BACKGROUND INFORMATION ON TAX EXPENDITURE ANALYSIS AND HISTORICAL SURVEY OF TAX EXPENDITURE ESTIMATES

Scheduled for a Public Hearing
Before the
SENATE COMMITTEE ON FINANCE
on March 1, 2011

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JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The Senate Committee on Finance has scheduled a public hearing on March 1, 2011, entitled "How Did We Get Here? Changes in the Law and Tax Environment since the Tax Reform Act of 1986." This document,[1] prepared by the staff of the Joint Committee on Taxation ("Joint Committee staff"), provides a discussion of the concept and measurement of tax expenditures as well as providing historical background on tax expenditures.

Tax expenditure analysis can help both policymakers and the public to understand the actual size of government, the uses to which government resources are put, and the tax and economic policy consequences that follow from the implicit or explicit choices made in fashioning legislation.

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. Part III discusses equity, efficiency and administrability issues in the design of tax expenditures. Historical data on tax expenditures including estimates of tax expenditures over time and a legislative history of new tax expenditures are presented in Part IV.

[1] This document may be cited as follows: Joint Committee on Taxation, *Background Information on Tax Expenditure Analysis and Historical Survey of Tax Expenditure Estimates* (JCX-15-11), February 28, 2011. This document can be found on our website at www.jct.gov.

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."[2] 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 similar to those direct spending programs that are available as entitlements to those who meet the statutory criteria established for the programs.

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. It is appropriate to evaluate tax expenditures with respect to cost, distributional consequences, alternative means of provision, and economic effects and to allow policymakers to evaluate the tradeoffs among these and other potentially competing policy goals.

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. 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 less than $50 million over the relevant five fiscal years. The Joint Committee staff emphasizes, however, that in the process of listing tax

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[2] Congressional Budget and Impoundment Control Act of 1974 (Pub. L. No. 93-344), sec. 3(3). The Budget Act requires CBO and the Department of the Treasury ("the Treasury") to publish annually detailed lists of tax expenditures. The Joint Committee staff issued reports prior to the statutory obligation placed on the CBO and continued to do so thereafter. In light of this precedent and a subsequent statutory requirement that the CBO rely exclusively on the Joint Committee staff estimates when considering the revenue effects of proposed legislation, the CBO has always relied on the Joint Committee staff for the production of its annual tax expenditure publication. See Pub. L. No. 99-177, sec. 273, codified at 2 USC 601(f).

expenditures, no judgment is made, nor any implication intended, about the desirability of any special tax provision as a matter of public policy.

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.[3] 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 the Joint Committee's annual reports 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 in these annual reports.[4]

Some provisions in the 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 two-percent floor on itemized deductions for unreimbursed employee expenses. Tax provisions that provide treatment less favorable than normal income tax law and are not related directly to progressivity are called *negative tax expenditures.*[5] Special provisions of the law the principal purpose for which is to enforce *general tax rules,* or to prevent the violation *of other laws,* are not treated as negative tax expenditures even though they may increase the tax burden for certain taxpayers. Examples of these compliance and enforcement provisions include (1) the section 382 limitation on net operating loss carryforwards and certain built-in losses following ownership changes, (2) the section 1091 wash sale rules, (3) the section 1287 denial of capital gain treatment for gains on certain obligations not in registered form, and (4) the section 162(f) disallowance of a deduction for fines and penalties.[6]

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[3] The Federal income tax on individuals also applies to estates and trusts, which are subject to a separate income tax rate schedule (sec. 1(e) of the Code). Estates and trusts may benefit from some of the same tax expenditure provisions that apply to individuals. The tax expenditures that apply to estates and trusts have been included in the estimates of tax expenditures for individual taxpayers.

[4] Other analysts have explored applying the concept of tax expenditures to 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,* 47, March 1994, pp. 39-62. Prior to 2003, the President's budget contained a section that reviewed and tabulated estate and gift tax provisions that the Treasury considered tax expenditures.

[5] Although the Budget Act does not require the identification of negative tax expenditures, the Joint Committee staff has presented a number of negative tax expenditures for completeness.

[6] See Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2008-2012* (JCS-2-08), October 31, 2008, p. 9.

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 are classified as exceptions to normal income tax law.

The Joint Committee staff views the personal exemptions and the standard deduction as defining the zero-rate bracket that is a part of normal tax law. An itemized deduction that is not necessary for the generation of income is classified as a tax expenditure, but only to the extent that it, when added to a taxpayer's other itemized deductions, exceeds the standard deduction.

All employee compensation is subject to tax unless the Code contains a specific exclusion for the income. Specific exclusions for employer-provided benefits include: coverage under accident and health plans,[7] accident and disability insurance, group term life insurance, educational assistance, tuition reduction benefits, transportation benefits (parking, van pools, and transit passes), dependent care assistance, adoption assistance, 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, and *de minimis* fringe benefits). Each of these exclusions is classified as a tax expenditure in the annual reports.

Under normal income tax law, employer contributions to pension plans and income earned on pension assets generally 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 partially excluded or fully excluded from gross income.[8] Under normal income tax law, retirees would be

[7] Present law contains an exclusion for employer–provided coverage under accident and health plans (sec. 106) and an exclusion for benefits received by employees under employer–provided accident and health plans (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.

[8] For taxpayers with modified adjusted gross incomes above certain levels, up to 85 percent of social security and tier 1 railroad retirement benefits are includable in income.

entitled to exclude 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, the value of Medicare Part B insurance generally is greater than the Part B premium that enrollees must pay, and the value of Medicare Part D (prescription drug) insurance generally is greater than the Part D 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, as are the exclusion of the value of Medicare Part B insurance in excess of Part B premiums and the exclusion of the value of Part D insurance in excess of Part D premiums.

Public assistance benefits are excluded from gross income by statute or by Treasury regulations. The Joint Committee staff estimates tax expenditures 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.[9] However, the Joint Committee staff does not classify this exclusion as a tax expenditure.[10] The measurement of imputed income for tax purposes presents administrative problems and its exclusion from taxable income may be regarded as an administrative necessity.[11] 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.

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[9] The National Income and Product Accounts include estimates of this imputed income. The accounts appear in *Survey of Current Business*, published monthly by the U.S. Department of Commerce, Bureau of Economic Analysis. However, a taxpayer-by-taxpayer accounting of imputed income would be necessary for a tax expenditure estimate.

[10] The Treasury Department provides a tax expenditure calculation for the exclusion of net rental income of homeowners that combines the positive tax expenditure for the failure to impute rental income with the negative tax expenditure for the failure to allow a deduction for depreciation and other costs.

[11] 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.

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, exchange, gift, or transfer at death. Thus, the deferral of tax until realization is not classified as a tax expenditure. However, reduced rates of tax, further deferrals of tax (beyond the year of sale, exchange, gift, or transfer at death), and exclusions of certain capital gains are classified as tax expenditures. Because of the same concern for administrative feasibility, 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.

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. The Joint Committee staff estimates 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.[12] 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, then: (1) the income that is received at the time the option is exercised is excluded for purposes of the regular income tax but, in the case of an incentive stock option, included for purposes of the alternative minimum tax ("AMT"); (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. 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 negative tax expenditure created by the denial of the deduction for employers is incorporated in the calculation of the tax expenditure.

