4. FEDERAL RECEIPTS

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

Growth in receipts.—Total receipts in 1995 are estimated to be $1,353.8 billion, an increase of $104.7 billion or 8.4 percent relative to 1994. This increase is largely due to assumed increases in incomes resulting from both real economic growth and inflation. However, it is also attributable, in part, to enactment of the Omnibus Budget Reconciliation Act of 1993 (OBRA93), which is estimated to increase 1995 receipts $21.0 billion relative to 1994, and the effect of the Health Care Security Act and other Administration proposals, which are estimated to increase 1995 receipts by a net $12.2 billion. Receipts are projected to grow at an average annual rate of 5.4 percent between 1995 and 1999, to $1,672.9 billion.

As a share of GDP, receipts are projected to rise from 18.8 percent in 1994 to 19.3 percent in 1995, and to decline slightly to 19.1 percent in 1999.

TABLE 4–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	1993 actual	Estimate					
		1994	1995	1996	1997	1998	1999
Individual income taxes	509.7	549.9	595.0	627.7	664.1	701.6	745.1
Corporation income taxes	117.5	130.7	140.4	145.8	149.8	152.5	157.2
Social insurance taxes and contributions	428.3	461.9	490.4	518.3	548.5	580.0	610.2
(On-budget)	(116.4)	(125.7)	(135.2)	(143.6)	(151.0)	(158.6)	(165.0)
(Off-budget)	(311.9)	(336.2)	(355.2)	(374.7)	(397.5)	(421.4)	(445.1)
Excise taxes	48.1	54.6	71.9	71.7	72.7	73.6	74.9
Estate and gift taxes	12.6	12.7	13.9	15.0	16.1	17.3	18.5
Customs duties	18.8	19.2	20.9	21.3	22.2	23.1	24.0
Miscellaneous receipts	18.6	20.0	21.3	27.6	31.6	38.7	43.1
Total receipts	**1,153.5**	**1,249.1**	**1,353.8**	**1,427.3**	**1,505.1**	**1,586.9**	**1,672.9**
(On-budget)	*(841.6)*	*(912.9)*	*(998.6)*	*(1,052.6)*	*(1,107.6)*	*(1,165.5)*	*(1,227.8)*
(Off-budget)	*(311.9)*	*(336.2)*	*(355.2)*	*(374.7)*	*(397.5)*	*(421.4)*	*(445.1)*

TABLE 4–2. CHANGES IN RECEIPTS

(In billions of dollars)

	Estimate					
	1994	1995	1996	1997	1998	1999
Receipts under tax rates and structure in effect January 1, 1993[1]	1,224.0	1,292.8	1,352.4	1,405.2	1,478.7	1,555.5
Enacted legislative changes:						
Omnibus Budget Reconciliation Act of 1993[2]	24.3	45.3	52.5	65.9	58.3	57.9
North America Free Trade Agreement Implementation Act[2]	–0.1	–0.1	–0.2	–0.1	1.2	–1.6
Social security (OASDI) taxable earnings base increases:						
$57,600 to $60,600 on Jan. 1, 1994	1.0	3.1	3.4	3.9	4.4	5.0
$60,600 to $62,100 on Jan. 1, 1995	.....	0.5	1.5	1.8	2.0	2.2
$62,100 to $63,900 on Jan. 1, 1996	.....	.....	0.7	2.0	2.2	2.5
$63,900 to $66,600 on Jan. 1, 1997	.....	.....	.....	1.0	3.1	3.4
$66,600 to $69,300 on Jan. 1, 1998	.....	.....	.....	.....	1.1	3.1
$69,300 to $72,300 on Jan. 1, 1999	.....	.....	.....	.....	.....	1.2
Proposals[2]	–0.1	12.2	16.9	25.5	35.9	43.7
Total, receipts under existing and proposed legislation	**1,249.1**	**1,353.8**	**1,427.3**	**1,505.1**	**1,586.9**	**1,672.9**

[1] These estimates assume social security and medicare taxalbe earnings bases of $57,600 and $135,000, respectively, through 1999.
[2] Net of income offsets.

ENACTED LEGISLATION

The Omnibus Budget Reconciliation Act of 1993.—This Act, which achieved the largest deficit reduction in our Nation's history, was signed by President Clinton on August 10, 1993. By providing substantial, fair, and balanced deficit reduction, it represented a vital first step toward economic renewal and growth in jobs and higher living standards for families today and in the future. Roughly half of the deficit reduction provided in the Act came from tax increases; 80 percent of these increases from households making over $200,000—the top 1.3 percent of the population. Almost twenty million low-income working families are receiving a tax cut, while only the 1.4 million most well-off American households are paying higher income taxes. The major revenue provisions of the Act are described below.

Stimulus/Investment

Provide capital gains exclusion for certain small business stock.—A noncorporate taxpayer who holds qualified small business stock for more than 5 years is allowed to exclude 50 percent of any gain on the sale or exchange of the stock. The amount of gain eligible for the 50 percent exclusion is limited to the greater of 10 times the taxpayer's basis in the stock or $10 million in gain from the sale of stock in that corporation. This exclusion applies to stock issued after August 10, 1993.

Modify minimum tax depreciation rules.—A corporate taxpayer is subject to an alternative minimum tax of 20 percent on minimum taxable income in excess of an exemption amount. Alternative minimum taxable income is the taxpayer's taxable income increased by certain tax preferences and adjustments. Effective for property placed in service after December 31, 1993, depreciation is no longer an adjustment to taxable income in determining alternative minimum taxable income.

Increase expensing deduction for small business.—Effective for property placed in service in taxable years beginning after December 31, 1992, the amount a taxpayer is allowed to expense under section 179 is increased from $10,000 to $17,500.

Expand and simplify earned income tax credit (EITC).—For eligible taxpayers with one qualifying child, the EITC is increased to 26.3 percent of the first $7,750 of earned income in 1994, for a maximum credit of $2,038. The credit is reduced by 15.98 percent of earned income (or adjusted gross income, if greater) in excess of $11,000. For 1995 and thereafter, the credit rate increases to 34 percent; the phase-out rate remains at 15.98 percent. For taxpayers with two or more qualifying children, the EITC is 30 percent of the first $8,425 of earned income in 1994, for a maximum credit of $2,527. The credit is reduced by 17.68 percent of earned income (or adjusted gross income, if greater) in excess of $11,000. The credit rate increases to 36 percent for 1995 and to 40 percent for 1996 and subsequent years. The phase-out rate increases to 20.22 percent for 1995 and to 21.06 percent for 1996 and subsequent years. The EITC is extended to low-income workers who do not have any qualifying children if they are between the ages of 25 and 65 and cannot be claimed as a dependent on another taxpayer's return. For these taxpayers, the EITC is 7.65 percent of the first $4,000 of earned income in 1994, for a maximum credit of $306. The maximum credit is reduced by 7.65 percent of earned income above $5,000. Beginning in 1995, all maximum income levels on which the EITC may be claimed and all income thresholds for the phaseout of the EITC are indexed for inflation. The supplemental young child credit and the supplemental health insurance credit of prior law are repealed.

Modify passive loss rules for certain real estate persons.—Effective with respect to taxable years beginning after December 31, 1993, the rental real estate income and losses of a taxpayer who materially participates in rental real estate activities is no longer subject to the passive loss rules that limit deductions and credits from passive trade or business activities.

Increase recovery period for depreciation of nonresidential real property.—Effective with respect to property placed in service on or after May 13, 1993, the period over which a taxpayer may recover the cost or other basis of the property through depreciation is increased from 31.5 to 39 years. The provision does not apply to property placed in service before January 1, 1994 if a binding contract to purchase or construct the property had been entered into prior to May 13th or if construction had commenced prior to that date.

Provide tax benefits for empowerment zones and enterprise communities.—Certain tax benefits will be provided for nine empowerment zones and 95 enterprise communities designated during 1994 and 1995. Six empowerment zones and 65 enterprise communities will be located in eligible urban areas and three empowerment zones and 30 enterprise communities will be located in rural areas. The tax incentives will be available during the period that the designation remains in effect, which generally will be 10 years.

Extend exclusion for employer-provided educational assistance.—The exclusion for certain amounts paid by an employer for educational assistance provided to an employee, which had expired with respect to amounts paid after June 30, 1992, is extended retroactively from July 1, 1992 through December 31, 1994.

Extend targeted jobs tax credit.—The targeted jobs tax credit, which was available to employers who hire individuals from several targeted groups, had expired with respect to individuals hired after June 30, 1992. This credit is extended retroactively from July 1, 1992 through December 31, 1994.

Extend research and experimentation (R&E) tax credit.—The 20 percent tax credit provided for certain research and experimentation expenditures, which had expired with respect to expenditures made after June

30, 1992, is extended retroactively from July 1, 1992 through June 30, 1995.

Modify research and experimentation (R&E) allocation rules.—Under prior law, companies with foreign operations were allowed to allocate 64 percent of domestic R&E expenditures to their domestic operations and 64 percent of foreign R&E expenditures to their foreign operations. The remaining expenses were to be allocated on the basis of gross sales or gross income. Effective for the first taxable year beginning on or before August 1, 1994 that follows the last taxable year to which the prior law rules applied, the allowable percentages are reduced to 50 percent.

Extend tax exemption for small issue manufacturing bonds.—Prior to July 1, 1992, interest on certain small issues of private activity bonds was exempt from tax if at least 95 percent of the bond proceeds was used to finance manufacturing facilities or certain land or property for first-time farmers. The authority to issue these bonds is permanently extended, with special placed-in-service rules for the period July 1, 1992 through December 31, 1993.

Extend tax credit for orphan drug clinical testing expenses.—Under prior law, a 50 percent nonrefundable tax credit was allowed for a taxpayer's qualified clinical testing expenses paid or incurred in the testing of certain drugs, generally referred to as orphan drugs, for rare diseases or conditions. This credit, which expired with respect to expenses incurred after June 30, 1992, is extended for 30 months, from July 1, 1992 through December 31, 1994.

Extend tax exemption for qualified mortgage bonds.—The proceeds of qualified mortgage bonds are used to finance the purchase, rehabilitation or improvement of single-family, owner-occupied residences located within the jurisdiction of the issuer of the bonds. Qualified governmental units may elect to exchange qualified mortgage bond authority for authority to issue mortgage credit certificates. These certificates entitle homebuyers to nonrefundable income tax credits for a specified percentage of interest paid on mortgage loans on their principal residence. This exemption, which had expired with respect to bonds issued after June 30, 1992, is permanently extended retroactive to July 1, 1992.

Extend low-income housing tax credit.—A tax credit is allowed in annual installments over ten years for qualifying newly constructed or substantially rehabilitated low-income rental housing. This credit is permanently extended effective with respect to expenditures incurred on or after July 1, 1992. Under prior law, the credit had expired with respect to expenditures incurred after June 30, 1992.

Extend tax deduction for health insurance costs of self-employed individuals.—Up to 25 percent of the amount paid by a self-employed individual for health insurance expenses incurred before July 1, 1992 was deductible under prior law. This deduction is extended for 18 months and applies to expenditures incurred on or after July 1, 1992 through December 31, 1993.

Extend minimum tax exception for gifts of appreciated tangible property.—Charitable contributions of tangible personal property, such as art-work, are not treated as a minimum tax preference item for purposes of computing alternative minimum taxable income. This provision, which had expired with respect to gifts made after June 30, 1992, is permanently extended retroactive to July 1, 1992 for tangible property and to January 1, 1993 for all property.

Repeal luxury tax on yachts, aircraft, jewelry and furs.—Effective for sales after January 1, 1993, the 10 percent excise tax on the retail price of yachts and boats in excess of $100,000, and on the retail price of jewelry and furs above $10,000 is repealed. In addition, effective for sales on or after the date of enactment, the $30,000 threshold for the luxury excise tax on automobiles is indexed annually for inflation.

Revenue Raisers—Individual Income Tax Provisions

Increase top rates for high income individuals.—Effective for taxable years beginning after December 31, 1992, the top individual income tax rate for individuals and estates and trusts is increased from 31 to 36 percent. In addition, a 10 percent surtax is levied on individuals with taxable income in excess of $250,000 and on estates and trusts with taxable income in excess of $7,500.

Modify alternative minimum tax for individuals.—The tax rate on alternative minimum taxable income in excess of the exemption amount, which had been 24 percent, is replaced with a two-tiered graduated rate schedule of 26 and 28 percent. The exemption amount is increased to $45,000 for married individuals filing joint returns, to $33,750 for unmarried individuals, and to $22,500 for married individuals filing separate returns and estates and trusts. These changes are effective for taxable years beginning after December 31, 1992.

Extend limitation on itemized deductions and phaseout of personal exemptions.—The limitation on itemized deductions and the phaseout of personal exemptions, which were scheduled to expire after December 31, 1995 and December 31, 1996, respectively, are permanently extended.

Increase taxable portion of social security benefits.—Under prior law, a portion of a taxpayer's social security or railroad retirement tier 1 benefits was included in gross income if the taxpayer's provisional income exceeded $25,000 for a single return and $32,000 for a married couple filing a joint return. The amount included in gross income was the lesser of: (1) 50 percent of the taxpayer's social security or railroad retirement tier 1 benefit, or (2) 50 percent of the excess of the taxpayer's provisional income over the applicable threshold amount. Effective for taxable years beginning after December 31, 1993, the threshold amounts are increased to $34,000 for a single return and $44,000 for a married couple filing a joint return. In addition, the amount included in gross income is the lesser of

85 percent of the taxpayer's social security or railroad retirement tier 1 benefit, or 85 percent of the excess of the taxpayer's provisional income over the applicable threshold amount.

Repeal medicare health insurance (HI) wage base cap.—Effective for wages and self-employment income earned after December 31, 1993, the dollar limit on income subject to HI taxes is repealed.

Reinstate top estate and gift tax rates.—Effective for decedents dying, gifts made, and generation skipping transfers occurring after December 31, 1992, the top marginal tax rates of 53 percent (applicable to taxable transfers greater than $2.5 million and less than or equal to $3.0 million) and 55 percent (applicable to taxable transfers over $3.0 million) are reinstated.

Reduce deductible portion of business meals and entertainment expenses.—The deductible portion of otherwise allowable business meals and entertainment expenses is reduced from 80 percent to 50 percent effective for taxable years beginning after December 31, 1993. The Administration will monitor and consider ways to ease the impact of this change.

Modify deduction for moving expenses.—Deductions from gross income for certain costs associated with moving to a new residence in connection with one's employment are no longer allowed effective for such costs incurred after December 31, 1993. Expenses no longer deductible include: the costs of pre-move house hunting trips and temporary living expenses, expenses associated with selling the old residence and purchasing the new residence, and the cost of meals consumed while traveling to the new location. Also, in order to claim a moving expense deduction, the taxpayer's new principal place of work must be at least 50 miles farther from the taxpayer's former residence than was the taxpayer's former principal place of work.

Reduce pension compensation cap.—The limit on compensation taken into account under a tax-qualified pension plan is reduced to $150,000, effective for benefits accruing in plan years beginning after December 31, 1993.

Revenue Raisers—Business Provisions

Increase corporate tax rate.—Effective for taxable years beginning on or after January 1, 1993, a new top marginal tax rate of 35 percent is levied on corporate taxable income in excess of $10 million. The 35 percent rate also applies to net corporate capital gains. A corporation with taxable income in excess of $15 million is required to increase its tax liability by the lesser of three percent of the excess or $100,000; this recaptures the benefit of the 34 percent rate on income less than or equal to $10 million.

Modify corporate estimated income tax rules.—To avoid a penalty for underpayment of estimated tax, a corporation must base its estimated tax payments on 100 percent of the tax shown on its return for the current year. The 100 percent of last year's liability safe-harbor provided to large and small corporations under prior law remains in effect. This change is effective for taxable years beginning after December 31, 1993.

Cap possessions tax credit.—Under prior law, certain domestic corporations with business operations in the U.S. possessions were allowed to elect the use of a tax credit that generally eliminated U.S. tax on certain income related to their operations in the possessions. Effective for taxable years beginning after December 31, 1993, the credit allowed to a possession corporation against U.S. tax on its active business income (income derived from the active conduct of a possession-based business, or from the sale of assets used in such a business) is determined as under prior law, but is subject to either of two alternative limitations. One alternative limitation is based on factors that reflect the corporation's economic activity in the possessions (the economic activity limitation) and the other limitation is based on a statutorily defined percentage of the credit that would be allowable under prior-law rules (the percentage limitation).

Require securities dealers to mark to market.—This provision conforms the accounting and tax treatment of securities inventories by generally requiring that securities be included in inventory at their market value effective for taxable years ending on or after December 31, 1993. The income attributable to this change is included in income ratably over 5 years.

Revise foreign tax credit for oil and gas and shipping income.—Prior law provided more favorable foreign tax credit treatment for income associated with foreign oil and gas or shipping activities than for income earned abroad by other United States industries. Effective with respect to income earned in taxable years beginning after December 31, 1992, certain passive income related to oil and gas and shipping operations is placed in the passive category for foreign tax credit limitation purposes. In addition, passive income related to foreign oil and gas extraction is excluded from the computation of the foreign oil and gas extraction income foreign tax credit limitations.

Improve transfer pricing compliance.—Under prior law, a "substantial" valuation misstatement (the net transfer pricing adjustment exceeds $10 million but is less than $20 million), could result in a penalty of 20 percent of the understatement of tax. The penalty for a "gross" valuation misstatement (the net transfer pricing adjustment is greater than or equal to $20 million) was 40 percent. However, a net increase in taxable income attributable to a price redetermination was disregarded, if it could be shown that there was a reasonable cause for the taxpayer's determination of the price, and that the taxpayer acted in good faith with respect to the price. Effective for taxable years beginning after December 31, 1993, the threshold for a "substantial" misstatement is lowered to the lesser of $5 million or 10 percent of gross receipts and the threshold for a "gross" misstatement is the lesser of $20 million or 20 percent of gross receipts. In addition, penalties will no longer be excused for reasonable cause and good faith unless certain statutory requirements are met.

Revenue Raisers—Excise Taxes

Increase transportation fuels tax.—Effective October 1, 1993, an additional tax of 4.3 cents per gallon is imposed on all transportation fuels. Taxable fuels include motor fuels used for highway transportation or in motorboats, gasoline used in aviation and in off-highway non-business uses, diesel fuel used in trains, and fuels used in inland waterways transportation. Increased revenues from this tax are retained in the General Fund of the Treasury.

Extend current 2.5 cents per gallon motor fuels tax.—Under prior law, a temporary 2.5 cents per gallon tax was levied on gasoline, special motor fuels, and diesel fuels used for highway transportation, in motor boats, and in trains. Revenues from this tax, which was scheduled to expire after September 30, 1995, were deposited in the General Fund of the Treasury. This tax is extended from October 1, 1995 through September 30, 1999. Revenues are to be transferred to the Highway Trust Fund; however, revenues from the tax on diesel fuel used in trains, which is reduced to 1.25 cents per gallon, are to be retained in the General Fund of the Treasury.

Revenue Raisers—Other

Extend Federal Unemployment Act (FUTA) surtax.—The temporary unemployment surtax of 0.2 percent imposed on employers, which was scheduled to expire with respect to wages paid after December 31, 1996, is extended through December 31, 1998.

North America Free Trade Agreement (NAFTA) Implementation Act.—This Act approves the agreement entered into by the United States, Canada and Mexico on December 17, 1992. It eliminates tariffs and other restrictions on trade among the three nations over a 15 year phase-in period. Although NAFTA will generate net economic and revenue gains through its effect on the economy, technical requirements of the Budget Enforcement Act require that the revenue losses from the tariff tax reduction be offset. The provisions of the Act that affect governmental receipts are as follows:

Reduce tariff rates.—Tariffs on trade among the United States, Canada and Mexico will be eliminated. About half of the tariffs disappeared on January 1, 1994; most of the rest will be phased-out over 10 years, though in some sectors—notably agriculture—tariffs will be phased-out over 15 years.

Implement a new electronic Federal tax deposit system.—A new electronic fund transfer system will be established for the collection of depository taxes. The system shall be designed to ensure that taxes are credited to the Treasury on the date such taxes are deposited to the Federal tax deposit system.

Disclose certain tax information to the United States Customs Service.—The Secretary of the Treasury is provided with authority to disclose certain tax information that will assist the Customs Service in conducting audits and in recovering taxes, duties or fees determined to be due as a result of such audits.

TABLE 4–3. EFFECT OF MAJOR LEGISLATION ENACTED IN 1993 ON RECEIPTS

(In billions of dollars)

	Estimate					
	1994	1995	1996	1997	1998	1999
Omnibus Budget Reconciliation Act of 1993						
Individual income taxes	9.8	24.5	26.1	32.1	26.0	27.3
Corporation income taxes	6.8	7.6	8.9	14.2	11.9	10.7
Social insurance taxes and contributions	2.0	6.6	7.1	8.8	9.8	9.2
Excise taxes	6.0	6.1	9.8	10.0	9.9	9.9
Estate and gift taxes	0.5	0.5	0.6	0.6	0.6	0.7
Customs duties	–0.9	.....	.....	.....	.....	.....
Miscellaneous receipts	.....	.....	.....	0.1	0.1	.....
Total, Omnibus Budget Reconciliation Act of 1993 [1]	24.3	45.3	52.5	65.9	58.3	57.9
North America Free Trade Agreement Implementation Act						
Individual income taxes	*	0.2	0.2	0.2	1.0	–0.5
Corporation income taxes	0.1	0.2	0.2	0.2	0.2	0.3
Social insurance taxes and contributions	*	0.1	0.2	0.2	0.9	–0.5
Excise taxes	*	0.1	*	0.1	*	0.2
Customs duties	–0.3	–0.6	–0.8	–0.9	–1.0	–1.1
Total, North America Free Trade Agreement Implementation Act [1]	–0.1	–0.1	–0.2	–0.1	1.2	–1.6
ADDENDUM						
Total effect on receipts by source:						
Individual income taxes	9.9	24.6	26.3	32.3	27.0	26.9
Corporation income taxes	6.9	7.8	9.1	14.5	12.2	11.0
Social insurance taxes and contributions	2.1	6.7	7.3	9.0	10.7	8.8
Excise taxes	6.0	6.2	9.9	10.1	9.9	10.1
Estate and gift taxes	0.5	0.5	0.6	0.6	0.6	0.7
Customs duties	–1.2	–0.6	–0.8	–0.9	–1.0	–1.1
Miscellaneous receipts	.....	.....	.....	0.1	0.1	.....
Total effect on receipts [1]	24.1	45.2	52.4	65.7	59.5	56.3

*$50 million or less.
[1] Net of income offsets.

ADMINISTRATION PROPOSALS

Health Security Act.—The Administration's Health Security Act, which was transmitted to Congress on November 20, 1993, would provide insurance to all legal residents of the United States for expenses resulting from a wide range of medical services. A detailed discussion of this Act is presented in Chapter 4 of the 1995 budget. The major provisions of the Act that affect governmental receipts include the following:

Increase tax on tobacco products.—Effective October 1, 1994, the excise tax on cigarettes would be increased by $.75 per pack to $.99 per pack. Comparable increases in Federal excise taxes on other tobacco products are also proposed.

Levy assessment on corporate alliance employers.—A one-percent annual assessment would be levied on the total payroll of firms that provide health insurance through corporate alliances. The assessment generally would be effective January 1, 1996.

Increase deduction for health insurance costs of self-employed individuals.—The health insurance deduction for self-employed individuals would be increased to 100 percent of premiums paid to a health alliance for the comprehensive benefit package. The current 25 percent health insurance deduction for self-employed taxpayers would remain in effect until the taxpayer's State of residence establishes a regional alliance.

Limit exclusion of employer-provided health coverage.—Effective January 1, 1997, contributions for health benefits made through cafeteria plans would no longer be excluded from an employee's taxable income. In addition, effective January 1, 2004, employer-paid premiums for supplemental health coverage (coverage for benefits in excess of the basic comprehensive benefit package) would be taxable to the employee for income and employment tax purposes.

