software, and leasehold improvements, but this set of assets corresponds closely to machinery and equipment.

[30] The homeowner's tax base under a comprehensive income tax is net rents. Under current law, the homeowner's tax base is -(interest + property taxes). The tax expenditure base is the difference between the comprehensive income base and current law's tax base, which for homeowners is the sum of net rents plus interest plus property taxes.

[31] This estimate combines the positive tax expenditure for the failure to impute rental income with the negative tax expenditure for the failure to allow a deduction for depreciation and other costs.

Appendix Table 3, as well as the tables in the body of the main text, e.g., Tables 19–1 and 19–2, show estimates of the tax expenditure caused by the exclusion of implicit net rental income from investment in owner-occupied housing. This estimate starts with the NIPA calculated value of gross rent on owner-occupied housing, and subtracts interest, taxes, economic depreciation, and other costs in arriving at an estimate of net-rental income from owner-occupied housing. [32]

Accrued Capital Gains

Under a comprehensive income baseline, all real gains would be taxed as accrued. These gains would be taxed as ordinary income rather than at preferential rates. There would be no deferred unrealized gains on assets held at death, nor gains carried over on gifts, or other preferential treatments. Indeed, all of the provisions related to capitals gains listed in the tax expenditure budget would be dropped. Instead, in their place the difference between the ordinary tax on real gains accrued and the actual tax paid would be calculated. For 1999, for instance, the tax on real accrued gains on corporate equity is estimated at $594 billion. This compares to an estimated tax on realized gains of $62 billion, for forgone revenues of $562 billion. However, this forgone revenue may easily turn into a revenue gain given the limits on capital losses. For 2000, for instance, real accrued losses in corporate equity amounted to $1.4 trillion. Yet, taxpayers paid an estimated $70 billion in capital gains taxes. This roughly translates into an overpayment of taxes to the tune of $464 billion.

Double Tax on Corporate Profits

A comprehensive income tax would tax all sources of income once. Taxes would not vary by type or source of income.

[32] National Income and Production Accounts, Table 2.4.

In contrast to this benchmark, current law taxes income that shareholders earn on investment in corporate stocks at least twice, and at combined rates that generally are higher than those imposed on other sources of income. Corporate profits are taxed once at the company level under the corporation income tax. They are taxed again at the shareholder level when received as a dividend or recognized as a capital gain. Corporate profits can be taxed more then twice when they pass through multiple corporations before being distributed to noncorporate shareholders. Corporate level taxes cascade because corporations are taxed on capital gains they realize on the sale of stock shares and on some dividend income received. Compared to a comprehensive income tax, current law's double (or more) tax on corporate profits is an example of a negative tax expenditure because it subjects income to a larger tax burden than implied by a comprehensive income baseline.

Appendix A Table 3 provides an estimate of the negative tax expenditure caused by the multiple levels of tax on corporate profits. This negative tax expenditure is measured as the shareholder level tax on dividends paid and capital gains realized out of earnings that have been fully taxed at the corporate level. It also includes the corporate tax paid on inter-corporate dividends and on corporate capital gains attributable to the sale of stock shares. The estimate includes the reduction in the dividends and capital gains tax rates enacted in JGTRRA.

The negative tax expenditure is large in magnitude; it exceeds $34 billion in the years 2007 through in 2011. It is comparable in size (but opposite in sign) to all but the largest official tax expenditures. JGTRRA reduced but did not eliminate the double tax on corporate profits.

Appendix Table 1. COMPARISON OF CURRENT TAX EXPENDITURES WITH THOSE IMPLIED BY A COMPREHENSIVE INCOME TAX [1]