The individual 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. In one case the restrictive effects of the AMT are presented separately because there are no underlying positive tax

[12] 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.

expenditures reflecting these effects: the negative tax expenditures for the AMT's disallowance of personal exemptions and the standard deduction.

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. In addition, a tax expenditure has been measured for depreciation in those specific cases where the tax treatment of a certain type of asset deviates from the overall treatment of other similar types of assets. For example, the tax treatment of leasehold improvements of commercial buildings is depreciated using a recovery period of 15 years, while the general treatment of improvements to commercial buildings (e.g., owned commercial buildings) is a 39 year recovery period. In this case, the difference between depreciation (in this case straight line) using 15 years and 39 years for the recovery period represents a tax expenditure. 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 (nor, for that matter, any indexing with respect to expenses associated with these assets). Thus, normal income tax law would not take into account the effects of inflation on tax depreciation.

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 (except where its application is deemed infeasible), 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.) As another example, the deductions for contributions to nuclear decommissioning trust accounts and certain environmental settlement trust accounts are not viewed as tax expenditures 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 incomes of these two types of trust accounts, and these tax rate reductions are viewed as tax expenditures.

The Joint Committee staff assumes that normal income tax law would provide for the carryback and carryforward of net operating losses. The staff also assumes that the general limits on the number of years that such losses may be carried back or forward were chosen for reasons of administrative convenience and compliance concerns and may be assumed to represent normal income tax law. Exceptions to the general limits on carrybacks and carryforwards are viewed as tax expenditures.

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 directly 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.[13]

Certain income of pass-through entities is exempt from the corporate income tax. The income of sole proprietorships, S corporations, most partnerships, and other entities (such as regulated investment companies, real estate investment trusts, real estate mortgage investment conduits, and cooperatives) 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 section 501 also generally are exempt from corporate income tax. The tax exemption for organizations that have a direct business analogue or compete with for-profit organizations organized for similar purposes is a tax expenditure.[14] The tax exemption for certain nonprofit cooperative business organizations, such as trade associations, is not treated as a tax expenditure just as the entity-level exemption given to for-profit pass-through business entities is not treated as a tax expenditure. 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. However, there are numerous exceptions that allow for otherwise unrelated business income to escape taxation,[15] and these

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[13] See discussion of the individual AMT above.

[14] These organizations include small insurance companies, mutual or cooperative electric companies, State credit unions, and Federal credit unions.

[15] These exceptions include certain passive income that arguably may relate to business activities, such as royalties or rents received from licensing trade names or other assets typically used in a trade or business, as well as

exceptions are treated as tax expenditures. In general, the imputed income derived from nonbusiness 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, as is the exclusion of income granted to holders of tax-exempt financing issued by charities.

other passive income such as certain dividends and interest. Other exceptions include income derived from certain research activities and income from certain trade show and fair activities.

II. MEASUREMENT OF TAX EXPENDITURES

Tax expenditure calculations 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.[16] Taxpayer behavior is assumed to remain unchanged for tax expenditure estimate purposes.[17] This assumption is made to simplify the calculation and conform to the presentation of government outlays. This approach to tax expenditure measurement is in contrast to the approach taken in revenue estimating; all Joint Committee staff revenue estimates reflect anticipated taxpayer behavior.

The tax expenditure calculations in the annual reports are based on the relevant CBO revenue baseline and Joint Committee staff projections of the gross income, deductions, and expenditures of individuals and corporations. 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 (or that will be denied in the case of negative tax expenditures) 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 calculations in the annual reports are based on projections of actual claims under the various tax provisions, not the potential tax benefits to which taxpayers are entitled.

Some tax expenditure calculations are based partly on statistics for income, deductions, and expenses for prior years. Accelerated depreciation is an example. Estimates for this tax

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[16] 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. For positive tax expenditures, the major difference between outlay equivalents and the tax expenditure calculations presented here is accounting for whether a tax expenditure converted into an outlay payment would itself be taxable, so that a gross-up might be needed to deliver the equivalent after-tax benefits.

[17] An exception to this absence of behavior in tax expenditure calculations is that a taxpayer is assumed to make simple additions or deletions in filing tax forms, what the Joint Committee staff refers to as "tax form behavior." For example, as noted above, if the exclusion for employer-paid health insurance were repealed, taxpayers would be allowed to claim the next best tax treatment for the previously excluded insurance. This next best tax treatment could be the inclusion of the employer-paid health insurance with other medical expenses that the taxpayer may be able to deduct as part of the itemized medical deduction on Schedule A. Similarly, a taxpayer that is eligible for one of two alternative credits is assumed to file for the second credit if the first credit is eliminated.

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 calculated separately, under the assumption that all other tax expenditures remain in the 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.[18]

Year-to-year differences in the calculations for each tax expenditure reflect changes in tax law, including phaseouts of tax expenditure provisions and changes that alter the definition of the normal income tax structure, such as the tax rate schedule, the personal exemption amount, and the standard deduction. For example, the dollar level of tax expenditures tends to increase and decrease as tax rates increase and decrease, respectively, without any other changes in law. Some of the calculations in any one year's 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 measurement techniques.

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 mandate, 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.

Comparisons with Treasury

The Treasury uses a different methodology for the estimation of tax expenditures. Among other differences, the Treasury identifies tax expenditures with respect to a reference tax law baseline as well as a normal income tax law baseline. Reference law tax expenditures are limited to special exceptions from a generally provided tax rule. Provisions under the reference

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[18] See Leonard E. Burman, Christopher Geissler, and Eric J. Toder, "How Big Are Total Individual Income Tax Expenditures, and Who Benefits from Them?" *American Economic Review*, 98, May 2008, pp. 79-83. The authors estimate the combined revenue effects of a large number of individual income tax expenditures. They find significant and sometimes somewhat counterintuitive interactions among provisions. Interactions tend to increase the combined revenue effect of exclusions, capital gains and dividends treatment, and nonrefundable and refundable credits and decrease the combined revenue effect of itemized deductions relative to what a simple summation would suggest. Overall they estimate that eliminating all of the provisions they consider would raise about eight percent more revenue than the sum of individual estimates for each provision.

law baseline are generally tax expenditures under the normal income tax law baseline, but the reverse is not always true. Also, under the Treasury methodology, each tax expenditure is measured by the difference between tax liability under present law and the tax liability that would result if the tax expenditure provision were repealed and taxpayers were prohibited from taking advantage of any of the remaining tax expenditure provisions that apply to the income or the expenses associated with the repealed tax expenditure. For example, the tax expenditure provision for the exclusion for employer-paid health insurance is measured by the difference between tax liability under present law and the tax liability that would result if the exclusion were repealed and taxpayers were required to include all of the employer-paid health insurance in income, with no offsetting deductions (i.e., no deductibility on schedule A). The Treasury estimates may also differ as a result of different data sources and different projections of incomes and expenses among other reasons.