Provide deduction for qualified long-term care services.—Effective for taxable years beginning after December 31, 1995, expenses incurred by certain incapacitated individuals for qualified long-term care services would be deductible as a medical expense (subject to the current law 7.5 percent of adjusted gross income floor).

Modify tax treatment of qualified long-term care insurance premiums and benefits.—Effective for policies issued after December 31, 1995, premiums for qualified long-term care insurance would be deductible as a medical expense (subject to the current law 7.5 percent of adjusted gross income floor). Effective on that date,

taxpayers would also be able to exclude from taxable income up to $150 per day in benefits paid under a long-term care policy, provided the qualified policy did not provide benefits in excess of $150 per day. Taxpayers participating in plans providing more than $150 per day in benefits would not be eligible for the exclusion. The $150 cap would be adjusted annually for inflation. In addition, employers would be able to deduct the cost of premiums paid for qualified long-term care coverage, and employees would be able to exclude the value of coverage from taxable income.

Modify tax treatment of accelerated death benefits.—Distributions under a life insurance contract on the life of an insured individual who is terminally ill and expected to die within 12 months would be treated as an amount paid by reason of death and would be excluded from taxable income with respect to such distributions made in taxable years beginning after December 31, 1993.

Provide tax credit for the cost of personal assistance services required by employed individuals.—Impaired taxpayers with earned income would be allowed to claim a non-refundable tax credit for 50 percent of certain impairment-related personal assistance services expenses, up to a maximum of $15,000 in expenses, effective for expenses incurred in taxable years beginning after December 31, 1995. Specifically, the maximum allowable annual tax credit would be the lesser of 50 percent of the taxpayer's earned income or $7,500. The credit would be gradually phased-out for taxpayers with adjusted gross income between $50,000 and $70,000.

Provide tax credit for primary health services providers in health professional shortage areas.—Effective for taxable years beginning after December 31, 1994, physicians who receive the required certification and commence work full-time in an area that is designated as being short of health professionals would be eligible to receive a non-refundable tax credit of $1,000 per month for up to 60 months. Certified nurse midwives, nurse practitioners, and physician assistants who work in health professional shortage areas would receive a non-refundable tax credit of $500 per month for up to 60 months.

Increase expensing limit for medical equipment in health professional shortage areas.—The expensing limit for medical equipment used by physicians who work full-time in a designated area and placed in service after December 31, 1994 would be increased by $10,000.

Modify self-employment tax treatment of certain subchapter S corporation shareholders and partners.—Effective for taxable years beginning after December 31, 1995, certain limited partners and shareholders who own 2 percent or more of the stock in a service industry subchapter S corporation would be required to pay the self-employment social security and medicare taxes on their non-wage income from the Subchapter S corporation.

Modify penalty for failure to report payments to independent contractors.—To prevent employers from avoiding their health care premium payment responsibilities, the Secretary of the Treasury would be given greater authority to prevent mischaracterization of employees as independent contractors. In addition, the penalty for not reporting a payment made to an independent contractor would be increased by $50 or 5 percent of the payment, whichever was greater. These changes would be effective for information returns due more than 30 days following date of enactment.

Modify tax treatment of health care organizations.—The Administration's reform plan would require all health plans receiving premiums through health alliances to charge community rated premiums for the comprehensive benefit package, thus eliminating the need for the favorable income tax treatment provided Blue Cross/Blue Shield organizations under current law. Specifically, such organizations would no longer be allowed to deduct the difference between 25 percent of their health claims and adjusted surplus; in addition, these organizations would be required to include 20 percent of the change in their unearned premium reserves in taxable income. Recognizing that a nonprofit health care provider should not qualify for tax exemption unless it provides services that are beneficial to the community, nonprofit hospitals and other nonprofit health providers would be required to assess the health needs of their community and develop a plan to meet those needs in order to retain tax-exempt status. These changes generally would be effective for taxable years beginning after December 31, 1996.

Relate early retiree health premium discounts to income.—Effective January 1, 1998, retirees between the ages of 55 and 64 (early retirees) would be eligible for a discount for the employer share of their health insurance premiums. However, single taxpayers with combined income above $90,000 and married couples filing joint returns with combined income above $115,000 would be required to repay the discount.

Levy assessments on employers to pay for coverage for early retirees.—A temporary assessment would be levied on employers who provide health insurance benefits to early retirees. The assessment would be levied for 3 years, 1998, 1999, and 2000, and in each year employers would pay 50 percent of the greater of: (1) the estimated employer savings in the current year for providing health coverage to retirees between the ages of 55 and 64 as a result of the health care reform legislation, and (2) the annual average of the actual early-retiree health benefits paid by the employer during the period 1991–93, adjusted for medical cost inflation.

Modify employer contributions to post-retirement medical and life insurance reserves and retiree health accounts maintained by pension plans.—Employers would no longer be able to contribute to retiree medical 401(h) accounts in pension plans, generally effective January 1, 1995. Moreover, additions to reserves for post-retirement medical or life benefits in funded welfare benefit plans, typically Voluntary Employee's Beneficiary Ac-

counts (VEBAs), would be funded no more rapidly than over a period of at least 10 years.

Recapture medicare Part B subsidies.—Effective January 1, 1996, high-income taxpayers who choose to enroll in medicare Part B would be required to pay additional premiums. The additional premium would increase the taxpayers' total contribution from about 25 percent of program costs to about 75 percent of program costs. The additional premiums would be phased-in for single taxpayers with combined income above $90,000 and married couples filing joint returns with combined income above $115,000.

Extend medicare hospital insurance coverage to all State and local government employees.—Effective October 1, 1995, mandatory medicare coverage would be extended to all employees of State and local governments not covered under present law.

Levy assessment on premiums for health coverage purchased through regional alliances.—A 1.5 percent assessment would be levied on premiums for comprehensive health coverage purchased through regional alliances.

Effect of employer mandate, cost containment, and subsides on individual income and payroll taxes.—Under this Act, employers would be required to contribute towards the costs of a comprehensive health insurance plan for their employees. The effects of the mandate would be mitigated by subsidies to employers and reductions in the growth of health insurance costs. In combination, these effects would result in a net increase in taxable wages and receipts from individual income taxes and payroll taxes.

Modify Federal pay raise (receipt effect).—National and locality pay increases would sum to 1.6 percent in 1995, 2.2 percent in 1996, and 2.5 percent in each year, 1997 through 1999. These proposed pay adjustments affect employee contributions to the Civil Service Retirement System (CSRS).

Levy surcharge on civil judgments.—Where the Justice Department wins a judgment for civil debt, an enforceable 15 percent surcharge will be added. The surcharge would apply to all judgments rendered after September 30, 1994.

Reform Pension Benefit Guaranty Corporation funding (receipt effect).—The Administration is proposing comprehensive, balanced reforms that will assure that the hard-earned pensions of American workers and retirees are secure. In addition to strengthening the funding requirements for underfunded plans, the proposal modifies existing tax rules regarding contributions to certain types of plans and modifies or eliminates existing excise taxes levied on some pension plan contributions.

Reallocate old age and survivors (OASI) and disability (DI) insurance tax rates.—To prevent the projected insolvency of the DI trust fund, a reallocation of OASI and DI payroll tax rates is proposed. The proposal has no net effect on receipts or the deficit.

Adjust civil monetary penalites for inflation.—The Administration proposes to adjust civil monetary penalties for inflation. A "catch-up" adjustment would be effective October 1, 1994; additional adjustments would be made every four years, if needed.

Increase and/or establish new Bureau of Alcohol Tobacco and Firearms (BATF) fees.—Effective October 1, 1994, many existing fees levied by the BATF on alcohol, tobacco and firearms would be increased and several new fees would be established. The amounts collected from these fees, which are listed below, would be used to offset the costs of the Bureau of Alcohol, Tobacco and Firearms.

Increase Federal firearms dealer license fee.—Under current law, firearms dealers pay $90 for an original 3-year license and $200 for a 3-year renewal license. The Administration proposes to increase the licensing fee to $600 per year. It is believed that this increase would drastically reduce the number of dealers.

Levy fee on firearms importers.—A sliding scale fee, based on the number of firearms imported on a permit, would be levied on importers of firearms.

Levy fee on applications for certification of labelling and testing of alcoholic beverages.—To offset the cost of operating the alcohol compliance program, a fee would be charged for processing applications for certification of alcoholic beverage labels and for review of formulae, statements of process, laboratory tests and other analyses performed under the authority of the Federal Alcohol Administration Act.

Increase Federal license and permit fees levied on manufacturers of and dealers in explosives.—Existing fees levied on explosives manufacturers and dealers, which range from $2 to $50, would be increased to range from $25 to $500.

Levy fee on applications for permits to manufacture alcohol and tobacco products.—A fee, to be based on the size of the business, would be levied on original applications for permits to manufacture alcohol and tobacco.

Modify collection of alcohol special occupational tax.—In order to increase compliance, wholesalers will not be able to sell to retailers until the retailer shows evidence that the special occupational tax has been paid.

Increase and/or expand fees collected under the securities laws.—Effective October 1, 1994, several existing securities-related fees would be increased and/or expanded to new markets. Amounts collected from these fees, which are listed below, would be deposited into a special fund to be established in the Treasury to fully-fund the Securities and Exchange Commission (SEC). Amounts collected in excess of the SEC's appropriation would be deposited in the General Fund of the Treasury.

Increase tender offer and merger acquisition fees.—The existing fees, which are 1/50th of one percent of

the cash, securities or property involved in a tender offer or merger acquisition, would be increased to 1/29th of one percent.

Increase securities sales fee.—The fee on the sale of all U.S. exchange-listed securities would be increased from 1/300th of one percent of the sale to 1/250th of one percent of the sale. In addition, the fee would be expanded to cover the sale of all over-the-counter securities transactions effective January 1, 1995.

Increase securites registration fee.—Applicants filing securites registration statements currently pay a fee equal to 1/50th of one percent of the maximum aggregate price at which the securities are proposed to be offered. An increase in the fee to 1/29th of one percent is proposed.

Increase investment advisor registration fee.—The existing one-time registration fee of $150 levied on investment advisors would be increased to an annual fee based on the volume of assets under management.

Levy fees on users of Federal fisheries.—Effective October 1, 1994, fees would be levied on the beneficiaries of Federal fisheries management programs. Amounts collected would be used to rebuild U.S. fisheries and to maintain the productivity of healthy fisheries.

Tax simplification.—The Administration supports revenue-neutral initiatives designed to promote sensible and equitable administration of the internal revenue laws. These include simplification, technical corrections, and taxpayer compliance measures.

IRS initiative.—The 1990 budget agreement included an IRS tax compliance initiative, which provided additional funding for activities that would reasonably be expected to increase revenue collections. The Administration is considering a similar multi-year IRS initiative—beginning in 1995—to increase taxpayer compliance further. This initiative would add 5,000 FTEs to compliance efforts in 1995, most of whom would be used to increase the number of focused examinations of tax returns, to collect more delinquent taxes, and to make more effective use of information-reporting documents.

The cost of this program would be $405 million per year, or $2.025 billion over five years. The initiative will yield far more revenue than its cost over the five-year period, and would continue to enhance tax revenue after that period (assuming continued funding at the same rate). In view of this deficit-reducing potential, the Administration would consider budgetary treatment similar to the 1990 budget agreement, under which the cost of the initiative was considered outside the discretionary caps. Under no circumstances would the Administration permit projected additional revenues to fund mandatory spending increases or tax reductions. Subsequent to the release of the President's budget, the Administration will work with the congress to develop such an initiative. Therefore, the revenue yield and costs of this initiative are not reflected in the President's 1995 budget itself.

TABLE 4–4. EFFECT OF PROPOSALS ON RECEIPTS

(In billions of dollars)

	Estimate					
	1994	1995	1996	1997	1998	1999
Health Security Act:						
Increase tax on tobacco products [1]	.....	12.0	11.3	11.2	11.1	11.0
Levy assessment on corporate alliance employers [1]	.....	.....	3.8	5.0	5.1	5.1
Increase deduction for health insurance costs of the self-employed	–0.1	–0.5	–0.6	–0.9	–1.7	–2.5
Limit exclusion of employer-provided health coverage	.....	.....	.....	5.3	8.1	8.7
Provide deduction for qualified long-term care services	.....	.....	–0.1	–0.2	–0.2	–0.2
Modify tax treatment of long-term care insurance premiums and benefits	.....	.....	–0.1	–0.2	–0.3	–0.4
Modify tax treatment of accelerated death benefits	–*	–*	–*	–*	–*	–*
Provide tax credit for cost of personal assistance services	.....	.....	–*	–0.1	–0.1	–0.1
Provide tax credit for health service providers in shortage areas	.....	.....	–*	–*	–*	–*
Increase expensing limit for medical equipment in shortage areas	.....	–*	–*	–*	–*	–*
Modify self-employment tax treatment of certain S corporation shareholders and partners	.....	.....	0.2	0.5	0.5	0.5
Modify penalty for failure to report payments to independent contractors	.....	0.1	0.1	0.1	0.1	0.1
Modify tax treatment of health care organizations	.....	.....	.....	0.1	0.2	0.2
Relate early retiree health premium discounts to income	.....	.....	.....	*	*	0.1
Levy assessments on employers to pay for early retirees [1]	.....	.....	.....	.....	2.4	4.3
Modify employer contributions to post-retirement medical and life insurance reserves and retiree health accounts	.....	*	*	*	*	0.1
Recapture medicare Part B subsidies	.....	.....	0.2	0.9	0.8	0.9
Extend medicare coverage to all State and local government employee [1]	.....	.....	1.6	1.6	1.5	1.5
Levy assessment on premiums for health coverage purchased through regional alliances [1]	.....	.....	0.5	1.6	4.3	5.5
Effect of employer mandate, cost containment, and subsidies on individual income and payroll taxes	.....	.....	0.1	0.9	4.4	9.3
Subtotal, Health Security Act [1]	**–0.1**	**11.6**	**16.9**	**25.6**	**36.2**	**44.0**
Other proposals:						
Modify Federal pay raise (receipt effect)	.....	–0.1	–0.1	–0.2	–0.3	–0.4
Levy surcharge on civil judgements	.....	*	*	*	*	*
Reform PBGC funding (receipt effect)	*	0.1	–0.4	–0.4	–0.5	–0.4
Reallocate old age survivors (OASI) and disability (DI) tax rates	.....	.....	.....	.....	.....	.....
Adjust civil monetary penalties for inflation	.....	*	*	*	*	*
Increase or establish new BATF fees [1]	.....	0.1	0.1	*	*	*
Increase or expand fees collected under securities laws	.....	0.4	0.4	0.4	0.4	0.4
Levy fees on users of Federal fisheries [1]	.....	0.1	0.1	0.1	0.1	0.1
Subtotal, other proposals [1]	*	0.5	*	–0.2	–0.3	–0.2
Total effect of proposals [1]	**–0.1**	**12.2**	**16.9**	**25.5**	**35.9**	**43.7**

* $50 million or less.
[1] Net of income offsets.

TABLE 4–5. RECEIPTS BY SOURCE

(In millions of dollars)

Source	1993 actual	1994 estimate	1995 estimate
Individual income taxes (federal funds):			
Withheld	430,427	455,119	482,654
Other	154,800	174,824	201,816
Refunds	−75,546	−79,978	−87,351
Proposals	.....	37	50
Health Security Act (proposal)	.....	−101	−2,122
Total net individual income taxes	**509,680**	**549,901**	**595,048**
Corporation income taxes:			
Federal funds:			
Gross collections	130,917	145,566	157,150
Refunds	−14,027	−15,529	−16,834
Proposals	.....	.....	−4
Health Security Act (proposal)	.....	−1	−604
Total Federal funds net corporation income taxes	116,891	130,035	139,708
Trust funds:			
Gross collections (Hazardous substance superfund)	629	684	729
Total Trust funds net corporation income taxes	629	684	729
Total net corporation income taxes	**117,520**	**130,719**	**140,437**
Social insurance taxes and contributions (trust funds):			
Employment taxes and contributions:			
Old-age and survivors insurance (Off-budget)	281,735	303,650	322,067
Proposals	.....	−11,942	−16,114
Health Security Act (proposal)	.....	.....	−1,221
Disability insurance (Off-budget)	30,199	32,529	34,506
Proposals	.....	11,942	16,114
Health Security Act (proposal)	.....	.....	−131
Hospital insurance	81,224	90,115	99,344
Health Security Act (proposal)	.....	.....	−338
Railroad retirement:			
Social Security equivalent accout	1,414	1,472	1,495
Rail pension fund	2,367	2,387	2,423
Total employment taxes and contributions	396,939	430,153	458,145
On-budget	85,005	93,974	102,924
Off-budget	311,934	336,179	355,221
Unemployment insurance:			
State taxes deposited in Treasury [1]	20,966	21,557	22,008
Federal unemployment tax receipts [1]	5,437	5,443	5,536
Railroad unemployment tax receipts [1]	64	41	23
Railroad debt repayment [1]	89	.....	.....
Total unemployment insurance	26,556	27,041	27,567
Other retirement contributions:			
Federal employees' retirement—employee contributions	4,709	4,636	4,646
Proposals	.....	.....	−55
Contributions for non-Federal employees [2]	96	93	89
Total other retirement contributions	4,805	4,729	4,681
Total social insurance taxes and contributions	**428,300**	**461,923**	**490,393**
On-budget	116,366	125,744	135,172
Off-budget	311,934	336,179	355,221

Source	1993 actual	1994 estimate	1995 estimate
Excise taxes:			
Federal funds:			
Alcohol taxes:			
Distilled spirits	3,797	3,802	3,763
Beer	3,329	3,342	3,352
Wines	578	565	555
Liquor Occupations	112	110	110
Refunds	−233	−227	−226
Total alcohol taxes	7,583	7,592	7,554
Tobacco taxes:			
Cigarettes	5,786	5,563	5,529
Cigars	54	54	53
Cigarette papers and tubes	2	2	2
Smokeless tobacco	33	33	33
Pipe tobacco	11	11	11
Refunds	−11	−11	−11
Health Security Act (proposal)	.....	.....	16,041
Total tobacco taxes	5,875	5,652	21,658
Miscellaneous excise taxes:			
Fuels	3,422	9,460	9,775
Firearms, shells, and cartridges	99	102	105
Pistols and revolvers	45	47	50
Bows and arrows	23	25	27
Gas guzzlers	134	136	139
Telephone and teletype services	3,320	3,493	3,675
Wagers and related occupations	17	18	18
Employee pension plans, etc	126	129	132
Undistributed income of private foundations	212	218	223
Policies issued by foreign insurers	101	107	113
Ship passengers	15	16	16
Ozone depleting chemicals and products	854	943	797
Luxury items	379	309	402
Other	1,709	60	109
Proposals	.....	−1	84
Refunds	−353	−355	−354
Total miscellaneous excise taxes	10,103	14,707	15,311
Undistributed Federal tax deposits and unapplied collections	962	720	734
Total Federal fund excise taxes	24,522	28,672	45,256
Trust funds:			
Highway:			
Gasoline	12,605	12,536	12,636
Trucks, buses, and trailers	1,199	1,320	1,387
Tires	305	318	320
Diesel fuel	3,582	3,931	4,089
Highway use of heavy vehicles	630	636	656
Refunds	−282	−452	−447
Total highway trust fund	18,039	18,290	18,642
Airport and airway:			
Transportation of persons	2,776	4,742	5,087
Transportation of property	156	261	283
Fuels	123	185	179
International departure	223	235	252
Refunds	−17	−17	−18
Total airport and airway trust fund	3,262	5,407	5,783
Aquatic resources	276	296	292
Black lung disability	634	654	668
Inland waterway	79	93	102
Hazardous substance superfund	826	838	849
Oil spill liability	229	.....	.....

TABLE 4–5. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	1993 actual	1994 estimate	1995 estimate
Vaccine injury compensation	38	148	141
Leaking underground storage tank	153	153	155
Total trust fund excise taxes	23,535	25,878	26,632
Total excise taxes	**48,057**	**54,550**	**71,888**
Estate and gift taxes	**12,577**	**12,749**	**13,885**
Customs duties and fees:			
Federal funds	18,119	18,530	20,173
Trust funds	683	668	683
Total customs duties and fees	**18,802**	**19,198**	**20,856**
Miscellaneous receipts: [3]			
Miscellaneous taxes	138	152	157
United Mine Workers of America combined benefit fund	161	239	236
Deposit of earnings, Federal Reserve System	14,908	15,847	16,604
Fees for permits and regulatory and judicial services:			
Immigration, passport, and consular fees	332	446	461
Patent and copyright fees	*	*	*
Registration and filing fees	640	708	737
Proposals			378
Coal mining reclamation fees	238	258	261
Miscellaneous fees for permits, licenses, etc	3	3	3
Proposals			40
Miscellaneous fees for regulatory and judicial services	426	391	421
Proposals			39
Fees for legal and judicial services	80	75	75
Total fees for permits and regulatory and judicial services	1,719	1,881	2,415
Fines, penalties, and forfeitures	1,686	1,791	1,764
Proposals			17
Restitutions, reparations, and recoveries under military occupation	11	11	11
Gifts and contributions	130	116	110
Refunds and recoveries	−154	−6	−5
Total miscellaneous receipts	**18,599**	**20,031**	**21,309**
Total budget receipts	**1,153,535**	**1,249,071**	**1,353,815**
On-budget	841,601	912,892	998,594
Off-budget	311,934	336,179	355,221
MEMORANDUM			
On-budget:			
Federal funds	704,848	763,250	838,888
Trust funds	314,712	313,842	321,803
Interfund transactions	−177,958	−164,200	−162,097
Total on-budget	841,601	912,892	998,594
Off-budget (trust funds)	311,934	336,179	355,221
Total	**1,153,535**	**1,249,071**	**1,353,815**

* $500 thousand or less.

[1] Deposits by States are State payroll taxes that cover the benefit part of the program. Federal unemployment tax receipts cover administrative costs at both the Federal and State level. Railroad unemployment tax receipts cover both the benefits and administrative costs of the program for the railroads.

[2] Represents employer and employee contributions to the civil service retirement and disability fund for covered employees of Government-sponsored, privately owned enterprises and the District of Columbia municipal government.

[3] Includes both Federal and trust funds. Trust fund amounts in miscellaneous receipts are: 1993, $446 million; 1994, $532 million; and 1995, $521 million.

5. USER FEES AND OTHER COLLECTIONS

This section discusses income to the Government from the public. The Government provides goods and services to specific public beneficiaries under its sovereign powers and in business-like transactions and may collect fees for these goods and services. The fees collected may be governmental receipts, offsetting receipts, or offsetting collections.

Governmental receipts are collections from the public that result primarily from the exercise of the Government's sovereign or governmental powers. They consist mostly of individual and corporate income taxes and social insurance taxes, but also include compulsory user charges. Offsetting receipts and offsetting collections result from business-like or market-oriented activities (for example, proceeds from the sale of postage stamps or electricity, fees or admittance to recreation areas, or the proceeds from the sale Government-owned land). Offsetting receipts are deposited in receipt accounts, whereas offsetting collections are credited directly to expenditure accounts. Offsetting receipts and collections are deducted from gross budget authority and outlays, rather than combined with governmental receipts. The purpose of this treatment is to produce budget totals for receipts, budget authority, and outlays that represent governmental rather than market activity.

As shown in Table 5–1 total offsetting collections from the public, including those proposed by the Administration (but excluding the collections of the off-budget Postal Service), are estimated to be $148.0 billion in 1995. Table 5–1 itemizes all offsetting collections from the public credited to receipt accounts and appropriation accounts. The information in Table 5–1 regarding offsetting collections deposited in receipt accounts is also available, in greater detail, in Table 5–3.

The budget contains a variety of user fee and other offsetting collections proposals that would yield $1.5 billion in 1995 and $8.4 billion over the years 1995 through 1999. These proposals establish or increase fees in order to recover more of the costs of providing Government services. Table 5–2 splits the proposals between discretionary and mandatory categories for the appropriate scoring under the Budget Enforcement Act of 1990 (BEA).

