

**[JOINT COMMITTEE PRINT]**

**ESTIMATES OF FEDERAL TAX  
EXPENDITURES FOR  
FISCAL YEARS 2002-2006**

PREPARED FOR THE  
**COMMITTEE ON WAYS AND MEANS**  
AND THE  
**COMMITTEE ON FINANCE**

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BY THE STAFF OF THE  
**JOINT COMMITTEE ON TAXATION**



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## CONTENTS

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	<i>Page</i>
INTRODUCTION .....	1
I. THE CONCEPT OF TAX EXPENDITURES .....	2
II. MEASUREMENT OF TAX EXPENDITURES .....	16
III. TAX EXPENDITURE ESTIMATES .....	18
Table 1. Tax Expenditure Estimates by Budget Function, Fiscal Years 2002–2006 .....	20
Table 2. Distribution of All Returns, Taxable Re- turns, Itemized Returns, and Tax Liability by Income Class .....	29
Table 3. Distribution of Selected Individual Tax Ex- penditures by Income Class .....	30

## INTRODUCTION

This report<sup>1</sup> on tax expenditures for fiscal years 2002–2006 is prepared by the staff of the Joint Committee on Taxation (“Joint Committee staff”) for the House Committee on Ways and Means and the Senate Committee on Finance. The report also is submitted to the House and Senate Committees on the Budget.

As in the case of earlier reports,<sup>2</sup> the estimates of tax expenditures in this report were prepared in consultation with the staff of the Office of Tax Analysis in the Treasury Department (“the Treasury”). The Treasury published its estimates of tax expenditures for fiscal years 2000–2006 in the Administration’s budgetary statement of April 2001.<sup>3</sup> The lists of tax expenditures in this Joint Committee staff report and the Administration’s budgetary statement overlap considerably; the differences are discussed in Part I of this report under the heading “Comparisons with Treasury.”

The Joint Committee staff has made its estimates (as shown in Table 1) based on the provisions in tax law as enacted through December 31, 2001. Expired or repealed provisions are not listed unless they have continuing revenue effects that are associated with ongoing taxpayer activity. Proposed extensions or modifications of expiring provisions are not included until they have been enacted into law.

Part I of this report contains a discussion of the concept of tax expenditures. Part II is a discussion of the measurement of tax expenditures. Estimates of tax expenditures for fiscal years 2002–2006 are presented in Table 1 in Part III. Table 2 shows the distribution of tax returns by income class, and Table 3 presents distributions of selected individual tax expenditures by income class.

<sup>1</sup>This report may be cited as follows: Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2002–2006* (JCS–1–02), January 17, 2002.

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

<sup>3</sup>Office of Management and Budget, “Tax Expenditures,” *Budget of the United States Government: Analytical Perspectives, Fiscal Year 2002*, April 9, 2001, pp. 61–93.

## I. THE CONCEPT OF TAX EXPENDITURES

### *Overview*

"Tax expenditures" are defined under the Congressional Budget and Impoundment Control Act of 1974 ("the Budget Act") as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."<sup>4</sup> Thus, tax expenditures include any reductions in income tax liabilities that result from special tax provisions or regulations that provide tax benefits to particular taxpayers.

Special income tax provisions are referred to as tax expenditures because they may be considered to be analogous to direct outlay programs, and the two can be considered as alternative means of accomplishing similar budget policy objectives. Tax expenditures are most similar to those direct spending programs that have no spending limits, and that are available as entitlements to those who meet the statutory criteria established for the programs.<sup>5</sup>

Estimates of tax expenditures are prepared for use in budget analysis. They are a measure of the economic benefits that are provided through the tax laws to various groups of taxpayers and sectors of the economy. The estimates also may be useful in determining the relative merits of achieving specified public goals through tax benefits or direct outlays.

The legislative history of the Budget Act indicates that tax expenditures are to be defined with reference to a normal income tax structure (referred to here as "normal income tax law"). The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of income that is larger in scope than "income" as defined under general U.S. income tax principles.<sup>6</sup> The Joint Committee staff has used its judgment in distinguishing between those income tax provisions (and regulations) that can be viewed as a part of normal income tax law and those special provisions that result in tax expenditures. A provision traditionally has been listed as a tax expenditure by the Joint Committee staff if there is a reasonable basis for such classification and the provision results in more than a de minimis revenue loss, which solely for this purpose means a total revenue loss of at least \$50 million over the five fiscal years 2002–2006. The Joint Committee staff empha-

<sup>4</sup> Congressional Budget and Impoundment Control Act of 1974 (P.L. 93–344), sec. 3(3).

<sup>5</sup> There are a few tax expenditures that have statutorily imposed limits. One example is the tax credit for low-income rental housing. This credit is available only to those who have received credit allocations from State housing authorities. There are statutory limits on the total amounts of credit allocations that the States can make each year.

<sup>6</sup> For this reason, the tax expenditure list in Table 1 includes, for example, estimates for the net exclusion of pension contributions and earnings, 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.

sizes, however, that in the process of listing tax expenditures, no judgment is made, nor any implication intended, about the desirability of any special tax provision as a matter of public policy.

If a tax expenditure provision were eliminated, Congress might choose to continue financial assistance through other means rather than terminate all Federal assistance for the activity. If a replacement spending program were enacted, the higher revenues received as a result of the elimination of a tax expenditure might not represent a net budget gain. A replacement program could involve direct expenditures, direct loans or loan guarantees, regulatory activity, a different form of tax expenditure, or a general reduction in tax rates. Joint Committee staff estimates of tax expenditures do not anticipate such policy responses.

The Budget Act uses the term tax expenditure to refer to the special tax provisions that are contained in the Federal income taxes on individuals and corporations.<sup>7</sup> Other Federal taxes such as excise taxes, employment taxes, and estate and gift taxes may also have exceptions, exclusions, and credits, but those special tax provisions are not included in this report because they are not part of the income tax. Thus, for example, the income tax exclusion for employer-paid health insurance is included, but the Federal Insurance Contributions Act ("FICA") tax exclusion for employer-paid health insurance is not treated as a tax expenditure.<sup>8</sup>

Some provisions in the Internal Revenue Code provide for special tax treatment that is less favorable than normal income tax law. Examples of such provisions include (1) the denial of deductions for certain lobbying expenses, (2) the denial of deductions for certain executive compensation, and (3) the 2-percent floor on itemized deductions for unreimbursed employee expenses. Tax provisions that provide treatment less favorable than normal income tax law are not shown in this report because they are not included in the statutory definition of a tax expenditure.

### ***Individual Income Tax***

Under the Joint Committee staff methodology, the normal structure of the individual income tax includes the following major components: one personal exemption for each taxpayer and one for each dependent, the standard deduction, the existing tax rate schedule, and deductions for investment and employee business expenses. Most other tax benefits to individual taxpayers can be classified as exceptions to normal income tax law.

Personal exemptions and the standard deduction are treated as part of normal income tax law because these amounts approximate the level of income below which it would be difficult for an indi-

<sup>7</sup> The Federal income tax on individuals also applies to estates and trusts, which are subject to a separate income tax rate schedule (Internal Revenue Code section 1(e)). Estates and trusts may benefit from some of the same tax expenditure provisions that apply to individuals. In Table 1 of this report, the tax expenditures that apply to estates and trusts have been included in the estimates of tax expenditures for individual taxpayers.

<sup>8</sup> In its budget statement, the Treasury Department identifies tax expenditures in the unified transfer tax (the estate and gift tax and the generation-skipping transfer tax). See, Office of Management and Budget, "Tax Expenditures," April 9, 2001, pp. 91-93. Other analysts have explored applying the concept of tax expenditures to the payroll and excise taxes. See, Jonathan Barry Forman, "Would a Social Security Tax Expenditure Budget Make Sense?" *Public Budgeting and Financial Management*, 5, 1993, pp. 311-335, and Bruce F. Davie, "Tax Expenditures in the Federal Excise Tax System," *National Tax Journal*, XLVII, March 1994, pp. 39-62.

vidual or a family to obtain minimal amounts of food, clothing, and shelter. Those itemized deductions that are not necessary for the generation of income are classified as tax expenditures, but only to the extent that they exceed the standard deduction level.

All employee compensation is subject to tax unless the tax code contains a specific exclusion for the income. There are specific exclusions for the following employer-provided benefits: coverage under accident and health plans,<sup>9</sup> accident and disability insurance, group term life insurance, educational assistance, transportation benefits (parking, van pools, and transit passes), child care, meals and lodging furnished for the convenience of the employer, employee awards, and other miscellaneous fringe benefits (e.g., employee discounts, services provided to employees at no additional cost to employers, tuition reductions, and de minimis fringe benefits). Each of these exclusions is classified as a tax expenditure in this report.