Tax expenditures versus revenue estimates

A tax expenditure calculation is not the same as a revenue estimate for the repeal of the tax expenditure provision for three reasons. First, unlike revenue estimates, tax expenditure calculations do not incorporate the effects of the behavioral changes that are anticipated to occur in response to the repeal of a tax expenditure provision. Second, tax expenditure calculations are concerned with changes in the reported tax liabilities of taxpayers.[19] Because tax expenditure analysis focuses on tax liabilities as opposed to Federal government tax receipts, there is no concern for the short-term timing of tax payments. Revenue estimates are concerned with changes in Federal tax receipts that are affected by the timing of all 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. This FICA effect would be reflected in revenue estimates, but is not considered in tax expenditure calculations. There may also be interactions between income tax provisions and other Federal taxes such as excise taxes and the estate and gift tax.

If a tax expenditure provision were repealed, it is likely that the repeal would be made effective for taxable years beginning after a certain date. Because most individual taxpayers have taxable years that coincide with the calendar year, the repeal of a provision affecting the individual income tax most likely would be effective for taxable years beginning after December 31 of a certain year. However, the Federal government's fiscal year begins October 1. Thus, the revenue estimate for repeal of a provision would show a smaller revenue gain in the first fiscal year than in subsequent fiscal years. This is due to the fact that the repeal would be effective after the start of the Federal 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, and very often repeal or modification of a tax provision includes transition relief that would not be captured in a tax expenditure calculation.

[19] Reported tax liabilities may reflect compliance issues, and thus calculations of tax expenditures reflect existing compliance issues.

III. EFFICIENCY, EQUITY, AND ADMINISTRABILITY CONSIDERATIONS RELATING TO TAX EXPENDITURES

In general

As with the tax system as a whole, it is useful to evaluate tax expenditures in terms of how well they fare along the following dimensions.

- First, does the tax expenditure promote or hinder economic efficiency? That is, to what extent does the tax expenditure influence taxpayer behavior in desirable ways or distort taxpayer behavior in undesirable ways?
- Second, is the tax expenditure fair? Does the tax expenditure treat similarly situated individuals similarly? Does the tax expenditure account for individuals' different capacities to bear the burden of taxation?
- Third, is the tax expenditure simple and easily administered? Is it costly for taxpayers to determine their tax liability and file their taxes? Can the tax expenditure be easily administered by the government? Is enforcement costly? Can some individuals successfully avoid their legal liabilities?

The design of a tax system and tax expenditures involves tradeoffs between these different goals.

Efficiency issues related to tax expenditures

While some tax expenditures exist to address equity concerns and to measure ability to pay properly, many present law tax expenditures were enacted specifically to encourage activities which, it was argued, may have been underprovided by the market in the absence of a subsidy provided by the Federal Government. Some argue, for example, that tax expenditures for energy-efficient products help correct inefficiencies in the market for fossil fuels owing to pollution from the consumption of such fuels.

In judging the efficiency impacts of a particular exclusion, deduction, or credit, the possible efficiency gains of a provision that is designed to overcome an inefficient market outcome must be weighed against the efficiency losses that would occur as marginal tax rates are raised to make up the revenue loss of the provision. To the extent the tax expenditure itself is not viewed as counteracting an inefficient market outcome then the effect of a tax expenditure may be to distort the allocation of resources inefficiently toward the tax-favored activity as well as to create efficiency losses that occur as marginal tax rates are raised to make up the revenue loss of the tax expenditure.

In many cases, however, it is not clear whether the stimulation of a specific activity because of an exclusion, deduction or credit increases or decreases the efficiency of the economy. For example, some contend that the exclusion from the tax base of employer provided health insurance contributes to inefficiency in the economy. The exclusion encourages employers to increase benefits under their health plans, so that individuals pay little or nothing each time they consume a service; this, it is argued, leads individuals to demand additional medical

services, merely because they are treated as free, even if these services do not contribute significantly to their health. As a result, additional resources may be drawn into the health care sector without substantial compensating benefits, thereby reducing the production of other goods and services for which consumers are willing to pay more. Thus, in addition to the efficiency costs of the higher marginal rates necessary to make up the revenue loss of this exclusion, it is argued that additional inefficiencies are created by unnecessary diversion of resources into the health care sector.

On the other hand, others contend that tax incentives for employer provided health insurance are desirable to compensate for underprovision of insurance which would occur if the determination of the amount of health insurance was left to the market. For example, it is argued that the particular problems of adverse selection in insurance markets (e.g., the tendency of healthy individuals to go without insurance to avoid the cost of premiums that are increased by the higher medical costs of unhealthy insured individuals) would lead many individuals to buy less insurance than is efficient. Such underprovision could lead to increased demand on public medical facilities by uninsured individuals faced with large medical bills. Allowing an exclusion for health insurance only if it is employer provided may encourage pooling of risks and enable insurance costs to be lower than otherwise.

Equity in the structure of tax expenditures

The structure of incentive provisions in the tax code can involve important issues of equity. For example, some argue that to be considered fair, a tax incentive should reduce the cost of the preferred activity by an equal percentage for each taxpayer; for example, credits, such as the residential energy credit in present law, generally operate in this manner by providing a fixed percentage of credit for all qualified expenditures regardless of the income of the taxpayer. Judged solely by this criterion, provisions such as the charitable contributions deduction and the mortgage interest deduction may be viewed as inequitable. This is because such deductions, under a system of progressive tax rates, reduce the cost to the taxpayer of, for example, charitable donations or housing payments, by a greater percentage for higher income individuals than for lower income individuals.

Many tax provisions affecting individuals appear to subsidize particular activities, rather than improving the measurement of the ability to pay taxes. For example, it can be argued that the allowance of certain itemized deductions and the favorable tax treatment of Individual Retirement Arrangements ("IRAs") constitute either explicit incentives or deductions for expenditures that represent significant personal benefits. Thus, from this point of view, if such activities are to be recognized in computing tax liability, then a uniform rate of cost reduction should apply.

On the other hand, it has been argued that upon closer examination, some of these provisions are not subsidies; rather, they represent appropriate adjustments in the proper measurement of income. For example, the subtraction of certain amounts from gross income is deemed necessary to measure ability to pay taxes. Thus, to achieve equity, it may be necessary to allow certain deductions from income even though such treatment provides a tax benefit which generally increases with income (since marginal tax rates generally increase with income). For example, many consider deductions for extraordinary medical expenses and casualty losses

to be necessary to measure ability to pay, since such expenditures and losses can significantly affect the individual's resources and thus ability to pay tax. Similarly, it is argued that deductions are appropriate for charitable contributions where the donor does not receive a more than incidental benefit from the funds given to charitable organizations, and by giving away his or her economic resources the taxpayer's ability to bear the burden of taxation is diminished.

Simplicity and administrability considerations relating to tax expenditures

All else equal, a simple tax system is preferred from the standpoint of complying with, and enforcing, the tax laws. In general, the proliferation of tax expenditures complicates the tax code. A complicated tax system requires a large amount of resources to administer and understand. When the system has a large number of tax expenditures, the agency administering the system must have a large staff to formulate the rules and to insure that taxpayers calculate tax liability correctly. Alternatively, an understaffed tax agency might encourage widespread noncompliance, increasing the budgetary cost of providing desirable tax expenditures. Taxpayers themselves must invest large amounts of time in understanding the rules so as to avoid overpaying their taxes, or alternatively, find that they are better off by paying for professional advice and tax return preparation. This time and effort diverted from other activities is a source of inefficiency generated by a complicated tax system.

