

[PRELIMINARY COMMITTEE PRINT]

ESTIMATES OF FEDERAL TAX
EXPENDITURES

COMMITTEE ON WAYS AND MEANS

PREPARED BY THE STAFFS
OF THE
TREASURY DEPARTMENT
AND
JOINT COMMITTEE ON INTERNAL
REVENUE TAXATION



OCTOBER 4, 1972

U.S. GOVERNMENT PRINTING OFFICE

84-423

WASHINGTON : 1972

JCS-28-72

FEDERAL TAX EXPENDITURES

In the Senate version of the Revenue Act of 1971, a provision added on the floor would have required the inclusion in the budget of estimates of losses in revenue from provisions of the Federal income tax laws and also estimates of indirect "expenditures" through the operation of the Federal tax laws. Data of this type have commonly become known as "tax expenditures." The statement made by the conferees in this respect is as follows:

"The conferees concluded that it would be more appropriate to have such estimates of tax expenditures made by the Treasury Department and to have the estimates submitted annually to the Committee on Ways and Means of the House, the Committee on Finance of the Senate, and the Joint Committee on Internal Revenue Taxation. It is expected that these tax expenditure reports to the tax committees will initially be modeled after similar reports previously made and included in the annual reports of the Secretary of the Treasury in 1968 and 1970. Modifications may, of course, be made from time to time in consultation with the tax committees. In addition to making these reports to the tax committees on an annual basis, the Treasury Department may desire to include these data on tax expenditures in the annual report of the Secretary of the Treasury. The Treasury Department has indicated its willingness to submit information to the tax committees in the manner indicated above and as a result the amendment no longer appears necessary."

The staffs of the Treasury Department and Joint Committee have been cooperating in the preparation of such a report, and this pamphlet represents a preliminary presentation of data for 1971 and prior years. It is planned later to prepare a revised and more extensive report which will be made available to the public.

In general terms tax expenditure items are intended to represent the amount of tax reductions which occur because of the allowance of an exclusion, deduction, preferential rate of tax, or deferral of tax liability. There are differences in points of view as to the "tax expenditure" concept,¹ including differences as to the items which should be selected and those which should not in any such listing. Questions have also been raised as to whether there should also be included in such an analysis those items which are taxed more heavily than income generally (such as corporate income) or deductions which are subjected to special limitations (such as capital losses). In this preliminary report the staffs have not attempted to consider any changes in the items listed as "tax expenditures." Instead, there are included in the tax expenditures items which have previously been included in any of the earlier reported versions of such a report made by the Treasury Department plus items in the Revenue Act of 1971 which are of a similar character.

¹ See, e.g., the criticism in Bitiker, *Accounting for Federal Tax Subsidies in the National Budget*, XXII, National Tax Journal 244 and the reply in Surrey and Hellmuth, *The Tax Expenditure Budget—Response to Professor Bitiker*, 22 National Tax Journal 528.

This report includes two tables. The first shows estimated Federal income tax expenditures for the calendar years 1967 through 1971. The 1971 tabulation is broken down into effects on corporations and effects on individuals. Only the 1971 data represent a new tabulation.² The data shown in table 1 are broken down into categories which are comparable to the budget functional classification of expenditures. The report also includes a table showing the estimated distribution of selected tax expenditure items by adjusted gross income classes. There are other tabulations which it is hoped can be included in the published report.

The purpose of tax expenditure data is to provide information as to the economic benefits provided by the tax laws to the various sectors of the economy. To aid in the analysis, the cost and beneficiaries (in terms of areas of activity) are shown by the same functional categories as in the Federal budget. The listing of any of these provisions involves no direct, or indirect, presumption about the desirability of any of these provisions in terms of public policy. This table, however, is intended as a tool which may be helpful to the tax committees of Congress in reviewing various provisions of the tax laws.

The estimates of tax expenditures are difficult to determine and are subject to important limitations. It is believed, however, that despite these limitations, the order of magnitude of the amounts involved may be helpful to the committee.

The major limitations with respect to the estimates of tax expenditures are:

1. The estimate of each tax expenditure item is made independently of any other tax expenditure item. As a result, if two or more items were to be eliminated, the result of the combination of changes being made at the same time might produce a lesser or greater revenue effect than the sum of the amounts shown for each item individually. This, of course, also means that the addition of the various tax expenditure items is of quite limited usefulness.