Discretionary.—The following discretionary user fee proposals would be credited as offsets to the BEA's discretionary spending limits.

TABLE 5–1. OFFSETTING COLLECTIONS FROM THE PUBLIC

(In millions of dollars)

Type	1993 actual	Estimate	
		1994	1995
Collections deposited in receipt accounts:			
Medicare premiums	15,306	17,581	20,054
Military assistance trust fund property sales	13,239	13,370	13,740
Outer Continental Shelf payments, naval petroleum reserve lease and other undistributed offsetting receipts	2,785	2,708	3,903
Sale of property and services, interest income and all other collections deposited in receipt accounts	13,589	14,978	15,208
Subtotal, collections from the public deposited in receipt accounts	44,919	48,637	52,905
Collections credited to appropriation accounts:			
Postal Service stamp sales and other collections	46,502	47,842	49,110
Deposit insurance funds	50,866	31,356	25,315
Tennessee Valley Authority and Power Administration collections	8,367	8,940	8,817
Commodity Credit Corporation loan repayments and other collections	9,229	7,903	10,487
Other loan repayments	9,686	10,606	7,543
Loan guaranty and other insurance premiums, interest income, and all other collections credited to appropriation accounts	44,941	43,757	42,933
Subtotal, collections from the public credited to appropriation accounts	169,591	150,405	144,206
Offsetting collections from the public	214,510	199,041	197,110
Offsetting collections from the public excluding off-budget Postal Service collections	168,008	151,199	148,000

Table 5–2. PROPOSED USER FEES AND OTHER COLLECTIONS

(In millions of dollars)

	Estimate				
	1995	1996	1997	1998	1999
Outlay offsets:					
Discretionary:					
Agriculture:					
Meat/poultry plant overtime inspection fee (FSIS)	–103	–103	–103	–103	–103
Catastrophic Crop Insurance fee for administrative activities (FSA)	–40	–40	–40	–40	–40
Commodity standards and overtime inspection fees (AMS)	–6	–6	–6	–6	–6
Licensing fees (PSA)	–9	–12	–12	–12	–12
Standardization fee (FGIS)	–5	–5	–5	–5	–5
Guaranteed loan fee (FmHA)	–13	–13	–13	–13	–13
Commerce:					
Fisheries management program fees [1]	–82	–82	–82	–82	–82
Marine sanctuary fee	–3	–3	–3	–3	–3
Aeronautical chart fee	–3	–3	–3	–3	–3
Health and Human Services:					
Food and Drug Administration	–338	–350	–368	–378	–389
Interior:					
National Park Service entrance and recreation fees	–27	–33	–33	–37	–33
Justice:					
Bankruptcy reorganization petition fee	–5	–5	–5	–5	–5
Pre-merger notification filing fee	–13	–13	–13	–13	–13
Transportation:					
FAA certification and surveillance of foreign repair stations	–2	–2	–2	–2	–2
Treasury:					
Definitive marketable securities fee	–1	–1	–1	–1	–1
Treasury direct account fee	–2	–2	–2	–2	–2
Customs merchandise processing fee	–94	–94	–94	–94	–94
IRS installment agreements	–54	–54	–54	–54	–54
IRS tax return copy fee	–5	–5	–5	–5	–5
IRS refund indicator fee	–87	–87	–87	–87	–87
Environmental Protection Agency:					
Pesticide registration fee	–15	–15	–15	.....	.....
Federal Trade Commission:					
Pre-merger notification filing fee	–13	–13	–13	–13	–13
Securities and Exchange Commission:					
Fee increases [1]	–378	–356	–366	–372	–377
Small Business Administration:					
Service fees	–26	–27	–28	–29	–30
Corps of Engineers:					
Wetland permit fees	–6	–12	–12	–12	–12
Subtotal, discretionary	–1,329	–1,336	–1,363	–1,371	–1,384
Mandatory:					
Interior:					
Hardrock royalty [2]	.....	–16	–112	–110	–108
Fee collection support, National Park System	–5	–8	–10	–12	–13
National Park Renewal Fund	.....	–12	–25	–34	–42
Justice:					
Surcharge on civil judgments [1]	–39	–39	–39	–39	–39
Transportation:					
Tonnage duty fees	–100	–100	–100	–100	–100
Extend rail safety	.....	–39	–40	–42	–43
Treasury:					
Federal firearms dealer license fee [1]	–25	–25	–23	–23	–23
Alcohol labeling program fee [1]	–5	–5	–5	–5	–5
Explosives license and permit fees [1]	–3	–3	–3	–3	–3
Firearms importer permits [1]	–1	–1	–1	–1	–1
Alcohol and tobacco permit applications fee [1]	–6	–6	–6	–6	–6
Environmental Protection Agency:					
Reregistration of pesticides fee	–5	–5	–5	–19	–19
Subtotal, mandatory	–189	–259	–371	–395	–403
Total user fees and other collections	–1,518	–1,595	–1,734	–1,765	–1,787

[1] Governmental receipts.
[2] Not coded as a user fee in the database.

Agriculture

- *Meat/poultry plant overtime inspection fee.*—Charge fees for all overtime inspection of meat and poultry products at all establishments inspected by the Food Safety and Inspection Service. Currently, fees to reimburse the cost of overtime inspection are required at some Food Safety Inspection Service inspected establishments, but not at others. The Federal government would continue to pay the full cost for a primary, eight-hour inspection shift.
- *Catastrophic Crop Insurance fee for administrative activities.*—Authorize the Farm Service Agency to collect a nominal fee from agriculture producers to help defray the administrative costs associated with the proposed free catastrophic crop insurance coverage.
- *Commodity standards and overtime inspection fees.*—Establish fees for the Agricultural Marketing Service to develop agricultural commodity standards and to recover the costs of overtime inspections for egg products.
- *Licensing fees.*—Establish a licensing fee for the costs of administering the programs of the Packers and Stockyards Administration. The fee would be applied to livestock market agencies, livestock dealers, meat packers and live poultry dealers as defined in the Packers and Stockyards Act.
- *Standardization fee.*—Establish a user fee for standardization activities of the Federal Grain Inspection Service, including maintaining uniform standards for grain quality, determining criteria and recommending specifications for grain inspection instrumentation and developing an agency-wide quality assurance program.
- *Guaranteed loan fee.*—Charge a one percent fee on Farmers Home Administration (FmHA) single-family loan guarantees. This fee would go to defraying the costs of administering the program. A similar fee is charged on other FmHA guaranteed loans.

Commerce

- *Fisheries Management Program Fees.*—Charge users of fisheries management programs fees which would fund or finance rebuilding U.S. fisheries and maintaining the productivity of healthy fisheries.
- *Marine Sanctuary Fee.*—Charge fees to support the operation of the National Marine Sanctuaries.
- *Aeronautical Chart fee.*—Charge fees to support the costs of maintaining and distributing of aeronautical charts.

Health and Human Services

- *Food and Drug Administration.*—Assess user fees on FDA-regulated industries to capture a portion of the private benefit those industries receive from FDA regulation. Includes user fees authorized by the Prescription Drug User Fee Act of 1992 and the Mammography Quality Standards Act of 1992.

Interior

- *National Park Service entrance and recreation fees.*—Implements NPR recommendation to expand authority to collect park entrance and recreation user fees. Additional revenues collected in 1995 (less receipts used for collection costs) are made available in 1996 to augment park operations and resource protection.

Justice

- *Bankruptcy reorganization petition fee.*—Increase fees assessed against debtor businesses filing bankruptcy reorganization petitions. The proceeds would be available to the United States Trustees as offsetting collections for increased oversight of the process of distributing debtor assets to creditors.
- *Pre-merger notification filing fee.*—Increase the pre-merger notification filing fee from $25,000 to $40,000 per filing. One-half of the fee increase would go to the Department of Justice and one-half would go to the Federal Trade Commission.

Transportation

- *FAA certification and surveillance of foreign repair stations.*—Permit recovery of full costs associated with the Federal Aviation Administration's certification and surveillance of foreign repair stations.

Treasury

- *Definitive marketable securities fee.*—Assess a fee for issuing definitive marketable securities.
- *Treasury direct account fee.*—Charge an annual maintenance fee to investors with large Treasury Direct Accounts.
- *Customs merchandise processing fee.*—Increase the current ad valorem charge and the maximum and minimum fees in the merchandise processing fee.
- *IRS installment agreements.*—Assess a small charge to cover the costs of administering installment agreements under which taxpayers pay taxes.
- *IRS tax return copy fee.*—Increase the charge for providing photocopies of tax returns from $4.25 to approximately $12.00. This proposal enables the IRS to recover its costs and encourages taxpayers to request less costly abstracts of tax returns from summary data stored on IRS computers.
- *IRS refund indicator fee.*—Charge institutions for providing a direct deposit indicator after receipt of an electronically filed tax return. The indicator is not necessary for the IRS to process the return however, it is useful to institutions in processing refund anticipation loans.

Environmental Protection Agency

- *Pesticide registration fee.*—Impose user fees on manufacturers of pesticides to recover the costs of EPA's registration program.

Federal Trade Commission

- *Pre-merger notification filing fee.*—Increase the pre-merger notification filing fee from $25,000 to $40,000 per filing. One-half the fee increase would go to the Department of Justice and one-half the fee increase would go to the Federal Trade Commission.

Securities and Exchange Commission

- *Fee increases.*—Increase and/or expand several existing securities-related fees. Amounts collected from these fees, which are listed below, would be deposited into a special fund to be established in the Treasury to fully-fund the Securities and Exchange Commission (SEC). Amounts collected in excess of the SEC's appropriation would be deposited in the General Fund of the Treasury.
  - —Increase from 1/50th to 1/29th of one percent the fee for a tender offer and merger acquisition fees.
  - —Increase the fee on the sale of all U.S. exchange-listed securities from the current level of 1/300th of one percent of the amount of the sale to 1/250th of one percent. In addition, the fee would be expanded to cover the sale of all over-the-counter (OTC) securities transactions effective January 1, 1995.
  - —Increase the fee applicants filing securities registration statements must pay from 1/50th to 1/29th of one percent of the maximum aggregate price at which the securities are proposed to be offered.
  - —Increase the SEC's existing one-time $150 fee to become a registered SEC investment advisor to an annual fee based on the volume of assets under management.

Small Business Administration

- *Service fees.*—Impose a $15 per hour fee on individuals obtaining assistance from Small Business Development Centers. Also impose fees for certain SBA publications, administrative loan servicing and SBA's electronic bulletin board.

Corps of Engineers

- *Wetland permit fees.*—Increase the fee structure for certain types of permits issued by the Army Corps of Engineers pursuant to Section 404 of the Clean Water Act. The new fee structure would more closely approximate the costs of evaluating such applications.

Mandatory.—The following mandatory user fee proposals would be scored as "pay-as-you-go" savings under the BEA's scoring rules.

Interior

- *Hardrock royalty.*—Impose an 8% royalty on hardrock minerals removed from public lands.
- *Fee Collection Support, National Park System.*—Use up to 15 percent of increased revenues estimated under new authority to collect park entrance and other recreation user fees to defray additional expenses necessary to collect the proposed new receipts.
- *National Park Renewal Fund.*—Implements NPR recommendation to create a new, National Park Renewal Fund, which would receive half of the additional revenues, net of fee collection costs, and return them to the collecting parks for direct expenditure from receipts in 1996.

Transportation

- *Tonnage duty fees.*—Increase the existing tonnage duty fees by 150 percent. These fees would offset the costs of services provided to the maritime industry by the Coast Guard.
- *Extend rail safety.*—Extend existing fees, which are due to expire at the end of 1995.

Treasury

- *Federal firearms dealer license fee.*—Increase the federal firearms dealer license fee from its current $90 for three year original license and $200 for three year renewal license to a $600/yr fee for each license.
- *Alcohol labeling program fee.*—Collect a fee to offset the cost of operating of the Alcohol Compliance Program. This fee would be charged for processing applications for Certification of Label Approval for alcoholic beverages and for reviews of formulae, statements of process, laboratory tests and analyses performed under the authority of the Federal Alcohol Administration Act and the Internal Revenue Code.
- *Explosives license and permit fees.*—Increase the fees for explosives licenses and permits from a present range of $2 through $50 to proposed levels of $25 to $500.
- *Firearms importer permits.*—Assess a fee against firearms importers for the processing and clearance of permits to import firearms. The fee on importers would be on a sliding scale based on the number of firearms imported on a particular permit.
- *Alcohol and tobacco permit applications fee.*—Assess a charge for processing original applications for alcohol and tobacco permits at a rate depending on the size of the business.

Justice

- *Surcharge on civil judgments.*—Create an enforceable 15 percent surcharge on judgments for civil debt collected by the Justice Department.

Environmental Protection Agency

- *Reregistration of pesticides fee.*—Increase and extend fees collected from pesticide manufacturers in support of reregistration of old pesticides.

Table 5–3 itemizes all receipts on the outlay side of the budget not credited to appropriation accounts. The presentation includes payments from one part of the government to another, called intragovernmental transactions, as well as collections from the public. In total, offsetting receipts are estimated at $288.7 billion in 1995.

TABLE 5–3. OFFSETTING RECEIPTS BY TYPE
(In millions of dollars)

Type	1993 actual	1994 estimate	1995 estimate
INTRAGOVERNMENTAL TRANSACTIONS			
On-budget receipts:			
Federal intrafund transactions:			
Distributed by agency:			
Interest from the Federal Financing Bank	11,333	9,601	8,794
Interest on Government capital in enterprises	2,191	2,165	1,945
Other	553	853	894
Total Federal intrafunds	14,077	12,620	11,633
Trust intrafund transactions:			
Distributed by agency:			
Payments to railroad retirement[1]	3,435	3,616	3,711
Other	184	1	1
Total intrafund transactions	17,697	16,237	15,345
Interfund transactions:			
Distributed by agency:			
Federal fund payments to trust funds:			
Contributions to insurance programs:			
Military retirement fund	12,273	11,908	12,564
Supplementary medical insurance	44,227	38,148	34,899
Hospital insurance	495	2,240	4,789
Railroad social security equivalent fund	2,996	3,109	3,194
Rail industry pension fund	2	−7	*
Civilian supplementary retirement contributions	20,118	20,585	20,768
Unemployment insurance	13,148	3,963	1,210
National separation liability	172	96	91
Other	1,375	471	526
Miscellaneous payments:			
State and local government fiscal assistance	.....	15	15
Other	650	504	574
Subtotal	95,456	81,033	78,630
Trust fund payments to Federal funds:			
Repayment of loans or advances to trust funds	2,914	2,921	3,056
Charges for services to trust funds	412	329	338
Other	617	622	646
Subtotal	3,944	3,873	4,039
Total interfunds distributed by agency	99,401	84,905	82,669
Undistributed by agency:			
Employer share, employee retirement[2]:			
Civil service retirement and disability insurance	7,735	7,842	8,007
CSRDI from Postal Service	4,785	5,136	5,669
Hospital insurance (contribution as employer)[3]	2,375	2,448	2,531
Military retirement fund	13,179	12,671	12,158
Other Federal employees retirement	112	119	128
Total employer share, employee retirement	28,186	28,217	28,493
Interest received by on-budget trust funds	55,537	56,772	57,191
Total interfund transactions undistributed by agency	83,723	84,990	85,684
Total interfund transactions	183,123	169,895	168,353
Total on-budget receipts	197,385	182,515	179,987
Off-budget receipts:			
Interfund transactions:			
Distributed by agency:			
Federal fund payments to trust funds:			
Old-age, survivors, and disability insurance	6,246	5,790	6,639
Undistributed by agency:			
Employer share, employee retirement (off-budget)	6,416	6,463	6,756
Interest received by off-budget trust funds	26,788	29,073	31,669
Total off-budget receipts	39,449	41,326	45,064
Total intragovernmental transactions	**240,269**	**227,457**	**228,762**
PROPRIETARY RECEIPTS FROM THE PUBLIC			
Distributed by agency:			
Interest:			
Interest on loans, Foreign Assistance Act	370	352	300
Other interest on foreign loans and deferred foreign collections	746	765	749
Interest on deposits in tax and loan accounts	542	624	740
Other interest (domestic—civil)[4]	842	961	1,575
Total interest	2,501	2,701	3,364
Rents:			
Rent and bonuses from land leases, etc	16	9	10
Rent of land and other real property	62	63	70
Rent of equipment and other personal property	5	8	8
Total rents	83	80	88
Royalties	1,028	1,107	1,079
Sale of products:			
Sale of timber and other natural land products	817	853	875

TABLE 5–3. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Type	1993 actual	1994 estimate	1995 estimate
Sale of minerals and mineral products	467	437	622
Sale of power and other utilities	705	788	820
Sale of other products [4]	9	44	48
Recovery of mint manufacturing expense	84	93	61
Total sale of products	2,082	2,216	2,427
Fees and other charges for services and special benefits:			
Medicare premiums and other charges (trust funds)	15,306	17,581	20,054
Nuclear waste disposal revenues	437	391	551
Veterans life insurance (trust funds)	393	317	304
Other [3]	1,737	1,906	2,004
Total fees and other charges	17,872	20,195	22,913
Sale of Government property:			
Sale of land and other real property [4]	19	45	46
Sale of equipment and other personal property:			
Military assistance program sales (trust funds)	13,239	13,370	13,740
Sale of scrap and salvage material	−5	.....	.....
Total sale of Government property	13,254	13,415	13,786
Realization upon loans and investments:			
Dollar repayments of loans, Agency for International Development	866	687	597
Foreign military credit sales	469	574	628
Negative loan subsidies	274	451	617
Downward reestimates of subsidies	276	871	.....
Dollar conversion of foreign currency	15	15	15
Repayment of loans to United Kingdom	100	102	104
Other	314	167	167
Total realization upon loans and investments	2,313	2,867	2,127
Recoveries and refunds [4]	1,469	1,707	1,807
Miscellaneous receipt accounts [4]	1,534	1,371	1,410
Total proprietary receipts from the public distributed by agency	42,135	45,644	48,985
Undistributed by agency:			
Other interest: Interest received from Outer Continental Shelf escrow account		.....	855
Rents and royalties on the Outer Continental Shelf:			
Rents and bonuses	176	199	588
Royalties	2,608	2,509	2,460
Total proprietary receipts from the public undistributed by agency	2,785	2,708	3,903
Total proprietary receipts from the public [5]	**44,919**	**48,367**	**52,905**
OFFSETTING GOVERNMENTAL RECEIPTS			
Distributed by agency:			
Defense cooperation	38	.....	.....
Other	2,103	2,270	2,765
Undistributed by agency:			
Spectrum auction proceeds	.....	500	4,300
Total offsetting governmental receipts	2,141	2,770	7,065
Total offsetting receipts	**287,330**	**278,594**	**288,731**

* $500 thousand or less.

[1] Interchange receipts between the social security and railroad retirement funds place the social security funds in the same position they would have been if there were no separate railroad retirement system.

[2] Includes contributions from Postal Service off-budget accounts.

[3] Includes provision for covered Federal civilian employees and military personnel.

[4] Includes both Federal funds and trust funds.

[5] Consists of:

	1993 actual	*1994 estimate*	*1995 estimate*
Federal funds	14,632	15,761	17,462
Trust funds	30,281	32,590	35,427
Off-budget	6	16	16

6. TAX EXPENDITURES

Tax expenditures are revenue losses due to preferential provisions of the Federal tax laws, such as special exclusions, exemptions, deductions, credits, deferrals, or tax rates. Tax expenditures are an alternative to other Government policy instruments, such as direct expenditures and regulations. The Congressional Budget Act of 1974 (Public Law 93–344) requires that a list of tax expenditures be included in the budget.

Tax expenditures relating to the individual and corporate income taxes are considered first in this chapter, followed by those relating to the unified transfer tax. The supplement at the end of the chapter presents major tax expenditures in the income tax ranked by revenue loss.

The Omnibus Budget Reconciliation Act of 1993 (OBRA 93) had a number of effects on income tax expenditures. The Act broadened the tax base by reducing some tax preferences, such as the exclusion for a portion of social security income and the credit available for business income earned in U.S. possessions. Conversely, the Act narrowed the tax base, and increased tax expenditures, by creating, renewing, or expanding several other tax preferences. New provisions include empowerment zones. Certain expired provisions, such as mortgage revenue bonds and the low-income housing tax credit, were extended permanently. Others, such as the research and experimentation tax credit and the targeted jobs tax credit, were extended but not made permanent. Expanded tax expenditures include more generous expensing provisions for small business investments and increases in the earned income tax credit.

OBRA 93 also increased the revenue losses from tax expenditures by raising the top individual and corporate tax rates. As tax rates rise, the revenue losses from deductions and exclusions also increase. For example, raising the top marginal tax rate from 31 percent to 39.6 percent would increase the revenue loss from a $1,000 exclusion in this tax bracket from $310 to $396.

In addition to reflecting the changes associated with OBRA 93, this year's tax expenditure budget includes two new features that better indicate the long-term effects of tax expenditures. First, revenue loss estimates are now presented through 1999, as is done for outlay programs. Second, a new table reports present-value estimates of the revenue losses for tax expenditures that involve deferrals of tax payments into the future or have similar long-term effects.

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

The Treasury Department prepared all tax expenditure estimates presented here based upon income tax law enacted as of December 31, 1993. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity in years before 1993.

The total revenue loss estimates for tax expenditures for fiscal years 1993–99 are displayed by the budget's functional categories in table 6–1. Descriptions of the specific tax expenditure provisions follow the tables of estimates and discussion of general features of the tax expenditure concept.

As in prior years, two baseline concepts—the normal tax baseline and the reference tax law baseline—are considered for the estimates. For the most part, the two concepts coincide. However, items treated as tax expenditures under the normal tax baseline, but not the reference tax law baseline, are indicated by the designation "normal tax method" in the tables. The revenue losses for these items are zero using the reference tax rules. The alternative baseline concepts are discussed in detail following the estimates.

Table 6–2 reports the respective portions of the total revenue losses that arise under the individual and corporate income taxes. Listing revenue loss estimates under the individual and corporate headings does not imply that these categories of filers benefit from the special tax provisions in proportion to the respective tax expenditure amounts shown. Rather, these breakdowns show the specific tax accounts through which the various provisions are cleared. The ultimate beneficiaries of corporate tax expenditures, for example, could be stockholders, employees, customers, or others, depending on the circumstances.

Table 6–6 at the end of this chapter ranks the major tax expenditures by fiscal year 1995 revenue loss. This table merges several individual entries provided in table 6–1; for example, table 6–6 contains one merged entry for charitable contributions instead of the three separate entries found in table 6–1.