Under normal income tax law, employer contributions to pension plans and income earned on pension assets would be taxable to employees as the contributions are made and as the income is earned, and employees would not receive any deduction or exclusion for their pension contributions. Under present law, employer contributions to qualified pension plans and employee contributions made at the election of the employee through salary reduction are not taxed until distributed to the employee, and income earned on pension assets is not taxed until distributed. The tax expenditure for "net exclusion of pension contributions and earnings" is computed as the income taxes forgone on current tax-excluded pension contributions and earnings less the income taxes paid on current pension distributions (including the 10-percent additional tax paid on early withdrawals from pension plans).

Under present law, social security and tier 1 railroad retirement benefits are fully or partially excluded from gross income.<sup>10</sup> Under normal income tax law, retirees would be entitled to an exclusion for only the portion of the retirement benefits that represents a return of the payroll taxes that they paid during their working years. Thus, the exclusion of social security and railroad retirement benefits in excess of payroll tax payments is classified as a tax expenditure.

All Medicare benefits are excluded from taxation. The value of Medicare Part A insurance generally is greater than the Health Insurance ("HI") tax contributions that enrollees made during their working years, and the value of Medicare Part B insurance generally is greater than the Part B premium that enrollees must pay. The exclusion of the value of Medicare Part A insurance in excess of HI tax contributions is classified as a tax expenditure, and the exclusion of the value of Medicare Part B insurance in excess of premiums paid also is classified as a tax expenditure.

<sup>9</sup> Present law contains an exclusion for employer-provided coverage under accident and health plans (sec. 106 of the Internal Revenue Code of 1986, the "Code") and an exclusion for benefits received by employees under employer-provided accident and health plans (Code sec. 105(b)). These two exclusions are viewed as a single tax expenditure. Under normal income tax law, the value of employer-provided accident and health coverage would be includable in the income of employees, but employees would not be subject to tax on the accident and health insurance benefits (reimbursements) that they might receive.

<sup>10</sup> For taxpayers with modified adjusted gross incomes above certain levels, up to 85 percent of social security retirement benefits are includable in income.

Public assistance benefits are excluded from gross income by statute or by Internal Revenue Service regulations. Table 1 contains tax expenditure estimates for workers' compensation benefits, special benefits for disabled coal miners, and cash public assistance benefits (which include Supplemental Security Income benefits and Temporary Assistance for Needy Families benefits).

The individual income tax does not include in gross income the imputed income that individuals receive from the services provided by owner-occupied homes and durable goods.<sup>11</sup> However, the Joint Committee staff does not classify this exclusion as a tax expenditure. The measurement of imputed income for tax purposes presents administrative problems and its exclusion from taxable income may be regarded as an administrative necessity.<sup>12</sup>

Under normal income tax law, individuals would be allowed to deduct only the interest on indebtedness incurred in connection with a trade or business or an investment. Thus, the deduction for mortgage interest on a principal or second residence is classified as a tax expenditure.

The Joint Committee staff assumes that, for administrative feasibility, normal income tax law would tax capital gains in full in the year the gains are realized through sale or exchange. Thus, the deferral of tax until realization is not classified as a tax expenditure, but reduced rates of tax, further deferrals of tax (beyond the year of sale or exchange), and exclusions of certain capital gains are classified as tax expenditures.

It also is assumed that normal income tax law would not provide for any indexing of the basis of capital assets for changes in the general price level. Thus, under normal income tax law (as under present law), the income tax would be levied on nominal gains as opposed to real gains in asset values. If, as an alternative, normal income tax law were defined to include full indexing of the basis of capital assets, the capital gains tax expenditure estimates in Table 1 generally would be lower than those shown.

There are many types of State and local government bonds and private purpose bonds that qualify for tax-exempt status for Federal income tax purposes. Table 1 contains a separate tax expenditure listing for each type of bond.

Under the Joint Committee staff view of normal tax law, compensatory stock options would be subject to regular income tax at the time the options are exercised and employers would receive a corresponding tax deduction.<sup>13</sup> The employee's income would be equal to the difference between the purchase price of the stock and the market price on the day the option is exercised. Present law provides for special tax treatment for incentive stock options and options acquired under employee stock purchase plans. When certain requirements are satisfied, (1) the income that is received at

<sup>11</sup> The National Income and Product Accounts include estimates of this imputed income. The accounts appear in U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, published monthly.

<sup>12</sup> If the imputed income from owner-occupied homes were included in adjusted gross income, it would be proper to include all mortgage interest deductions and related property tax deductions as part of the normal income tax structure, since interest and property tax deductions would be allowable as a cost of producing imputed income. It also would be appropriate to allow deductions for depreciation and maintenance expenses for owner-occupied homes.

<sup>13</sup> If the option has a readily ascertainable fair market value, normal law would tax the option at the time it is granted and the employer would be entitled to a deduction at that time.

the time the option is exercised is excluded for purposes of the regular income tax but included for purposes of the alternative minimum tax, (2) the gain from any subsequent sale of the stock is taxed as a capital gain, and (3) the employer does not receive a tax deduction with respect to the option. The special tax treatment provided to the employee is viewed as a tax expenditure by the Joint Committee staff, and an estimate of this tax expenditure is contained in Table 1. However, it should be noted that the revenue loss from the special tax treatment provided to the employee is accompanied by a significant revenue gain from the denial of the deduction to the employer.

The individual alternative minimum tax ("AMT") and the passive activity loss rules are not viewed by the Joint Committee staff as a part of normal income tax law. Instead, they are viewed as provisions that reduce the magnitude of the tax expenditures to which they apply. For example, the AMT reduces the value of the deduction for State and local income taxes (for those taxpayers subject to the AMT) by not allowing the deductions to be claimed in the calculation of AMT liability. Similarly, the passive loss rules defer otherwise allowable deductions and credits from passive activities until a time when the taxpayer has passive income or disposes of the assets associated with the passive activity. Exceptions to the individual AMT and the passive loss rules are not classified as tax expenditures by the Joint Committee staff because the effects of the exceptions already are incorporated in the estimates of related tax expenditures.

### ***Business Income Taxation***

Regardless of the legal form of organization (sole proprietorship, partnership, or S or C corporation), the same general principles are used in the computation of taxable business income. Thus, most business tax expenditures apply equally to unincorporated and incorporated businesses.

One of the most difficult issues in defining tax expenditures for business income relates to the tax treatment of capital costs. Under present law, capital costs may be recovered under a variety of alternative methods, depending upon the nature of the costs and the status of the taxpayer. For example, investments in equipment and structures may qualify for tax credits, expensing, accelerated depreciation, or straight-line depreciation. The Joint Committee staff generally classifies as tax expenditures cost recovery allowances that are more favorable than those provided under the alternative depreciation system (sec. 168(g)), which provides for straight-line recovery over tax lives that are longer than those permitted under the accelerated system.

As indicated above, the Joint Committee staff assumes that normal income tax law would not provide for any indexing of the basis of capital assets. Thus, normal income tax law would not take into account the effects of inflation on tax depreciation. The expensing and depreciation tax expenditure estimates in Table 1 are larger than would be the case if normal income tax law provided for inflation adjustments in the basis of assets for tax depreciation purposes.



The Joint Committee staff uses several accounting standards in evaluating the provisions in the Code that govern the recognition of business receipts and expenses. Under the Joint Committee staff view, normal income tax law is assumed to require the accrual method of accounting, the standard of "economic performance" (used in the Code to test whether liabilities are deductible), and the general concept of matching income and expenses. In general, tax provisions that do not satisfy all three standards are viewed as tax expenditures. For example, the deduction for contributions to taxpayer-controlled mining reclamation reserve accounts is viewed as a tax expenditure because the contributions do not satisfy the economic performance standard. (Adherence to the standard would require that the taxpayer make an irrevocable contribution toward future reclamation, involving a trust fund or similar mechanism, as occurs in a number of areas in the Code.) The deduction for contributions to nuclear decommissioning trust accounts is not viewed as a tax expenditure because the contributions are irrevocable (i.e., they satisfy the economic performance standard). However, present law provides for a reduced rate of tax on the income of nuclear decommissioning trust accounts, and this reduced rate of tax is viewed as a tax expenditure.