Description	Revenue Effect 2008
A. Tax Expenditure Under a Comprehensive Income Tax	
Accelerated depreciation of machinery and equipment (normal tax method)	64,670
Capital gains (except agriculture, timber, iron ore, and coal)	51,960
Net exclusion of pension contributions and earnings: Employer plans	48,480
Net exclusion of pension contributions and earnings: 401(k) plans	43,970
Capital gains exclusion on home sales	38,890
Exclusion of net imputed rental income on owner-occupied housing	35,680
Exclusion of interest on public purpose State and local bonds	27,150
Exclusion of interest on life insurance savings	21,925
Deferral of income from controlled foreign corporations (normal tax method)	12,770
Accelerated depreciation on rental housing (normal tax method)	12,300
Net exclusion of pension contributions and earnings: Keogh plans	11,890
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	6,650
Exclusion of workers' compensation benefits	5,830
Expensing of research and experimentation expenditures (normal tax method)	5,280
Credit for low-income housing investments	4,940
B. Possibly a Tax Expenditure Under a Comprehensive Income Tax, But With Some Qualifications	
Deductibility of mortgage interest on owner-occupied homes	89,430
Step-up basis of capital gains at death	35,900
Child tax credit	32,341
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	27,900
Exclusion of Social Security benefits for retired workers	18,930
Deduction for U.S. production activities	13,810
Deductibility of State and local property tax on owner-occupied homes	12,620
Earned income tax credit	5,340
C. Uncertain	
Exclusion of employer contributions for medical insurance premiums and medical care	160,190
Deductibility of charitable contributions, other than education and health	45,760
Social Security benefits for the disabled	5,620
Deductibility of charitable contributions, health	5,160
Deductibility of charitable contributions, education	5,120
Deductibility of medical expenses	4,920
D. Probably Not a Tax Expenditure Under a Comprehensive Income Tax	
Exception from passive loss rules for $25,000 of rental loss	7,520

[1] The measurement of certain tax expenditures under a comprehensive income tax baseline may differ from the official budget estimate even when the provision would be a tax expenditure under both baselines.

Source: Table 19–2, Tax Expenditure Budget.

Appendix Table 2. COMPARISON OF CURRENT TAX EXPENDITURES WITH THOSE IMPLIED BY A COMPREHENSIVE CONSUMPTION TAX [1]

Description	Revenue Effect 2008
A. Tax Expenditure Under a Consumption Base	
Exclusion of workers' compensation benefits	5,830
B. Probably a Tax Expenditure Under a Consumption Base	
Deductibility of mortgage interest on owner-occupied homes	89,430
Child tax credit	32,341
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	27,900
Exclusion of Social Security benefits for retired workers	18,930
Deductibility of State and local property tax on owner-occupied homes	12,620
Earned income tax credit	5,340
C. Uncertain	
Exclusion of employer contributions for medical insurance premiums and medical care	160,190
Deductibility of charitable contributions, other than education and health	45,760
Exclusion of net imputed rental income on owner-occupied housing	35,680
Social Security benefits for disabled	5,620
Credit for low-income housing investments	4,940
Deductibility of medical expenses	4,920
Deductibility of charitable contributions, health	5,160
Deductibility of charitable contributions, education	5,120
D. Not a Tax Expenditure Under a Consumption Base	
Accelerated depreciation of machinery and equipment (normal tax method)	64,670
Capital gains (except agriculture, timber, iron ore, and coal)	51,960
Net exclusion of pension contributions and earnings: Employer plans	48,480
Net exclusion of pension contributions and earnings: 401(k) plans	43,970
Capital gains exclusion on home sales	38,890
Step-up basis of capital gains at death	35,900
Exclusion of interest on public purpose State and local bonds	27,150
Exclusion of interest on life insurance savings	21,925
Deduction for U.S. production activities	13,810
Deferral of income from controlled foreign corporations (normal tax method)	12,770
Accelerated depreciation on rental housing (normal tax method)	12,300
Net exclusion of pension contributions and earnings: Keogh plans	11,890
Exception from passive loss rules for $25,000 of rental loss	7,520
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	6,650
Expensing of research and experimentation expenditures (normal tax method)	5,280

[1] The measurement of certain tax expenditures under a consumption tax baseline may differ from the official budget estimate even when the provision would be a tax expenditure under both baselines.Source: Table 19–2, Tax Expenditure Budget.

Appendix Table 3. REVISED TAX EXPENDITURE ESTIMATES [1]

Provision	Revenue Loss						
	2006	2007	2008	2009	2010	2011	2012
Imputed Rent On Owner-Occupied Housing	28,780	32,110	35,680	39,440	43,596	48,190	53,269
Double Tax on corporate profit [2]	–33,530	–34,930	–36,160	–37,280	–38,435	–39,625	–40,852

[1] Calculations described in the appendix text.
[2] This is a negative tax expenditure, a tax provision that overtaxes income relative to the treatment specified by the baseline tax system.

Appendix B

PERFORMANCE MEASURES AND THE ECONOMIC EFFECTS OF TAX EXPENDITURES

The Government Performance and Results Act of 1993 (GPRA) directs Federal agencies to develop annual and strategic plans for their programs and activities. These plans set out performance objectives to be achieved over a specific time period. Most of these objectives will be achieved through direct expenditure programs. Tax expenditures, however, may also contribute to achieving these goals. This Appendix responds to the report of the Senate Governmental Affairs Committee on GPRA4 [33] calling on the Executive Branch to undertake a series of analyses to assess the effect of specific tax expenditures on the achievement of agencies' performance objectives.