TABLE 6–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX

(In millions of dollars)

	Total Revenue Loss						
	1993	1994	1995	1996	1997	1998	1999
National defense:							
Exclusion of benefits and allowances to armed forces personnel	2,115	2,060	2,030	2,020	2,015	2,030	2,055
International affairs:							
Exclusion of income earned abroad by United States citizens	510	860	895	945	1,000	1,055	1,115
Exclusion of income of foreign sales corporations	1,200	1,300	1,400	1,500	1,600	1,700	1,800
Inventory property sales source rules exception	1,100	1,200	1,300	1,400	1,500	1,600	1,700
Interest allocation rules exception for certain financial operations	100	95	95	95	95	95	95
Deferral of income from controlled foreign corporations (normal tax method)	1,600	1,600	1,700	1,800	2,000	2,200	2,400
General science, space, and technology:							
Expensing of research and experimentation expenditures (normal tax method)	2,060	2,230	2,390	2,560	2,740	2,930	3,130
Credit for increasing research activities	1,240	1,395	1,270	740	315	135	45
Suspension of the allocation of research and experimentation expenditures	0	270	270	0	0	0	0
Energy:							
Expensing of exploration and development costs:							
Oil and gas	185	145	140	100	60	55	95
Other fuels	20	20	20	20	20	25	25
Excess of percentage over cost depletion:							
Oil and gas	995	1,010	1,035	1,055	1,065	1,090	1,105
Other fuels	100	100	100	100	105	105	105
Alternative fuel production credit	760	900	970	1,000	990	940	880
Exception from passive loss limitation for working interests in oil and gas properties	50	50	50	50	50	50	50
Capital gains treatment of royalties on coal	10	15	15	15	15	15	15
Exclusion of interest on State and local IDBs for energy facilities	165	175	175	175	175	175	165
New technology credit	55	60	65	70	75	80	85
Alcohol fuel credit [1]	15	15	35	45	50	50	50
Tax credit and deduction for clean-fuel burning vehicles and properties	15	50	65	65	65	75	80
Exclusion from income of conservation subsidies provided by public utilities	50	100	145	175	190	190	190
Natural resources and environment:							
Expensing of exploration and development costs, nonfuel minerals	50	50	50	50	50	50	55
Excess of percentage over cost depletion, nonfuel minerals	185	195	195	195	200	205	210
Capital gains treatment of iron ore	*	*	*	*	*	*	*
Special rules for mining reclamation reserves	50	50	50	50	50	50	50
Exclusion of interest on State and local IDBs for pollution control and sewage	595	610	625	615	600	585	565
Capital gains treatment of certain timber income	10	15	15	15	15	15	15
Expensing of multiperiod timber growing costs	535	560	575	600	635	670	695
Investment credit and seven-year amortization for reforestation expenditures	35	35	35	40	40	40	45
Tax incentives for preservation of historic structures	135	130	125	125	120	115	115
Agriculture:							
Expensing of certain capital outlays	75	70	70	65	65	65	70
Expensing of certain multiperiod production costs	90	85	85	80	80	80	85
Treatment of loans forgiven solvent farmers as if insolvent	10	10	10	10	10	10	10
Capital gains treatment of certain income	115	135	140	145	145	145	150
Commerce and housing:							
Financial institutions and insurance:							
Exemption of credit union income	300	340	380	420	465	510	560
Excess bad debt reserves of financial institutions	30	35	40	40	45	50	55
Exclusion of interest on life insurance savings	7,520	8,115	8,730	9,385	10,090	10,805	11,660
Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5
Tax exemption of certain insurance companies	105	110	110	115	120	130	135
Small life insurance company deduction	120	125	135	140	145	155	160
Exemption of RIC expenses from the 2% floor for miscellaneous itemized deductions	525	600	690	810	925	1,055	1,205
Housing:							
Exclusion of interest on owner-occupied mortgage revenue bonds	1,715	1,760	1,785	1,775	1,715	1,640	1,575
Exclusion of interest on State and local debt for rental housing	1,000	970	920	870	810	750	685
Deductibility of mortgage interest on owner-occupied homes	48,705	51,835	54,800	57,985	61,420	65,050	68,785
Deductibility of State and local property tax on owner-occupied homes	13,055	13,865	14,655	15,545	16,425	17,395	18,395
Deferral of income from post 1987 installment sales	820	915	935	950	965	980	995
Deferral of capital gains on home sales	13,265	13,925	14,620	15,195	15,620	15,915	16,065
Exclusion of capital gains on home sales for persons age 55 and over	4,625	4,770	4,960	5,155	5,300	5,400	5,450
Exception from passive loss rules for $25,000 of rental loss	6,070	5,945	5,775	5,680	5,625	5,595	5,545
Accelerated depreciation of rental housing (normal tax method)	1,190	1,085	1,100	1,145	1,220	1,290	1,345
Commerce:							
Cancellation of indebtedness	60	120	110	70	35	10	–10
Permanent exceptions from imputed interest rules	140	150	150	150	155	155	160
Capital gains (other than agriculture, timber, iron ore, and coal) (normal tax method)	5,510	6,565	6,920	7,045	7,120	7,160	7,225

TABLE 6–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

	Total Revenue Loss						
	1993	1994	1995	1996	1997	1998	1999
Step-up basis of capital gains at death	25,340	26,850	28,305	29,480	30,265	30,710	30,655
Carryover basis of capital gains on gifts	120	125	130	135	140	145	150
Ordinary income treatment of loss from small business corp. stock sale	25	30	30	35	35	35	35
Accelerated depreciation of buildings other than rental housing (normal tax method)	2,895	2,995	3,185	3,430	3,745	4,075	4,410
Accelerated depreciation of machinery and equipment (normal tax method)	19,625	22,775	23,210	22,550	22,330	21,380	20,155
Expensing of certain small investments (normal tax method)	1,540	2,095	1,560	1,235	905	610	385
Amortization of start-up costs (normal tax method)	200	200	200	210	215	220	225
Graduated corporation income tax rate (normal tax method)	3,325	3,655	3,890	4,140	4,340	4,540	4,745
Exclusion of interest on small-issue IDBs	865	690	545	420	325	280	255
Deferral of gains from sale of broadcasting facilities to minority owned business	260	275	290	305	320	335	350
Treatment of Alaska Native Corporations	65	45	30	20	15	10	5
Transportation:							
Deferral of tax on shipping companies	15	15	15	15	15	15	15
Exclusion of reimbursed employee parking expenses	1,790	1,845	1,930	2,015	2,100	2,190	2,275
Exclusion for employer-provided transit passes	10	30	40	50	65	80	95
Community and regional development:							
Credit for low-income housing investments	1,545	1,925	2,265	2,600	2,945	3,270	3,500
Investment credit for rehabilitation of structures (other than historic)	90	90	80	80	80	70	70
Exclusion of interest on IDBs for airports, docks, and sports and convention facilities	730	785	830	870	915	960	1,005
Exemption of certain mutuals' and cooperatives' income	25	25	30	30	30	35	35
Empowerment zones	5	155	330	440	510	565	620
Education, training, employment, and social services:							
Education:							
Exclusion of scholarship and fellowship income (normal tax method)	790	835	875	920	965	1,015	1,065
Exclusion of interest on State and local student loan bonds	310	310	305	295	275	255	240
Exclusion of interest on State and local debt for private nonprofit educational institutions	705	735	750	770	785	810	845
Exclusion of interest on savings bonds transferred to educational institutions	*	5	5	5	10	10	15
Parental personal exemption for students age 19 or over	505	520	535	545	565	580	595
Deductibility of charitable contributions (education)	1,960	2,120	2,230	2,340	2,460	2,590	2,720
Exclusion of employer provided educational assistance	215	235	85	0	0	0	0
Training, employment, and social services:							
Targeted jobs credit	160	305	395	325	60	40	20
Exclusion of employer provided child care	620	675	725	775	830	890	955
Exclusion of employee meals and lodging (other than military)	490	525	550	580	610	640	670
Credit for child and dependent care expenses	2,540	2,675	2,820	2,975	3,145	3,320	3,510
Credit for disabled access expenditures	150	160	160	160	165	165	165
Expensing of costs of removing certain architectural barriers to the handicapped	20	20	20	20	20	20	20
Deductibility of charitable contributions, other than education and health	13,130	14,290	15,080	15,830	16,630	17,460	18,330
Exclusion of certain foster care payments	25	30	30	35	35	40	40
Exclusion of parsonage allowances	235	260	290	320	355	395	440
Health:							
Exclusion of employer contributions for medical insurance premiums and medical care	46,895	51,445	56,265	61,675	67,345	73,450	79,995
Credit for child medical insurance premiums[2]	110	125	0	0	0	0	0
Deductibility of medical expenses	3,010	3,270	3,560	3,870	4,195	4,535	4,890
Exclusion of interest on State and local debt for private nonprofit health facilities	1,405	1,455	1,495	1,535	1,585	1,640	1,700
Deductibility of charitable contributions (health)	1,770	1,910	2,020	2,130	2,230	2,340	2,460
Tax credit for orphan drug research	0	35	15	0	0	0	0
Special Blue Cross/Blue Shield deduction	105	115	125	140	100	170	185
Income security:							
Exclusion of railroad retirement system benefits	415	395	400	405	410	420	425
Exclusion of workmen's compensation benefits	3,815	4,240	4,455	4,740	5,065	5,565	6,100
Exclusion of public assistance benefits (normal tax method)	500	545	585	605	640	695	735
Exclusion of special benefits for disabled coal miners	100	100	100	95	95	90	80
Exclusion of military disability pensions	130	130	130	130	130	130	130
Net exclusion of pension contributions and earnings:							
Employer plans	49,430	48,750	55,540	59,010	59,490	59,950	60,400
Individual Retirement Accounts	5,720	5,415	5,290	5,275	5,175	4,970	4,615
Keogh plans	3,245	3,670	3,875	4,130	4,400	4,690	5,000
Exclusion of employer provided death benefits	25	30	35	35	40	40	45
Exclusion of other employee benefits:							
Premiums on group term life insurance	2,620	2,750	2,880	3,020	3,170	3,325	3,485
Premiums on accident and disability insurance	135	140	140	145	150	160	165
Income of trusts to finance supplementary unemployment benefits	35	35	35	35	35	35	35
Special ESOP rules (other than investment credit)	2,070	2,035	1,760	1,635	1,545	1,415	1,285
Additional deduction for the blind	40	45	45	45	50	50	55
Additional deduction for the elderly	1,510	1,535	1,555	1,570	1,585	1,600	1,605

TABLE 6–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

	Total Revenue Loss						
	1993	1994	1995	1996	1997	1998	1999
Tax credit for the elderly and disabled	60	65	65	70	70	75	75
Deductibility of casualty losses	695	770	230	230	230	230	230
Earned income credit[3]	3,605	3,940	5,100	5,795	6,435	6,740	7,125
Social Security:							
Exclusion of social security benefits:							
OASI benefits for retired workers	18,310	16,695	16,525	17,370	18,140	18,880	19,670
Disability insurance benefits	1,725	1,765	1,905	2,105	2,320	2,540	2,765
Benefits for dependents and survivors	3,620	3,610	3,730	3,940	4,150	4,365	4,590
Veterans benefits and services:							
Exclusion of veterans disability compensation	1,755	1,860	1,920	1,855	1,885	1,985	2,025
Exclusion of veterans pensions	80	80	75	70	70	75	85
Exclusion of GI bill benefits	45	55	65	70	75	80	80
Exclusion of interest on State and local debt for veterans housing	100	90	85	80	75	75	75
General purpose fiscal assistance:							
Exclusion of interest on public purpose State and local debt	11,575	11,970	12,350	12,690	13,085	13,535	14,040
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	22,555	24,255	25,640	27,130	28,740	30,435	32,185
Tax credit for corporations receiving income from doing business in U.S. possessions	3,075	2,890	2,630	2,680	2,735	2,815	2,960
Interest:.							
Deferral of interest on savings bonds	1,130	1,190	1,250	1,310	1,380	1,450	1,520
Addendum—Aid to State and local governments:							
Deductibility of:							
Property taxes on owner-occupied homes	13,055	13,865	14,655	15,545	16,425	17,395	18,395
Nonbusiness State and local taxes other than on owner-occupied homes	22,555	24,255	25,640	27,130	28,740	30,435	32,185
Exclusion of interest on:							
Public purpose State and local debt	11,575	11,970	12,350	12,690	13,085	13,535	14,040
IDBs for certain energy facilities	165	175	175	175	175	175	165
IDBs for pollution control and sewage and waste disposal facilities	595	610	625	615	600	585	565
Small-issue IDBs	865	690	545	420	325	280	255
Owner-occupied mortgage revenue bonds	1,715	1,760	1,785	1,775	1,715	1,640	1,575
State and local debt for rental housing	1,000	970	920	870	810	750	685
IDBs for airports, docks, and sports and convention facilities	730	785	830	870	915	960	1,005
State and local student loan bonds	310	310	305	295	275	255	240
State and local debt for private nonprofit educational facilities	705	735	750	770	785	810	845
State and local debt for private nonprofit health facilities	1,405	1,455	1,495	1,535	1,585	1,640	1,700
State and local debt for veterans housing	100	90	85	80	75	75	75

Note: Provisions with estimates denoted "normal tax method" have no revenue loss under the reference tax law method.
All estimates have been rounded to the nearest $5 million. Totals in table 6-1 may differ from figures in table 6-2 because of rounding.
* $2.5 million or less.
[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts of $675 million in 1995.
[2] The figures in the table indicate the effect of the child medical insurance premium credit on receipts. The effect on outlays in 1994 is $395 million.
[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays in 1995 is $15,795 million.

TABLE 6–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES

(In millions of dollars)

	Revenue Loss													
	Corporations							Individuals						
	1993	1994	1995	1996	1997	1998	1999	1993	1994	1995	1996	1997	1998	1999
National defense:														
Exclusion of benefits and allowances to armed forces personnel	—	—	—	—	—	—	—	2,115	2,060	2,030	2,020	2,015	2,030	2,055
International affairs:														
Exclusion of income earned abroad by United States citizens	—	—	—	—	—	—	—	510	860	895	945	1,000	1,055	1,115
Exclusion of income of foreign sales corporations	1200	1,300	1,400	1,500	1,600	1,700	1,800	—	—	—	—	—	—	—
Inventory property sales source rules exception	1,100	1,200	1,300	1,400	1,500	1,600	1,700	—	—	—	—	—	—	—
Interest allocation rules exception for certain financial operations	100	95	95	95	95	95	95	—	—	—	—	—	—	—
Deferral of income from controlled foreign corporations (normal tax method)	1,600	1,600	1,700	1,800	2,000	2,200	2,400	—	—	—	—	—	—	—
General science, space, and technology:														
Expensing of research and experimentation expenditures (normal tax method)	2,025	2,195	2,345	2,515	2,685	2,875	3,075	35	35	45	45	55	55	55
Credit for increasing research activities	1,210	1,365	1,240	730	315	135	45	30	30	30	10	—	—	—
Suspension of the allocation of research and experimentation expenditures	0	270	270	—	—	—	—	—	—	—	—	—	—	—
Energy:														
Expensing of exploration and development costs:														
Oil and gas	140	110	105	75	45	40	70	45	35	35	25	15	15	25
Other fuels	15	15	15	15	15	20	20	5	5	5	5	5	5	5
Excess of percentage over cost depletion:														
Oil and gas	745	760	775	790	800	815	830	250	250	260	265	265	275	275
Other fuels	85	85	85	85	90	90	90	15	15	15	15	15	15	15
Alternative fuel production credit	640	760	820	850	840	800	750	120	140	150	150	150	140	130
Exception from passive loss limitation for working interests in oil and gas properties	—	—	—	—	—	—	—	50	50	50	50	50	50	50
Capital gains treatment of royalties on coal	—	—	—	—	—	—	—	10	15	15	15	15	15	15
Exclusion of interest on State and local IDBs for energy facilities	65	70	70	70	70	70	65	100	105	105	105	105	105	100
New technology credit	55	60	65	70	75	80	85	*	*	*	*	*	*	*
Alcohol fuel credit [1]	5	5	5	5	5	5	5	10	10	30	40	45	45	45
Tax credit and deduction for clean-fuel burning vehicles and properties	15	45	55	55	55	60	60	0	5	10	10	10	15	20
Exclusion from income of conservation subsidies provided by public utilities	35	45	85	110	120	120	120	15	55	60	65	70	70	70
Natural resources and environment:														
Expensing of exploration and development costs, nonfuel minerals	45	45	45	45	45	45	50	5	5	5	5	5	5	5
Excess of percentage over cost depletion, nonfuel minerals	160	165	165	165	170	175	180	25	30	30	30	30	30	30
Capital gains treatment of iron ore	—	—	—	—	—	—	—	*	*	*	*	*	*	*
Special rules for mining reclamation reserves	45	45	45	45	45	45	45	5	5	5	5	5	5	5
Exclusion of interest on State and local IDBs for pollution control and sewage and waste disposal facilities	240	245	250	245	240	235	225	355	365	375	370	360	350	340
Capital gains treatment of certain timber income	—	—	—	—	—	—	—	10	15	15	15	15	15	15
Expensing of multiperiod timber growing costs	390	405	415	435	460	485	505	145	155	160	165	175	185	190
Investment credit and seven-year amortization for reforestation expenditures	20	20	20	20	20	20	25	15	15	15	20	20	20	20
Tax incentives for preservation of historic structures	45	40	40	40	35	35	35	90	90	85	85	85	80	80
Agriculture:														
Expensing of certain capital outlays	10	10	10	10	10	10	10	65	60	60	55	55	55	60
Expensing of certain multiperiod production costs	10	10	10	10	10	10	10	80	75	75	70	70	70	75
Treatment of loans forgiven solvent farmers as if insolvent	—	—	—	—	—	—	—	10	10	10	10	10	10	10
Capital gains treatment of certain income	—	—	—	—	—	—	—	115	135	140	145	145	145	150
Commerce and housing:														
Financial institutions and insurance:														
Exemption of credit union income	300	340	380	420	465	510	560	—	—	—	—	—	—	—
Excess bad debt reserves of financial institutions	30	35	40	40	45	50	55	—	—	—	—	—	—	—
Exclusion of interest on life insurance savings	210	225	245	265	280	305	325	7,310	7,890	8,485	9,120	9,810	10,500	11,335
Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	—	—	—	—	—	—	—
Tax exemption of certain insurance companies	105	110	110	115	120	130	135	—	—	—	—	—	—	—
Small life insurance company deduction	120	125	135	140	145	155	160	—	—	—	—	—	—	—
Exemption of RIC expenses from the 2% floor for miscellaneous itemized deductions	—	—	—	—	—	—	—	525	600	690	810	925	1,055	1,205
Housing:														
Exclusion of interest on owner-occupied mortgage subsidy bonds	690	705	715	705	680	650	625	1,025	1,055	1,070	1,070	1,035	990	950
Exclusion of interest on State and local debt for rental housing	400	385	365	345	320	295	270	600	585	555	525	490	455	415

TABLE 6–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

	Revenue Loss													
	Corporations							Individuals						
	1993	1994	1995	1996	1997	1998	1999	1993	1994	1995	1996	1997	1998	1999
Deductibility of mortgage interest on owner-occupied homes	—	—	—	—	—	—	—	48,705	51,835	54,800	57,985	61,420	65,050	68,785
Deductibility of State and local property tax on owner-occupied homes	—	—	—	—	—	—	—	13,055	13,865	14,655	15,545	16,425	17,395	18,395
Deferral of income from post 1987 installment sales	210	225	235	240	245	250	255	610	690	700	710	720	730	740
Deferral of capital gains on home sales	—	—	—	—	—	—	—	13,265	13,925	14,620	15,195	15,620	15,915	16,065
Exclusion of capital gains on home sales for persons age 55 and over	—	—	—	—	—	—	—	4,625	4,770	4,960	5,155	5,300	5,400	5,450
Exception from passive loss rules for $25,000 of rental loss	—	—	—	—	—	—	—	6,070	5,945	5,775	5,680	5,625	5,595	5,545
Accelerated depreciation on rental housing (normal tax method)	780	720	730	765	815	855	895	415	365	370	385	405	430	450
Commerce:														
Cancellation of indebtedness	—	—	—	—	—	—	—	60	120	110	70	35	10	–10
Permanent exceptions from imputed interest rules	—	—	—	—	—	—	—	140	150	150	150	155	155	160
Capital gains (other than agriculture, timber, iron ore, and coal) (normal tax method)	—	—	—	—	—	—	—	5,510	6,565	6,920	7,045	7,120	7,160	7,225
Step-up basis of capital gains at death	—	—	—	—	—	—	—	25,340	26,850	28,305	29,480	30,265	30,710	30,655
Carryover basis of capital gains on gifts	—	—	—	—	—	—	—	120	125	130	135	140	145	150
Ordinary income treatment of loss from small business corporation stock sale	—	—	—	—	—	—	—	25	30	30	35	35	35	35
Accelerated depreciation of buildings other than rental housing (normal tax method)	2,190	2,275	2,415	2,605	2,845	3,100	3,350	705	720	765	820	895	980	1,060
Accelerated depreciation of machinery and equipment (normal tax method)	15,840	18,420	18,720	18,140	17,965	17,200	16,210	3,785	4,355	4,490	4,410	4,365	4,180	3,940
Expensing of certain small investments (normal tax method)	590	785	595	470	345	235	145	945	1,310	965	765	560	380	240
Amortization of start-up costs (normal tax method)	100	100	100	105	105	110	110	100	100	100	105	110	110	115
Graduated corporation income tax rate (normal tax method)	3,325	3,655	3,890	4,140	4,340	4,540	4,745	—	—	—	—	—	—	—
Exclusion of interest on small issue IDBs	335	265	210	160	125	110	100	530	425	335	260	200	170	155
Deferral of gains from sale of broadcasting facilities to minority owned business	260	275	290	305	320	335	350	*	*	*	*	*	*	*
Treatment of Alaska Native Corporations	65	45	30	20	15	10	5	—	—	—	—	—	—	—
Transportation:														
Deferral of tax on shipping companies	15	15	15	15	15	15	15	—	—	—	—	—	—	—
Exclusion of reimbursed employee parking expenses	—	—	—	—	—	—	—	1,790	1,845	1,930	2,015	2,100	2,190	2,275
Exclusion for employer-provided transit passes	—	—	—	—	—	—	—	10	30	40	50	65	80	95
Community and regional development:														
Credit for low-income housing investments	465	580	680	780	885	980	1,050	1,080	1,345	1,585	1,820	2,060	2,290	2,450
Investment credit for rehabilitation of structures (other than historic)	30	30	25	25	25	20	20	60	60	55	55	55	50	50
Exclusion of interest on IDBs for airports, docks, and sports and convention facilities	295	315	335	350	370	385	405	435	470	495	520	545	575	600
Exemption of certain mutuals' and cooperatives' income	25	25	30	30	30	35	35	—	—	—	—	—	—	—
Empowerment zones	0	45	95	130	155	175	195	5	110	235	310	355	390	425
Education, training, employment, and social services:														
Education:														
Exclusion of scholarship and fellowship income (normal tax method)	—	—	—	—	—	—	—	790	835	875	920	965	1,015	1,065
Exclusion of interest on State and local student loan bonds	125	125	120	115	110	100	95	185	185	185	180	165	155	145
Exclusion of interest on State and local debt for private nonprofit educational facilities	285	295	300	310	315	325	340	420	440	450	460	470	485	505
Exclusion of interest on savings bonds transferred to educational institutions	—	—	—	—	—	—	—	*	5	5	5	10	10	15
Parental personal exemption for students age 19 or over	—	—	—	—	—	—	—	505	520	535	545	565	580	595
Deductibility of charitable contributions (education)	600	640	670	700	740	780	820	1,360	1,480	1,560	1,640	1,720	1,810	1,900
Exclusion of employer provided educational assistance	—	—	—	—	—	—	—	215	235	85	—	—	—	—
Training, employment, and social services:														
Targeted jobs credit	130	260	320	270	50	30	15	30	45	75	55	10	10	5
Exclusion of employer provided child care	—	—	—	—	—	—	—	620	675	725	775	830	890	955
Exclusion of employee meals and lodging (other than military)	—	—	—	—	—	—	—	490	525	550	580	610	640	670
Credit for child and dependent care expenses	—	—	—	—	—	—	—	2,540	2,675	2,820	2,975	3,145	3,320	3,510
Credit for disabled access expenditures	120	130	130	130	135	135	135	30	30	30	30	30	30	30
Expensing of costs of removing certain architectural barriers to the handicapped	15	15	15	15	15	15	15	5	5	5	5	5	5	5
Deductibility of charitable contributions, other than education and health	750	800	840	880	930	980	1,020	12,380	13,490	14,240	14,950	15,700	16,480	17,310
Exclusion of certain foster care payments	—	—	—	—	—	—	—	25	30	30	35	35	40	40
Exclusion of parsonage allowances	—	—	—	—	—	—	—	235	260	290	320	355	395	440