### ***Corporate Income Tax***

The income of corporations (other than S corporations) generally is subject to the corporate income tax. The corporate income tax includes a graduated tax rate schedule. The lower tax rates in the schedule are classified by the Joint Committee staff as a tax expenditure (as opposed to normal income tax law) because they are intended to provide tax benefits to small business and, unlike the graduated individual income tax rates, are unrelated to concerns about ability of individuals to pay taxes.

Exceptions to the corporate alternative minimum tax are not viewed as tax expenditures because the effects of the AMT exceptions are already incorporated in the estimates of related tax expenditures.<sup>14</sup>

Certain income of pass-through entities is exempt from the corporate income tax. The income of sole proprietorships, S corporations, and most partnerships is taxed only at the individual level. The special tax rules for these pass-through entities are not classified as tax expenditures because the tax benefits are available to any entity that chooses to organize itself and operate in the required manner.

Nonprofit corporations that satisfy the requirements of Code section 501 also generally are exempt from corporate income tax. The tax exemption of certain nonprofit cooperative business organizations, such as trade associations, is not treated as a tax expenditure for the same reason applicable to for-profit pass-through business entities. With respect to other nonprofit organizations, such as charities, tax-exempt status is not classified as a tax expenditure because the nonbusiness activities of such organizations generally must predominate and their unrelated business activities are subject to tax. In general, the imputed income derived from nonbusi-

<sup>14</sup> See discussion of individual AMT on page 6.

ness activities conducted by individuals or collectively by certain nonprofit organizations is outside the normal income tax base. However, the ability of donors to such nonprofit organizations to claim a charitable contribution deduction is a tax expenditure (because such contributions do not generate income to the donor), as is the exclusion of income granted to holders of tax-exempt financing issued by charities.

### ***Recent Legislation***

The Fallen Hero Survivor Benefit Fairness Act of 2001 (H.R. 1727), enacted on June 5, 2001 (P.L. 107-15), broadened the exclusion for survivor annuities paid on account of the death of public safety officers killed in the line of duty. Under prior law, the exclusion was effective for annuities with respect to public safety officers dying after December 31, 1996. The Act extended the exclusion to annuities with respect to officers dying prior to January 1, 1997, effective for payments received after December 31, 2001.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (H.R. 1836), enacted on June 7, 2001 (P.L. 107-16), modified a number of tax expenditures, as follows:

—The child tax credit was increased to \$600 per child in 2001 through 2004, \$700 per child in 2005 through 2008, \$800 per child in 2009, and \$1,000 per child in 2010 and thereafter. In addition, the child credit was made refundable to the extent of 10 percent of the taxpayer's earned income in excess of \$10,000 for calendar years 2001-2004 (and 15 percent after 2004), and the refundable portion of the credit is no longer reduced by the amount of the alternative minimum tax, effective for taxable years beginning after December 31, 2000.

—The adoption tax credit for children other than special needs children, which was scheduled to expire for expenses paid or incurred after December 31, 2001, was permanently extended and the maximum credit for such adoptions was increased to \$10,000 per child. The maximum credit for taxpayers adopting special needs children was also increased to \$10,000. The income phase-out range for the adoption credit was increased and the credit is now allowed against the alternative minimum tax. All of these provisions are effective for taxable years beginning after December 31, 2001. In taxable years beginning after December 31, 2002, a \$10,000 credit for the adoption of special needs children will be provided in the year the adoption is finalized regardless of whether the taxpayer has adoption expenses.

—The exclusion for employer-provided adoption assistance, which was scheduled to expire for amounts paid or incurred after December 31, 2001, was permanently extended. The maximum exclusion was increased to \$10,000 per child and the income phase-out range for the exclusion was also increased, both effective for taxable years beginning after December 31, 2001. In taxable years beginning after December 31, 2002, a \$10,000 exclusion for the adoption of special needs children will be provided in the year the adoption is finalized regardless of whether the taxpayer has adoption expenses.

—The dependent care tax credit was modified in several ways. The maximum amount of eligible employment-related expenses was increased from \$2,400 to \$3,000 for one qualifying individual and

from \$4,800 to \$6,000 for two or more qualifying individuals, the maximum credit was increased from 30 percent to 35 percent of eligible expenses, and the beginning point for the phase-down of the credit was increased from \$10,000 to \$15,000 of adjusted gross income. All of these changes are effective for taxable years beginning after December 31, 2002.

—A number of changes were made to the earned income credit: (1) for married taxpayers, the phase-out ranges were modified, (2) the definition of earned income was simplified by excluding non-taxable employee compensation, (3) the provision that reduces the earned income credit by the amount of a taxpayer's alternative minimum tax was repealed, (4) the definition of a qualifying child was simplified, and (5) the calculation of the credit was simplified by replacing modified adjusted gross income with adjusted gross income. These changes are effective for taxable years beginning after December 31, 2001.

—The following changes were made to Coverdell education savings accounts<sup>15</sup> ("Coverdell accounts"): (1) the annual limit on contributions was increased from \$500 to \$2,000, (2) the definition of qualified education expenses was expanded to include elementary and secondary school expenses, (3) the income phase-out range for married taxpayers filing joint returns was increased so that it is twice the range for single taxpayers, (4) the various age limitations no longer apply to special needs beneficiaries, (5) corporations and other entities now are permitted to make contributions to Coverdell accounts regardless of the income of the corporation or entity, (6) taxpayers may claim a HOPE credit or Lifetime Learning credit and, in the same taxable year, exclude from gross income amounts distributed from Coverdell accounts on behalf of the same student, provided that the distribution is not used for the same education expenses for which a credit was claimed, and (7) there is no longer an excise tax on contributions made to Coverdell accounts during a taxable year in which contributions are made to a qualified State tuition program on behalf of the same beneficiary. All of these changes are effective for taxable years beginning after December 31, 2001.

—The rules governing the tax-exempt status of prepaid tuition programs were modified as follows: (1) the definition of "qualified tuition program" was expanded to include programs maintained by certain private educational institutions, (2) the definition of qualified higher education expenses was modified to include certain expenses of special needs beneficiaries, (3) an exclusion from gross income was provided for distributions from qualified tuition programs that are used for qualified higher education expenses, (4) taxpayers may claim a HOPE credit or Lifetime Learning credit and, in the same taxable year, exclude from gross income amounts distributed from a qualified tuition program on behalf of the same student, provided that the distribution is not used for the same education expenses for which a credit was claimed. (5) a transfer of credits from one qualified tuition program to another program for the same beneficiary will no longer be considered a taxable distribu-

<sup>15</sup>These accounts were previously referred to as "education IRAs" but were renamed by S. 1190, enacted on July 26, 2001 (P.L. 107-22).

tion, and (6) the present-law penalty on tuition program distributions not used for higher education expenses is replaced by the same tax that now applies to distributions from Coverdell accounts that are not used for higher education expenses. These provisions are effective for taxable years beginning after December 31, 2001, except that the exclusion from gross income for distributions from tuition programs maintained by private educational institutions is effective for taxable years beginning after December 31, 2003.

—The exclusion for employer-provided educational assistance for undergraduate courses, which was scheduled to expire for courses beginning after December 31, 2001, was permanently extended and the exclusion was broadened to include graduate courses, effective for graduate courses beginning after December 31, 2001.

—Several changes were made to the deduction for interest on student loans: (1) the income phase-out ranges for the deduction were increased, (2) the limit on the number of months during which interest payments are deductible was repealed, and (3) the restriction that voluntary payments of interest are not deductible was repealed. These changes are effective for interest paid after December 31, 2001.

—The exclusion for scholarship and fellowship income was broadened to include awards under the National Health Service Corps Scholarship Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program, thus providing an exception to the general rule that the exclusion does not apply to amounts representing payment for services that are required of the student. The exclusion for awards under these two programs is effective for amounts received after December 31, 2001. The exclusion does not apply to amounts received by students for regular living expenses, including room and board.

—The additional amount of governmental bonds for public schools that small governmental units may issue without being subject to the arbitrage rebate requirements was increased from \$5 million to \$10 million. In addition, the list of private activities for which tax-exempt bonds may be issued was expanded to include elementary and secondary public school facilities which are owned by private for-profit corporations pursuant to public-private partnership agreements with State or local agencies. These provisions are effective for bonds issued after December 31, 2001.

—Numerous changes were made in the rules relating to individual retirement arrangements ("IRAs") and qualified pension plans. Some of the changes include: (1) increased contribution limits and catch-up contributions for IRAs; (2) provisions for expanding pension plan coverage, including increased contribution and benefit limits for qualified plans, (3) provisions to enhance IRA and pension plan fairness for women, including additional catch-up contributions for individuals over age 50, and (4) provisions for increasing portability for plan participants. These provisions are generally effective for taxable years beginning after December 31, 2001.