2. In the case of many of the items, especially those for which information is not available on tax returns, the lack of data makes estimates in many of these areas quite tenuous. Where complete information is not available on tax returns, it has been necessary to obtain information from whatever sources are available, and, when sources are limited, to make assumptions on which to base the estimates.

3. The estimates for the various tax expenditure items do not take into account any effects that the removal of one or more of the items might have on investment patterns, consumption or other aspects of economic activity. In other words, the estimates shown do not take into account the induced effects of changing the provisions.

4. Often tax expenditure items which have been added in recent years do not become fully effective until the lapse of several years.

² The 1971 data represent the same estimates as were presented on July 21, 1972 to the Joint Economic Committee by the Honorable Edwin S. Cohen, Under Secretary of the Treasury. However, the data are expanded to take into account changes made in the Revenue Act of 1971. Mr. Cohen at that time stated that a more detailed report was being prepared in consultation with the staff of the Joint Committee on Internal Revenue Taxation.

As a result, the eventual annual cost of items added in recent years are not fully reflected in the year 1971. Conversely, if various items now in the law were to be eliminated, it is unlikely, in many cases, that the full revenue effects shown would be realized until an extended period of years has passed.

5. In some cases, if a tax expenditure item were to be eliminated, it is probable that Congress would, at least to some extent, desire to deal with the underlying problem by a direct expenditure program. The effect of any such program is not taken into account in the estimates shown. In addition, if some of these provisions were removed from the tax laws, this removal might be accompanied by revisions in tax rates, personal exemptions or the minimum standard deduction, as has happened in the past. This has not been taken into account in the expenditure estimates shown.

6. There are features of the law which are not taken into account in the estimates shown. For example, the effect of income splitting and head-of-household treatment, as well as the graduation in the rate structure of the individual income tax, are not taken into account in these tables. Also, the effect of estate and gift taxes is not shown nor is the interrelationship of these provisions with some of the tax expenditure items taken into account.

7. Differences in personal income levels and corporate profits can also account for differences in the cost of tax expenditure items from year to year. Also, some tax expenditure items themselves may be larger or smaller from year to year, wholly independent of tax considerations.

TABLE 1.—ESTIMATED FEDERAL INCOME TAX EXPENDITURES,¹ CALENDAR YEARS 1967-71²

[Millions of dollars]

Item	1967	1968	1969	1970	1971		Total
					Corpo- rations	Indi- viduals	
NATIONAL DEFENSE							
Exclusion of benefits and allowances to Armed Forces personnel.....	500	550	550	500	-----	650	650
INTERNATIONAL AFFAIRS							
Exemption for certain income earned abroad by U.S. citizens.....	40	45	45	40	-----	50	50
Exclusion of income earned by individuals in U.S. possessions.....	10	10	10	10	-----	10	10
Western Hemisphere trade corporations.....	50	55	55	50	75	-----	75
Exclusion of gross-up on dividends of less-developed country corporations.....	50	55	55	55	55	-----	55
Deferral of income of controlled foreign subsidiaries.....	150	165	170	165	165	-----	165
Exclusion of income earned by corporations in U.S. possessions.....	70	80	85	80	80	-----	80
DISC.....							(3)
AGRICULTURE							
Farming: Expensing and capital gain treatment.....	800	860	880	820	50	790	840
Timber: Capital gain treatment for certain income.....	130	140	140	130	125	50	17
NATURAL RESOURCES							
Expensing of exploration and development costs.....	300	330	340	325	260	65	4 325
Excess of percentage over cost depletion.....	1,300	1,430	1,470	980	785	200	985
Capital gains treatment of royalties on coal and iron ore.....	5	5	5	5	5	-----	5
COMMERCE AND TRANSPORTATION							
Investment credit.....	2,300	3,000	2,630	910	1,495	305	9 1,800
Depreciation on buildings (other than rental housing) in excess of straight-line.....	500	550	550	500	320	160	480
Asset depreciation range.....					600	100	6 700
Dividend exclusion.....	225	260	290	280	-----	300	300
Capital gains: Corporation (other than farming and timber) ?.....	500	525	525	425	380	-----	380
Capital gains: Individuals (other than farming and timber) ?.....	N.A.	N.A.	N.A.	N.A.	-----	5,600	5,600
Bad debt reserves of financial institutions in excess of actual.....	600	660	680	380	400	-----	8 400
Exemption of credit unions.....	40	45	45	40	40	-----	40
Deductibility of interest on consumer credit.....	1,300	1,600	1,700	1,700	-----	1,800	1,800
Expensing of research and development expenditures.....	500	550	565	540	545	-----	545
\$25,000 surtax exemption.....	1,800	2,000	2,300	2,000	2,300	-----	2,300
Deferral of tax on shipping companies.....	10	10	10	10	10	-----	10
Rail freight car amortization.....				105	45	-----	9 45
HOUSING AND COMMUNITY DEVELOPMENT							
Deductibility of interest on mortgages on owner-occupied homes.....	1,900	2,200	2,600	2,800	-----	2,400	2,400
Deductibility of property taxes on owner-occupied homes.....	1,800	2,350	2,800	2,900	-----	2,700	2,700
Depreciation on rental housing in excess of straight-line.....	250	250	275	255	300	200	500
Housing rehabilitation.....					10	15	25
HEALTH, LABOR, AND WELFARE							
Disability insurance benefits.....	N.A.	100	120	130	-----	155	155
Provisions relating to aged, blind, and disabled: Combined cost for additional exemption, retirement income credit, and exclusion of OASDHI for aged.....	2,300	2,700	2,800	2,950	-----	3,250	3,250
Additional exemption for blind.....	10	10	10	10	-----	10	10
Sick pay exclusion.....	85	95	105	105	-----	120	120
Exclusion of unemployment insurance benefits.....	300	325	350	400	-----	800	800
Exclusion of workmen's compensation benefits.....	150	180	210	210	-----	320	320
Exclusion of public assistance benefits.....	50	50	50	50	-----	65	65