TABLE 6–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

	Revenue Loss													
	Corporations							Individuals						
	1993	1994	1995	1996	1997	1998	1999	1993	1994	1995	1996	1997	1998	1999
Health:														
Exclusion of employer contributions for medical insurance premiums and medical care	—	—	—	—	—	—	—	46,895	51,445	56,265	61,675	67,345	73,450	79,995
Credit for child medical insurance premiums [2]	—	—	—	—	—	—	—	110	125	—	—	—	—	—
Deductibility of medical expenses	—	—	—	—	—	—	—	3,010	3,270	3,560	3,870	4,195	4,535	4,890
Exclusion of interest on State and local debt for private nonprofit health facilities	565	585	600	615	635	660	685	840	870	895	920	950	980	1,015
Deductibility of charitable contributions (health)	380	400	420	450	470	490	520	1,390	1,510	1,600	1,680	1,760	1,850	1,940
Tax credit for orphan drug research	0	35	15	—	—	—	—	—	—	—	—	—	—	—
Special Blue Cross/Blue Shield deduction	105	115	125	140	100	170	185	—	—	—	—	—	—	—
Income security:														
Exclusion of railroad retirement system benefits	—	—	—	—	—	—	—	415	395	400	405	410	420	425
Exclusion of workmen's compensation benefits	—	—	—	—	—	—	—	3,815	4,240	4,455	4,740	5,065	5,565	6,100
Exclusion of public assistance benefits (normal tax method)	—	—	—	—	—	—	—	500	545	585	605	640	695	735
Exclusion of special benefits for disabled coal miners	—	—	—	—	—	—	—	100	100	100	95	95	90	80
Exclusion of military disability pensions	—	—	—	—	—	—	—	130	130	130	130	130	130	130
Net exclusion of pension contributions and earnings:														
Employer plans	—	—	—	—	—	—	—	49,430	48,750	55,540	59,010	59,490	59,950	60,400
Individual Retirement Accounts	—	—	—	—	—	—	—	5,720	5,415	5,290	5,275	5,175	4,970	4,615
Keogh plans	—	—	—	—	—	—	—	3,245	3,670	3,875	4,130	4,400	4,690	5,000
Exclusion of employer provided death benefits	—	—	—	—	—	—	—	25	30	35	35	40	40	45
Exclusion of other employee benefits:														
Premiums on group term life insurance	—	—	—	—	—	—	—	2,620	2,750	2,880	3,020	3,170	3,325	3,485
Premiums on accident and disability insurance	—	—	—	—	—	—	—	135	140	140	145	150	160	165
Income of trusts to finance supplementary unemployment benefits	—	—	—	—	—	—	—	35	35	35	35	35	35	35
Special ESOP rules (other than investment credit)	2,070	2,035	1,760	1,635	1,545	1,415	1,285	—	—	—	—	—	—	—
Additional deduction for the blind	—	—	—	—	—	—	—	40	45	45	45	50	50	55
Additional deduction for the elderly	—	—	—	—	—	—	—	1,510	1,535	1,555	1,570	1,585	1,600	1,605
Tax credit for the elderly and disabled	—	—	—	—	—	—	—	60	65	65	70	70	75	75
Deductibility of casualty losses	—	—	—	—	—	—	—	695	770	230	230	230	230	230
Earned income credit [3]	—	—	—	—	—	—	—	3,605	3,940	5,100	5,795	6,435	6,740	7,125
Social Security:														
Exclusion of social security benefits:														
OASI benefits for retired workers	—	—	—	—	—	—	—	18,310	16,695	16,525	17,370	18,140	18,880	19,670
Disability insurance benefits	—	—	—	—	—	—	—	1,725	1,765	1,905	2,105	2,320	2,540	2,765
Benefits for dependents and survivors	—	—	—	—	—	—	—	3,620	3,610	3,730	3,940	4,150	4,365	4,590
Veterans benefits and services:														
Exclusion of veterans disability compensation	—	—	—	—	—	—	—	1,755	1,860	1,920	1,855	1,885	1,985	2,025
Exclusion of veterans pensions	—	—	—	—	—	—	—	80	80	75	70	70	75	85
Exclusion of GI bill benefits	—	—	—	—	—	—	—	45	55	65	70	75	80	80
Exclusion of interest on State and local debt for veterans housing	40	35	35	30	30	30	30	60	55	50	50	45	45	45
General purpose fiscal assistance:														
Exclusion of interest on public purpose State and local debt	4,660	4,810	4,955	5,095	5,255	5,440	5,645	6,915	7,160	7,395	7,595	7,830	8,095	8,395
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	—	—	—	—	—	—	—	22,555	24,255	25,640	27,130	28,740	30,435	32,185
Tax credit for corporations receiving income from doing business in U.S. possessions	3,075	2,890	2,630	2,680	2,735	2,815	2,960	—	—	—	—	—	—	—
Interest:														
Deferral of interest on savings bonds	—	—	—	—	—	—	—	1,130	1,190	1,250	1,310	1,380	1,450	1,520
Addendum—Aid to State and local governments:														
Deductibility of:														
Property taxes on owner-occupied homes	—	—	—	—	—	—	—	13,055	13,865	14,655	15,545	16,425	17,395	18,395
Nonbusiness State and local taxes other than on owner-occupied homes	—	—	—	—	—	—	—	22,555	24,255	25,640	27,130	28,740	30,435	32,185
Exclusion of interest on:														
Public purpose State and local debt	4,660	4,810	4,955	5,095	5,255	5,440	5,645	6,915	7,160	7,395	7,595	7,830	8,095	8,395
IDBs for certain energy facilities	65	70	70	70	70	70	65	100	105	105	105	105	105	100
IDBs for pollution control and sewage and waste disposal facilities	240	245	250	245	240	235	225	355	365	375	370	360	350	340
Small-issue IDBs	335	265	210	160	125	110	100	530	425	335	260	200	170	155
Owner-occupied mortgage revenue bonds	690	705	715	705	680	650	625	1,025	1,055	1,070	1,070	1,035	990	950
State and local debt for rental housing	400	385	365	345	320	295	270	600	585	555	525	490	455	415
IDBs for airports, docks, and sports and convention facilities	295	315	335	350	370	385	405	435	470	495	520	545	575	600
State and local student loan bonds	125	125	120	115	110	100	95	185	185	185	180	165	155	145

TABLE 6–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued
(In millions of dollars)

	Revenue Loss													
	Corporations							Individuals						
	1993	1994	1995	1996	1997	1998	1999	1993	1994	1995	1996	1997	1998	1999
State and local debt for private nonprofit educational facilities	285	295	300	310	315	325	340	420	440	450	460	470	485	505
State and local debt for private nonprofit health facilities	565	585	600	615	635	660	685	840	870	895	920	950	980	1,015
State and local debt for veterans housing	40	35	35	30	30	30	30	60	55	50	50	45	45	45

Note: Provisions with estimates denoted "normal tax method" have no revenue loss under the reference tax law method.
All estimates have been rounded to the nearest $5 million.
* $2.5 million or less.
[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts of $675 million in 1995.
[2] The figures in the table indicate the effect of the child medical insurance premium credit on receipts. The effect on outlays in 1994 is $395 million.
[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays in 1995 is $15,795 million.

Interpreting Tax Expenditure Estimates

Tax expenditure revenue loss estimates do not necessarily equal the increase in Federal revenues (or the reduction in budget deficits) that would accompany the repeal of the special provisions, for the following reasons:

- *Eliminating a tax expenditure may have incentive effects that alter economic behavior.* These incentives can affect the resulting magnitudes of the formerly subsidized activity or of other tax preferences or Government programs. For example, if deductibility of mortgage interest were limited, some taxpayers would hold smaller mortgages, with a concomitantly smaller effect on the budget than if no such limits were in force.
- *Tax expenditures are interdependent even without incentive effects.* Repeal of a tax expenditure provision can increase or decrease the the revenue losses associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the revenue losses from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the revenue loss from other deductions if taxpayers are led to claim the standard deduction instead of itemizing. Similarly, if two provisions were repealed simultaneously, the increase in tax liability could be greater or less than the sum of the two separate tax expenditures, since each is estimated assuming that the other remains in force.
- *The annual value of tax expenditures for tax deferrals is reported on a cash basis in all tables except table 6–3.* Cash-based estimates reflect the difference between taxes deferred in the current year and incoming revenues that are received due to deferrals of taxes from prior years. While such estimates are useful as a measure of cash flows into the Government, they do not always accurately reflect the true economic cost of these provisions. For example, for a provision where activity levels have changed, so that incoming tax receipts from past deferrals are greater than deferred receipts from new activity, the cash-basis tax expenditure estimate can be negative, despite the fact that in present-value terms current deferrals do have a real cost to the Government. Alternatively, in the case of a newly enacted deferral provision, a cash-based estimate can overstate the real cost to the Government because the newly deferred taxes will ultimately be received. Present-value estimates, which are a useful supplement to the cash-basis estimates for provisions involving deferrals, are discussed below.
- *Repeal of some provisions could affect overall levels of income and rates of economic growth.* In principle, repeal of major tax provisions may have some impact on the budget economic assumptions. In general, however, most changes in particular provisions are unlikely to have significant effects on macroeconomic conditions.

Present-Value Estimates

Discounted present-value estimates of revenue losses are presented in table 6–3 for certain provisions that involve tax deferrals or similar long-term revenue effects. These estimates complement the cash-based tax expenditure estimates presented in the other tables in this chapter.

The present-value estimates represent the revenue losses, net of future tax payments, that follow from activities undertaken during calendar year 1994 which cause the deferrals or related revenue effects. For instance, a pension contribution in 1994 would cause a deferral of tax payments on wages in 1994 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 1994 pension contribution and accrued earnings will be paid out and taxes will be due; these receipts are included in the present-value estimate. In general, this conceptual approach is similar to the one used for reporting the budgetary effects of credit programs, where direct loans and guarantees in a given year affect future cash flows.

The discount rate used for the present-value estimates is the interest rate on comparable maturity Treasury debt. As noted in the table, the estimates for several of the provisions have been made based on the normal tax baseline, as by definition there is

TABLE 6–3. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 1994

(In millions of dollars)

Provision	Present Value of Revenue Loss
Deferral of income from controlled foreign corporations (normal tax method)	1,640
Expensing of research and experimentation expenditures (normal tax method)	2,035
Expensing of exploration and development costs—oil and gas	275
Expensing of exploration and development costs—other fuels	35
Expensing of exploration and development costs—nonfuels	90
Expensing of multiperiod timber growing costs	235
Expensing of certain multiperiod production costs—agriculture	65
Expensing of certain capital outlays—agriculture	80
Deferral of capital gains on home sales	15,605
Accelerated depreciation of rental housing (normal tax method)	1,140
Accelerated depreciation of buildings other than rental housing (normal tax method)	670
Accelerated depreciation of machinery and equipment (normal tax method)	22,105
Expensing of certain small investments (normal tax method)	3,995
Amortization of start-up costs (normal tax method)	165
Deferral of capital gains from sale of broadcasting facilities to minority-owned businesses	230
Deferral of tax on shipping companies	10
Credit for low-income housing investments	2,055
Exclusion of pension contributions and earnings—employer plans	40,500
Exclusion of IRA contributions and earnings	1,735
Exclusions of contribution and earnings for Keogh plans	2,710
Exclusion of interest on State and local public-purpose bonds	16,140
Exclusion of interest on State and local non-public purpose bonds	8,780
Deferral of interest on U.S. savings bonds	655

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

no tax expenditure for these provisions under the reference tax law baseline.

Outlay Equivalents

The concept of "outlay equivalents" complements "revenue losses" as a measure of the budget effect of tax expenditures. It is the amount of outlay that would be required to provide the taxpayer the same after-tax income as would be received through the tax preference. The outlay equivalent measure allows a comparison of the cost of the tax expenditure with that of a direct Federal outlay. Outlay equivalents are reported in table 6–4.

The measure is larger than the revenue loss estimate when the tax expenditure is judged to function as a Government payment for service. This occurs because an outlay program would increase the taxpayer's pre-tax income. For some tax expenditures, however, the revenue loss equals the outlay equivalent measure. This occurs when the tax expenditure is judged to function like a price reduction or tax deferral that does not directly enter the taxpayer's pre-tax income.[1]

[1] Budget outlay figures generally reflect the pre-tax price of the resources. In some instances, however, Government purchases or subsidies are exempted from tax by a special tax provision. When this occurs, the outlay figure understates the resource cost of the program and is, therefore, not comparable with other outlay amounts. For example, the outlays for certain military personnel allowances are not taxed. If this form of compensation were treated as part of the employee's taxable income, the Defense Department would have to make larger cash payments to its military personnel to leave them as well off after tax as they are now. The tax subsidy must be added to the tax-exempt budget outlay to make this element of national defense expenditures comparable with other outlays.

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TABLE 6–4. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX

(In millions of dollars)

	Outlay Equivalents						
	1993	1994	1995	1996	1997	1998	1999
National defense:							
Exclusion of benefits and allowances to armed forces personnel	2,465	2,395	2,365	2,350	2,355	2,375	2,395
International affairs:							
Exclusion of income earned abroad by United States citizens	675	1,135	1,185	1,255	1,325	1,400	1,480
Exclusion of income of foreign sales corporations	1,845	2,000	2,155	2,310	2,460	2,615	2,770
Inventory property sales source rules exception	1,690	1,845	2,000	2,155	2,310	2,460	2,615
Interest allocation rules exception for certain financial operations	150	140	140	140	140	140	140
Deferral of income from controlled foreign corporations (normal tax method)	1,600	1,600	1,700	1,800	2,000	2,200	2,400
General science, space, and technology:							
Expensing of research and experimentation expenditures (normal tax method)	2,060	2,230	2,390	2,560	2,740	2,930	3,130
Credit for increasing research activities	1,900	2,150	1,950	1,145	485	205	65
Suspension of the allocation of research and experimentation expenditures	0	385	385	—	—	—	—
Energy:							
Expensing of exploration and development costs:							
Oil and gas	185	145	140	100	60	55	95
Other fuels	20	20	20	20	20	25	25
Excess of percentage over cost depletion:							
Oil and gas	1,400	1,425	1,455	1,480	1,505	1,535	1,560
Other fuels	140	140	140	140	150	150	150
Alternative fuel production credit	1,070	1,260	1,370	1,400	1,390	1,330	1,240
Exception from passive loss limitation for working interests in oil and gas properties	50	50	50	50	50	50	50
Capital gains treatment of royalties on coal	15	20	20	20	20	20	20
Exclusion of interest on State and local IDBs for energy facilities	235	245	250	255	250	245	240
New technology credit	85	90	95	100	105	110	115
Alcohol fuel credit [1]	15	15	35	45	50	50	50
Tax credit and deduction for clean-fuel burning vehicles and properties	20	65	90	90	95	105	110
Exclusion from income of conservation subsidies provided by public utilities	70	140	205	245	265	265	265
Natural resources and environment:							
Expensing of exploration and development costs, nonfuel minerals	50	50	50	50	50	50	55
Excess of percentage over cost depletion, nonfuel minerals	260	270	270	275	280	285	300
Capital gains treatment of iron ore	*	*	*	*	*	*	*
Special rules for mining reclamation reserves	50	50	50	50	50	50	50
Exclusion of interest on State and local IDBs for pollution control and sewage and waste disposal facilities	855	885	895	885	865	840	815
Capital gains treatment of certain timber income	15	20	20	20	20	20	20
Expensing of multiperiod timber growing costs	535	555	575	605	635	665	700
Investment credit and seven-year amortization for reforestation expenditures	40	40	40	40	45	45	45
Tax incentives for preservation of historic structures	135	130	125	125	120	115	115
Agriculture:							
Expensing of certain capital outlays	75	70	65	65	60	65	65
Expensing of certain multiperiod production costs	90	90	85	80	80	80	85
Treatment of loans forgiven solvent farmers as if insolvent	10	10	10	10	10	10	10
Capital gains treatment of certain income	155	180	185	195	195	195	200
Commerce and housing:							
Financial institutions and insurance:							
Exemption of credit union income	380	435	490	535	590	650	715
Excess bad debt reserves of financial institutions	45	50	55	65	70	75	80
Exclusion of interest on life insurance savings	10,580	11,415	12,275	13,190	14,185	15,250	16,395
Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5
Tax exemption of certain insurance companies	145	150	160	165	170	180	190
Small life insurance company deduction	170	180	190	200	210	220	230
Exemption of RIC expenses from the 2% floor for miscellaneous itemized deductions	700	800	915	1,075	1,230	1,405	1,605
Housing:							
Exclusion of interest on owner-occupied mortgage revenue bonds	2,460	2,540	2,575	2,545	2,465	2,360	2,260
Exclusion of interest on State and local debt for rental housing	1,425	1,395	1,325	1,245	1,160	1,070	985
Deductibility of mortgage interest on owner-occupied homes	48,705	51,835	54,800	57,985	61,420	65,050	68,785
Deductibility of State and local property tax on owner-occupied homes	13,055	13,865	14,655	15,545	16,425	17,395	18,395
Deferral of income from post 1987 installment sales	820	915	935	950	965	980	995
Deferral of capital gains on home sales	13,265	13,925	14,620	15,195	15,620	15,915	16,065
Exclusion of capital gains on home sales for persons age 55 and over	6,165	6,360	6,615	6,875	7,065	7,200	7,265
Exception from passive loss rules for $25,000 of rental loss	6,070	5,945	5,775	5,680	5,625	5,595	5,545
Accelerated depreciation on rental housing (normal tax method)	1,190	1,085	1,100	1,145	1,220	1,290	1,345
Commerce:							
Cancellation of indebtedness	60	120	110	70	35	10	–10
Permanent exceptions from imputed interest rules	140	150	150	150	155	155	160

TABLE 6–4. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

	Outlay Equivalents						
	1993	1994	1995	1996	1997	1998	1999
Capital gains (other than agriculture,timber, iron ore, and coal) (normal tax method)	7,345	8,755	9,225	9,395	9,495	9,545	9,635
Step-up basis of capital gains at death	34,060	36,090	38,045	39,625	40,679	41,280	41,205
Carryover basis of capital gains on gifts	120	125	130	135	140	145	150
Ordinary income treatment of loss from small business corp. stock sale	35	40	40	50	50	50	50
Accelerated depreciation of buildings other than rental housing (normal tax method)	2,895	2,995	3,185	3,430	3,745	4,075	4,410
Accelerated depreciation of machinery and equipment (normal tax method)	19,625	22,775	23,210	22,550	22,330	21,380	20,155
Expensing of certain small investments (normal tax method)	1,540	2,095	1,560	1,235	905	610	385
Amortization of start-up costs (normal tax method)	200	200	200	210	215	220	225
Graduated corporation income tax rate (normal tax method)	4,750	5,220	5,555	5,910	6,200	6,485	6,780
Exclusion of interest on small issue industrial development bonds	1,220	985	770	595	465	400	370
Deferral of gains from sale of broadcasting facilities to minority owned business	260	275	290	305	320	335	350
Treatment of Alaska Native Corporations	65	45	30	20	15	10	5
Transportation:							
Deferral of tax on shipping companies	15	15	15	15	15	15	15
Exclusion of reimbursed employee parking expenses	2,330	2,400	2,510	2,625	2,735	2,845	2,960
Exclusion for employer-provided transit passes	15	35	50	65	80	100	115
Community and regional development:							
Credit for low-income housing investments	1,555	1,935	2,275	2,610	2,955	3,280	3,510
Investment credit for rehabilitation of structures (other than historic)	90	90	80	80	80	70	70
Exclusion of interest on IDBs for airports, docks, and sports and convention facilities	1,055	1,135	1,200	1,260	1,320	1,385	1,450
Exemption of certain mutuals' and cooperatives' income	25	25	30	30	30	35	35
Empowerment zones	5	150	330	440	510	565	620
Education, training, employment, and social services:							
Education:							
Exclusion of scholarship and fellowship income (normal tax method)	1,000	1,070	1,120	1,180	1,235	1,300	1,365
Exclusion of interest on State and local student loan bonds	445	445	440	420	395	370	345
Exclusion of interest on State and local debt for private nonprofit educational facilities	1,015	1,055	1,080	1,105	1,135	1,170	1,210
Exclusion of interest on savings bonds transferred to educational institutions	5	5	5	10	10	15	20
Parental personal exemption for students age 19 or over	560	575	595	605	630	645	660
Deductibility of charitable contributions (education)	1,960	2,120	2,230	2,340	2,460	2,590	2,720
Exclusion of employer provided educational assistance	255	275	100	—	—	—	—
Training, employment, and social services:							
Targeted jobs credit	160	305	395	325	60	40	20
Exclusion of employer provided child care	810	880	945	1,010	1,085	1,160	1,245
Exclusion of employee meals and lodging (other than military)	600	640	670	705	740	780	815
Credit for child and dependent care expenses	3,200	3,375	3,555	3,755	3,965	4,190	4,425
Credit for disabled access expenditures	205	220	220	220	225	225	225
Expensing of costs of removing certain architectural barriers to the handicapped	20	20	20	20	20	20	20
Deductibility of charitable contributions, other than education and health	13,130	14,290	15,080	15,830	16,630	17,460	18,330
Exclusion of certain foster care payments	30	40	40	45	45	50	50
Exclusion of parsonage allowances	290	320	355	395	440	485	540
Health:							
Exclusion of employer contributions for medical insurance premiums and medical care	58,910	64,670	70,805	77,615	84,750	92,435	100,675
Credit for child medical insurance premiums [2]	130	145	—	—	—	—	—
Deductibility of medical expenses	3,010	3,270	3,560	3,870	4,195	4,535	4,890
Exclusion of interest on State and local debt for private nonprofit health facilities	2,015	2,100	2,155	2,215	2,285	2,365	2,455
Deductibility of charitable contributions (health)	1,770	1,910	2,020	2,130	2,230	2,340	2,460
Tax credit for orphan drug research	0	50	20	—	—	—	—
Special Blue Cross/Blue Shield deduction	150	160	175	185	140	240	260
Income security:							
Exclusion of railroad retirement system benefits	415	395	400	405	410	420	425
Exclusion of workmen's compensation benefits	3,815	4,240	4,455	4,740	5,065	5,565	6,100
Exclusion of public assistance benefits (normal tax method)	500	545	585	605	640	695	735
Exclusion of special benefits for disabled coal miners	100	100	100	95	95	90	80
Exclusion of military disability pensions	130	130	130	130	130	130	130
Net exclusion of pension contributions and earnings:							
Employer plans	67,320	66,960	75,940	80,410	81,040	81,650	82,230
Individual Retirement Accounts	7,790	7,510	7,430	7,475	7,430	7,245	6,885
Keogh plans	4,270	4,965	5,240	5,585	5,955	6,345	6,760
Exclusion of employer provided death benefits	30	40	45	45	50	50	55
Exclusion of other employee benefits:							
Premiums on group term life insurance	3,440	3,610	3,785	3,970	4,165	4,365	4,580
Premiums on accident and disability insurance	180	185	185	195	205	215	225
Income of trusts to finance supplementary unemployment benefits	35	35	35	35	35	35	35
Special ESOP rules (other than investment credit)	2,955	2,910	2,510	2,340	2,205	2,020	1,840
Additional deduction for the blind	50	55	55	55	60	60	65

TABLE 6–4. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

	Outlay Equivalents						
	1993	1994	1995	1996	1997	1998	1999
Additional deduction for the elderly	1,830	1,855	1,880	1,900	1,920	1,935	1,940
Tax credit for the elderly and disabled	75	80	80	85	90	90	95
Deductibility of casualty losses	900	1,000	300	300	300	300	300
Earned income credit[3]	4,240	4,635	5,995	6,815	7,575	7,925	8,380
Social Security:							
Exclusion of social security benefits:							
OASI benefits for retired workers	18,310	16,695	16,525	17,370	18,140	18,880	19,670
Disability insurance benefits	1,725	1,765	1,905	2,105	2,320	2,540	2,765
Benefits for dependents and survivors	3,620	3,610	3,730	3,940	4,150	4,365	4,590
Veterans benefits and services:							
Exclusion of veterans disability compensation	1,755	1,860	1,920	1,855	1,885	1,985	2,025
Exclusion of veterans pensions	80	80	75	70	70	75	85
Exclusion of GI bill benefits	45	55	65	70	75	80	80
Exclusion of interest on State and local debt for veterans housing	140	130	120	115	110	105	105
General purpose fiscal assistance:							
Exclusion of interest on public purpose State and local debt	16,585	17,265	17,800	18,295	18,870	19,525	20,250
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	22,555	24,255	25,640	27,130	28,740	30,435	32,185
Tax credit for corporations receiving income from doing business in U.S. possessions	4,395	4,160	3,810	3,885	3,960	4,085	4,295
Interest:							
Deferral of interest on savings bonds	1,130	1,190	1,250	1,310	1,380	1,450	1,520
Addendum—Aid to State and local governments:							
Deductibility of:							
Property taxes on owner-occupied homes	13,055	13,865	14,655	15,545	16,425	17,395	18,395
Nonbusiness State and local taxes other than on owner-occupied homes	22,555	24,255	25,640	27,130	28,740	30,435	32,185
Exclusion of interest on:							
Public purpose State and local debt	16,585	17,265	17,800	18,295	18,870	19,525	20,250
IDBs for certain energy facilities	235	245	250	255	250	245	240
IDBs for pollution control and sewage and waste disposal facilities	855	885	895	885	865	840	815
Small-issue IDBs	1,220	985	770	595	465	400	370
Owner-occupied mortgage revenue bonds	2,460	2,540	2,575	2,545	2,465	2,360	2,260
State and local debt for rental housing	1,425	1,395	1,325	1,245	1,160	1,070	985
IDBs for airports, docks, and sports and convention facilities	1,055	1,135	1,200	1,260	1,320	1,385	1,450
State and local student loan bonds	445	445	440	420	395	370	345
State and local debt for private nonprofit educational facilities	1,015	1,055	1,080	1,105	1,135	1,170	1,210
State and local debt for private nonprofit health facilities	2,015	2,100	2,155	2,215	2,285	2,365	2,455
State and local debt for veterans housing	140	130	120	115	110	105	105

Note: Provisions with estimates denoted "normal tax method" have outlay equivalents of zero under the reference tax law method.
All estimates have been rounded to the nearest $5 million.
* $2.5 million or less.
[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts of $675 million in 1995.
[2] The figures in the table indicate the effect of the child medical insurance premium credit on receipts. The effect on outlays in 1994 is $395 million.
[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays in 1995 is $15,795 million.