The Economic Growth and Tax Relief Reconciliation Act also created five new tax expenditures:

—The Act provided a new above-the-line deduction for qualified higher education expenses. In 2002 and 2003, the maximum deduc-

tion is \$3,000 and the deduction is available only to taxpayers with adjusted gross income ("AGI") that is equal to or less than \$65,000 (\$130,000 for joint returns). In 2004 and 2005, a maximum deduction of \$4,000 is available to taxpayers with AGI equal to or less than \$65,000 (\$130,000 for joint returns), and a maximum deduction of \$2,000 is available to taxpayers with AGI of more than \$65,000 (\$130,000 for joint returns) but no more than \$80,000 (\$160,000 for joint returns). The deduction is effective for taxable years beginning after December 31, 2001, but does not apply to taxable years beginning after December 31, 2005.

—The Act provided a new tax credit for employers who provide child care for employees. The credit is equal to 25 percent of expenditures on child care plus 10 percent of expenditures on child care resource and referral services. The credit is effective for taxable years beginning after December 31, 2001.

—The Act provided a new exclusion for certain restitution payments made to eligible individuals (and the heirs and estates of such individuals) who were persecuted for racial or religious reasons by Nazi Germany or other Axis regimes. The exclusion is effective for amounts received on or after January 1, 2000. This tax expenditure is not listed in Table 1 because the estimated revenue loss is below the de minimis amount.

—The Act provided a temporary nonrefundable tax credit for up to \$2,000 of elective contributions to qualified pension plans and IRAs. The rate of the credit is based on the taxpayer's adjusted gross income. The credit is effective for taxable years beginning after December 31, 2001, and before January 1, 2007.

—The Act provided a nonrefundable income tax credit for the administrative and retirement-education expenses for new pension plans adopted by small businesses. The credit is equal to 50 percent of the first \$1,000 in expenses for each of the first three years of the new plan. The credit is effective with respect to costs paid or incurred in taxable years beginning after December 31, 2001, with respect to plans established after that date.

The Railroad Retirement and Survivors' Improvement Act of 2001 (H.R. 10), enacted on December 21, 2001 (P.L. 107-90), creates the National Railroad Retirement Trust, transfers certain funds to the trust, and amends Code sec. 501(c) to include the trust in the list of tax exempt organizations. The tax exemption for 501(c) organizations is not viewed as a tax expenditure for the reasons explained earlier.<sup>16</sup>

The Victims of Terrorism Tax Relief Act of 2001 (H.R. 2884) was passed by the House of Representatives and the Senate on December 20, 2001. Upon enactment, this bill will provide certain tax benefits to the victims of the terrorist attacks that occurred on April 19, 1995, and September 11, 2001. Some of the tax provisions in this bill could be viewed as tax expenditures but none are listed in Table 1 because the estimated revenue losses for fiscal years 2002 through 2006 are below the de minimis amount (\$50 million).

<sup>16</sup> See discussion on page 7.

### ***Expiring Provisions***

The tax credit for electricity production from wind, closed-loop biomass, and poultry waste expired for facilities placed in service after December 31, 2001. The tax expenditure estimate in Table 1 is based on the credits that will be earned from electricity produced from facilities placed in service prior to January 1, 2002.

The work opportunity tax credit expired for employees hired after December 31, 2001. The tax expenditure estimate in Table 1 is based on credits that will be earned for workers hired prior to January 1, 2002.

The welfare-to-work tax credit expired for employees hired after December 31, 2001. The tax expenditure estimate in Table 1 is based on credits that will be earned for workers hired prior to January 1, 2002.

Qualified zone academy bonds were authorized to be issued in 2001 and earlier calendar years. No additional authorizations have been enacted for calendar years 2002 and thereafter. The tax expenditure estimate in Table 1 is based on bonds issued prior to 2002 and bonds that will be issued in 2002 and thereafter using the remaining bond authority from calendar years 2001 and earlier.

### ***Comparisons With Treasury Department***

The Joint Committee staff and Treasury lists of tax expenditures differ in three respects. First, the Treasury uses a different classification of those provisions that can be considered a part of normal income tax law under both the individual and business income taxes. In general, the Joint Committee staff methodology involves a narrower concept of normal income tax law. Thus, the Joint Committee list of tax expenditures includes some provisions that are not contained in the Treasury list. The cash method of accounting provides an example. The Treasury considers the cash accounting option for certain businesses to be a part of normal income tax law, but the Joint Committee staff methodology treats it as a departure from normal income tax law that constitutes a tax expenditure.

Second, the Joint Committee staff and Treasury estimates of tax expenditures span slightly different sets of years. The Treasury's estimates cover a seven-year period—the last fiscal year, the current fiscal year when the President's budget is submitted, and the next five fiscal years, i.e., fiscal years 2000–2006. The Joint Committee staff estimates cover the current fiscal year and the succeeding four fiscal years, i.e., fiscal years 2002–2006.

Third, the Joint Committee staff list excludes those provisions that are estimated to result in revenue losses below the de minimis amount, i.e., less than \$50 million over the five fiscal years 2002 through 2006. The Treasury rounds all yearly estimates to the nearest \$10 million and excludes those provisions with estimates that round to zero in each year, i.e., provisions that result in less than \$5 million in revenue loss in each of the years 2000 through 2006.

For the past nine years, the President's budget has contained a section that reviews and tabulates the estate and gift tax provisions that the Treasury considers as tax expenditures. The Joint Committee staff considers estate and gift tax provisions as being

outside of the normal income tax structure and thus omits them from its list of tax expenditures.

In some cases, two or more of the tax expenditure items in the Treasury list have been combined into a single item in the Joint Committee staff list, and vice versa. The Table 1 descriptions of some tax expenditures also may vary from the descriptions used by the Treasury.

The following is a list of tax provisions that are contained in the Joint Committee staff list of tax expenditures (and are shown in Table 1) but are not contained in the Treasury list:

#### *Natural resources and environment*

- Exclusion of contributions in aid of construction for water and sewer utilities
- Special rules for mining reclamation reserves
- Special tax rate for nuclear decommissioning reserve funds

#### *Agriculture*

- Exclusion of cost-sharing payments
- Cash accounting for agriculture
- Five-year carryback period for net operating losses attributable to farming

#### *Insurance companies*

- Special treatment of life insurance company reserves
- Deduction of unpaid loss reserves of property and casualty companies

#### *Business and commerce*

- Expensing of magazine circulation expenditures
- Special rules for magazine, paperback book, and record returns
- Completed contract rules
- Cash accounting, other than agriculture
- Deferral of gain on like-kind exchanges
- Exception from net operating loss limitations for corporations in bankruptcy
- Tax credit for employer-paid FICA taxes on tips
- Deferral of gain on involuntary conversions resulting from Presidentially-declared disasters

#### *Employment*

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

#### *Medicare*

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

The following tax provisions are not included in the Joint Committee staff list of tax expenditures or the Treasury list. However, these provisions are viewed as tax expenditures by the Joint Committee staff. These provisions are not listed in Table 1 because the estimated revenue losses for fiscal years 2002 through 2006 are below the de minimis amount (\$50 million):

*Energy*

- Expensing of tertiary injectants

*Financial institutions*

- Exclusion of investment income from structured settlement arrangements

*Income security*

- Exclusion of survivor annuities paid to families of public safety officers killed in the line of duty

The following is a list of the tax provisions that are included in the Treasury list and are viewed as tax expenditures by the Joint Committee staff but are excluded from Table 1 because the estimated revenue losses for fiscal years 2002 through 2006 are below the de minimis amount (\$50 million):

*Energy*

- Tax credit for electric vehicles
- Deductions for clean-fuel vehicles and refueling property

*Natural resources and environment*

- Tax credit and seven-year amortization for reforestation expenditures

*Agriculture*

- Deferral of tax on gains from the sale of stock in a qualified refiner or processor to an eligible farmer's cooperative

*Financial institutions*

- Bad debt reserves of financial institutions

*Insurance companies*

- Special alternative tax on small property and casualty insurance companies
- Tax exemption for certain small insurance companies

*Business and commerce*

- Exclusion of income from discharge of indebtedness incurred in connection with qualified real property

*Social services*

- Expensing of costs for removing architectural barriers

There are three additional tax expenditure provisions in the Treasury list that are not included in the Joint Committee staff list. Two of the provisions involve exceptions to the passive loss



rules: the exception for working interests in oil and gas properties, and the exception for up to \$25,000 of rental losses. The Joint Committee staff does not classify these two provisions as tax expenditures; the effects of the passive loss rules (and exceptions to the rules) are included in the estimates of the tax expenditure provisions that are affected by the rules.<sup>17</sup> The third tax expenditure in the Treasury list that is not included in the Joint Committee staff list is the exemption of certain income of telephone and electric cooperatives. The Joint Committee staff does not classify this provision as a tax expenditure because the special tax rules for pass-through entities are assumed to be a part of normal tax law.<sup>18</sup>

<sup>17</sup> See discussion of the alternative minimum tax and passive loss rules, above on page 6.