See footnotes at end of table.

TABLE 1.—ESTIMATED FEDERAL INCOME TAX EXPENDITURES,¹ CALENDAR YEARS 1967-71²—Continued
[Millions of dollars]

Item	1967	1968	1969	1970	1971		Total
					Corpo- rations	Indi- viduals	
HEALTH, LABOR, AND WELFARE—Continued							
Net exclusion of pension contributions and earnings:							
Plans for employees.....	3,000	4,000	3,150	3,075		3,650	3,650
Plans for self-employed persons.....	60	135	160	175		250	250
Exclusion of other employee benefits:							
Premiums on group term life insurance.....	400	400	440	440		500	500
Deductibility of accident and death benefits.....	25	25	25	25		30	30
Medical insurance premiums and medical care.....	1,100	1,400	1,450	1,450		2,000	2,000
Privately financed supplementary unemployment benefits.....	25	15	15	20		5	5
Meals and lodging.....	150	165	170	170		170	170
Exclusion of interest on life insurance savings.....	900	1,000	1,050	1,050		1,100	1,100
Deductibility of charitable contributions (other than education).....	2,200	3,000	3,450	3,550		3,200	3,200
Deductibility of medical expenses.....	1,500	1,600	1,700	1,700		1,900	1,900
Deductibility of child and dependent care expenses.....	25	25	25	25		30	10 30
Deductibility of casualty losses.....	70	80	80	80		165	165
Excess of standard deduction over minimum.....	11 3,200	11 3,600	3,800	3,000		700	700
Pollution control amortization.....			15	15	15		15
Credit for employing public assistance recipients under WIN program.....							(13)
5-year amortization of child care facilities.....							(13)
EDUCATION							
Additional personal exemption for students.....	500	500	525	500		550	550
Deductibility of contributions to educational institutions.....	170	200	200	200		275	275
Exclusion of scholarships and fellowships.....	50	60	60	60		110	110
VETERANS' BENEFITS AND SERVICES							
Exclusion of certain veterans' benefits.....	550	600	600	650		700	700
GENERAL GOVERNMENT							
Political contributions.....							(14)
AID TO STATE AND LOCAL FINANCING							
Exemption of interest on State and local debt.....	1,800	2,000	2,200	2,300	1,800	800	2,600
Deductibility of nonbusiness State and local taxes (other than on owner-occupied homes).....	2,800	4,150	5,100	5,600		5,600	5,600
TOTAL.....	(15)	(15)	(15)	(15)	(15)	(15)	(15)

Note: Changes in the figures from year to year not only reflect changes in the tax laws, in utilization of the items and in personal income and profit levels but also, in some instances, reflect revised and/or new sources of data and improved estimating methods.