Tax Expenditure Baselines

A tax expenditure is a preferential exception to the baseline provisions of the tax structure. The 1974 Congressional Budget Act does not, however, specify the baseline provisions of the tax law. Deciding whether provisions are preferential exceptions, therefore, is a matter of judgement. As in prior years, this year's tax expenditure estimates are presented using two baselines: the *normal tax baseline,* which is used by the Joint Committee on Taxation, and the *reference tax law baseline,* which has been used by the Administration since 1983.

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

The reference tax law baseline is closer to existing law. Reference law tax expenditures are limited to special exceptions in the tax code that serve programmatic functions. These functions correspond to specific budget categories such as national defense, agriculture, or health care. While tax expenditures under the reference law baseline are generally tax expenditures under the normal tax baseline, the reverse is not always true.

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

- *Income is taxable when realized in exchange.* Thus, neither the deferral of tax on unrealized capital gains nor the tax exclusion of imputed income (such as the rental value of owner-occupied housing or farmers' consumption of their own produce)

is regarded as a tax expenditure. Both accrued and imputed income would be taxed under a comprehensive income tax.

- *There is a separate corporation income tax.* Under a comprehensive income tax corporate income would be taxed only once—at the shareholder level, whether or not distributed in the form of dividends.
- *Values of assets and debt are not adjusted for inflation.* A comprehensive income tax would adjust the cost basis of capital assets and debt for changes in the price level during the time the assets or debt are held. Thus, under a comprehensive income tax baseline the failure to take account of inflation in measuring depreciation, capital gains, and interest income would be regarded as a negative tax expenditure (i.e., a tax penalty), and failure to take account of inflation in measuring interest costs would be regarded as a positive tax expenditure (i.e., a tax subsidy).

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

- *Tax rates.* The separate schedules applying to the various taxpaying units are included in the reference law baseline. Thus, corporate tax rates below the maximum statutory rate do not give rise to a tax expenditure. The normal tax baseline is similar, except that it specifies the current maximum rate as the baseline for the corporate income tax. The lower tax rates applied to the first $10 million of corporate income are thus regarded as a tax expenditure. Similarly, under the reference law baseline, preferential tax rates for capital gains generally do not yield a tax expenditure; only capital gains treatment of otherwise "ordinary income," such as that from coal and iron ore royalties and the sale of timber and certain agricultural products, is considered a tax expenditure. The alternative minimum tax is treated as part of the baseline rate structure under both the reference and normal tax methods.
- *Income subject to the tax.* Income subject to tax is defined as gross income less the costs of earning that income. The Federal income tax defines gross income to include: (1) consideration received in the exchange of goods and services, including labor services or property; and (2) the taxpayer's share of gross or net income earned and/or reported by another entity (such as a partnership). Under the reference tax rules, therefore, gross income does not include gifts—defined as receipts of money or property that are not consideration in an exchange—or most transfer payments, which can be thought of as gifts from the Government.[2] The normal tax baseline also excludes gifts between individuals from gross income. Under the normal tax baseline, however, all cash transfer payments from the Government to private individuals are counted in gross income, and exemptions of such transfers from tax are identified as tax expenditures. The costs of earning income are generally deductible in determining taxable income under both the reference and normal tax baselines.[3]
- *Capital recovery.* Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. Under the normal tax baseline, the depreciation allowance for machinery and equipment is determined using straight-line depreciation over tax lives equal to mid-values of the asset depreciation range (a depreciation system in effect from 1971 through 1980). The normal tax baseline for real property is computed using 40-year straight-line depreciation.
- *Treatment of foreign income.* Both the normal and reference tax baselines allow a tax credit for foreign income taxes paid (up to the amount of U.S. income taxes that would otherwise be due), which prevents double taxation of income earned abroad. Under the normal tax method, however, controlled foreign corporations (CFCs) are not regarded as entities separate from their controlling U.S. shareholders. Thus, the deferral of tax on income received by CFCs is regarded as a tax expenditure under this method. In contrast, except for tax haven activities, the reference law baseline follows current law in treating CFCs as separate taxable entities whose income is not subject to U.S. tax until distributed to U.S. taxpayers. Under this baseline, deferral of tax on CFC income is not a tax expenditure because U.S. taxpayers generally are not taxed on accrued, but unrealized, income.

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

Other Considerations

Additional tax expenditure analysis may be helpful to policy makers. For example, information on the programmatic and economic effects of tax expenditures could be useful. The outputs and efficiency of tax expenditures could then be compared more systematically with direct outlay programs.

In addition, the tax expenditure analysis could be extended beyond the income and transfer taxes to include payroll and excise taxes. The exclusion of certain forms of compensation from the wage base, for instance, reduces payroll taxes, as well as income taxes. Payroll tax exclusions are complex to analyze, however, because they also affect social insurance benefits. Certain targeted excise tax provisions might also be considered

[2] Gross income does, however, include transfer payments associated with past employment, such as social security benefits.

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

tax expenditures. In this case challenges include determining an appropriate baseline.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported upon in this chapter follow.

NATIONAL DEFENSE

Benefits and allowances to armed forces personnel.—The housing and meals provided military personnel, either in cash or in kind, are excluded from income subject to tax.

INTERNATIONAL AFFAIRS

Income earned abroad.—A U.S. citizen or resident alien who resides in a foreign country or who stays in one or more foreign countries for a minimum of 11 out of the past 12 months may exclude $70,000 per year of foreign-earned income. Eligible taxpayers also may exclude or deduct reasonable housing costs in excess of one-sixth of the salary of a civil servant at grade GS–14, step 1. These provisions do not apply to Federal employees working abroad; however, the tax expenditure estimate does reflect certain allowances that are excluded from their taxable income.

Income of Foreign Sales Corporations.—The Foreign Sales Corporation (FSC) provisions exempt from tax a portion of U.S. exporters' foreign trading income to reflect the FSC's sales functions as foreign corporations. These provisions conform to the General Agreement on Tariffs and Trade.

Source rule exceptions.—The worldwide income of U.S. persons is taxable by the United States and a credit for foreign taxes paid is allowed. The amount of foreign taxes that can be credited is limited to the pre-credit U.S. tax on the foreign source income. Two exceptions give rise to tax expenditures: sales of inventory property that reduces the U.S. tax of exporters; and, for financial institutions and certain financing operations of nonfinancial enterprises, an exception from the rules that require allocation of interest expenses between domestic and foreign activities of a U.S. taxpayer.

Income of U.S.-controlled foreign corporations.—The income of foreign corporations controlled by U.S. shareholders is not subject to U.S. taxation. The income becomes taxable only when the controlling U.S. shareholders receive dividends or other distributions from their foreign stockholding. Under the normal tax method, the currently attributable foreign source pre-tax income from such a controlling interest is subject to U.S. taxation, whether or not distributed. Thus, under the normal tax baseline the excess of controlled foreign corporation income over the amount distributed to a U.S. shareholder gives rise to a tax expenditure in the form of a tax deferral.

GENERAL SCIENCE, SPACE, AND TECHNOLOGY

Expensing R&E expenditures.—Research and experimentation (R&E) projects can be viewed as investments because their benefits accrue for several years when they are successful. It is difficult, however, to identify whether a specific R&E project is completed and successful and, if it is successful, what its expected life will be. For these reasons, the statutory provision that these expenditures may be expensed is considered part of the reference law. Under the normal tax method, however, the expensing of R&E expenditures is viewed as a tax expenditure. The baseline assumed for the normal tax method is that all R&E expenditures are successful and have an expected life of five years.

R&E credit.—Under legislation that expires on July 1, 1995, the tax credit is 20 percent of the qualified expenditures in excess of each year's base amount. This threshold is determined by multiplying a "fixed-base percentage" (limited to a maximum of .16 for existing companies) by the average amount of the company's gross receipts for the four preceding years. The "fixed-base percentage" is the ratio of R&E expenses to gross receipts for the 1984 to 1988 period. Start-up companies that did not both incur qualified expenses and have gross receipts in at least three of the base years are assigned a "fixed-base percentage" of .03. A similar credit with its own separate threshold is provided for taxpayers' basic research grants to universities. Beginning in 1989, the otherwise deductible qualified R&E expenditures were reduced by the amount of the credit.

Allocation of R&E expenditures.—Regulations issued in 1977 were designed to achieve a reasonable allocation of R&E expenses between corporations' domestic and foreign activities, but successive legislative and administrative actions suspended this requirement. Under legislation that expires on July 1, 1995, 50 percent of both U.S.- and foreign-based R&E expenses were allocated to their respective income sources. The remaining R&E expenses then had to be allocated on the basis of gross sales or gross income.

ENERGY

Exploration and development costs.—In the case of successful investments in domestic oil and gas wells, intangible drilling costs, such as wages, the costs of using machinery for grading and drilling, and the cost of unsalvageable materials used in constructing wells, may be expensed rather than amortized over the productive life of the property.

Integrated oil companies may currently deduct only 70 percent of such costs and amortize the remaining 30 percent over five years. The same rule applies to the exploration and development costs of surface stripping and the construction of shafts and tunnels for other fuel minerals.

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

Alternative fuel production credit.—A nontaxable credit of $3 per barrel (in 1979 dollars) of oil-equivalent production is provided for several forms of alternative fuels. It is generally available as long as the price of oil stays below $29.50 (in 1979 dollars).

Oil and gas exception to passive loss limitation.—Although owners of working interests in oil and gas properties are subject to the alternative minimum tax, they are exempted from the "passive income" limitations. This means that the working interest-holder, who manages on behalf of himself and all other owners the development of wells and incurs all the costs of their operation, may aggregate negative taxable income from such interests with his income from all other sources. Thus, he will be relieved of the minimum tax rules limit on tax deferrals.

Capital gains treatment of royalties on coal.—Sales of certain coal under royalty contracts can be treated as capital gains. While the top statutory rate on ordinary income is 39.6 percent, the rates on capital gains are limited to 28 percent.

Tax-exempt bonds for energy facilities.—Certain energy facilities, such as municipal electric and gas utilities, may benefit from tax-exempt financing.

New technology credits.—A credit of 10 percent is available for investment in solar and geothermal energy facilities. In addition, a credit of 1.5 cents is provided per kilowatt hour of electricity produced from renewable resources such as wind and biomass. The renewable resources credit applies only to electricity produced by a facility placed in service before July 1, 1999.

Alcohol fuel credit.—Gasohol, a motor fuel composed of at least 10 percent alcohol, is exempt from 5.4 of the 18.4 cents per gallon Federal excise tax on gasoline. There is a corresponding income tax credit for alcohol used as a fuel in applications where the excise tax is not assessed. This credit, equal to a subsidy of 54 cents per gallon for alcohol used as a motor fuel, is intended to encourage substitution of alcohol for petroleum-based gasoline.

Credit and deduction for clean-fuel vehicles and property.—A tax credit of 10 percent is provided for electric vehicles. In addition, a deduction is provided for other clean-fuel burning vehicles as well as refueling property.

Exclusion of utility conservation subsidies.—Subsidies by public utilities for customer expenditures on energy conservation measures are excluded from the gross income of the customer.

NATURAL RESOURCES AND ENVIRONMENT

Exploration and development costs.—As is true for fuel minerals, certain capital outlays associated with exploration and development of nonfuel minerals may be expensed rather than depreciated over the life of the asset.

Percentage depletion.—Most nonfuel mineral extractors also make use of percentage depletion rather than cost depletion, with percentage depletion rates ranging from 22 percent for sulphur down to 5 percent for sand and gravel.

Capital gains treatment of iron ore and of certain timber income.—Iron ore and certain timber sold under a royalty contract can be treated as capital gains.

Mining reclamation reserves.—Taxpayers are allowed to establish reserves to cover certain costs of mine reclamation and of closing solid waste disposal properties. Net increases in reserves may be taken as a deduction against taxable income.

Tax-exempt bonds for pollution control and waste disposal.—Interest on State and local government debt issued to finance private pollution control and waste disposal facilities was excludable from income subject to tax. This authorization was repealed for pollution control equipment and a cap placed on the amount of debt that could be issued for waste disposal facilities by the Tax Reform Act of 1986.

Expensing multiperiod timber growing costs.—Generally, costs must be capitalized when goods are produced for inventory used in one's own trade or business, or under contract to another party. Timber production, however, was specifically exempted from these multiperiod cost capitalization rules, creating a special benefit derived from this deferral of taxable income.

Credit and seven-year amortization for reforestation.—A special 10 percent investment tax credit is allowed for up to $10,000 invested annually in clearing land and planting trees for the ultimate production of timber. The same amount of forestation investment

may also be amortized over a seven-year period. Without this preference, the amount would have to be capitalized and could be recovered (deducted) only when the trees were sold or harvested 20 or more years later. Moreover, the amount of forestation investment that is amortizable is not reduced by any of the investment credit that is allowed.

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

AGRICULTURE

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

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

Loans forgiven solvent farmers.—Farmers are granted special tax treatment by being forgiven the tax liability on certain forgiven debt. Normally, the amount of loan forgiveness is accounted for as a gain (income) of the debtor and he must either report the gain, or reduce his recoverable basis in the property to which the loan relates. If the debtor elects to reduce basis and the amount of forgiveness exceeds his basis in the property, the excess forgiveness is taxable. However, in the case of insolvent (bankrupt) debtors, the amount of loan forgiveness never results in an income tax liability.[4] Farmers with forgiven debt are considered insolvent for tax purposes, and thus qualify for income tax forgiveness.

Capital gains treatment of certain income.—Certain agricultural income, such as unharvested crops, can be treated as capital gains.

COMMERCE AND HOUSING

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

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

Bad debt reserves.—Only commercial banks with less than $500 million in assets, mutual savings banks, and savings and loan associations are permitted to deduct additions to bad debt reserves in excess of actually experienced losses. The deduction for additions to loss reserves allowed qualifying mutual savings banks and savings and loan associations is 8 percent of otherwise taxable income. To qualify, the thrift institutions must maintain a specified fraction of their assets in the form of mortgages, primarily residential.

Interest on life insurance savings.—Savings in the form of policyholder reserves are accumulated from premium payments and interest is earned on the reserves. Such interest income is not taxed as it accrues nor when received by beneficiaries upon the death of the insured.

Small property and casualty insurance companies.— Insurance companies that have annual net premium incomes of less than $350,000 are exempted from tax; those with $350,000 to $2,100,000 of net premium incomes may elect to pay tax only on the income earned by their investment portfolio.

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

Mutual funds (RIC) expenses.—Individuals may deduct miscellaneous expenses only to the extent that they exceed 2 percent of their adjusted gross income. Certain costs incurred by individuals in managing their personal securities portfolios are among the miscellaneous deductions allowed taxpayers who itemize deductions. Mutual funds (or regulated investment companies) perform these portfolio management functions for their shareholders and pay out their portfolio incomes net of these expenses. Shareholders are permitted to report their fund income net of management expenses; thus, they are thereby able to deduct portfolio management expenses without regard to the miscellaneous deduction limitation.

Mortgage housing bonds.—Interest on all mortgage revenue bonds issued by State and local governments is exempt from taxation. Proceeds are used to finance homes purchased by first-time buyers—with low to

[4] The insolvent taxpayer's carryover losses and unused credits are extinguished first, and then his basis in assets reduced to no less than amounts still owed creditors. Finally, the remainder of the forgiven debt is excluded from tax.

moderate incomes—of dwellings with prices under 90 percent of the average area purchase price.

There are limits imposed on the amount of tax-exempt State and local government bonds that could be issued to fund private activity. The volume cap for single-family mortgage revenue bonds and multifamily rental housing bonds is combined with the cap for student loans and industrial development bonds (IDBs). The cap is set at $50 per capita or a minimum of $150 million for each State.

States are authorized to issue mortgage credit certificates (MCCs) in lieu of qualified mortgage revenue bonds because the bonds are relatively inefficient subsidies to first-time home buyers. MCCs entitle home buyers to income tax credits for a specified percentage of interest on qualified mortgage loans. In this way, the entire amount of the subsidy flows directly to the home buyer without being partly diverted to financial middlemen or bondholders. A State cannot issue an aggregate annual amount of MCCs greater than 25 percent of its annual ceiling for qualified mortgage bonds. Because of the relationship between MCCs and qualified mortgage bonds, their estimates are presented as one line item in the tables.

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

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

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

Capital gains on home sales.—When a primary residence is sold, the homeowner can defer paying a capital gains tax on the proceeds by purchasing or constructing a home of value at least equal to that of the prior home (net of sales and qualified fix-up expenses) within two years. This deferral is a tax expenditure.

Capital gains on sales by owners aged 55 or older.—A taxpayer who is 55 years of age or older at the time of the sale of his residence may elect to exclude from tax up to $125,000 of the gain from its sale. This is a once-in-a-lifetime election. In effect, this provision converts some prior deferrals of tax into forgiveness of tax.

Passive loss real estate exemption.—The Tax Reform Act of 1986 disallowed the offset of passive losses against income from other sources. Losses up to $25,000 attributable to certain rental real estate activity, however, are exempted from this rule.

Accelerated depreciation of real property, machinery and equipment.—As previously noted, the tax depreciation allowance provisions are part of the reference law rules, and thus do not cause tax expenditures under the reference method. Under the normal tax method, however, a 40-year tax life for depreciable real property is the norm, so the statutory depreciation period in effect from 1987 to 1993 for nonresidential properties of 31.5 years gives rise to tax expenditures. OBRA 93 lengthened the statutory depreciation period for nonresidential property to 39 years for property placed in service after February 25, 1993. The statutory depreciation period for residential property is 27.5 years. Statutory depreciation of machinery and equipment also is somewhat accelerated relative to the normal tax baseline. In addition, tax expenditures arise from pre-1987 tax allowances for real and personal property.

Cancellation of indebtedness.—Individuals are not required to report the cancellation of certain indebtedness as current income. However, if they do not, it would be included as an adjustment in the basis of the underlying property.

Imputed interest rules.—Under reference law rules commonly referred to as original issue discount (OID), both the holder and seller of a financial contract are generally required to report interest earned in the period it accrues, not when the contract payments are

made. Moreover, the amount of interest accruable is determined by the actual price paid for the contract, not by the stated or nominal principal and interest stipulated in the contract.[5]

Exceptions to the general rules for accounting for interest expense or income include the following: (a) permission for the mortgagor of his personal residence to treat the discount from the nominal principal of his mortgage loan, commonly called "points," as prepaid interest which is deductible in the year paid, not the year accrued; and (b) sellers of farms and small businesses worth less than $1 million, in exchange for the purchaser's debt obligation, are exempted from the OID rules. This is $750,000 more than the $250,000 exemption that the reference tax law generally allows for such transactions.

Capital gains (other than agriculture, timber, iron ore and coal).—While the top statutory rate on ordinary income is 39.6 percent, the rates on capital gains are limited to 28 percent. This treatment is considered a tax expenditure under the normal tax method but not under the reference law method.

Step-up in basis of capital gains at death.—Capital gains on assets held at the owner's death are not subject to capital gains taxes. The cost basis of the appreciated assets is adjusted upward to the market value at the owner's date of death. The step-up in the heir's cost basis means that, in effect, the capital gain is forgiven.

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

Ordinary income treatment of losses from sale of small business corporate stock shares.—Up to $100,000 in losses from the sale of such stock may be treated as ordinary losses, and therefore not be subject to the $3,000 annual capital loss write-off limit if the corporation's capitalization is less than $1 million.

Expensing of certain small investments.—Qualifying investments in tangible property up to $17,500 ($10,000 prior to 1993) can be expensed rather than depreciated over time. To the extent that qualifying investment during the year exceeds $200,000, the amount eligible for expensing is decreased. The amount expensed is completely phased out when qualifying investments exceed $217,500.

Business start-up costs.—When an individual or corporation acquires or otherwise enters into a new business, certain start-up expenses, such as the costs of investigating opportunities and legal services, are normally incurred. The taxpayer may elect to amortize these outlays over 60 months although they are similar to other payments he makes for nondepreciable intangible assets that are not recoverable until the business is sold. Under the normal tax method this gives rise to a tax expenditure, while under the reference method it does not.

Graduated corporation income tax rate schedule.—The schedule is graduated, with rates of 15 percent on the first $50,000 of taxable income, 25 percent on the next $25,000, 34 percent on the next $9.925 million, and a rate of 35 percent on income over $10 million. As compared with a flat 35 percent tax rate, the lower rates provide a $111,000 reduction in tax liability for corporations with taxable incomes of $10 million. This benefit is recaptured in the cases of corporations with taxable incomes exceeding $100,000. This is accomplished by (1) a 5 percent additional tax on corporate incomes in excess of $100,000, but less than $335,000 and (2) a 3 percent additional tax on income over $15 million but less than $18.33 million. At this point the $111,000 is fully recaptured. Since this rate schedule is part of the reference tax law, it does not give rise to a tax expenditure under the reference method. A flat corporation income tax rate is taken as the baseline under the normal tax method; therefore the lower rates do yield a tax expenditure under this concept.

Small issue industrial development bonds.—The interest on small issue industrial development bonds (IDBs) issued by State and local governments to finance private business property is excluded from income subject to tax. Depreciable property financed with small issue IDBs must be depreciated, however, using the straight-line method. The tax exemption of small issue bonds expired in 1986, except for small issue IDBs exclusively issued to finance manufacturing facilities for which the tax exemption is permanent. The annual volume of small issue IDBs is subject to the unified volume cap discussed in the mortgage housing bond section above.