<sup>18</sup> See discussion on page 7, above.

## II. MEASUREMENT OF TAX EXPENDITURES

### *Tax Expenditure Estimates Generally*

A tax expenditure is measured by the difference between tax liability under present law and the tax liability that would result from a recomputation of tax without benefit of the tax expenditure provision. Taxpayer behavior is assumed to remain unchanged for tax expenditure estimate purposes.<sup>19</sup>

The tax expenditure estimates in this report are based on Congressional Budget Office and Joint Committee staff projections of the gross income, deductions, and expenditures of individuals and corporations for calendar years 2001–2006. These projections are used to compute tax liabilities for the present-law revenue baseline and tax liabilities for the alternative baseline that assumes that the tax expenditure provision does not exist.

Internal Revenue Service (“IRS”) statistics from recent tax returns are used to develop projections of the tax credits, deductions, and exclusions that will be claimed under the present-law baseline. These IRS statistics show the actual usage of the various tax expenditure provisions. In the case of some tax expenditures, such as the earned income credit, there is evidence that some taxpayers are not claiming all of the benefits to which they are entitled, while others are filing claims that exceed their entitlements. The tax expenditure estimates in this report are based on projections of actual claims under the various tax provisions, not the tax benefits to which taxpayers are entitled.

Some tax expenditure estimates are based partly on statistics for income, deductions, and expenses for prior years. Accelerated depreciation is an example. Estimates for this tax expenditure are based on the difference between tax depreciation deductions under present law and the deductions that would have been claimed in the current year if investments in the current year and all prior years had been depreciated using the alternative (normal income tax law) depreciation system.

Each tax expenditure is estimated separately, under the assumption that all other tax expenditures remain in the tax code. If two or more tax expenditures were estimated simultaneously, the total change in tax liability could be smaller or larger than the sum of the amounts shown for each item separately, as a result of interactions among the tax expenditure provisions.

Year-to-year differences in the estimates for each tax expenditure reflect changes in tax law, including phaseouts of tax expenditure provisions and changes that alter the definition of the normal in-

<sup>19</sup> An alternative way to measure tax expenditures is to express their values in terms of “outlay equivalents.” An outlay equivalent is the dollar size of a direct spending program that would provide taxpayers with net benefits that would equal what they now receive from a tax expenditure. The Treasury Department presents estimates of outlay equivalents in the President’s budget in addition to presenting estimates in the same manner as the Joint Committee staff.

come tax structure, such as the tax rate schedule, the personal exemption amount, and the standard deduction. Some of the estimates for this tax expenditure report may differ from estimates made in previous years because of changes in law and economic conditions, the availability of better data, and improved estimating techniques.

### ***Tax Expenditures versus Revenue Estimates***

A tax expenditure estimate is not the same as a revenue estimate for the repeal of the tax expenditure provision for three reasons. First, tax expenditure estimates do not incorporate any changes in taxpayer behavior, whereas revenue estimates incorporate the effects of the behavioral changes that are anticipated to occur in response to the repeal of a tax provision. Second, tax expenditure estimates are concerned with changes in the tax liabilities of taxpayers. Because the tax expenditure focus is on tax liabilities as opposed to Federal government tax receipts, there is no concern for the timing of tax payments. Revenue estimates are concerned with changes in Federal tax receipts which are affected by the timing of tax payments. Third, some of the tax provisions that provide an exclusion from income also apply to the FICA tax base, and the repeal of the income tax provision would automatically increase FICA tax revenues as well as income tax revenues.

If a tax expenditure provision were repealed, it is likely that the repeal would be made effective at the beginning of a calendar year. In this case, the revenue estimate for repeal would show a smaller revenue gain in the first fiscal year than in subsequent years, because the repeal would be occurring after the start of the government's fiscal year. The revenue estimate might also reflect some delay in the timing of the revenue gains as a result of the taxpayer tendency to postpone or forgo changes in tax withholding and estimated tax payments.

### **III. TAX EXPENDITURE ESTIMATES**

Tax expenditures are grouped in Table 1 in the same functional categories as outlays in the Federal budget. Estimates are shown separately for individuals and corporations. Those tax expenditures that do not fit clearly into any single budget category have been placed in the most appropriate category.

Several of the tax expenditure items involve small amounts of revenue, and those estimates are indicated in Table 1 by footnote 1. For each of these items, the footnote means that the tax expenditure is less than \$50 million in the fiscal year.

Table 2 presents tax return information for each of nine income classes on the number of all returns (including filing and nonfiling units), the number of taxable returns, the number of returns with itemized deductions, and the amount of tax liability.

Table 3 provides distributional estimates by income class for some of the tax expenditures that affect individual taxpayers. Not all tax expenditures that affect individuals are shown in this table because of the difficulty in making reliable estimates of the income distribution of items that do not appear on tax returns under present law.

**Table 1.—Tax Expenditure Estimates By Budget Function, Fiscal Years 2002–2006**  
[Billions of Dollars]

Function	Corporations					Individuals					Total 2002–06
	2002	2003	2004	2005	2006	2002	2003	2004	2005	2006	
<b>National Defense</b>											
Exclusion of benefits and allowances to Armed Forces personnel .....						2.3	2.3	2.4	2.4	2.4	11.8
Exclusion of military disability benefits .....						0.1	0.1	0.1	0.1	0.1	0.5
<b>International Affairs</b>											
Exclusion of income earned abroad by U.S. citizens .....						2.8	3.0	3.2	3.4	3.6	16.0
Exclusion of certain allowances for Federal employees abroad .....						0.3	0.4	0.4	0.4	0.5	2.0
Exclusion of extraterritorial income .....	4.8	5.2	5.6	6.0	6.5						28.1
Deferral of active income of controlled foreign corporations .....	4.2	4.4	4.7	5.0	5.3						23.6
Inventory property sales source rule exception ..	4.8	5.2	5.6	6.0	6.4						28.0
Deferral of certain financing income .....	0.6	0.2									0.8
<b>General Science, Space, and Technology</b>											
Tax credit for qualified research expenditures ...	5.0	5.4	4.7	2.8	1.5	(1)	(1)	(1)	(1)	(1)	19.4
Expensing of research and experimental expenditures .....	4.5	4.7	4.7	4.8	5.0	(1)	(1)	(1)	(1)	(1)	23.7
<b>Energy</b>											
Expensing of exploration and development costs:											
Oil and gas .....	1.6	1.2	0.7	0.3	0.6	(1)	(1)	(1)	(1)	(1)	4.4
Other fuels .....	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2
Excess of percentage over cost depletion:											
Oil and gas .....	0.5	0.4	0.4	0.4	0.4	(1)	(1)	(1)	(1)	(1)	2.2
Other fuels .....	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.1
Tax credit for enhanced oil recovery costs .....	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	1.4
Tax credit for production of non-conventional fuels .....	1.3	0.8	0.5	0.5	0.5	0.3	0.2	0.1	0.1	0.1	4.5
Tax credit for alcohol fuels <sup>2</sup> .....	(1)	(1)	(1)	(1)	(1)						(1)