Comparison of tax expenditure, spending, and regulatory policies. Tax expenditures by definition work through the tax system and, particularly, the income tax. Thus, they may be relatively advantageous policy approaches when the benefit or incentive is related to income and is intended to be widely available. [34] Because there is an existing public administrative and private compliance structure for the tax system, the incremental administrative and compliance costs for a tax expenditure may be low in many cases. In addition, some tax expenditures actually simplify the operation of the tax system, (for example, the exclusion for up to $500,000 of capital gains on home sales). Tax expenditures also implicitly subsidize certain activities. Spending, regulatory or tax-disincentive policies can also modify behavior, but may have different economic effects. Finally, a variety of tax expenditure tools can be used e.g., deductions, credits, exemptions, deferrals, floors, ceilings; phase-ins; phase-outs; dependent on income, expenses, or demographic characteristics (age, number of family members, etc.). This wide range of policy instruments means that tax expenditures can be flexible and can have very different economic effects.

Tax expenditures also have limitations. In many cases they add to the complexity of the tax system, which raises both administrative and compliance costs. For example, personal exemptions, deductions, credits, and phase-outs can complicate filing and decision-making. The income tax system may have little or no contact with persons who have no or very low incomes, and does not require information on certain characteristics of individuals used in some spending programs, such as wealth. These features may reduce the effectiveness of tax expenditures for addressing certain income-transfer objectives. Tax expenditures also generally do not enable the same degree of agency discretion as an outlay program. For example, grant or direct Federal service delivery programs can prioritize activities to be addressed with specific resources in a way that is difficult to emulate with tax expenditures.

Outlay programs have advantages where direct Government service provision is particularly warranted such as equipping and providing the armed forces or administering the system of justice. Outlay programs may also be specifically designed to meet the needs of low-income families who would not otherwise be subject to income taxes or need to file a tax return. Outlay programs may also receive more year-to-year oversight and fine tuning through the legislative and executive budget process. In addition, many different types of spending programs including direct Government provision; credit programs; and payments to State and local governments, the private sector, or individuals in the form of grants or contracts provide flexibility for policy design. On the other hand, certain outlay programs such as direct Government service provision may rely less directly on economic incentives and private-market provision than tax incentives, which may reduce the relative efficiency of spending programs for some goals. Spending programs also require resources to be raised via taxes, user charges, or Government borrowing, which can impose further costs by diverting resources from their most efficient uses. Finally, spending programs, particularly on the discretionary side, may respond less readily to changing activity levels and economic conditions than tax expenditures.

Regulations have more direct and immediate effects than outlay and tax-expenditure programs because regulations apply directly and immediately to the regulated party (i.e., the intended actor) generally in the private sector. Regulations can also be fine-tuned more quickly than tax expenditures because they can often be changed as needed by the Executive Branch without legislation. Like tax expenditures, regulations often rely largely on voluntary compliance, rather than detailed inspections and policing. As such, the public administrative costs tend to be modest relative to the private resource costs associated with modifying activities. Historically, regulations have tended to rely on proscriptive measures, as opposed to economic incentives. This reliance can diminish their economic efficiency, although this feature can also promote full compliance where (as in certain safety-related cases) policymakers believe that trade-offs with economic considerations are not of paramount importance. Also, regulations generally do not directly affect Federal outlays or receipts. Thus, like tax expenditures, they may escape the degree of scrutiny that outlay programs receive. However, major regulations are subjected to a formal regulatory analysis that goes well beyond the analysis required for outlays and tax-expenditures. To some extent, the GPRA requirement for performance evaluation will address this lack of formal analysis.

[33] Committee on Government Affairs, United States Senate, "Government Performance and Results Act of 1993" (Report 103–58, 1993).

[34] Although this chapter focuses upon tax expenditures under the income tax, tax expenditures also arise under the unified transfer, payroll, and excise tax systems. Such provisions can be useful when they relate to the base of those taxes, such as an excise tax exemption for certain types of consumption deemed meritorious.

Some policy objectives are achieved using multiple approaches. For example, minimum wage legislation, the earned income tax credit, and the food stamp program are regulatory, tax expenditure, and direct outlay programs, respectively, all having the objective of improving the economic welfare of low-wage workers.