Deferral of gains from sale of broadcasting facility to minority owned business.—The voluntary sale of assets generally requires the seller to pay tax on the gain that has accrued over the period of ownership. However, in the case of an involuntary sale, as when an owner's property must be sold in a condemnation preceding, or to implement a change in a government's regulatory policy, the owner is permitted to defer payment of tax, provided the proceeds are reinvested in similar property within a specified period. In 1979, the Federal Communications Commission instituted a policy of encouraging minority group ownership of broadcast licenses. Since that time, the tax laws have been interpreted to permit voluntary sellers of licensed broadcasting facilities to defer payment of cap-

[5] Thus, when a borrower on December 31, 1993, issues a promise to pay $1,000 plus interest at 10 percent on December 31, 1994, for a total repayment of $1,100, and accepts $900 from a lender in exchange for the contract, the rules require that both parties: (a) recognize that $900 is the amount lent, so that the effective loan interest rate is not the nominal 10 percent rate but is 22.2 percent; and (b) both report $200 as interest paid or received in 1994, as the case may be.

ital gains tax when the buyer has been certified as a "minority business," in effect treating the sale as "involuntary."

Treatment of Alaskan Native Corporations losses.—Tax law restricts the ability of profitable corporations to reduce their tax liabilities by merging or buying corporations with accumulated net operating losses (NOLs) and as yet unrefunded claims to investment credits. Alaska Native Corporations have a limited exemption (fifteen years after the NOL or credit claim was first experienced) from these restrictions that includes NOLs and credits claimable prior to April 26, 1988.

TRANSPORTATION

Shipping companies that are U.S. flag carriers.—Certain companies that operate U.S. flag vessels receive a deferral of income taxes on that portion of their income used for shipping purposes, primarily construction, modernization and major repairs to ships, and repayment of loans to finance these qualified investments. Once indefinite, the deferral has been limited to 25 years since January 1, 1987.

Exclusion of reimbursed employee parking expenses.—Parking at or near an employer's business premises that is paid for by the employer is excludable from the income of the employee as a working condition fringe benefit. The maximum amount of the parking exclusion is $155 month, indexed in $5 increments. The tax expenditure estimate does not include parking at facilities owned by the employer.

Exclusion of employer-provided transit passes.—Transit passes, tokens, and fare cards provided by an employer to defray an employee's commuting costs are excludable from the employee's income as a de minimis fringe benefit, if the total value of the benefit does not exceed $60 per month, indexed in $5 increments.

COMMUNITY AND REGIONAL DEVELOPMENT

Low-income housing investment.—Through 1989, a tax credit for investment in new, substantially rehabilitated, and certain unrehabilitated low-income housing was structured to have a present value of 70 percent of construction or rehabilitation costs incurred and was allowed over 10 years. For Federally subsidized projects and those involving unrehabilitated existing low income housing, the credit was structured to have a present value of 30 percent. Beginning on January 1, 1990, the credit was extended at a present value of 70 percent, including projects financed with other Federal subsidies, but only if substantial rehabilitation was done. Notwithstanding the capital grant character of this subsidy, the investor's recoverable basis is not reduced by the substantial credit allowed.

Rehabilitation of structures.—A 10 percent investment tax credit is available for the rehabilitation of buildings that are used for business or productive activities and that were erected before 1936 for other than residential purposes. A full reduction by the amount of the credit is required in the taxpayer's recoverable basis.

Tax-exempt bonds for airports and similar facilities.—Government-owned airports, docks and wharves, as well as high-speed rail facilities that need not be government-owned, may continue to be financed with tax-exempt bond issues. These bonds are not covered by a volume cap.

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

Empowerment zones—Qualifying businesses in designated economically depressed areas can receive tax benefits such as an employer wage credit, increasing expensing of investment in equipment, tax-exempt financing, and accelerated depreciation. In addition, a tax credit for contributions to certain community development corporations can be available.

EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES

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

Tax-exempt bonds for educational purposes.—Interest on State and local government debt issued to finance student loans or the construction of facilities used by private nonprofit educational institutions is excluded from income subject to tax. The aggregate volume of such private activity bonds that each State may issue during any calendar year is limited.

U.S. savings bonds for education.—Interest on U.S. savings bonds, issued after December 31, 1989, may be excluded from tax if the bonds, plus accrued interest, are transferred to an educational institution as payment for educational expenses. The exclusion from tax is phased out for joint returns with adjusted gross incomes of $61,850 to $91,850 and $41,200 to

$56,200 for single and head of household returns in 1994.

Dependent students age 19 or older.—Taxpayers can claim personal exemptions for dependent children age 19 or over who receive parental support payments of $1,000 or more per year, are full-time students, and do not claim a personal exemption on their own tax returns. This preferential arrangement usually generates tax savings because the students' marginal tax rates are more often than not lower than their parents' marginal tax rates.

Charitable contributions.—Contributions to charitable, religious, and certain other nonprofit organizations are allowed as an itemized deduction for individuals, generally up to 50 percent of adjusted gross income. Taxpayers who donate capital assets to charitable or educational organizations can deduct the assets' current value without the taxation of any appreciation in value. Corporations can also deduct charitable contributions up to 10 percent of their pre-tax income. Tax expenditures resulting from the deductibility of contributions are shown separately for educational and other institutions. Contributions to health institutions are reported under the health function.

Employer provided benefits.—Many employers provide employee benefits that are not counted in employee income. The employers' costs for these benefits are deductible business expenses. The exclusion from an employee's income of the value of educational assistance, child care, meals and lodging, as well as ministers' housing allowances and the rental value of parsonages are tax expenditures. The exclusion for educational assistance and legal services expires on December 31, 1994. Health and other insurance benefits are reported under the health and income security functions. Certain parking and transit benefits are reported under the transportation function.

Targeted jobs credit.—Employers may claim a tax credit for qualified wages paid to individuals who begin work before January 1, 1995, and who are certified as members of various targeted groups. The amount of the credit that may be claimed is 40 percent of the first $3,000 paid during the first year of employment. The 40 percent credit also applies to the summer employment wages paid 16 and 17 year old youths who are members of low income families. Employers must reduce their deduction for wages paid by the amount of the credit claimed.

Child and dependent care expenses.—A tax credit may be claimed by married couples for child and dependent care expenses incurred when one spouse works full time and the other works at least part time or goes to school. The credit may also be claimed by divorced or separated parents who have custody of children, and by single parents. Expenditures up to a maximum $2,400 for one dependent and $4,800 for two or more dependents are eligible for the credit. The credit is equal to 30 percent of qualified expenditures for taxpayers with incomes of $10,000 or less. The credit is reduced to a minimum of 20 percent by one percentage point for each $2,000 of income between $10,000 and $28,000.

Disabled access expenditures.—A credit is provided of 50 percent of eligible disabled access expenditures in excess of $250. The credit is limited to $5,000.

Costs of removing architectural barriers to the handicapped.—The investment cost of making any business accessible to persons suffering physical or mental disabilities may be deducted, rather than capitalized as part of the taxpayer's basis in such property and recovered by subsequent depreciation allowances, as is generally required.

Foster care payments.—Foster parents provide a home and care for children who are wards of the State, under contract with the State. Compensation received for this service is explicitly excluded from the gross incomes of foster parents, making the expenses they incur nondeductible. This activity is, in effect, tax-exempt.

HEALTH

Employer paid medical insurance and expenses.—Employee compensation, in the form of payments by employers for health insurance premiums and other medical expenses, is deducted as a business expense by employers, but it is not included in employee gross income.

Child health insurance.—The earned income tax credit provided for a credit for certain child health insurance expenses. This credit was repealed after December 31, 1993.

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

Tax-exempt bonds for hospital construction.—Interest earned on State and local government debt issued to finance hospital construction is excluded from income subject to tax.

Charitable contributions to health institutions.—Contributions to nonprofit health institutions are allowed as a deduction for individuals and corporations. Tax expenditures resulting from the deductibility of contributions to other charitable institutions are listed under the education, training, employment, and social services function.

Orphan drugs.—To encourage the development of drugs for the treatment of rare diseases or physical conditions, a tax credit is granted equal to 50 percent

of the costs for clinical testing that has to be completed before manufacture and distribution are approved by the Food and Drug Administration. Because the drug firm is not required to reduce its deduction for testing expenses (an R&D expenditure) by the amount of this credit, the private cost of clinically testing orphan drugs is reduced substantially. This tax expenditure expires December 31, 1994.

Blue Cross and Blue Shield.—Although these organizations are not qualified as exempt, they are provided exceptions from otherwise applicable insurance company income tax accounting rules that effectively eliminate their tax liabilities.

INCOME SECURITY

Railroad retirement benefits.—These benefits are not generally subject to the income tax unless the recipient's gross income reaches a certain threshold discussed more fully under the social security function.

Workmen's compensation benefits.—Workmen's compensation provides payments to disabled workers. These benefits, although income to the recipients, are a tax preference because they are not subject to the income tax.

Public assistance benefits.—The exclusion from taxable income of public assistance benefits received by individuals is listed as a tax expenditure under the normal tax method because, under this method, cash transfers from government are included in gross income. In contrast, gifts not conditioned on the performance of services, including transfers from government, are not taxable under the reference law. Therefore, under the reference tax method, the tax exclusion for public assistance benefits is not shown as a tax expenditure.

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

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

Pension contributions and earnings.—Certain employer contributions to pension plans, along with individual contributions to individual retirement accounts (IRAs) and amounts set aside by the self-employed, are excluded from adjusted gross income in the year of contribution. The investment income earned by pension funds and other qualifying retirement plans is not taxable when earned, and this deferral is, therefore, also a tax expenditure.

Limited amounts (about $9,260 in 1994) can be excluded from an employee's adjusted gross income under a qualified cash or deferred arrangement with the employer (401(k) plan). An employee's own contribution of no more than $9,500 or the 401(k) limitation (whichever is greater) may be excluded annually from an employee's adjusted gross income when placed in a tax-sheltered annuity (403(b) plan).

Employees may deduct annual contributions to an IRA of $2,000 (or 100 percent of compensation, if less), or $2,250 on a joint return with only one spouse earning income, if: (a) neither the individual or spouse is an active participant in an employer-provided retirement plan; or (b) their adjusted gross income falls below $40,000 ($25,000 for a single taxpayer). The allowable IRA deduction is phased out between $40,000 and $50,000 for a joint return and $25,000 and $35,000 for a single return. Beyond these income limits, nondeductible contributions to IRAs are available to taxpayers who are active participants in employer-provided retirement plans. Self-employed persons can make deductible contributions to their own retirement (Keogh) plans equal to 25 percent of their income, up to a maximum of $30,000 per year.

Employer provided insurance benefits.—Many employers cover part or all the cost of premiums or payments for: (a) employees' life insurance benefits; (b) accident and disability benefits; (c) death benefits; and (d) supplementary unemployment benefits. The amounts are deductible by the employers and are excluded as well from employees' gross incomes for tax purposes.

Employer Stock Ownership Plan (ESOP) provisions.—A special type of employee benefit plan, organized as a trust, is tax-exempt. Employer-paid contributions (the value of stock issued to the ESOP) are deductible by the employer as part of employee compensation costs. They are not included in the employees' gross income for tax purposes, however, until they are paid out as benefits. The following special income tax provisions for ESOPs are intended to increase ownership of corporations by their employees: (1) annual employer contributions are subject to less restrictive limitations (percentages of employees' cash compensation); (2) ESOPs may borrow to purchase employer stock, guaranteed by their agreement with the employer that the debt will be serviced by his payment (deductible by him) of a portion of wages (excludable by the employees) to service the loan; (3) ESOPs' lenders may exclude half the interest from their gross income; (4) employees who sell appreciated company stock to the ESOP may defer any taxes due until they withdraw benefits; and (5) dividends paid to ESOP-held stock are deductible by the employer.

Support of the aged and the blind.—Taxpayers who are blind or 65 years of age or older may take an additional $950 standard deduction if single, or $750 if married. In addition, individuals who are 65 years of age or older, or who are permanently disabled, can take a tax credit equal to 15 percent of the sum of their earned and retirement income. Qualified income is limited to no more than $2,500 for single individuals

or married couples filing a joint return where only one spouse is 65 years of age or older, and up to $3,750 for joint returns where both spouses are 65 years of age or older. These limits are reduced by one-half of the taxpayer's adjusted gross income over $7,500 for single individuals and $10,000 for married couples filing a joint return.

Casualty losses.—Neither the purchase of property nor insurance premiums to protect its value are deductible as costs of earning income; therefore, reimbursement for insured loss of such property is not reportable as a part of gross income. However, a special provision permits relief for taxpayers suffering an uninsured loss. They may deduct casualty and theft losses of more than $100 each, but only to the extent that total losses during the year exceed 10 percent of adjusted gross income.

Earned income credit.—This credit may be claimed by low income workers. For a family with one qualifying child, the credit is 26.3 percent of the first $7,750 of earned income in 1994. The credit is 30.0 percent of the first $8,425 of income for a family with two or more qualifying children. When the taxpayer's income exceeds $11,000, the credit is phased out at the rate of 15.98 percent (17.68 percent if two or more qualifying children are present). It is completely phased out at $23,760 of adjusted gross income ($25,300 if two or more qualifying children are present).

Beginning in 1994, the credit may also be claimed by workers who do not have children. Qualifying workers must be at least age 25 and may not be claimed as a dependent on another taxpayer's return. The credit is not available to workers age 65 or older. In 1994, the credit is 7.65 percent of the first $4,000 of earned income. When the taxpayer's income exceeds $5,000, the credit is phased out at the rate of 7.65 percent. It is completely phased out at $9,000 of adjusted gross income.

For workers with or without children, the income level at which the credit's phase-outs begin and the maximum amounts of income on which the credit can be taken are adjusted for inflation. Earned income tax credits in excess of tax liabilities are refundable to individuals, and as such are paid by the Federal Government. This portion of the credit is included in outlays, while the amount that offsets tax liabilities is shown as a tax expenditure.

Social Security

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

Social Security benefits for the disabled, dependents and survivors.—Benefit payments from the Social Security Trust Fund, for disability and for dependents and survivors, are excluded from the beneficiaries' gross incomes, and thus give rise to tax expenditures.

Veterans Benefits and Services

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

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

General Government

Public purpose State and local debt.—Interest on State and local government debt, issued to finance government activities, is excluded from Federal taxation. State and local governments, therefore, can sell debt obligations at a lower interest cost than would be possible if such interest were subject to tax. Only the excluded interest on bonds for public purposes, such as schools, roads, and sewers, is included here.

Nonbusiness State and local taxes excluding home-owner property taxes.—The deductibility of nonbusiness State and local taxes gives indirect assistance to these governments by reducing the costs of the services they provide and, thus, the burden on their taxpayers. Although general sales taxes may no longer be deducted, State and local income taxes still may be deducted.

Business income earned in U.S. possessions.—Under certain conditions, U.S. corporations receiving income from an active trade or business, or from investments located in a U.S. possession, can claim a special credit against U.S. tax otherwise due.

Interest

U.S. savings bonds.—The interest on U.S. savings bonds is not taxable until the bonds are redeemed,

thereby deferring tax liability. The deferral is equivalent to an interest-free loan and, therefore, it is a tax expenditure.

TAX EXPENDITURES IN THE UNIFIED TRANSFER TAX

Exceptions to the general terms of the Federal unified transfer tax favor particular transferees or dispositions of transferors, similar to Federal direct expenditure or loan programs. The transfer tax provisions identified as tax expenditures satisfy the reference law criteria for inclusion in the tax expenditure budget that were described above. There is no generally accepted normal tax baseline for transfer taxes.

Unified Transfer Tax Reference Rules

The reference tax rules for the unified transfer tax from which departures represent tax expenditures include:

- *Definition of the taxpaying unit.* The payment of the tax is the liability of the transferor whether the transfer of cash or property was made by gift or bequest.
- *Definition of the tax base.* The base for the tax is the transferor's cumulative, taxable lifetime gifts made plus the net estate at death. Gifts in the tax base are all annual transfers in excess of $10,000 to any donee except the donor's spouse. Excluded are, however, payments on behalf of family members' educational and medical expenses, as well as the cost of ceremonial gatherings and celebrations that are not in honor of the donor.
- *Property valuation.* In general, property is valued at its fair market value at the time it is transferred. This is not necessarily the case in the valuation of property for transfer tax purposes. Executors of estates are provided the option to value assets at the time of the testator's death or up to six months later.
- *Tax rate schedule.* A single graduated tax rate schedule applies to all taxable transfers. This is reflected in the name of the "unified transfer tax" that has replaced the former separate gift and estate taxes. The tax rates vary from 18 percent on the first $10,000 of aggregate taxable transfers, to 55 percent on amounts exceeding $3 million. A $192,800 lifetime credit is provided against the tax in determining the final amount of transfer taxes that are due and payable. This allows each taxpayer to make a $600,000 tax-free transfer of assets that otherwise would be liable to the unified transfer tax.[6]
- *Time when tax is due and payable.* Donors are required to pay the tax annually as gifts are made. The generation-skipping transfer tax is payable by the donees whenever they accede to the gift. The net estate tax liability is due and payable within nine months after the decedent's death. The Internal Revenue Service may grant an extension of up to 10 years for a reasonable cause. Interest is charged on the unpaid tax liability at a rate equal to the cost of Federal short-term borrowing, plus three percentage points.

[6] An additional tax, at a flat rate of 55 percent, is imposed on lifetime, generation-skipping transfers in excess of $1 million. It is considered a generation-skipping transfer whenever the transferee is at least two generations younger than the transferor, as it would be in the case of transfers to grandchildren or great-grandchildren. The liability of this tax is on the recipients of the transfer.

Tax Expenditures by Function

The 1993–99 estimates of tax expenditures in the Federal unified transfer tax are displayed by functional category in table 6–5. Outlay equivalent estimates are similar to revenue loss estimates for transfer tax expenditures and, therefore, are not shown separately. A description of the provisions follows.

Natural Resources and Environment

Donations of conservation easements.—Bequests for conservation are excluded from taxable estates. A conservation bequest is the value of property and easements (in perpetuity) to such property the use of which is restricted to any one or more of the following: the public for outdoor recreation; protection of the natural habitats of fish, wildlife, plants, etc.; scenic enjoyment of the public; and preservation of historic land areas and structures. Similar conservation gifts are excluded from the gift tax base and are also deductible from the donor's otherwise taxable income in the year of the gift.

Agriculture

Special use valuation of farms.—Farmland owned and operated by a decedent and/or a member of the family may be valued for estate tax purposes on the basis of its "continued use" as a farm if: the farmland is at least 25 percent of the decedent's gross estate; the entire value of all farm property is at least 50 percent of the gross estate; and family heirs to the farm agree to continue to operate the property as a farm for at least 10 years. Since continued use valuation of farmland is frequently substantially less than the fair market value, the resulting reduction in tax liability serves as a subsidy to the continued operation of family farms.

Tax deferral of closely held farms.—Decedents' estates may use a preferential, extended installment payment period of five to 15 years to discharge estate tax liabilities if the value of the farm properties exceeds 35 percent of the net estates. The interest charged is only 4 percent for the first five years, rather than the standard Federal short-term borrowing rate plus three percentage points, which applies during the last 10 years of the repayment period.

Commerce and Housing Credit

Special use valuation of closely held businesses.—The two estate tax incentives to family farming are also available to the estates of owners of nonfarm family businesses. If the same three conditions previously described are met, the real property in their estates is eligible for continued use valuation.

Tax deferral of closely held businesses.—Nonfarm family businesses that satisfy the net estate requirements qualify for preferential 15 year deferred estate tax payment. Also, the redemption of stock, required to pay funeral and administrative expenses and estate and gift taxes, may be characterized as a sale of stock. This applies in those cases where the family business is incorporated and only the closely held corporation stock, rather than the business assets, appear in the decedent's estate. This subjects to tax only the appreciation in the value of the stock whereas, under reference tax law rules, all of the proceeds generally would be taxed as a dividend. To be eligible for this special provision, the value of stock in closely held corporations must exceed 35 percent of the decedent's gross estate, less debt and funeral expenses.

Education, Training, Employment, and Social Services

Bequests to tax-exempt organizations.—These bequests are deductible from decedent's otherwise taxable lifetime transfers.

Health

Bequests to health providers.—Such bequests, that are exempt from the income tax, are deductible from otherwise taxable lifetime transfers of decedents.

General Government

State and local death taxes.—A credit is allowed for state death taxes against any Federal estate tax that otherwise would be due. The amount of the state death tax credit is determined by a rate schedule that reaches a limit of 16 percent of the taxable estate in excess of $60,000. This provision is intended to restrain states from competing for wealthy individuals' official domicile.

TABLE 6–5. REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE FEDERAL UNIFIED TRANSFER TAX

(In millions of dollars)

Description	Fiscal Years						
	1993	1994	1995	1996	1997	1998	1999
Natural Resources and Environment:							
Deductions for donations of conservation easements	*	*	*	*	*	*	*
Agriculture:							
Special use valuation of farm real property	70	70	75	80	85	90	95
Tax deferral of closely held farms	55	55	60	65	70	75	80
Commerce:							
Special use valuation of real property used in closely held businesses	20	20	20	20	25	25	25
Tax deferral of closely held business	10	10	10	10	10	15	15
Education, training, employment, and social services:							
Deduction for charitable contributions (education)	500	505	550	590	630	670	715
Deduction for charitable contributions (other than education and health)	1,480	1,490	1,620	1,735	1,850	1,965	2,095
Health:							
Deduction for charitable contributions (health)	455	460	500	535	570	605	645
General government:							
Credit for State death taxes	2,775	2,795	3,035	3,255	3,475	3,695	3,935

Note: All estimates have been rounded to the nearest $5 million.
*$2.5 million or less.

