ESTIMATES OF FEDERAL TAX EXPENDITURES

PREPARED FOR THE

COMMITTEE ON WAYS AND MEANS

AND THE

COMMITTEE ON FINANCE

BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

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Introduction

This report on tax expenditures is published as part of the report by the Joint Committee on Taxation to the Committees on the Budget. As in the case of earlier reports,[1] the estimates in this report also were prepared with the extensive assistance of the staff of the Office of Tax Analysis in the Treasury Department. The first two reports were prepared in compliance with the request by the conferees on the Revenue Act of 1971 that tax expenditure data be submitted regularly to Congress by the Joint Committee staff. The last report was published one year ago for submission to the Committees on the Budget.

In January, the Administration published its estimates of tax expenditures for fiscal years 1977–1979 in Special Analysis G of the Budget for fiscal year 1979.[2]

This report covers fiscal years 1978–1983. The tax expenditure items included in this pamphlet and in Special Analysis G are identical. Differences between the special analysis and this report over the inclusiveness of the list have been resolved. The tax expenditure report by the Congressional Budget Office (CBO) (which will be published shortly) also will contain the same listings. The staff of the Joint Committee generally has made its estimates in terms of the provisions in present law (as of December 31, 1977) and assumed that the expiration dates will not be extended or otherwise modified and no other changes will be made in the present law.

The concept of tax expenditures

Tax expenditure data are intended to show the cost to the Federal Government, in terms of revenues it has foregone, from tax provisions that either have been enacted as incentives for the private sector of the economy or have that effect even though initially having a different objective. The tax incentives usually are designed to encourage certain kinds of economic behavior as an alternative to employing direct expenditures or loan programs to achieve the same or similar objectives. These provisions take the form of exclusions, deductions, credits, preferential tax rates, or deferrals of tax liability. Tax expenditures also are analogous to uncontrolled expenditures made through individual entitlement programs because the taxpayer who can meet the criteria specified in the Internal Revenue Code may use the provision indefinitely without any further action by the Federal Government. This is possible because provisions in the Internal Revenue Code rarely have expiration dates that would require specific

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[1] Committees on Ways and Means and Finance, *Estimates of Federal Tax Expenditures*, October 4, 1972, June 1, 1973, July 8, 1975, March 15, 1976, and March 15, 1977.

[2] "Tax Expenditures," Special Analysis G, *Special Analyses of the Budget of the United States Government for Fiscal Year 1979*, pp. 148–174.

congressional action to continue the availability of the tax provision. For many provisions, the revenue loss is determined by the taxpayer's level of income and his tax rate bracket. From the viewpoint of the budget process, fiscal policy and the allocation of resources, uncontrollable outlays or receipts restrict the range of adjustments that can be made in public policy. One of the initial purposes of the enumeration of tax expenditures was to provide Congress with the information it would need to select between a tax or an outlay approach to accomplish a goal of public policy.

The staff followed the definition of tax expenditures developed in the legislative process that produced the Budget Control Act. Included in this report as tax expenditures are virtually all tax provisions which have been characterized as tax expenditures under almost any of the prior listings by other sources. As a result, listing an item as a tax expenditure in this report is a part of a process of providing information, and the listing becomes a catalog of past public policy decisions accompanied by estimates of their effects upon budget receipts. No judgment is made, nor any inference intended, about the desirability of any specific provision as public policy or about the effectiveness of the tax approach relative to other methods of achieving the particular public policy goals desired.

In this report, a tax expenditure is described as a tax incentive that departs from simply allowing the taxpayer to deduct from gross income the costs incurred in earning net income. Under this concept, deductions are allowed for current expenditures which are directly related to the process of earning income, and therefore these expenditures are not treated as tax expenditures. These deductions also may be treated as business costs, and they are deducted on returns filed by corporations, partnerships and individual proprietorships. On the other hand, capital costs by their nature are not incurred entirely in one year. The basic tax provision allows depreciation ratably (i.e., straight-line depreciation) over the useful life of the capital asset, but tax law also permits accelerated depreciation to provide investors with faster capital recovery through shorter lives and/or faster rates of depreciation. Such faster tax treatment of capital costs is classified as a tax expenditure; in this report, those items appear as various types of accelerated depreciation: asset depreciation range (ADR), depreciation in excess of straight-line, percentage depletion allowances (in excess of cost depletion), and current expensing of costs that otherwise would be capitalized.