¹ Estimates are prepared on an individual basis for each item on the assumption that the item would be eliminated from the law without any other changes in the law with respect to the other items. If two or more changes in the law are made, the aggregate revenue effect will frequently not equal the sum of the revenue effects of the individual changes. Accordingly, the costs of the items are not additive.

² Roughly reflect fiscal years 1968-72.

³ Not effective in calendar year 1971, expected to amount to \$240,000,000 when fully effective.

⁴ Considered in isolation this estimate would be \$800,000,000. However, if considered in conjunction with percentage depletion the \$325,000,000 gives a more accurate picture of the revenue effect.

⁵ Effective for only a part year in calendar year 1971. The full-year effect would be \$3,300,000,000.

⁶ 1st-year effect, 2d-year effect would be \$1,700,000,000. Thereafter builds up for a period of years, reaching \$4,000,000,000 in the 6th year.

⁷ Assumes present restriction on capital losses is retained.

⁸ This will decline over time as present law becomes fully effective.

⁹ This item is being superseded by use of investment credit.

¹⁰ The liberalized child care deductions which become effective in calendar year 1972 would increase the estimate to 75,000,000.

¹¹ Standard deduction.

¹² Not effective in calendar year 1971, expected to amount to \$40,000,000 when effective.

¹³ Not effective in calendar year 1971, expected to amount to \$10,000,000 when fully effective.

¹⁴ Not effective in calendar year 1971, expected to amount to \$150,000,000 in a presidential year when fully effective.

¹⁵ As explained more fully in the text and in footnote 1, these totals are of limited significance and utility. However, as a matter of convenience the mathematical sums of the respective 7 columns are given here: \$36.55 billion; \$44.14 billion; \$46.64 billion; \$43.95 billion; \$9.86 billion; \$41.85 billion; and \$51.71 billion. Much of the increase in the figure given for 1971 over that for 1970 is due to the fact that the 1970 figure does not include any estimate for capital gains of individuals while the 1971 total includes \$5.6 billion.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

TABLE 2.—ESTIMATED DISTRIBUTION OF SELECTED ITEMS OF TAX PREFERENCES OF INDIVIDUALS BY ADJUSTED GROSS INCOME CLASS, CALENDAR YEAR 1971

(In millions of dollars)

Adjusted gross income class	Exclusion of benefits and allowances to Armed Forces personnel	Exemption for certain income earned abroad by U.S. citizens	Exclusion of income earned by individuals in U.S. possessions	Farming; Expensing and capital gain treatment	Timber: Capital gain treatment for certain income	Expensing of exploration and development costs	Excess of percentage over cost depletion	Investment credit	Depreciation on buildings (other than rental housing) in excess of straight-line	Asset depreciation range	Dividend exclusion	Deductibility of interest on consumer credit
0 to \$3,000.....	15	*	*	20	*	*	1	3	*	*	5	1
\$3,000 to \$5,000.....	120	1	*	55	2	1	2	16	3	2	13	44
\$5,000 to \$7,000.....	175	4	1	80	2	3	8	27	5	4	17	64
\$7,000 to \$10,000.....	180	6	1	120	2	2	6	41	11	6	29	185
\$10,000 to \$15,000.....	115	7	2	155	4	4	12	51	18	12	55	435
\$15,000 to \$20,000.....	28	16	3	90	2	4	12	32	12	9	46	380
\$20,000 to \$50,000.....	13	15	3	170	9	16	50	73	47	37	99	620
\$50,000 to \$100,000.....	3	1	*	55	8	14	43	33	28	23	27	59
\$100,000 and over.....	1	*	*	45	21	21	66	29	36	7	9	12
Total.....	650	50	10	790	50	65	200	305	160	100	300	1,800

*Less than \$500,000.