Nonetheless, if it is decided that a particular type of activity should be encouraged or facilitated by government support, in certain cases there are advantages to providing subsidies through the tax system, since it provides an administrative mechanism, already in place, reaching a large majority of the American public. The speed and dependability of conveying subsidies through the tax system has been contrasted with the possibly protracted and inaccessible operations of bureaucracy which would distribute subsidies made available through a spending program.

On the other hand, the tax system may be a poor mechanism for distributing subsidies in cases where consideration of many standards or criteria are important in improving the efficiency of a subsidy, since tax incentives are generally designed with rigid criteria that cannot flexibly consider all desirable criteria before granting the subsidy. Thus, no role is retained for the discretion of program administrators who, in the case of spending programs, often try to weigh conflicting objectives and improve the targeting of subsidies in making grant and contract determinations. Additional inefficiencies may result from administration of the subsidy by the revenue agency, which may be required to deal with policy objectives outside of its normal area of expertise. Finally, extensive use of the income tax for delivering subsidies may adversely affect individuals' perceptions of the equity of the tax system.

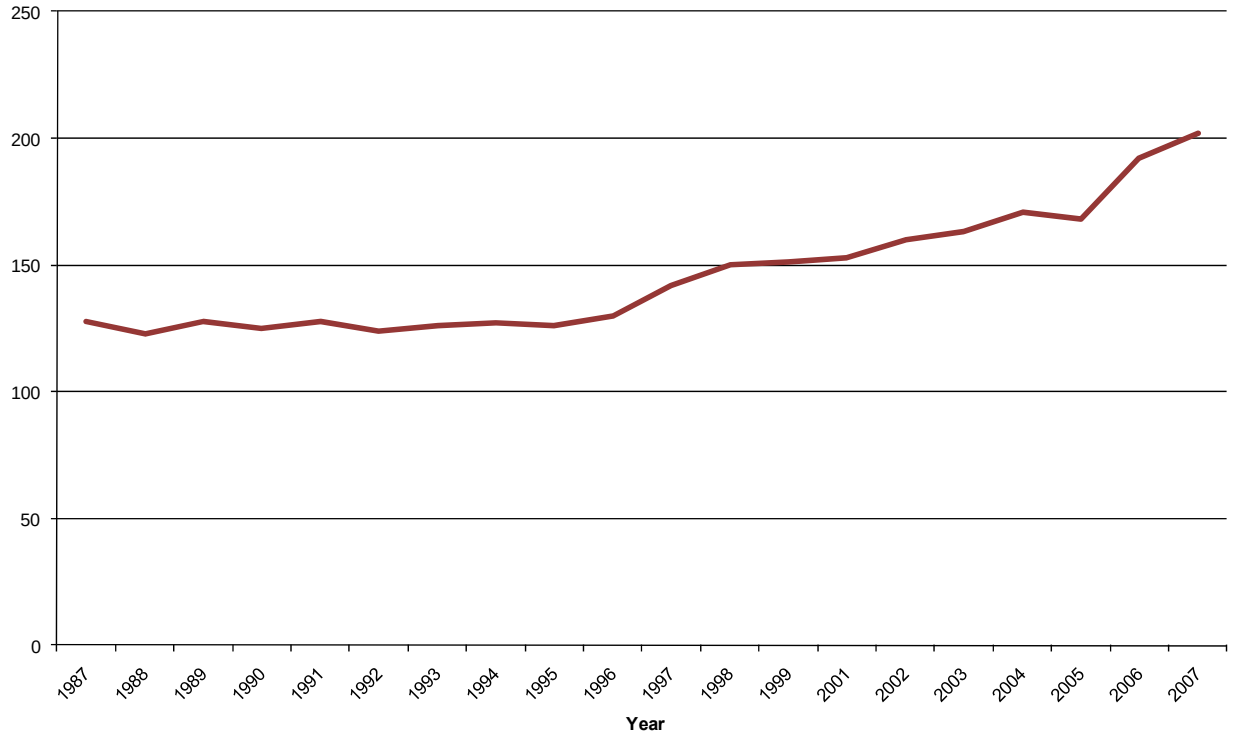
IV. HISTORICAL DATA ON TAX EXPENDITURES

Tax expenditures through time

Figure 1 shows the number of tax expenditures listed in the tables or the text that appear in the Joint Committee on Taxation's annual pamphlet on tax expenditures as in existence in each year from 1987 to 2007. It should be noted that counting the number of tax expenditures involves a certain amount of arbitrariness, since the number of tax expenditures reported in any particular year is sensitive to the level of disaggregation any piece of legislation or set of provisions is judged to warrant. This may change over time as particular components of provisions may become economically more or less important or as methodology changes. Nevertheless, it provides some measure of the extent to which tax expenditures have changed over time, particularly when combined with data on legislative activity reported below.

Of the 128 tax expenditures reported in 1987 for fiscal year 1988, 100 remained in effect in fiscal year 2007. Of the approximately 270 tax expenditures either in existence in fiscal year 1988 or adopted at any time between 1987 and 2007, 202 remained in place in 2007. Thus, in general, tax expenditures, once adopted, tend to stay in place.

Figure 1–Joint Committee on Taxation Count of Tax Expenditures, 1987-2007



The following tables report estimates of the ten largest individual and corporate tax expenditures at five-year intervals beginning with fiscal year 1975. For each provision, the sum of the tax expenditure estimates for the five fiscal years indicated is reported in nominal dollars. Thus the magnitudes of the estimates are not directly comparable across tables. Another factor

that makes it difficult to compare magnitudes directly across tables is the effect of tax rates on the dollar level of tax expenditure estimates. As noted above, the dollar level of tax expenditures tends to increase and decrease as tax rates increase and decrease, respectively, without any other changes in law. For provisions with both individual and corporate income tax effects, these were treated separately for purposes of determining their ranking on these lists. For example, the $15.72 billion tax expenditure estimate for the exclusion of interest on general purpose State and local debt in column 4 of Table 1 includes only the portion of the total tax expenditure estimate attributable to corporations. The $6.895 billion attributable to individuals was calculated separately, and thus did not rank among the top individual tax expenditures for fiscal years 1975-1979.

As noted above, there is some arbitrariness associated with identifying the ten largest provisions as differences in methodological choices about the level of disaggregation across years may influence which provisions are large enough to appear in the top ten. Descriptions of tax expenditures may also change slightly over time.

The list of top individual tax expenditures is persistent. Four of the items that appear on the list in 1975, the deduction for State and local taxes, net exclusion of pension contributions and earnings, deduction for mortgage interest on owner-occupied homes, and the exclusion of employer contributions for health, appear on all eight lists. The exclusion for social security benefits fails to make the top ten only in 2005, while of the preferential treatment of capital gains, the deduction for property taxes on owner-occupied homes, and the deduction for charitable contributions, other than for education and health, each fails to make the list in only two years.