Individuals who are employees—and do not carry on their own businesses—have analogous business-type deductions which also are not classified in this report as tax expenditures. The expenses also are costs which are incurred in earning net income, e.g., the cost of his tools that a mechanic uses. Most other deductions which individuals take on their tax returns represent personal consumption expenditures. These deductions reflect public policy decisions to facilitate specific types of consumption spending and are therefore generally classified here as tax expenditures. An exception to this rule is made for general personal exemptions and the standard deduction [3] which have not

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[3] The minimum standard allowance and the percentage standard deduction were repealed by the Tax Reduction and Simplification Act of 1977, and the standard deduction of $2,200 for single taxpayers and $3,200 for joint returns by married couples was enacted to replace them and was built into the tax structure as the zero bracket amount.

been treated as tax expenditures in any analysis of the subject or in the Budget Control Act. Individual tax expenditures also include various kinds of income, e.g., social security payments to the aged, dependents and survivors, which are tax-exempt income but would become components of adjusted gross income from which taxable income is derived in the absence of the tax exemption. It should be noted in this context that the Administration has proposed to include unemployment compensation in the income of taxpayers with adjusted gross income from all sources (including unemployment compensation) greater than $20,000 for single taxpayers and $25,000 for married taxpayers.

A number of tax provisions are not treated as tax expenditures. The general tax rate structure is not part of tax expenditure analysis: the structure of graduated tax rates and taxable income brackets in the individual income tax and separate tax structures for single persons, married persons filing separately, heads-of-households and income splitting for married persons. Other such items are the personal exemption—one per taxpayer and each dependent—and the standard deduction. On the other hand, included as tax expenditures are the additional personal exemptions for the aged and blind and itemized personal deductions.

In the business tax area, the combined corporate normal and surtax tax rate is considered to be the general tax rate structure and is not classified as a tax expenditure. The surtax exemption is treated as a departure designed to benefit small corporations, and therefore it is treated as a tax expenditure.

There is no provision for negative tax expenditures, and no provisions are classified as disincentives. Thus, the corporate surtax rate is treated as the basic provision and not a departure from the normal tax. The limitation on the deduction of a net long-term capital loss is a limit to the incentive made available through the special treatment for capital gains.

Imputations of income in kind received from the services of durable assets are not treated as income in the tax code and are not here classified as tax expenditures. They might be considered as income under other concepts of income for tax purposes. Measurement of the imputed income-in-kind would be a formidable task. The imputed income from an owner-occupied home is the most prominent of these items, and among the others are the income that could be imputed to household furniture and appliances, books and art collections and automobiles. Food stamps are a form of income in kind that also is omitted from this listing.

Foreign tax credits are not classified here as tax expenditures since they are generally considered as the way of taking into account the interrelationship of domestic and foreign tax systems. In addition, this analysis does not attempt to go behind the current legal interpretation and attribution of payments by U.S. corporations to foreign governments as taxes (e.g., it does not attempt to treat any such payments as royalties as in the case of oil income), when the payments are designated in that way by those governments.

Measurement of tax expenditures

Estimates of tax expenditures are difficult to determine and are subject to important limitations.

Each tax expenditure is measured in isolation. The amount of the deduction is added back in the calculation of taxable income, which raises its level. The difference in tax liabilities as estimated under present law including the tax expenditure and this new higher level of tax liabilities is taken as the amount of the tax expenditure. For this computation and in keeping with the general practice of revenue estimating, it is assumed that nothing else changes.

Some further observations on these estimating problems follow.

First, 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 separately. This is why totals are not shown for table 1, except in a footnote.

Second, in some cases if a tax expenditure item were to be eliminated, it is possible that Congress would, at least to some extent, desire to deal with the underlying problem by a direct expenditure or loan program. The effect of any such program is not taken into account in the estimates shown. A direct expenditure could become a tax expenditure if it takes the form of a payment to an individual or business that is not included in income subject to taxation. 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 standard deduction, as has happened in the past. Other fiscal and monetary policies might be adopted to offset a tax change. None of these possibilities has been taken into account in the estimates.

Third, when tax expenditure items have been added to the tax law in the past, they did not become fully effective until the lapse of several years. As a result, the eventual annual cost of some items is not fully reflected until some time in the future. 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 had passed.

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

Fifth, in the case of many of the items, especially those for which information is not available on tax returns, it is necessary to obtain information from whatever sources are available and to base the estimates on these sources.

Tax expenditures by functional category

To aid analysis of the economic benefits provided through the tax laws to various sectors of the economy, the costs (tax expenditures) and beneficiaries (in terms of area of activity) are grouped in table 1 in the same functional categories as outlays in the Federal budget. Where possible and relevant, estimates are shown separately for individuals and corporations. Some tax expenditures do not fit clearly into any of the budget functional categories, and they have been placed in the functional category which is the most appropriate. The Office of Management and Budget, the Congressional Budget Office and the Joint Committee staff concur on these placements.