Exclusion of interest on State and local government industrial development bonds for energy production facilities .....	(1)	(1)	(1)	(1)	(1)	0.1	0.1	0.1	0.1	0.1	0.7
Exclusion of energy conservation subsidies provided by public utilities .....						(1)	(1)	(1)	(1)	(1)	0.1
Tax credit for investments in solar and geothermal energy facilities .....	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.1
Tax credit for electricity production from wind, closed-loop biomass, and poultry waste .....	(1)	(1)	(1)	(1)	0.1	(1)	(1)	(1)	(1)	(1)	0.3
<b>Natural Resources and Environment</b>											
Expensing of exploration and development costs, nonfuel minerals .....	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.3
Excess of percentage over cost depletion, nonfuel minerals .....	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.7
Expensing of multiperiod timber-growing costs ..	0.2	0.2	0.2	0.2	0.2	(1)	(1)	(1)	(1)	(1)	0.9
Exclusion of interest on State and local government sewage, water, and hazardous waste facilities bonds .....	0.2	0.2	0.2	0.2	0.2	0.4	0.4	0.4	0.4	0.4	2.9
Special rules for mining reclamation reserves ....	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2
Special tax rate for nuclear decommissioning reserve fund .....	0.2	0.2	0.3	0.3	0.3						1.3
Exclusion of contributions in aid of construction for water and sewer utilities .....	(1)	(1)	(1)	(1)	(1)						0.1
<b>Agriculture</b>											
Expensing of soil and water conservation expenditures .....	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2
Expensing of fertilizer and soil conditioner costs .....	(1)	(1)	(1)	(1)	(1)	0.1	0.1	0.1	0.1	0.1	0.3
Expensing of the costs of raising dairy and breeding cattle .....	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.1
Exclusion of cost-sharing payments .....	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.1
Exclusion of cancellation of indebtedness income of farmers .....						0.1	(1)	(1)	(1)	(1)	0.2
Cash accounting for agriculture .....	(1)	(1)	(1)	(1)	(1)	0.5	0.3	0.3	0.3	0.3	1.7
Income averaging for farmers .....						(1)	(1)	(1)	(1)	(1)	0.1
Five-year carryback period for net operating losses attributable to farming .....	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2
<b>Commerce and Housing</b>											
<i>Financial institutions:</i>											
Exemption of credit union income .....	0.9	0.9	0.9	1.0	1.0						4.7

**Table 1.—Tax Expenditure Estimates By Budget Function, Fiscal Years 2002–2006—Continued**  
[Billions of Dollars]

Function	Corporations					Individuals					Total 2002-06
	2002	2003	2004	2005	2006	2002	2003	2004	2005	2006	
<i>Insurance companies:</i>											
Exclusion of investment income on life insurance and annuity contracts .....	1.3	1.4	1.4	1.5	1.5	23.6	24.2	24.9	25.5	26.2	131.6
Small life insurance company taxable income adjustment .....	0.1	0.1	0.1	0.1	0.1	.....	.....	.....	.....	.....	0.7
Special treatment of life insurance company reserves .....	1.2	1.3	1.3	1.4	1.4	.....	.....	.....	.....	.....	6.6
Deduction of unpaid loss reserves for property and casualty insurance companies .....	2.9	3.0	3.0	3.1	3.2	.....	.....	.....	.....	.....	15.2
Special deduction for Blue Cross and Blue Shield companies .....	0.1	0.1	0.1	0.1	0.1	.....	.....	.....	.....	.....	0.5
<i>Housing:</i>											
Deduction for mortgage interest on owner-occupied residences .....	.....	.....	.....	.....	.....	66.5	69.8	72.1	76.5	80.5	365.5
Deduction for property taxes on owner-occupied residences .....	.....	.....	.....	.....	.....	21.4	22.1	21.4	18.8	15.5	99.2
Exclusion of capital gains on sales of principal residences .....	.....	.....	.....	.....	.....	13.8	13.8	13.9	14.0	14.1	69.6
Exclusion of interest on State and local government bonds for owner-occupied housing .....	0.3	0.3	0.3	0.3	0.3	0.7	0.8	0.8	0.8	0.8	5.3
Exclusion of interest on State and local government bonds for rental housing .....	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	1.0
Depreciation of rental housing in excess of alternative depreciation system .....	0.3	0.3	0.3	0.3	0.3	2.5	2.7	2.8	3.1	3.4	16.0
Tax credit for low-income housing .....	2.7	2.9	3.0	3.2	3.3	1.2	1.2	1.3	1.4	1.4	21.6
Tax credit for first-time homebuyers in the District of Columbia .....	.....	.....	.....	.....	.....	(1)	(1)	(1)	.....	.....	0.1
Tax credit for rehabilitation of historic structures .....	0.4	0.4	0.4	0.4	0.4	0.1	0.1	0.1	0.1	0.1	2.5
<i>Other business and commerce:</i>											
Reduced rates of tax on long-term capital gains .....	.....	.....	.....	.....	.....	65.1	57.4	56.8	53.8	53.3	286.4

Exclusion of capital gains at death .....						37.3	40.1	43.1	46.3	49.8	216.6
Carryover basis of capital gains on gifts .....						4.2	4.4	4.6	4.8	5.1	23.1
Deferral of gain on non-dealer installment sales .....	0.6	0.6	0.6	0.7	0.7	0.4	0.4	0.4	0.4	0.4	5.2
Deferral of gain on like-kind exchanges .....	1.3	1.4	1.4	1.5	1.5	0.4	0.5	0.5	0.5	0.5	9.5
Deferral of gain on involuntary conversions resulting from Presidentially-declared disasters .....						(1)	(1)	(1)	(1)	(1)	0.1
Depreciation of buildings other than rental housing in excess of alternative depreciation system .....	1.2	1.2	1.1	0.9	0.9	0.5	0.5	0.4	0.4	0.3	7.4
Depreciation of equipment in excess of alternative depreciation system .....	28.0	31.0	32.8	33.9	34.5	7.5	8.4	8.8	9.0	9.1	203.0
Expensing of depreciable business property ....	0.3	0.3	0.2	0.2	0.1	1.3	1.3	0.9	0.6	0.4	5.6
Amortization of business startup costs .....	(1)	(1)	(1)	(1)	(1)	0.5	0.5	0.5	0.5	0.6	2.6
Reduced rates on first \$10,000,000 of corporate taxable income .....	4.7	4.7	4.8	4.9	5.0						24.1
Permanent exemption from imputed interest rules .....	(1)	(1)	(1)	(1)	(1)	0.2	0.3	0.3	0.3	0.3	1.4
Expensing of magazine circulation expenditures .....	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2
Special rules for magazine, paperback book, and record returns .....	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.1
Completed contract rules .....	0.2	0.2	0.2	0.2	0.2	(1)	(1)	(1)	(1)	(1)	1.2
Cash accounting, other than agriculture .....	(1)	(1)	(1)	(1)	(1)	0.3	0.3	0.3	0.3	0.3	1.5
Exclusion of interest on State and local government small-issue industrial development bonds .....	0.1	0.1	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	1.9
Exception from net operating loss limitations for corporations in bankruptcy proceedings .....	0.5	0.5	0.5	0.5	0.5						2.5
Tax credit for employer-paid FICA taxes on tips .....	0.1	0.1	0.1	0.1	0.2	0.2	0.3	0.3	0.3	0.3	2.0
Ordinary income treatment of losses from sales of small business corporation stock .....						(1)	(1)	(1)	(1)	(1)	0.2
<b>Transportation</b>											
Deferral of tax on capital construction funds for shipping companies .....	0.1	0.1	0.1	0.1	0.1						0.5
Exclusion of employer-paid transportation benefits .....						3.7	3.7	3.8	3.8	3.9	18.9



**Table 1.—Tax Expenditure Estimates By Budget Function, Fiscal Years 2002–2006—Continued**  
[Billions of Dollars]

Function	Corporations					Individuals					Total 2002–06
	2002	2003	2004	2005	2006	2002	2003	2004	2005	2006	
Exclusion of interest on State and local government bonds for high-speed rail .....	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.5
<b>Community and Regional Development</b>											
Employment zone tax incentives .....	0.2	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	3.3
Renewal community tax incentives .....	0.1	0.1	0.1	0.2	0.2	0.3	0.4	0.4	0.4	0.4	2.7
New markets tax credit .....	(1)	(1)	0.1	0.2	0.2	(1)	0.1	0.1	0.2	0.3	1.3
District of Columbia tax incentives .....	(1)	(1)	0.1	0.1	0.1	(1)	0.1	0.1	0.1	0.1	0.6
Indian reservation tax incentives .....	0.2	0.2	0.1	(3)	–0.1	0.1	0.1	0.1	(3)	–0.1	0.7
Expensing of environmental remediation costs (“Brownfields”) .....	0.1	0.1	(1)	(3)	(3)	0.1	0.1	0.1	(3)	(3)	0.5
Tax credit for rehabilitation of structures, other than historic structures .....	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.1
Exclusion of interest on State and local government bonds for private airports, docks, and mass-commuting facilities .....	0.2	0.2	0.2	0.2	0.2	0.5	0.5	0.5	0.5	0.5	3.6
<b>Education, Training, Employment, and Social Services</b>											
<i>Education and training:</i>											
Tax credits for tuition for post-secondary education .....						4.3	4.3	4.3	4.3	4.3	21.5
Deduction for interest on student loans .....						0.6	0.6	0.7	0.8	0.8	3.5
Deduction for higher education expenses .....						1.5	2.1	3.7	2.9	0.1	10.3
Exclusion of earnings of trust accounts for education (“Coverdell accounts”) .....						0.3	0.4	0.5	0.6	0.7	2.5
Exclusion of interest on educational savings bonds .....						(1)	(1)	(1)	(1)	(1)	0.1
Exclusion of earnings of qualified tuition programs .....						0.1	0.2	0.2	0.3	0.3	1.1
Exclusion of scholarship and fellowship income .....						1.3	1.4	1.5	1.5	1.6	7.3
Exclusion of employer-provided education assistance benefits .....						0.5	0.7	0.8	0.8	0.9	3.7