Corporate tax expenditures reflect more fluidity over time. Only the exclusion of interest on general purpose State and local government debt appears among the top corporate tax expenditures every year, though some form of accelerated depreciation is present in every list. The expensing of research and development expenditures and the benefit of reduced corporate rates for the first dollars of corporate taxable income fail to appear only once each. Some of those items appearing in the earlier years were subsequently repealed, such as the general investment credit and the corporate capital gain preference.

Individual tax expenditures are generally of greater magnitude than corporate tax expenditures. This is especially true in the period after the Tax Reform Act of 1986. Except for the accelerated depreciation of equipment and then not always, all of the largest corporate tax expenditures are smaller than the smallest of the top ten individual tax expenditures.

Table 1.−Largest Tax Expenditures, Individual and Corporate, 1975-1979

INDIVIDUAL TAX EXPENDITURES		CORPORATE TAX EXPENDITURES	
Description of Tax Expenditure	**Total Amount (1975-1979) (Billions of dollars)**	**Description of Tax Expenditure**	**Total Amount (1975-1979) (Billions of dollars)**
Exclusion of capital gains at death	37.6	Investment Credit	29.0
Deduction for nonbusiness State and local taxes	37.3	Corporate surtax exemption	22.0
Net exclusion of pension contributions and earnings: employer plans	32.4	Exclusion of interest on general purpose State and local debt	15.7
Capital gain: individual (other than farming and timber)	32.0	Asset depreciation range	8.2
Deduction for mortgage interest on owner-occupied homes	25.7	Deferral of income of domestic international sales corporations	6.8
Exclusion of employer contributions to medical insurance premiums and medical care	21.2	Excess of percentage over cost depletion	6.2
Deduction for property taxes on owner-occupied homes	21.0	Expensing of construction period interest and taxes	5.3
Exclusion of social security OASI benefit for aged	17.7	Capital gain: corporate (other than farming and timber)	4.5
Exclusion of unemployment insurance benefits	13.6	Financial institutions: excess bad debt reserves	3.6
Exclusion of interest on life insurance savings	9.3	Expensing of research and development expenditures	3.5

Table 2.−Largest Tax Expenditures, Individual and Corporate, 1980-1984

INDIVIDUAL TAX EXPENDITURES		CORPORATE TAX EXPENDITURES	
Individual Tax Expenditure and Function	**Total Amount (1980-1984) (Billions of dollars)**	**Corporate Tax Expenditure and Function**	**Total Amount (1980-1984) (Billions of dollars)**
Deduction for nonbusiness State and local taxes	104.9	Investment Credit, other than for TRASOPs and for rehabilitated structures	89.4
Exclusion of employer contributions to medical insurance premiums and medical care	91.5	Reduced rates on first $100,000 of corporate taxable income	41.6
Deduction for mortgage interest on owner-occupied homes	89.5	Exclusion of interest on general purpose State and local debt	21.9
Net exclusion of pension contributions and earnings: Employer plans	85.5	Asset depreciation range	18.9
Capital gains (other than farming and timber)	80.4	Exclusion of interest on State and local housing bonds	12.0
Deduction for property taxes on owner-occupied homes	53.2	Expensing of research and development expenditures	11.3
Exclusion of social security OASI benefit for retired workers	53.1	Expensing of exploration and development costs	9.6
Deduction for charitable contributions, other than for education and health	39.4	Deferral of income of domestic international sales corporations	8.0
Deduction for medical expenses	23.2	Excess of percentage over cost depletion	7.5
Exclusion of interest on life insurance savings	23.0	Excess bad debt reserves of financial institutions	5.2

Table 3.−Largest Tax Expenditures, Individual and Corporate, 1985-1989

INDIVIDUAL TAX EXPENDITURES		CORPORATE TAX EXPENDITURES	
Individual Tax Expenditure and Function	**Total Amount (1985-1989) (Billions of dollars)**	**Corporate Tax Expenditure and Function**	**Total Amount (1985-1989) (Billions of dollars)**
Net exclusion of pension contributions and earnings: Employer plans	334.6	Investment Credit, other than for ESOPs, rehabilitation of structures, reforestation, leasing and energy property	176.0
Deduction for nonbusiness State and local taxes	143.5	Accelerated depreciation on equipment other than leased property	79.9
Exclusion of employer contributions to medical insurance premiums and medical care	133.4	Exclusion of interest on general purpose State and local debt	54.4
Capital gains, other than agricultural, timber, iron ore and coal	111.0	Reduced rates on first $100,000 of corporate taxable income	45.6
Deduction for mortgage interest on owner-occupied homes	75.6	Exclusion of interest on State and local government industrial development bonds	19.1
Exclusion of social security OASI benefit for retired workers	71.6	Expensing of research and development expenditures	16.3
Deduction for charitable contributions, other than for education and health	62.4	Capital gains, other than agricultural, timber, iron ore and coal	15.0
Deduction for property tax on owner-occupied homes	61.7	Tax credit for ESOPs	12.2
Individual Retirement Plans	59.3	Exclusion of possessions source income	8.8
Deduction for nonmortgage interest in excess of investment income	41.1	Expensing of exploration and development costs: oil and gas	8.0

Table 4.−Largest Tax Expenditures, Individual and Corporate, 1990-1994

INDIVIDUAL TAX EXPENDITURES		CORPORATE TAX EXPENDITURES	
Individual Tax Expenditure and Function	**Total Amount (1990-1994) (Billions of dollars)**	**Corporate Tax Expenditure and Function**	**Total Amount (1990-1994) (Billions of dollars)**
Net exclusion of pension contributions and earnings	272.9	Depreciation of equipment in excess of alternative depreciation system	70.9
Exclusions of contributions by employers and self-employed for medical insurance premiums and medical care	205.5	Reduced rates on first $75,000 of corporate taxable income	28.6
Deduction for mortgage interest on owner-occupied principal and second residences	133.5	Inventory property sales source rule exception	15.9
Exclusion of untaxed social security benefits	127.2	Merger rules for banks and thrift institutions	11.7
Deduction of nonbusiness State and local government income and personal property taxes	109.4	Exclusion and tax credit for corporations with possessions source income	11.5
Deferral of capital gains on sales of principal residences	57.4	Deduction of unpaid loss reserves for property and casualty insurance companies	8.2
Deduction for charitable contributions, other than for education and health	55.8	Expensing of research and development expenditures	8.1
Exclusion of interest on general purpose State and local government debts	54.1	Investment credit other than ESOPs, rehabilitation of structures, reforestation and energy property	7.1
Individual retirement plans	52.5	Exclusion of interest on general purpose State and local government debts	6.6
Deduction for property tax on owner-occupied homes	43.5	Exclusion of income of foreign sales corporations	4.3