TABLE 1.—TAX EXPENDITURE ESTIMATES BY FUNCTION AND SUBFUNCTION [1]

[Fiscal years, in millions of dollars]

Function and subfunction	Corporations						Individuals					
	1978	1979	1980	1981	1982	1983	1978	1979	1980	1981	1982	1983
National defense:												
Exclusion of benefits and allowances to Armed Forces personnel							1,260	1,370	1,470	1,585	1,715	1,850
Exclusion of military disability pensions							115	120	130	135	145	150
International affairs:												
Exclusion of income earned abroad by U.S. citizens							360	385	415	475	510	550
Deferral of income of domestic international sales corporations (DISC)	1,135	1,335	1,525	1,630	1,700	1,830						
Deferral of income of controlled foreign corporations	615	665	720	775	835	905						
Special rate for Western Hemisphere trade corporations	25	15	5									
General science, space, and technology:												
Expensing of research and development expenditures	1,450	1,520	1,610	1,695	1,715	1,635	30	30	35	35	35	35
Energy:												
Expensing of exploration and development costs	885	965	1,080	1,185	1,265	1,360	300	300	360	420	480	545
Excess of percentage over cost depletion	1,120	1,210	1,310	1,400	1,485	1,570	340	370	405	430	435	440
Capital gains treatment of royalties on coal	15	15	20	20	20	20	50	60	70	75	85	95
Natural resources and environment:												
Exclusion of interest on State and local government pollution control bonds	220	265	300	330	355	390	110	130	145	160	175	185
Exclusion of payments in aid of construction of water and sewage utilities	10	10	10	10	10	10						
5-yr amortization on pollution control facilities	−130	−45	40	130	180	140						
Tax incentives for preservation of historic structures		5	5	5	5	5	(2)	5	5	10	10	10
Capital gains treatment of certain timber income	205	230	250	275	300	335	60	65	70	80	85	95
Capital gains treatment of iron ore	5	10	10	10	10	10	5	10	10	10	10	10
Agriculture:												
Expensing of certain capital outlays	70	75	80	80	85	85	445	460	480	495	515	530
Capital gains treatment of certain ordinary income	10	10	10	15	15	15	350	365	385	405	425	450
Deductibility of noncash patronage dividends and certain other items of cooperatives	490	525	560	595	635	675	−175	−185	−190	−200	−210	−220
Commerce and housing credit:												
Dividend exclusion							475	505	530	560	590	620
Exclusion of interest on State and local industrial development bonds	235	270	315	355	400	445	115	135	155	175	195	220
Exemption of credit union income	80	90	100	115	125	140						
Excess bad debt reserves of financial institutions	705	790	930	1,025	1,040	1,085						
Deductibility of mortgage interest on owner-occupied homes							4,985	5,530	6,140	6,815	7,565	8,395
Deductibility of property tax on owner-occupied homes							4,665	5,180	5,750	6,385	7,085	7,865
Deductibility of interest on consumer credit							2,120	2,350	2,610	2,895	3,215	3,565
Expensing of construction period interest and taxes	500	525	555	585	615	645	140	90	145	165	205	230

See footnotes at end of table.

TABLE 1.—TAX EXPENDITURE ESTIMATES BY FUNCTION AND SUBFUNCTION [1]—Continued

Function and subfunction	Corporations						Individuals					
	1978	1979	1980	1981	1982	1983	1978	1979	1980	1981	1982	1983
Commerce and housing credit:												
Excess first-year depreciation	45	50	50	55	55	60	145	155	165	170	180	190
Depreciation on rental housing in excess of straightline	70	70	70	75	80	85	300	290	290	300	315	335
Depreciation on buildings (other than rental housing) in excess of straight line	140	130	115	110	105	105	125	115	105	95	90	95
Asset depreciation range	2,245	2,640	3,120	3,625	4,155	4,725	115	135	165	190	215	245
Capital gains (other than farming, timber, iron ore, and coal)	540	575	635	705	780	865	7,430	7,990	8,585	9,230	9,925	10,665
Deferral of capital gains on home sales							935	980	1,030	1,080	1,135	1,195
Capital gains at death							8,120	8,975	9,910	10,945	12,090	13,535
Corporate surtax exemption	3,885	3,540	2,905	3,005	3,225	3,480						
Investment credit	10,735	12,320	13,650	13,085	11,400	11,410	2,390	2,725	3,020	2,980	2,620	2,745
Transportation:												
Deductibility of nonbusiness State gasoline taxes							760	840	935	1,035	1,150	1,275
5-yr amortization on railroad rolling stock	−40	−40	−40	−40	−40	−35						
Deferral of tax on shipping companies	105	85	70	60	55	45						
Community and regional development:												
5-yr amortization for housing rehabilitation	5	5	5	[2]	[2]	−5	10	5	5	[2]	[2]	−5
Education, training, employment and social services:												
Exclusion of scholarship and fellowship income							295	330	355	385	415	450
Parental personal exemption for students age 19 or over							770	790	815	840	865	890
Exclusion of employee meals and lodging (other than military)							300	325	350	380	410	445
Exclusion of contributions to prepaid legal services plans							10	15	20	35	50	60
Investment credit for employee stock ownership plans (ESOP's)	255	305	330	190								
Deductibility of charitable contributions (education)	255	285	315	350	380	410	585	645	720	795	885	980
Deductibility of charitable contributions to other than education and health	315	350	390	430	470	510	4,370	4,855	5,385	5,980	6,635	7,365
Maximum tax on personal service income							665	800	955	1,150	1,375	1,655
Credit for child and dependent care expenses							525	575	635	695	765	840
Credit for employment of AFDC recipients and public assistance recipients under work-incentive programs	15	20	20	20	20	20						
New jobs tax credit	1,475	1,035	215	110	55	35	985	860	[2]	[2]	[2]	[2]
Health:												
Exclusion of employer contributions for medical insurance premiums and medical care							6,340	7,225	8,240	9,390	10,705	12,205
Deductibility of medical expenses							2,435	2,655	2,895	3,155	3,435	3,745
Expensing of removal of architectural and transportation barriers to the handicapped	10	10	[6]	[2]	[2]	[2]						
Deductibility of charitable contributions (health)	160	175	195	215	235	255	875	970	1,075	1,195	1,330	1,475