Tax expenditures, like spending and regulatory programs, have a variety of objectives and effects. When measured against a comprehensive income tax, for example, these include: encouraging certain types of activities (e.g., saving for retirement or investing in certain sectors); increasing certain types of after-tax income (e.g., favorable tax treatment of Social Security income); reducing private compliance costs and Government administrative costs (e.g., the exclusion for up to $500,000 of capital gains on home sales); and promoting tax neutrality (e.g., accelerated depreciation in the presence of inflation). Some of these objectives are well suited to quantitative measurement, while others are less well suited. Also, many tax expenditures, including those cited above, may have more than one objective. For example, accelerated depreciation may encourage investment. In addition, the economic effects of particular provisions can extend beyond their intended objectives (e.g., a provision intended to promote an activity or raise certain incomes may have positive or negative effects on tax neutrality).

Performance measurement is generally concerned with inputs, outputs, and outcomes. In the case of tax expenditures, the principal input is usually the revenue effect. Outputs are quantitative or qualitative measures of goods and services, or changes in income and investment, directly produced by these inputs. Outcomes, in turn, represent the changes in the economy, society, or environment that are the ultimate goals of programs.

Thus, for a provision that reduces taxes on certain investment activity, an increase in the amount of investment would likely be a key output. The resulting production from that investment, and, in turn, the associated improvements in national income, welfare, or security, could be the outcomes of interest. For other provisions, such as those designed to address a potential inequity or unintended consequence in the tax code, an important performance measure might be how they change effective tax rates (the discounted present-value of taxes owed on new investments or incremental earnings) or excess burden (an economic measure of the distortions caused by taxes). Effects on the incomes of members of particular groups may be an important measure for certain provisions.

An Overview of Evaluation Issues by Budget Function. The discussion below considers the types of measures that might be useful for some major programmatic groups of tax expenditures. The discussion is intended to be illustrative and not all encompassing. However, it is premised on the assumption that the data needed to perform the analysis are available or can be developed. In practice, data availability is likely to be a major challenge, and data constraints may limit the assessment of the effectiveness of many provisions. In addition, such assessments can raise significant challenges in economic modeling.

National defense. Some tax expenditures are intended to assist governmental activities. For example, tax preferences for military benefits reflect, among other things, the view that benefits such as housing, subsistence, and moving expenses are intrinsic aspects of military service, and are provided, in part, for the benefit of the employer, the U.S. Government. Tax benefits for combat service are intended to reduce tax burdens on military personnel undertaking hazardous service for the Nation. A portion of the tax expenditure associated with foreign earnings is targeted to benefit U.S. Government civilian personnel working abroad by offsetting the living costs that can be higher than those in the United States. These tax expenditures should be considered together with direct agency budget costs in making programmatic decisions.

International affairs. Tax expenditures are also aimed at goals such as tax neutrality. These include the exclusion for income earned abroad by nongovernmental employees and exclusions for income of U.S.-controlled foreign corporations. Measuring the effectiveness of these provisions raises challenging issues.

General science, space and technology; energy; natural resources and the environment; agriculture; and commerce and housing. A series of tax expenditures reduces the cost of investment, both in specific activities such as research and experimentation, extractive industries, and certain financial activities and more generally, through accelerated depreciation for plant and equipment. These provisions can be evaluated along a number of dimensions. For example, it could be useful to consider the strength of the incentives by measuring their effects on the cost of capital (the interest rate which investments must yield to cover their costs) and effective tax rates. The impact of these provisions on the amounts of corresponding forms of investment (e.g., research spending, exploration activity, equipment) might also be estimated. In some cases, such as research, there is evidence that the investment can provide significant positive externalities that is, economic benefits that are not reflected in the market transactions between private parties. It could be useful to quantify these externalities and compare them with the size of tax expenditures. Measures could also indicate the effects on production from these investments such as numbers or values of patents, energy production and reserves, and industrial production. Issues to be considered include the extent to which the preferences increase production (as opposed to benefiting existing output) and their cost-effectiveness relative to other policies. Analysis could also consider objectives that are more difficult to measure but still are ultimate goals, such as promoting the Nation's technological base, energy security, environmental quality, or economic growth. Such an assessment is likely to involve tax analysis as well as consideration of non-tax matters such as market structure, scientific, and other information (such as the effects of increased domestic fuel pro-

duction on imports from various regions, or the effects of various energy sources on the environment).