Table 5.−Largest Tax Expenditures, Individual and Corporate, 1995-1999

INDIVIDUAL TAX EXPENDITURES		CORPORATE TAX EXPENDITURES	
Individual Tax Expenditure and Function	**Total Amount (1995-1999) (Billions of dollars)**	**Corporate Tax Expenditure and Function**	**Total Amount (1995-1999) (Billions of dollars)**
Net exclusion of pension contributions and earnings: employer plans	391.6	Depreciation of equipment in excess of alternative depreciation system	97.7
Deduction for mortgage interest on owner-occupied principal and second residences	302.1	Reduced rates for first $10,000,000 of corporate taxable income	21.7
Exclusion of employer contributions for medical insurance premiums and medical care	269.7	Tax credit for section 936 income	19.7
Deduction of nonbusiness State and local government income and personal property taxes	139.0	Inventory property sales source rule exception	18.3
Exclusion of untaxed social security benefits (Social security and railroad retirement)	125.5	Exclusion of interest on general purpose State and local government debts	17.5
Deferral of capital gains on sales of principal residences	79.4	Depreciation on buildings other than rental housing in excess of alternative depreciation system	13.0
Exclusions of capital gains at death	77.5	Special treatment of life insurance company reserves	12.5
Deduction for charitable contributions, other than for education and health	77.0	Deduction of unpaid property loss reserves for property and casualty insurance companies	9.7
Deduction for property tax on owner-occupied homes	76.8	Exclusion of income of foreign sales corporations	7.5
Exclusion on investment income on life insurance and annuity contracts	61.8	Deferral of income of controlled foreign corporations	5.7

Table 6.−Largest Tax Expenditures, Individual and Corporate, 2000-2004

INDIVIDUAL TAX EXPENDITURES		CORPORATE TAX EXPENDITURES	
Individual Tax Expenditure and Function	**Total Amount (2000-2004) (Billions of dollars)**	**Corporate Tax Expenditure and Function**	**Total Amount (2000-2004) (Billions of dollars)**
Net exclusion of pension contributions and earnings: employer plans	416.0	Depreciation of equipment in excess of alternative depreciation system	119.0
Exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums	324.1	Exclusion of interest on public purpose State and local government debts	27.2
Deduction for mortgage interest on owner-occupied residences	301.4	Reduced rates for first $10,000,000 of corporate taxable income	22.0
Reduced rates of tax on long-term capital gains	194.6	Inventory property sales source rule exception	22.0
Deduction of nonbusiness State and local government income and personal property taxes	190.0	Deferral of active income of controlled foreign corporations	19.8
Exclusions of capital gains at death	136.1	Tax credit for Puerto Rico and possession income, and Puerto Rico economic activity	17.6
Exclusion of untaxed social security and railroad retirement benefits	131.9	Tax credit for qualified research expenditures	17.3
Deduction of charitable contributions, other than for education and health	124.3	Exclusion of income of foreign sales corporations	15.6
Exclusion of investment income on life insurance and annuity contracts	121.8	Expensing of research and experimental expenditures	14.9
Deduction for property taxes on owner-occupied residences	101.3	Deduction for unpaid property loss reserves for property and casualty insurance companies	14.7

Table 7.–Largest Tax Expenditures, Individual and Corporate, 2005-2009

INDIVIDUAL TAX EXPENDITURES		CORPORATE TAX EXPENDITURES	
Individual Tax Expenditure and Function	**Total Amount (2005-2009) (Billions of dollars)**	**Corporate Tax Expenditure and Function**	**Total Amount (2005-2009) (Billions of dollars)**
Net exclusion of pension contributions and earnings: employer plans	567.8	Depreciation of equipment in excess of alternative depreciation system	71.3
Exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums	493.7	Exclusion of interest on public purpose State and local government debts	38.3
Deduction for mortgage interest on owner-occupied residences	434.2	Inventory property sales source rule exception	30.9
Reduced rates of tax on dividends and long-term capital gains	356.8	Expensing of research and experimental expenditures	28.5
Tax credit for children under age 17	231.7	Deferral of active income of controlled foreign corporations	25.8
Exclusions of capital gains at death	215.6	Reduced rates for first $10,000,000 of corporate taxable income	23.7
Earned income credit	195.1	Production activity deduction	19.8
Deduction of nonbusiness State and local government income, sales and personal property taxes	185.8	Tax credit for low-income housing	17.5
Deductions for charitable contributions, other than for education and health	159.2	Exclusion of investment income on life insurance and annuity contracts	12.8
Exclusion of benefits provided under cafeteria plans	134.4	Tax credit for qualified research expenditures	10.7

Table 8.−Largest Tax Expenditures, Individual and Corporate, 2010-2014

INDIVIDUAL TAX EXPENDITURES		CORPORATE TAX EXPENDITURES	
Individual Tax Expenditure and Function	**Total Amount (2010-2014) (Billions of dollars)**	**Corporate Tax Expenditure and Function**	**Total Amount (2010-2014) (Billions of dollars)**
Exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums	659.4	Deferral of active income of controlled foreign corporations	70.6
Deduction for mortgage interest on owner-occupied residences	484.1	Exclusion of interest on public purpose State and local government debts	45.3
Reduced rates of tax on dividends and long-term capital gains	402.9	Deduction for income attributable to domestic production activities	43.2
Net exclusion of pension contributions and earnings: Defined benefit plans	303.2	Inventory property sales source rule exception	38.0
Earned income credit	268.8	Depreciation of equipment in excess of alternative depreciation system	37.1
Deduction of nonbusiness State and local government income, sales and personal property taxes	237.3	Inclusion of income arising from business indebtedness discharged by the reacquisition of a debt instrument	28.8
Net exclusion of pension contributions and earnings: Defined contribution plans	212.2	Tax credit for low-income housing	27.0
Exclusions of capital gains at death	194.0	Expensing of research and experimental expenditures	25.6
Deductions for charitable contributions, other than for education and health	182.4	Inventory methods and valuation: Last in first out	20.0
Exclusion of untaxed social security and railroad retirement benefits	173.0	Reduced rates for first $10,000,000 of corporate taxable income	15.9

New tax expenditures since the Tax Reform Act of 1986

The Tax Reform Act of 1986[20] "represents one of the most comprehensive revisions of the Federal income tax system since its inception."[21] Among other considerations, Congress was concerned that erosion of the tax base required tax rates to higher than otherwise would be necessary. With the elimination of various tax expenditures and other preferences and the enactment of other base-broadening provisions, the Act sharply reduced individual income tax rates. The Act retained some of the tax expenditures most widely utilized by individuals and business incentives believed to be beneficial to the economy.

Numerous changes to the Code have been enacted in subsequent tax legislation. The information that follows provides a list of the new tax expenditures contained in legislation since the passage of the Tax Reform Act of 1986.[22] Modifications and extensions of pre-existing tax expenditures are not listed. Items are grouped by the legislation by which they were created. Items that have since expired are shown in italics.

Technical and Miscellaneous Revenue Act of 1988, enacted on November 10, 1988 (Pub. L. No. 100-647).

- Exclusion of income from United States savings bonds used to pay higher education tuition and fees

Omnibus Budget Reconciliation Act of 1990, enacted on November 5, 1990 (Pub. L. No. 101-508).

- Enhanced oil recovery credit
- Credit for small producers of ethanol
- Credit for cost of providing access for disabled individuals
- *Credit for health insurance costs for coverage of children*
- Reduced rate of tax on capital gains (effective with increase in individual income tax rates)

[20] Pub. L. No. 99-514.