Income security:												
Exclusion of social security benefits:												
Disability insurance benefits							550	605	685	760	840	925
OASI benefits for retired workers							4,210	4,700	5,165	5,670	6,205	6,735
Benefits for dependents and survivors							950	1,040	1,160	1,275	1,395	1,515
Exclusion of railroad retirement system benefits							265	280	295	305	315	325
Exclusion of workmen's compensation benefits							835	970	1,115	1,285	1,475	1,695
Exclusion of special benefits for disabled coal miners							50	50	50	50	50	50
Exclusion of unemployment insurance benefits							1,200	1,135	1,090	1,015	950	905
Exclusion of public assistance benefits							345	360	380	395	410	430
Exclusion of sick pay							75	60	65	65	70	75
Net exclusion of pension contributions and earnings:												
Employer plans							9,940	11,335	12,925	14,740	16,815	19,175
Plans for self-employed and others							1,650	1,920	2,205	2,535	2,915	3,355
Exclusion of other employee benefits:												
Premiums on group term life insurance							905	955	1,010	1,065	1,120	1,185
Premiums on accident and disability insurance							75	80	85	85	95	100
Income of trusts to finance supplementary unemployment benefits							10	10	10	10	10	10
Exclusion of interest on life insurance savings							2,025	2,225	2,450	2,705	2,980	3,290
Exclusion of capital gains on home sales for persons age 65 and over							70	70	70	70	75	75
Additional exemption for elderly							1,155	1,215	1,275	1,340	1,405	1,475
Additional exemption for the blind							20	20	20	20	20	20
Deductibility of casualty losses							360	395	430	470	510	555
Tax credit for the elderly							250	255	255	255	255	255
Earned income credit:												
Nonrefundable portion							285	265				
Refundable portion							945	900				
Veterans benefits and services:												
Exclusion of veterans disability compensation							840	830	855	850	845	825
Exclusion of veterans pensions							40	40	40	40	35	35
Exclusion of GI bill benefits							200	170	150	130	110	95
General government:												
Credits and deductions for political contributions							60	75	60	85	65	90
General purpose fiscal assistance:												
Exclusion of interest on general purpose State and local debt	3,470	3,865	4,305	4,780	5,310	5,845	1,925	2,150	2,390	2,655	2,950	3,255
Deductibility of nonbusiness State and local taxes (other than on owner-occupied homes and gasoline)							8,505	9,440	10,480	11,630	12,910	14,330
Tax credit for corporations doing business in U.S. possessions	485	520	565	610	660	710						
Interest:												
Deferral of interest on savings bonds							625	670	725	780	840	905

[1] All estimates are based on the Internal Revenue Code as of Dec. 31, 1977.

[2] Less than $2,500,000.

SUM OF THE TAX EXPENDITURE ITEMS BY TYPE OF TAXPAYER, FISCAL YEARS 1978-83

[In millions of dollars]

	Corporations and individuals	Corporations	Individuals
Fiscal year:			
1978	124,415	31,815	92,600
1979	136,175	34,425	101,750
1980	146,571	36,356	110,215
1981	159,040	37,620	121,420
1982	171,265	37,740	133,525
1983	187,510	39,820	147,690

Note: These totals represent the mathematical sum of the estimated fiscal year effect of each of the tax expenditure items included in the table. The limitations on the use of the totals are explained in the text.

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

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