Parental personal exemption for students age 19 to 23 .....						1.0	1.0	0.9	0.4	0.1	3.4
Exclusion of interest on State and local government student loan bonds .....	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.3	1.7
Exclusion of interest on State and local government bonds for private nonprofit educational facilities .....	0.2	0.2	0.2	0.3	0.3	0.6	0.6	0.6	0.6	0.7	4.4
Tax credit for holders of qualified zone academy bonds .....	(1)	(1)	0.1	0.1	0.1						0.3
Deduction for charitable contributions to educational institutions .....	1.0	1.1	1.2	1.3	1.4	5.5	6.1	6.4	6.6	6.5	37.1
<i>Employment:</i>											
Exclusion of employee meals and lodging (other than military) .....						0.8	0.9	0.9	0.9	0.9	4.4
Exclusion of benefits provided under cafeteria plans <sup>4</sup> .....						11.4	12.7	13.7	14.8	15.6	68.2
Exclusion of housing allowances for ministers .....						0.4	0.4	0.5	0.5	0.5	2.3
Exclusion of miscellaneous fringe benefits .....						5.7	6.0	6.2	6.4	6.7	31.0
Exclusion of employee awards .....						0.1	0.1	0.1	0.1	0.1	0.7
Exclusion of income earned by voluntary employees' beneficiary associations .....						1.6	1.7	1.7	1.8	1.9	8.7
Special tax provisions for employee stock ownership plans (ESOPs) .....	0.8	0.9	0.9	0.9	0.9	0.2	0.2	0.3	0.3	0.3	5.7
Work opportunity tax credit .....	0.3	0.1	0.1	(1)	(1)	0.1	(1)	(1)			0.6
Welfare-to-work tax credit .....	0.1	(1)	(1)	(1)	(1)	(1)	(1)	(1)			0.2
Exclusion of spread on acquisition of stock under incentive stock option plans and employee stock purchase plans .....						0.5	0.6	0.8	0.9	1.0	3.8
<i>Social services:</i>											
Tax credit for children under age 17 <sup>5</sup> .....						26.9	26.9	26.8	30.2	31.5	142.3
Tax credit for child and dependent care expenses .....						3.1	3.1	3.0	2.5	2.0	13.8
Exclusion of employer-provided child care <sup>6</sup> .....						0.6	0.8	0.8	0.9	0.9	4.0
Tax credit for employer-provided child care .....	(1)	0.1	0.1	0.1	0.1	(1)	(1)	(1)	(1)	(1)	0.6
Exclusion of certain foster care payments .....						0.5	0.5	0.6	0.6	0.6	2.8
Adoption credit and employee adoption benefits exclusion .....						0.2	0.2	0.3	0.3	0.3	1.3
Deduction for charitable contributions, other than for education and health .....	1.7	1.9	2.1	2.2	2.4	30.0	32.9	34.8	35.8	35.1	178.9
Tax credit for disabled access expenditures .....	(1)	(1)	(1)	(1)	(1)	0.1	0.1	0.1	0.1	0.1	0.4

**Table 1.—Tax Expenditure Estimates By Budget Function, Fiscal Years 2002–2006—Continued**  
[Billions of Dollars]

Function	Corporations					Individuals					Total 2002–06
	2002	2003	2004	2005	2006	2002	2003	2004	2005	2006	
<b>Health</b>											
Exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums <sup>7</sup> .....						69.1	75.1	80.0	86.5	93.3	404.1
Exclusion of medical care and CHAMPUS/TRICARE medical insurance for military dependents, retirees, and retiree dependents .....						1.4	1.5	1.5	1.5	1.5	7.4
Deduction for health insurance premiums and long-term care insurance premiums by the self-employed .....						1.6	2.4	2.8	2.9	3.1	12.8
Deduction for medical expenses and long-term care expenses .....						5.6	6.0	6.4	6.8	7.2	32.0
Exclusion of workers' compensation benefits (medical benefits) .....						3.5	3.7	3.8	3.9	4.0	18.9
Archer medical savings accounts .....						(1)	(1)	(1)	(1)	(1)	0.1
Exclusion of interest on State and local government bonds for private nonprofit hospital facilities .....	0.4	0.4	0.4	0.4	0.4	1.0	1.0	1.0	1.0	1.1	7.2
Deduction for charitable contributions to health organizations .....	1.0	1.0	1.1	1.2	1.3	3.8	4.2	4.4	4.5	4.5	27.0
Tax credit for orphan drug clinical testing .....	0.1	0.1	0.1	0.1	0.1						0.7
<b>Medicare</b>											
Exclusion of untaxed Medicare benefits:											
Hospital insurance .....						16.9	18.0	19.5	21.0	22.6	98.0
Supplementary medical insurance .....						9.8	11.1	11.9	12.7	13.7	59.2
<b>Income Security</b>											
Exclusion of workers' compensation benefits (disability and survivors payments) .....						5.4	5.6	5.8	6.1	6.4	29.3
Exclusion of damages on account of personal physical injuries or physical sickness .....						1.4	1.4	1.4	1.4	1.4	7.0
Exclusion of special benefits for disabled coal miners .....						0.1	0.1	0.1	0.1	0.1	0.3

Exclusion of cash public assistance benefits .....						0.7	0.7	0.7	0.7	0.8	3.6
Net exclusion of pension contributions and earnings:											
Employer plans .....						87.9	87.7	86.7	89.1	93.5	445.0
Individual retirement plans .....						14.0	14.2	15.4	16.8	18.1	78.5
Keogh plans .....						5.6	5.7	5.8	6.0	6.3	29.3
Tax credit for certain individuals for elective deferrals and IRA contributions .....						1.3	1.9	1.7	1.6	1.5	8.0
Tax credit for new retirement plan expenses of small businesses .....	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.1
Exclusion of other employee benefits:											
Premiums on group term life insurance .....						2.3	2.4	2.5	2.6	2.7	12.5
Premiums on accident and disability insurance .....						2.3	2.4	2.6	2.7	2.8	12.8
Additional standard deduction for the blind and the elderly .....						2.0	2.1	2.2	2.3	2.3	10.8
Tax credit for the elderly and disabled .....						(1)	(1)	(1)	(1)	(1)	0.1
Deduction for casualty and theft losses .....						0.2	0.2	0.2	0.2	0.2	1.1
Earned income credit (EIC) <sup>5</sup> .....						33.7	35.0	35.7	36.2	37.0	177.6
<b>Social Security and Railroad Retirement</b>											
Exclusion of untaxed social security and railroad retirement benefits .....						22.6	23.5	24.3	25.0	25.7	121.1
<b>Veterans' Benefits and Services</b>											
Exclusion of veterans' disability compensation .....						2.3	2.4	2.4	2.5	2.6	12.1
Exclusion of veterans' pensions .....						0.1	0.1	0.1	0.1	0.1	0.6
Exclusion of veterans' readjustment benefits .....						0.1	0.1	0.1	0.1	0.1	0.7
Exclusion of interest on State and local government bonds for veterans' housing .....	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2
<b>General Purpose Fiscal Assistance</b>											
Exclusion of interest on public purpose State and local government debt .....	6.1	6.2	6.2	6.3	6.4	15.7	15.8	16.0	16.3	16.5	112.0
Deduction of nonbusiness State and local government income and personal property taxes .....						44.9	46.3	45.3	41.5	34.7	212.7
Tax credit for Puerto Rico and possession income, and Puerto Rico economic activity .....	2.6	2.2	2.0	1.8	0.5						9.1

**Table 1.—Tax Expenditure Estimates By Budget Function, Fiscal Years 2002-2006—Continued**  
[Billions of Dollars]

Function	Corporations					Individuals					Total 2002-06
	2002	2003	2004	2005	2006	2002	2003	2004	2005	2006	
<b>Interest</b>											
Deferral of interest on savings bonds .....						1.6	1.6	1.6	1.6	1.6	8.0

<sup>1</sup> Positive tax expenditure of less than \$50 million.