[21] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), May 4, 1987, p. 6.

[22] This list may not be exhaustive. Differences in the methodology for identifying tax expenditures generally, for determining what constitutes a new provision versus a modification or extension of an existing provision, and for whether a provision is *de minimis* may yield a different list of provisions.

Omnibus Budget Reconciliation Act of 1993, enacted on August 10, 1993 (Pub. L. No. 103-66).

- Exclusion for gain from certain small business stock
- Rollover of gain from sale of publicly traded securities into specialized small business investment companies
- *Tax incentives for businesses in* empowerment zones, *enterprise communities, and rural development investment areas*
- Accelerated depreciation for property on Indian reservations
- Indian employment credit
- Modification of passive loss rules for certain real estate professionals
- Modification of unrelated business taxable income rules relating to real estate
- Exclusion of income from discharge of indebtedness incurred in connection with qualified real property
- Credit for portion of employer paid FICA taxes on tips

Small Business Job Protection Act of 1996, enacted on August 20, 1996 (Pub. L. No. 104-188).

- Deferral of gain on involuntary conversions resulting from Presidentially-declared disasters
- Exclusion of contributions in aid of construction for water and sewer utilities
- Adoption tax credit
- Exclusion of employer adoption assistance programs
- Deferral of tax on earnings of qualified State tuition programs
- Tax-free transfer of assets from common trust funds to mutual funds

Health Insurance Portability and Accountability Act of 1996, enacted on August 21, 1996 (Pub. L. No. 104-191).

- Medical savings accounts
- Taxpayer Relief Act of 1997, enacted on August 5, 1997 (Pub. L. No. 105-34),
- Tax credit for taxpayers with qualifying children under the age of 17
- HOPE and Lifetime Learning credits for tuition for post-secondary education
- Exclusion of earnings of trust or custodial accounts for paying higher education expenses
- Deduction for interest on qualified higher education loans

- *Credit for holders of qualified zone academy bonds*
- Tax incentives for D.C. Enterprise Zones
- D.C. first-time homebuyer tax credit
- Welfare-to-work tax credit
- Income averaging for farmers
- Expensing of environmental remediation expenditures
- Tax refund to Amtrak based on the carryback of its net operating losses against the tax attributes of its predecessor railroads

Tax and Trade Relief Extension Act of 1998, as part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 (Pub. L. No. 105-277).

- Special five-year carryback period for net operating losses attributable to farming

FSC Repeal and Extraterritorial Income Exclusion Act of 2000, enacted on November 15, 2000 (Pub. L. No. 106-519).

- *Extraterritorial income exclusion*

Community Renewal Tax Relief Act of 2000, incorporated by reference in the Consolidated Appropriations Act, 2001, enacted on December 2, 2000 (Pub. L. No. 106-554).

- *Renewal community tax incentives*
- New markets tax credit

Economic Growth and Tax Relief Reconciliation Act of 2001, enacted on June 7, 2001 (Pub. L. No. 107-16).

- Deduction for qualified higher education expenses
- Tax credit for employers who provide child care for employees
- Exclusion for certain restitution payments made to individuals who were persecuted for racial or religious reasons by Nazi Germany or other Axis regimes
- Credit for certain individuals for elective deferrals and IRA contributions
- Nonrefundable credit for administrative and retirement-education expenses for new pension plans adopted by small businesses
- Treatment of electing Alaska Native Settlement Trusts

Victims of Terrorism Tax Relief Act of 2001, enacted on January 23, 2002 (Pub. L. No. 107-134).

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

Job Creation and Worker Assistance Act of 2002, enacted on March 9, 2002 (Pub. L. No. 107-147).

- Additional first-year depreciation deduction for qualified property to which the general rules of MACRS apply
- Above the line deduction for teacher classroom expenses
- Additional first-year depreciation deduction for qualified New York Liberty Zone property
- Authority to issue $8 billion of tax-exempt private activity bonds to finance the construction and rehabilitation of nonresidential real property and residential rental real property in the New York Liberty Zone
- Authority for one additional advance refunding for certain bonds for facilities located in New York City
- A five-year recovery period was provided for qualified New York Liberty Zone leasehold improvement property

Trade Act of 2002, enacted on August 6, 2002 (Pub. L. No. 107-210).

- *Tax credit for the purchase of health insurance coverage by certain taxpayers*

Jobs and Growth Tax Relief Reconciliation Act of 2003, enacted on May 28, 2003 (Pub. L. No. 108-27).

- Reduced rates of tax on qualified dividends

Military Family Tax Relief Act of 2003, enacted on November 11, 2003 (Pub. L. No. 108-121).

- Exclusion for amounts received under Department of Defense Homeowners Assistance Program
- Deduction for overnight travel expenses of National Guard and Reserve members

Medicare Prescription Drug, Improvement, and Modernization Act of 2003, enacted on December 8, 2003 (Pub. L. No. 108-173).

- Exclusion of untaxed Medicare benefits: Prescription drug insurance (Part D)
- Exclusion of subsidies to employers who maintain prescription drug plans for Medicare retirees

- Health savings accounts

American Jobs Creation Act of 2004, enacted on October 22, 2004 (Pub. L. No. 108-357).

- Production activity deduction
- Deduction of film and television production costs
- Tax credit for expenditures for maintaining railroad tracks
- Elective "tonnage tax" in lieu of corporate income tax on taxable income from certain shipping activities
- Tax credit for biodiesel blenders
- Charitable deduction for certain expenses incurred in carrying out sanctioned whaling activities
- Incentives for small refiners to comply with EPA sulfur regulations
- Exclusion of interest on State and local government bonds for qualified green building and sustainable design projects
- Deferral of gain from the disposition of electric transmission property to implement Federal Energy Regulatory Commission restructuring policy

H.R. 241, enacted on January 7, 2005, (Pub. L. No. 109-1).

- *Cash contributions for Indian Ocean tsunami victims*

H.R. 1134, enacted on April 25, 2005, (Pub. L. No. 109-7).

- Modified section 139 to provide an exclusion for certain disaster mitigation payments

The Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users, enacted on August 10, 2005 (Pub. L. No. 109-59).

- Tax credit for the cost of carrying tax-paid distilled spirits in wholesale inventories
- Exclusion of interest on State and local government qualified private activity bonds for highway projects and rail-truck transfer facilities

Energy Tax Incentives Act of 2005, enacted on August 8, 2005 (Pub. L. No. 109-58).

- *Tax credit for the holders of clean renewable energy bonds*
- Tax credit for the production of electricity from qualifying advanced nuclear power facilities
- Tax credits for investments in clean coal power generation facilities

- Temporary election for refiners to expense up to 50 percent of the cost of qualified property used in the refining of liquid fuels
- Two-year amortization for certain geological and geophysical costs incurred in connection with oil and gas exploration
- Deduction for expenditures on qualified energy-efficient commercial building property
- Tax credit for the purchase of qualified energy efficiency improvements to existing homes
- Tax credit for the production of certain energy-efficient appliances
- Tax credit for the purchase of qualified photovoltaic property and qualified solar water heating property used exclusively for purposes other than heating swimming pools and hot tubs
- Tax credit for eligible contractors for the construction of qualified energy-efficient homes
- Tax credits for alternative technology vehicles
- Tax credit for the cost of installing clean-fuel vehicle refueling property
- Temporary five-year carryback period for a portion of the net operating losses of certain electric utility companies
- Tax credits for biodiesel fuels

The Katrina Emergency Tax Relief Act of 2005, enacted on September 23, 2005 (Pub. L. No. 109-73).