(Continued)

TABLE 2.—ESTIMATED DISTRIBUTION OF SELECTED ITEMS OF TAX PREFERENCES OF INDIVIDUALS BY ADJUSTED GROSS INCOME CLASS, CALENDAR YEAR 1971—Continued

(In millions of dollars)

Adjusted gross income class	Deductibility of interest on mortgages on owner-occupied homes	Deductibility of property taxes on owner-occupied homes	Depreciation on rental housing in excess of straightline	Housing rehabilitation	Disability insurance benefits	Provisions relating to aged, blind, and disabled			Exclusion of unemployment insurance benefits	Exclusion of workmen's compensation benefits	Exclusion of public assistance benefits	Net exclusion of pension contributions and earnings	
						Combined cost for additional exemption retirement income credit, and exclusion of OASDHI for aged	Additional exemption for blind	"Sick pay" exclusion				Plans for employees	Plans for self-employed
0 to \$3,000.....	*	*	*	*	35	805	1	2	65	15	25	45	*
\$3,000 to \$5,000.....	27	41	4	*	40	750	2	13	110	28	20	145	7
\$5,000 to \$7,000.....	81	84	6	1	25	420	2	16	110	41	15	230	10
\$7,000 to \$10,000.....	276	263	14	1	30	585	2	32	185	69	5	535	13
\$10,000 to \$15,000.....	719	642	22	2	10	245	1	19	230	83	*	995	22
\$15,000 to \$20,000.....	543	505	15	1	5	125	1	20	65	39	*	685	18
\$20,000 to \$50,000.....	621	788	59	6	6	215	1	16	30	38	*	750	96
\$50,000 to \$100,000.....	101	240	35	3	3	70	*	2	5	6	*	175	71
\$100,000 and over.....	32	137	45	1	1	35	*	*	*	1	*	90	13
Total.....	2,400	2,700	200	15	155	3,250	10	120	800	320	65	3,650	250

*Less than \$500,000.

(Continued)

7

TABLE 2.—ESTIMATED DISTRIBUTION OF SELECTED ITEMS OF TAX PREFERENCES OF INDIVIDUALS BY ADJUSTED GROSS INCOME CLASS, CALENDAR YEAR 1971—Continued
(In millions of dollars)

Adjusted gross income class	Exclusion of other employee benefits				Meals and lodging	Exclusion of interest on life insurance savings	Deductibility of charitable contributions (other than education)	Deductibility of medical expenses	Deductibility of child and dependent care expense	Deductibility of casualty losses	Excess of standard deduction over minimum
	Premiums on group life insurance	Deductibility of accident and death benefits	Medical insurance premiums and medical care	Privately financed supplementary unemployment benefits							
0 to \$3,000.....	5	*	25	*	2	5	3	5	1	*	0
\$3,000 to \$5,000.....	20	1	80	*	14	20	31	100	7	5	3
\$5,000 to \$7,000.....	30	2	125	1	22	35	82	205	12	10	15
\$7,000 to \$10,000.....	75	5	300	1	35	85	225	325	5	30	100
\$10,000 to \$15,000.....	135	8	550	2	35	205	467	470	3	40	415
\$15,000 to \$20,000.....	95	6	380	1	25	185	364	310	1	20	115
\$20,000 to \$50,000.....	105	6	415	*	30	420	716	360	1	30	50
\$50,000 to \$100,000.....	25	1	95	*	5	80	426	90	*	20	2
\$100,000 and over.....	10	1	30	*	2	65	886	35	*	10	*
Total.....	500	30	2,000	5	170	1,100	3,200	1,900	30	165	700

*Less than \$500,000.

(Continued)

TABLE 2.—ESTIMATED DISTRIBUTION OF SELECTED ITEMS OF TAX PREFERENCES OF INDIVIDUALS BY ADJUSTED GROSS INCOME CLASS, CALENDAR YEAR 1971—Continued
 [In millions of dollars]

Adjusted gross income class	Capital gains: Individuals	Additional personal exemption for students	Deductibility of contributions to educational institutions	Exclusion of scholarships and fellowships	Exclusion of certain veterans' benefits	Exemption of interest on State and local debt	Deductibility of nonbusiness State and local taxes (other than on owner occupied homes)
0 to \$3,000.....	30	1	*	6	30	5	4
\$3,000 to \$5,000.....	60	17	3	26	95	*	56
\$5,000 to \$7,000.....	70	40	7	28	110	*	88
\$7,000 to \$10,000.....	150	101	20	22	130	5	361
\$10,000 to \$15,000.....	230	182	58	15	220	10	772
\$15,000 to \$20,000.....	210	92	70	10	70	20	772
\$20,000 to \$50,000.....	960	47	90	3	41	100	1,713
\$50,000 to \$100,000.....	920	54	20	*	3	300	906
\$100,000 and over.....	2,970	16	7	*	1	360	928
Total.....	5,600	550	275	110	700	800	5,600

*Less than \$500,000.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

6