<sup>2</sup> In addition, the exemption from excise tax for alcohol fuels results in a reduction in excise tax receipts, net of income tax effect, of \$0.7 billion per year in fiscal years 2002 through 2006.

<sup>3</sup> Negative tax expenditure of less than \$50 million.

<sup>4</sup> Estimate includes amounts of employer-provided health insurance purchased through cafeteria plans and employer-provided child care purchased through dependent care flexible spending accounts. These amounts are also included in other line items in this table.

<sup>5</sup> The amount of refundable child tax credit and earned income tax credit used to offset taxes other than income tax or paid out as refunds is: \$38.5 billion in 2002, \$39.5 billion in 2003, \$40.2 billion in 2004, \$40.5 in 2005, and \$43.4 billion in 2006.

<sup>6</sup> Estimate includes employer-provided child care purchased through dependent care flexible spending accounts.

<sup>7</sup> Estimate includes employer-provided health insurance purchased through cafeteria plans.

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

Source: Joint Committee on Taxation.

**Table 2.—Distribution by Income Class of All Returns, Taxable Returns, Itemized Returns, and Tax Liability at 2001 Rates and 2001 Law and 2001 Income Levels<sup>1</sup>**

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

Income Class [thousands] <sup>2</sup>	All returns <sup>3</sup>	Taxable returns	Itemized returns	Tax liability
Below \$10 .....	19,863	968	438	— \$6,374
\$10 to \$20 .....	23,269	6,904	882	— 12,740
\$20 to \$30 .....	18,533	10,000	2,110	3,385
\$30 to \$40 .....	15,753	11,970	3,240	22,375
\$40 to \$50 .....	13,129	11,283	3,823	33,480
\$50 to \$75 .....	21,903	20,883	9,547	100,125
\$75 to \$100 .....	12,946	12,856	8,427	109,947
\$100 to \$200 .....	12,788	12,758	10,556	226,366
\$200 and over .....	3,841	3,838	3,422	471,027
<b>Total .....</b>	<b>142,024</b>	<b>91,460</b>	<b>42,444</b>	<b>\$947,591</b>

<sup>1</sup> Tax law as in effect on July 1, 2001, is applied to the 2001 level and sources of income and their distribution among taxpayers.

<sup>2</sup> The income concept used to place tax returns into classes is adjusted gross income (AGI) plus: (a) tax-exempt interest, (b) employer contributions for health plans and life insurance, (c) employer share of FICA tax, (d) worker's compensation, (e) nontaxable Social Security benefits, (f) insurance value of Medicare benefits, (g) alternative minimum tax preference items, and (h) excluded income of U.S. citizens living abroad.

<sup>3</sup> Includes filing and nonfiling units. Filing units include all taxable and nontaxable returns. Nonfiling units include individuals with income that is exempt from Federal income taxation (e.g., transfer payments, interest from tax-exempt bonds, etc.). Excludes individuals who are dependents of other taxpayers and taxpayers with negative income.

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

Source: Joint Committee on Taxation.

**Table 3.—Distribution by Income Class of Selected Individual Tax Expenditure Items,  
at 2001 Rates and 2001 Income Levels <sup>1</sup>**

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

Income Class [thousands] <sup>2</sup>	Medical deduction		Real estate tax deduction	
	Returns	Amount	Returns	Amount
Below \$10 .....	41	\$7	27	\$1
\$10 to \$20 .....	717	220	288	30
\$20 to \$30 .....	830	317	1,124	140
\$30 to \$40 .....	856	416	1,994	326
\$40 to \$50 .....	779	600	2,813	684
\$50 to \$75 .....	1,204	1,252	7,700	2,463
\$75 to \$100 .....	529	913	7,278	3,651
\$100 to \$200 .....	305	894	9,381	7,595
\$200 and over .....	53	572	2,953	6,455
<b>Total .....</b>	<b>5,314</b>	<b>\$5,190</b>	<b>33,558</b>	<b>\$21,345</b>

Footnotes at end of table.

**Table 3.—Distribution by Income Class of Selected Individual Tax Expenditure Items,  
at 2001 Rates and 2001 Income Levels<sup>1</sup>—Continued**

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

Income Class [thousands] <sup>2</sup>	State and local income and personal property tax deduction		Charitable contributions deduction	
	Returns	Amount	Returns	Amount
Below \$10 .....	25	( <sup>3</sup> )	27	\$1
\$10 to \$20 .....	335	\$7	854	100
\$20 to \$30 .....	1,350	68	2,340	322
\$30 to \$40 .....	2,423	230	3,306	688
\$40 to \$50 .....	3,113	576	3,672	1,105
\$50 to \$75 .....	8,479	2,721	8,570	3,642
\$75 to \$100 .....	7,568	4,827	6,641	4,450
\$100 to \$200 .....	9,302	11,747	7,299	8,254
\$200 and over .....	3,029	24,559	2,384	18,640
<b>Total .....</b>	<b>35,625</b>	<b>\$44,735</b>	<b>35,093</b>	<b>\$37,202</b>

Footnotes at end of table.



**Table 3.—Distribution by Income Class of Selected Individual Tax Expenditure Items,  
at 2001 Rates and 2001 Income Levels<sup>1</sup>—Continued**

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

Income Class [thousands] <sup>2</sup>	Child care credit		Earned income credit <sup>4</sup>	
	Returns	Amount	Returns	Amount
Below \$10 .....	80	\$30	5,564	\$6,547
\$10 to \$20 .....	252	123	6,272	15,614
\$20 to \$30 .....	706	332	5,219	9,071
\$30 to \$40 .....	677	307	2,107	2,008
\$40 to \$50 .....	719	328	245	274
\$50 to \$75 .....	1,353	573	84	84
\$75 to \$100 .....	1,048	467	1	2
\$100 to \$200 .....	1,199	586	.....	.....
\$200 and over .....	205	106	.....	.....
<b>Total .....</b>	<b>6,239</b>	<b>\$2,851</b>	<b>19,492</b>	<b>\$33,600</b>

Footnotes at end of table.

**Table 3.—Distribution by Income Class of Selected Individual Tax Expenditure Items,  
at 2001 Rates and 2001 Income Levels <sup>1</sup>—Continued**

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

Income Class [thousands] <sup>2</sup>	Untaxed Social Security and Railroad Retirement benefits		Child Tax Credit <sup>4</sup>	
	Returns	Amount	Returns	Amount
Below \$10 .....	120	\$8	116	\$35
\$10 to \$20 .....	3,610	833	4,074	1,698
\$20 to \$30 .....	3,860	3,031	4,687	3,897
\$30 to \$40 .....	3,956	4,418	3,660	3,495
\$40 to \$50 .....	3,473	4,337	3,238	3,208
\$50 to \$75 .....	5,609	7,125	6,131	6,374
\$75 to \$100 .....	2,485	1,150	4,467	4,796
\$100 to \$200 .....	2,349	592	3,397	3,316
\$200 and over .....	736	260	( <sup>5</sup> )	( <sup>3</sup> )
<b>Total</b> .....	<b>26,197</b>	<b>\$21,754</b>	<b>29,772</b>	<b>\$26,819</b>

Footnotes at end of table.

**Table 3.—Distribution by Income Class of Selected Individual Tax Expenditure Items,  
at 2001 Rates and 2001 Income Levels<sup>1</sup>—Continued**

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

Income Class [thousands] <sup>2</sup>	Mortgage interest deduction	
	Returns	Amount
Below \$10 .....	32	\$11
\$10 to \$20 .....	336	117
\$20 to \$30 .....	1,114	433
\$30 to \$40 .....	1,905	981
\$40 to \$50 .....	2,693	2,235
\$50 to \$75 .....	7,421	7,927
\$75 to \$100 .....	7,023	12,204
\$100 to \$200 .....	8,904	23,978
\$200 and over .....	2,653	16,644
<b>Total</b> .....	<b>32,081</b>	<b>\$64,530</b>

*Footnotes for Table 3:*

<sup>1</sup>Excludes individuals who are dependents of other taxpayers with negative income.

<sup>2</sup>The income concept used to place tax returns into classes is adjusted gross income (AGI) plus: (a) tax-exempt interest, (b) employer contributions for health plans and life insurance, (c) employer share of FICA tax, (d) workers' compensation, (e) nontaxable Social Security benefits, (f) insurance value of Medicare benefits, (g) alternative minimum tax preference items, and (h) excluded income of U.S. citizens living abroad.

<sup>3</sup>Less than \$500,000.

<sup>4</sup>Includes the refundable portion.

<sup>5</sup>Less than 500 returns.

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

Source: Joint Committee on Taxation.