- Tax credit for employee retention for employers affected by Hurricanes Katrina, Rita, and Wilma
- Additional personal exemption for taxpayers who provide 60 days or more of free housing in their personal residence to individuals displaced by Hurricane Katrina
- Exclusion for the income from certain discharges of nonbusiness debt owed by individuals harmed by Hurricane Katrina

The Gulf Opportunity Zone Act of 2005, enacted on December 21, 2005 (Pub. L. No. 109-135).

- Additional first-year depreciation deduction for qualified Gulf Opportunity Zone property
- Partial expensing for Gulf Opportunity Zone clean-up costs
- Ten-year carryback period for casualty losses of Gulf Opportunity Zone public utility property by reason of Hurricane Katrina
- Five-year carryback period for net operating losses attributable to expenses

- Tax credit for the holders of Gulf Tax Credit Bonds
- Five-year carryback period for casualty losses of public utility property attributable to Hurricane Katrina
- Tax credit for Gulf Opportunity Zone employers providing in-kind lodging for employees and income exclusion for the employees

Tax Increase Prevention and Reconciliation Act of 2005, enacted on May 17, 2006 (Pub. L. No. 109-222).

- Tax exclusion for earnings of certain environmental settlement funds
- Reduced rates of tax for gains from the sale or exchange of self-created musical works
- Elective five-year amortization of expenses paid or incurred for the creation or acquisition of musical compositions

The Tax Relief and Health Care Act of 2006, enacted on December 20, 2006 (Pub. L. No. 109-432).

- Tax credit for corporate income earned in American Samoa
- Special depreciation allowance for cellulosic biomass ethanol plant property
- Partial expensing for investments in advanced mine safety equipment
- Credit for costs incurred in training qualified mine rescue team employees
- Deduction for premiums paid or accrued for qualified mortgage insurance
- 25-percent exclusion from gross income for capital gains from the conservation sale of a qualifying mineral or geothermal interest located on eligible Federal land

Hokie Spirit Memorial Fund, enacted December 19, 2007 (Pub. L. No. 110-141).

- Exclusion from gross income of amounts received from the Hokie Spirit Memorial Fund, established by the Virginia Tech Foundation

Mortgage Forgiveness Debt Relief Act of 2007, enacted December 20, 2007 (Pub. L. No. 110-142).

- Exclusion from gross income of indebtedness income arising from discharge of qualified principal residence indebtedness
- Exclusion from gross income of benefits provided to volunteer firefighters and emergency medical responders

Economic Stimulus Act of 2008, enacted February 13, 2008, (Pub. L. No. 110-185)

- *Recovery rebates for individual taxpayers*

- Additional first year depreciation deduction for qualified property

Food, Conservation, and Energy Act of 2008, enacted May 22, 2008 (Pub. L. No. 110-234 and 110-246).

- Exclusion of Conservation Reserve Program payments from SECA tax for individuals receiving Social Security retirement or disability payments
- Deduction for endangered species recovery expenditures
- Credit for cellulosic biofuel
- Tax credit bonds for qualified forestry conservation projects
- Agricultural chemicals security tax credit

Heroes Earnings Assistance and Relief Tax Act of 2008, enacted June 17, 2008 (Pub. L. No. 110-245).

- Employer wage credit for activated military reservists
- Exclusion of certain State and local payments to military personnel

Housing and Economic Recovery Act of 2008, enacted July 30, 2008 (Pub. L. No. 110-289).

- *First time homebuyer credit*
- Additional standard deduction for State and local real property taxes
- Bonds guaranteed by Federal Home Loan Banks eligible for treatment as tax-exempt bonds

Emergency Economic Stabilization Act of 2008, Energy Improvement and Extension Act of 2008, and Tax Extenders and Alternative Minimum Tax Relief Act of 2008, enacted October 3, 2008 (Pub. L. No. 110-343).

- New clean renewable energy bonds
- Credit for carbon dioxide sequestration
- Alternative motor vehicle credit and plug in electric vehicle credit
- Qualified energy conservation bonds
- Accelerated recovery period for depreciation of smart meters and smart grid system
- Special depreciation allowance for certain reuse and recycling property
- Treatment of amounts received in connection with the Exxon Valdez litigation.
- Tax exempt bond financing for the Midwestern Disaster Area
- Expensing for certain demolition and clean up costs

- Tax credit bonds
- Additional personal exemption for housing displaced individuals in the Midwestern Disaster area
- Mileage reimbursements to charitable volunteers excluded from gross income
- Exclusions for certain cancellations of indebtedness by reason of Midwestern disasters
- Expensing of qualified disaster expenses
- Special depreciation allowance for qualified disaster property
- Increased expensing for qualified disaster assistance property

The American Recovery and Reinvestment Act of 2009, enacted on February 17, 2009 (Pub. L. No. 111-5).

- *Making work pay credit*
- *Exclusion from gross income for up to $2,400 of unemployment compensation*
- *Deduction for any State or local sales or excise tax imposed on the purchase of a new car, light truck, motorcycle, or motor home*
- Election to receive an investment credit in lieu of a renewable electricity production credit
- Credit for alternative motor vehicles
- *Deferral of income arising from business indebtedness discharged by the reacquisition of a debt instrument*
- Credit for investment in advanced energy property
- Issuance of recovery zone economic development bonds and recovery zone facility bonds
- Tribal economic development bonds
- Suspension of classification of tax-exempt interest on certain bonds as a tax preference for AMT purposes
- Qualified school construction bonds
- *Build America bonds*
- *Credit against income taxes owed for tax year 2009 for individuals who receive a government pension or annuity from work not covered by social security*
- *Premium subsidy for COBRA continuation coverage for unemployed workers and their families*

Hiring Incentives to Restore Employment Act, enacted on March 18, 2010 (Pub. L. No. 111-147).

- *Credit for retention of certain newly hired workers*

Patient Protection and Affordable Care Act, enacted March 23, 2010 (Pub. L. No. 111-148), in combination with the Health Care and Education Reconciliation Act of 2010, enacted March 30, 2010, (Pub. L. No. 111-152).

- Credits and subsidies for participation in exchanges
- Tax credit for small businesses purchasing employer insurance
- Annual fees imposed on any covered entity engaged in the business of providing health insurance with respect to United States health risks are not deductible as ordinary and necessary business expenses
- Limits on deductible compensation
- Exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums
- Therapeutic research credit
- Exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums
- Surtax on unearned income

The Small Business Jobs Act of 2010, enacted on September 27, 2010, (Pub. L. No. 111-240).

- Extended carryback period for eligible small business credits from one year to five years