Housing investment also benefits from tax expenditures. The imputed net rental income from owner-occupied housing is excluded from the tax base. The mortgage interest deduction and property tax deduction on personal residences also are reported as tax expenditures because the value of owner-occupied housing services is not included in a taxpayer's taxable income. Taxpayers also may exclude up to $500,000 of the capital gains from the sale of personal residences. Measures of the effectiveness of these provisions could include their effects on increasing the extent of home ownership and the quality of housing. Similarly, analysis of the extent of accumulated inflationary gains is likely to be relevant to evaluation of the capital gains for home sales. Deductibility of State and local property taxes assists with making housing more affordable as well as easing the cost of providing community services through these taxes. Provisions intended to promote investment in rental housing could be evaluated for their effects on making such housing more available and affordable. These provisions should then be compared with alternative programs that address housing supply and demand.

Transportation. Employer-provided parking is a fringe benefit that, for the most part, is excluded from taxation. The tax expenditure estimates reflect the cost of parking that is leased by employers for employees; an estimate is not currently available for the value of parking owned by employers and provided to their employees. The exclusion for employer-provided transit passes is intended to promote use of this mode of transportation, which has environmental and congestion benefits. The tax treatments of these different benefits could be compared with alternative transportation policies.

Community and regional development. A series of tax expenditures is intended to promote community and regional development by reducing the costs of financing specialized infrastructure, such as airports, docks, and stadiums. Empowerment zone and enterprise community provisions are designed to promote activity in disadvantaged areas. These provisions can be compared with grants and other policies designed to spur economic development.

Education, training, employment, and social services. Major provisions in this function are intended to promote post-secondary education, to offset costs of raising children, and to promote a variety of charitable activities. The education incentives can be compared with loans, grants, and other programs designed to promote higher education and training. The child credits are intended to adjust the tax system for the costs of raising children; as such, they could be compared to other Federal tax and spending policies, including related features of the tax system, such as personal exemptions (which are not defined as a tax expenditure). Evaluation of charitable activities requires consideration of the beneficiaries of these activities, who are generally not the parties receiving the tax reduction.

Health. Individuals also benefit from favorable treatment of employer-provided health insurance. Measures of these benefits could include increased coverage and pooling of risks. The effects of insurance coverage on final outcome measures of actual health (e.g., infant mortality, days of work lost due to illness, or life expectancy) or intermediate outcomes (e.g., use of preventive health care or health care costs) could also be investigated.

Income security, Social Security, and veterans benefits and services. Major tax expenditures in the income security function benefit retirement savings, through employer-provided pensions, individual retirement accounts, and Keogh plans. These provisions might be evaluated in terms of their effects on boosting retirement incomes, private savings, and national savings (which would include the effect on private savings as well as public savings or deficits). Interactions with other programs, including Social Security, also may merit analysis. As in the case of employer-provided health insurance, analysis of employer-provided pension programs requires imputing the value of benefits funded at the firm level to individuals.

Other provisions principally affect the incomes of members of certain groups, rather than affecting incentives. For example, tax-favored treatment of Social Security benefits, certain veterans' benefits, and deductions for the blind and elderly provide increased incomes to eligible parties. The earned-income tax credit, in contrast, should be evaluated for its effects on labor force participation as well as the income it provides lower-income workers.

General purpose fiscal assistance and interest. The tax-exemption for public purpose State and local bonds reduces the costs of borrowing for a variety of purposes (borrowing for non-public purposes is reflected under other budget functions). The deductibility of certain State and local taxes reflected under this function primarily relates to personal income taxes (property tax deductibility is reflected under the commerce and housing function). Tax preferences for Puerto Rico and other U.S. possessions are also included here. These provisions can be compared with other tax and spending policies as means of benefiting fiscal and economic conditions in the States, localities, and possessions. Finally, the tax deferral for interest on U.S. savings bonds benefits savers who invest in these instruments. The extent of these benefits and any effects on Federal borrowing costs could be evaluated.

The above illustrative discussion, although broad, is nevertheless incomplete, omitting important details both for the provisions mentioned and the many that are not explicitly cited. Developing a framework that is sufficiently comprehensive, accurate, and flexible to reflect the objectives and effects of the wide range of tax expenditures will be a significant challenge. OMB, Treasury, and other agencies will work together, as appropriate, to address this challenge. As indicated above, over the next few years the Executive Branch's focus will be on the availability of the data needed to assess the effects of the tax expenditures designed to increase savings.