TABLE 6–6. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 1995 REVENUE LOSS

(In millions of dollars)

Total Revenue Loss	1995
Exclusion of employer contributions for medical insurance premiums and medical care	56,265
Net exclusion of employer pension contributions and earnings	55,540
Deductibility of mortgage interest on owner-occupied homes	54,800
Step-up basis of capital gains at death	28,305
Accelerated depreciation (normal tax method)	27,495
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	25,640
Deductibility of charitable contributions (all types)	19,330
Exclusion of OASI benefits for retired workers	16,525
Deductibility of State and local property tax on owner-occupied homes	14,655
Deferral of capital gains on home sales	14,620
Exclusion of interest on public purpose State and local debt	12,350
Exclusion of interest on life insurance savings	8,730
Exclusion of interest on State and local debt for various non-public purposes	7,515
Preferential treatment of capital gains (normal tax method)	6,920
Exception from passive loss rules for $25,000 of rental loss	5,775
Net exclusion of Individual Retirement Account contributions and earnings	5,290
Earned income credit[1]	5,100
Exclusion of capital gains on home sales for persons age 55 and over	4,960
Exclusion of workmen's compensation benefits	4,455
Graduated corporation income tax rate (normal tax method)	3,890
Net exclusion of Keogh plan contributions and earnings.	3,875
Exclusion of social security benefits for dependents and survivors	3,730
Deductibility of medical expenses	3,560
Exclusion of employer premiums on group term life insurance	2,880
Credit for child and dependent care expenses	2,820
Tax credit for corporations receiving income from doing business in U.S. possessions	2,630
Expensing of research and development expenditures (normal tax method)	2,390
Credit for low-income housing investments	2,265
Exclusion of benefits and allowances to armed forces personnel	2,030
Exclusion of reimbursed employee parking expenses	1,930
Exclusion of veterans disability compensation	1,920
Exclusion of social security disability insurance benefits	1,905
Special ESOP rules (other than investment credit)	1,760
Deferral of income from controlled foreign corporations (normal tax method)	1,700
Expensing of certain small investments (normal tax method)	1,560
Additional deduction for the elderly	1,555
Exclusion of income of foreign sales corporations	1,400
Excess of percentage over cost depletion, fuel and nonfuel minerals	1,330
Inventory property sales source rules exception	1,300
Credit for increasing research activities	1,270
Deferral of interest on savings bonds	1,250
Alternative fuel production credit	970
Deferral of income from post 1987 installment sales	935
Exclusion of income earned abroad by United States citizens	895
Exclusion of scholarship and fellowship income (normal tax method)	875
Exclusion of employer provided child care	725
Exemption of RIC expenses from the 2% floor for miscellaneous itemized deductions	690
Exclusion of public assistance benefits (normal tax method)	585
Expensing of multiperiod timber growing costs	575
Exclusion of employee meals and lodging (other than military)	550
Parental personal exemption for students age 19 or over	535
Exclusion of railroad retirement system benefits	400
Targeted jobs credit	395
Exemption of credit union income	380
Empowerment zones	330
Deferral of gains from sale of broadcasting facilities to minority owned business	290
Exclusion of parsonage allowances	290
Suspension of the allocation of research and experimentation expenditures	270
Deductibility of casualty losses	230
Expensing of exploration and development costs, fuel and nonfuel minerals	210
Amortization of start-up costs (normal tax method)	200
Credit for disabled access expenditures	160
Permanent exceptions from imputed interest rules	150
Exclusion from income of conservation subsidies provided by public utilities	145
Capital gains treatment of certain agricultural income	140
Exclusion of employer premiums on accident and disability insurance	140
Small life insurance company deduction	135
Carryover basis of capital gains on gifts	130
Exclusion of military disability pensions	130

TABLE 6–6. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 1995 REVENUE LOSS—Continued

(In millions of dollars)

Total Revenue Loss	1995
Special Blue Cross/Blue Shield deduction	125
Tax incentives for preservation of historic structures	125
Cancellation of indebtedness	110
Tax exemption of certain insurance companies	110
Exclusion of special benefits for disabled coal miners	100
Interest allocation rules exception for certain financial operations	95
Expensing of certain multiperiod production costs	85
Exclusion of employer provided educational assistance	85
Investment credit for rehabilitation of structures (other than historic)	80
Exclusion of veterans pensions	75
Expensing of certain agricultural capital outlays	70
Exclusion of GI bill benefits	65
New technology credit	65
Tax credit for the elderly and disabled	65
Tax credit and deduction for clean-fuel burning vehicles and properties	65
Exception from passive loss limitation for working interests in oil and gas properties	50
Special rules for mining reclamation reserves	50

Note: Provisions with estimates denoted "normal tax method" have no revenue loss under the reference tax law method.
[1] The figure in the table indicates the effect of the earned income tax credit on receipts. The effect on outlays in 1995 is $15,795 million.

3. FEDERAL RECEIPTS

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

Growth in receipts.—Total receipts in 1996 are estimated to be $1,415.5 billion, an increase of $69.0 billion or 5.1 percent relative to 1995. This increase is largely due to assumed increases in incomes resulting from both real economic growth and inflation. Receipts are projected to grow at an average annual rate of 4.9 percent between 1996 and 2000, rising to $1,710.9 billion.

As a share of GDP, receipts are projected to decline from 19.2 percent in 1995 to 18.6 percent in 2000. The Uruguay Round Agreements Act of 1994 and the Administration's proposed middle-class tax cut, which are discussed below, are in large part responsible for this decline in the receipts share of GDP.

TABLE 3–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	1994 actual	Estimate					
		1995	1996	1997	1998	1999	2000
Individual income taxes	543.1	588.5	623.4	642.5	680.5	717.3	756.4
Corporation income taxes	140.4	150.9	157.4	166.1	173.2	179.2	190.5
Social insurance taxes and contributions	461.5	484.4	509.3	532.7	559.2	585.9	614.3
(On-budget)	(126.4)	(133.2)	(139.0)	(144.7)	(151.2)	(157.0)	(163.4)
(Off-budget)	(335.0)	(351.3)	(370.4)	(388.0)	(408.0)	(428.9)	(450.9)
Excise taxes	55.2	57.6	57.2	58.4	59.3	60.7	61.8
Estate and gift taxes	15.2	15.6	16.8	18.0	19.4	20.9	22.5
Customs duties	20.1	20.9	22.3	24.1	26.1	28.0	31.2
Miscellaneous receipts	22.3	28.6	29.0	29.8	31.2	32.7	34.3
Total receipts	**1,257.7**	**1,346.4**	**1,415.5**	**1,471.6**	**1,548.8**	**1,624.7**	**1,710.9**
(On-budget)	*(922.7)*	*(995.2)*	*(1,045.1)*	*(1,083.6)*	*(1,140.8)*	*(1,195.8)*	*(1,260.0)*
(Off-budget)	*(335.0)*	*(351.3)*	*(370.4)*	*(388.0)*	*(408.0)*	*(428.9)*	*(450.9)*

TABLE 3–2. CHANGES IN RECEIPTS

(In billions of dollars)

	Estimate					
	1995	1996	1997	1998	1999	2000
Receipts under tax rates and structure in effect January 1, 1995 [1]	1,346.4	1,417.8	1,479.4	1,554.4	1,629.3	1,715.7
Social security (OASDI) taxable earnings base increases:.						
$61,200 to $63,000 on Jan. 1, 1996	.....	0.7	2.0	2.2	2.4	2.8
$63,000 to $64,800 on Jan. 1, 1997	.....	.....	0.7	2.0	2.3	2.6
$64,800 to $67,500 on Jan. 1, 1998	.....	.....	.....	1.1	3.1	3.5
$67,500 to $70,200 on Jan. 1, 1999	.....	.....	.....	.....	1.1	3.2
$70,200 to $73,200 on Jan. 1, 2000	.....	.....	.....	.....	.....	1.3
Proposals [2]	*	–3.0	–10.4	–10.9	– 13.6	–18.1
Total, receipts under existing and proposed legislation	**1,346.4**	**1,415.5**	**1,471.6**	**1,548.8**	**1,624.7**	**1,710.9**

*$50 million or less.
[1] These estimates assume a social security taxable earnings base of $61,200 through 2000.
[2] Net of income offsets.

ENACTED LEGISLATION

Uruguay Round Agreements Act of 1994.—This Act implements the Uruguay Round of Agreements that were entered into by the United States and members of the General Agreement on Tariffs and Trade (GATT) on April 15, 1994. It also extends for 10 months, through July 1995, the Generalized System of Preferences (GSP) program, which provides preferential duty treatment to U.S. imports of selected products from developing countries. In enacting this legislation, the United States joins 123 nations in the most sweeping trade agreement in history. The tariff reductions provided under the Agreements and the extension of GSP are largely offset by other revenue and outlay provisions. The major provisions of the Act that affect receipts are described below.

Reduce tariffs.—Overall, global tariffs on industrial goods are reduced by an average of 34 percent; U.S tariffs are reduced by slightly more than one-third, with matching tariff reductions by U.S. trading partners. Some reductions occur immediately, some over five years, and some, such as textiles, are phased in over ten years.

Extend GSP.—This program, which provides duty-free access to over 4,400 items from about 142 eligible developing countries that meet certain worker rights and other criteria, is extended for ten months through July 31, 1995.

Reform Pension Benefit Guaranty Corporation (PBGC).—The Retirement Protection Act of 1994 comprises a comprehensive series of reforms designed to improve the funding of single-employer defined benefit pension plans and reduce the potential exposure of the PBGC. A number of changes are made to the special funding rules applicable to underfunded pension plans that generally require sponsors of underfunded pension plans to increase their plan funding. In addition, the per participant cap on the variable rate premium that underfunded plans pay to the PBGC is phased-out. The phase-out creates additional incentives for employers to fund their plans, while at the same time it more than offsets the decline in receipts that results from the increased contributions.

Accelerate collection of certain excise taxes.—The due date for deposit of excise tax liability incurred during the semi-monthly period of September 16th through September 26th is accelerated to September 29th. Under prior law, the payment was due in the subsequent fiscal year. Special rules apply to taxes on ozone-depleting chemicals, communications services, and air transportation. The acceleration is effective generally on January 1, 1995.

Modify estimated tax payment rules for certain foreign income.—U.S. shareholders of a controlled foreign corporation must include earnings from the corporation in their own income for estimated tax purposes by annualizing the earnings. Estimated tax payments must also be made throughout the year for yearly income from intangible property includable in taxable income under section 936 of the tax code. A safe harbor is provided in determining the estimated tax liability. This provision is effective for tax years beginning in 1995.

Modify withholding requirements on certain payments.—Effective for payments made after December 31, 1996, taxpayers who receive Federal payments and unemployment compensation will be given the option of requesting that the agency making the payment withhold Federal income taxes from the payments. Effective for payments made after December 31, 1994, withholding of Federal income taxes is required on distributions of revenues from certain gaming activities by an Indian tribe to its members. Effective for benefits paid after December 31, 1994, the amount of social security or railroad retirement tier 1 benefits included in the gross income of a nonresident alien that is subject to withholding increases from 50 to 85 percent.

Modify earned income tax credit (EITC) eligibility rules.—Effective for taxable years beginning after December 31, 1994, the following changes are made in EITC eligibility rules: (1) members of the Armed Forces stationed outside the United States on extended active duty are allowed to claim the earned income tax credit; and (2) individuals who are nonresident aliens for any portion of the taxable year generally are ineligible to claim the earned income tax credit. Effective for taxable years beginning after December 31, 1993, income received for services provided while an individual is an inmate in a penal institution is removed from the definition of earned income for purposes of computing the EITC.

Require taxpayer identification numbers (TINs) at birth.—Taxpayers claiming dependents will be required to provide a TIN for each dependent, regardless of the dependent's age. This requirement is phased-in for tax years 1995 and 1996 and is fully effective in 1997.

Extend Internal Revenue Service (IRS) user fees.—The IRS provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS responds to these inquiries through the issuance of letter rulings, determination letters, and opinion letters. The fees charged for these requests, which were scheduled to expire effective with requests made after September 30, 1995, are extended through September 30, 2000.

Modify substantial understatement penalty for corporations participating in tax shelters.—Under prior law, corporations could avoid a substantial understatement penalty regarding a tax shelter if the taxpayer reasonably believed that its position would "more likely than not" be considered the proper tax treatment. Effective for transactions after December 8, 1994, the "more likely than not" standard is repealed and the corporation is subject to the substantial understatement penalty unless the general exception for reasonable cause applies.

Modify treatment of partnership distributions of marketable securities.—For purposes of measuring gain, the distribution by a partnership of marketable securities generally will be treated like a distribution of cash. A partner will recognize gain to the extent the fair market value of the marketable securities exceeds his adjusted basis in the partnership interest. Exceptions are provided, but in general, the change applies to partnership distributions of marketable securities after December 8, 1994.

Modify treatment of excess pension assets used for retiree health benefits.—The prior law provision permitting excess defined benefit pension plan assets to be used to provide retiree health benefits is extended, with modification, for five years through December 31, 2000.

Modify rounding rules for pension cost of living adjustments.—Effective for years beginning after December 31, 1994, the dollar limits on contributions and benefits under qualified pension plans are indexed in $5,000 increments, the dollar limit on elective deferrals is indexed in $500 increments, and the dollar limit on compensation taken into account for simplified employee pensions is indexed in $50 increments.

Social Security Independence and Program Improvements Act.—This Act establishes the Social Security Administration as an independent agency from the Department of Health and Human Services and makes several changes to the Social Security (OASDI) and Supplemental Security Income (SSI) programs. The provisions of the Act that affect receipts expand the exemption from OASDI taxes to certain immigrants and workers, including election workers, ministers, and police and firefighters.

Social Security Domestic Employment Reform Act of 1994.—The provisions of this Act make several changes to the OASDI and SSI programs. The major changes affecting receipts are described below.

Simplify payment of employment taxes on domestic workers and revise withholding threshold.—The threshold for withholding and paying Social Security taxes on domestic workers is raised from $50 per quarter under prior law to $1,000 per year. This new threshold, which will be indexed annually for inflation, is effective retroactive to January 1, 1994. For 1995 through 1997, employers are allowed to pay domestic employment taxes in a lump sum when they file their own tax returns. Beginning in 1998, employers will be required to satisfy their tax obligation quarterly through estimated payments or by increasing the tax withheld from their own wages. Household workers under age 18 are exempt from social security taxation and coverage unless household employment is their principal occupation.

Reallocate old age and survivors (OASI) and disability (DI) insurance tax rates.—To prevent the projected insolvency of the DI trust fund, a reallocation of OASI and DI payroll tax rates is provided. This provision has no net effect on receipts or the deficit.

ADMINISTRATION PROPOSALS

Provide tax relief to middle-income families.—Tax relief for middle-income families has always been a goal of this Administration. In 1993, however, the Administration faced a deficit crisis; bringing the deficit under control and concentrating tax relief on the working poor were the first priorities. The deficit reduction program has been even more of a success than planned. Now is the time to move beyond the working poor and provide middle-income Americans with a dividend from the successes the Administration has achieved in cutting the deficit and in reinventing government. The Administration is proposing the following middle-class tax cuts that are designed not only to provide tax relief, but also to provide incentives to save and invest in our future and so boost American productivity.

Provide tax credit for dependent children.—A $500 non-refundable credit will be allowed for each dependent child under the age of 13. The credit will equal $300 for 1996, 1997 and 1998, and will rise to $500 for 1999 and subsequent years. The credit will be phased-out for taxpayers with adjusted gross income (AGI) between $60,000 and $75,000. Both the credit amount and the phase-out range will be indexed for inflation. The credit must be applied after the earned income tax credit and cannot be used to offset alternative minimum tax liability.

Provide tax incentive for education and training.—Effective January 1, 1996, a deduction will be permitted for up to $5,000 in expenditures on post-secondary school education and training for the taxpayer, the taxpayer's spouse and dependents. The maximum allowable deduction will increase to $10,000 effective January 1, 1999. The maximum allowable deduction will be phased-out for taxpayers filing a joint return with AGI (before the proposed deduction) between $100,000 and $120,000. For taxpayers filing a head-of-household or single return, the maximum allowable deduction will be phased out for those with AGI between $70,000 and $90,000. Qualifying education expenses are those related to post-secondary education paid to institutions and programs eligible for Federal assistance. Deductible expenses will include tuition and fees, but will not include meals, lodging, books or transportation.

Expand Individual Retirement Accounts (IRAs).—Under present law, eligibility for deductible IRAs is phased-out for single taxpayers with AGI between $25,000 and $35,000 and for couples filing a joint return with AGI between $40,000 and $50,000. Effective January 1, 1996, the AGI thresholds and phase-out ranges will be doubled; therefore, eligibility will be phased-out for single taxpayers with AGI between $50,000 and $70,000 and for couples filing a joint return with AGI between $80,000 and $100,000. These

thresholds and the present law annual contribution limit of $2,000 will be indexed for inflation. Penalty-free withdrawals from IRAs will be allowed if the proceeds are used to pay post-secondary education costs, to buy or build a first home, to cover living costs if unemployed for at least 12 consecutive weeks, or to pay catastrophic medical expenses (including nursing home or other costs associated with caring for an incapacitated parent or grandparent). In addition, each individual eligible for a deductible IRA will have the option of contributing an amount up to the contribution limit to a traditional deductible IRA or to a new back-loaded special IRA. Contributions to this special IRA will not be tax deductible, but if the assets remain in the account for at least five years, all earnings from the account will be tax-free when withdrawn. Withdrawals of account balances from special IRAs during the five-year period will be subject to ordinary income tax and a 10 percent penalty. Penalty-free withdrawals from special IRAs will be allowed during the five year period for the purposes described above. As with current-law IRAs, penalty-free withdrawals will be allowed for any purpose after the taxpayer reaches the age of 59½, or upon disability or death of the taxpayer. Individuals whose AGI for a year falls below the eligibility thresholds will be allowed to convert an existing IRA into a special IRA.

Modify earned income tax credit (EITC) eligibility rules.—The Administration is proposing a package of modifications designed to target the EITC to intended recipients. Individuals who are living in the U.S. illegally or who do not have proper documentation for employment purposes will not be eligible to claim the EITC. Similarly, taxpayers with combined dividend and interest income in excess of $2,500 per year will not be eligible for the EITC. In addition, related compliance measures will be implemented. All of these modifications will be effective for taxable years beginning after December 31, 1995.

Deter expatriation tax avoidance.—The United States requires U.S. citizens and residents to pay tax on their worldwide income. However, some U.S. taxpayers relinquish their U.S. citizenship or residence and thereby avoid future U.S. tax on unrealized gains. To ensure that these individuals pay their fair share of U.S. tax, when a U.S. citizen renounces U.S. citizenship or when a noncitizen who has been a tax resident of the United States for at least 10 years becomes a nonresident of the United States, the Administration is proposing that such individual's assets be deemed to be disposed of and reacquired at their fair market value in a transaction in which gain or loss is recognized. There will be an exemption for up to $600,000 of gain and for U.S. real property interests. The provision will apply to any expatriation after February 5, 1995.

Tighten rules for taxing foreign trusts.—Some U.S. taxpayers avoid paying applicable U.S. tax on their share of income earned by foreign trusts. To ensure that U.S. tax is collected on this income, the Administration is proposing enhanced information reporting requirements for assets transferred to foreign trusts. In addition, under current law, distributions received by U.S. taxpayers from certain foreign trusts may be treated as nontaxable gifts. The Administration is proposing that U.S. taxpayers who receive such distributions pay U.S. tax on the distributions that represent trust income, unless U.S. law treats a U.S taxpayer as owning the trust assets.

Increase the number of empowerment zones.—Under the Omnibus Budget Reconciliation Act of 1993, certain tax incentives were provided for nine empowerment zones and 95 enterprise communities, to be designated during 1994 and 1995. The Act specified that six empowerment zones and 65 enterprise communities were to be located in eligible urban areas and three empowerment zones and 30 enterprise communities were to be located in rural areas. The six urban empowerment zones were subject to a total population cap of 750,000. The original nine empowerment zones and 95 enterprise communities were designated in December 1994; tax incentives will be available during the period that the designation remains in effect, which generally will be 10 years. The Administration proposes to provide tax incentives for two additional urban empowerment zones, increasing the total number to 11. In addition, the population cap for urban empowerment zones will be increased to 1,000,000.

Reduce excise taxes on certain vaccines.—A manufacturer's tax is levied on vaccines used to prevent diphtheria, pertussis, tetanus, measles, mumps, rubella or polio. These taxes are deposited in the Vaccine Injury Compensation Trust Fund and provide a source of revenue to compensate individuals who sustain certain injuries or die following administration of these vaccines. Because of large balances in the trust fund, a 50 percent reduction in revenues from these taxes is proposed. The decrease will allow continued program compensation while lowering the costs of vaccines to both public and private purchasers.

Expand fees collected under the securities laws.—The Administration proposes to expand certain fees collected under the securites laws as part of a legislative package to provide the Securities and Exchange Commission with a sound and stable long term funding structure. The Administration intends to work with Congress to secure early enactment of such a legislative proposal.

Assess fees for examination of FDIC-insured banks and bank holding companies (receipt effect).—The Administration proposes to require the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve to assess fees for examination of FDIC-insured banks and bank holding companies. The Federal Reserve currently funds the costs of such examina-

tions from earnings; therefore, deposits of earnings by the Federal Reserve, which are classified as governmental receipts, will increase by the amount of the fees.

Modify Federal pay raise (receipt effect).—National and locality pay increases for Federal employees would sum to 2.4 percent in 1996, 3.1 percent in 1997, and 2.1 percent each year in 1998-2000. These proposed pay adjustments affect Federal employee contributions to the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS).

Extend the environmental tax on corporate taxable income.—A tax equal to 0.12 percent of alternative minimum taxable income in excess of $2 million is levied on all corporations and deposited in the Hazardous Substance Superfund Trust Fund. Extension of this tax, which expires on December 31, 1995, is supported by the Administration. The Administration also supports extension of the excise taxes deposited in the Superfund, which are extended in the baseline estimates, but are scheduled to expire December 31, 1995.

Improve tax administration and compliance.—The Administration continues to support revenue-neutral initiatives designed to promote sensible and equitable administration of the internal revenue laws. These include simplification, technical corrections, and taxpayer compliance measures. In addition, the Administration supports and wants to work with Congress on the following proposals:

- intermediate sanctions and disclosure requirements to improve public charities' compliance with the requirements for tax-exempt status;
- a package of compliance initiatives that will support the Internal Revenue Service's efforts to modernize and streamline its operations, to alleviate taxpayer burdens by facilitating the payment of taxes and filing of tax returns, and to rationalize existing rules to treat taxpayers more fairly; and
- modifications to improve compliance with diesel dyeing requirements and facilitate refunds of the excise tax on the sale of certain fuels not used for taxable purposes.

The Administration will also continue to monitor and consider ways to ease the impact of the reduction of the deductible portion of otherwise allowable business meals and entertainment expenses.

Expiring provisions.—A number of tax provisions have expired or are scheduled to expire before January 1, 1996. The Administration supports the revenue-neutral extension of these provisions as discussed below and looks forward to working with the Congress to achieve that goal. These provisions include the following:

Exclusion for employer-provided educational assistance.—Certain amounts paid by an employer for educational assistance provided to an employee are excluded from the employee's gross income for income and payroll tax purposes. This exclusion expired with respect to amounts paid after December 31, 1994. The Administration has previously proposed permanent extension of this provision.

Targeted jobs tax credit.—A tax credit, generally equal to 40 percent of up to $6,000 of qualified first year wages, is provided to employers who hire individuals from several targeted groups. The credit expired with respect to individuals hired after December 31, 1994. The Administration strongly supports the goals of this program but has serious concerns over the cost-effectiveness of its current design. The Administration would support extension if the problems undermining the credit's effectiveness are addressed.

Research and experimentation (R&E) tax credit.—The 20 percent tax credit provided for certain research and experimentation expenditures expires with respect to expenditures made after June 30, 1995. The Administration has previously proposed permanent extension of this provision.

Research and experimentation (R&E) allocation rules.—Companies with foreign operations are allowed to allocate 50 percent of domestic R&E expenditures to their domestic operations and 50 percent of foreign R&E expenditures to their foreign operations. The remaining expenses are to be allocated on the basis of gross sales or gross income. This provision expires with respect to R&E expenses incurred after July 31, 1995.

Oil spill liability tax.—Under prior law, a five cents per barrel tax was levied on each barrel of domestic and imported crude oil entering a U.S. port. This tax, which was deposited in the Oil Spill Liability Trust Fund, was to expire on the earlier of December 31, 1994 or the date on which the unobligated balance in the fund reached $1 billion. This tax expired on December 31, 1994.

Tax credit for orphan drug clinical testing expenses.—A 50 percent non-refundable tax credit is allowed for a taxpayer's qualified clinical testing expenses paid or incurred in the testing of certain drugs, generally referred to as orphan drugs, for rare diseases or conditions. This credit expired with respect to expenses incurred after December 31, 1994.

Deduction for health insurance costs of self-employed individuals.—Up to 25 percent of the amount paid by a self-employed individual for health insurance expenses was deductible under prior law. This deduction expired effective with respect to expenses incurred after December 31, 1993. The Administration has previously proposed permanent extension of this provision.

Generalized System of Preferences (GSP).—Under GSP duty-free access is provided to over 4,000 items from about 142 eligible developing countries that meet certain worker rights and other criteria. This program, which was extended for 10 months under the Uruguay Round Agreements Act of 1994, is scheduled to expire after July 31, 1995.

Tax deduction for contributions to private foundations.—The deduction for a contribution to a private foundation is generally limited to the adjusted basis of the contributed property. However, a taxpayer who contributed qualified appreciated stock to a private foundation before January 1, 1995 is allowed to deduct the full fair market value of the stock, rather than the adjusted basis of the contributed stock.

TABLE 3–3. EFFECT OF PROPOSALS ON RECEIPTS

(In billions of dollars)

	Estimate						
	1995	1996	1997	1998	1999	2000	1995–2000
Provide tax relief to middle-income families:							
Provide tax credit for dependent children	.....	–3.5	–6.8	–6.6	–8.3	–10.1	–35.4
Provide tax incentive for education and training	.....	–0.7	–4.7	–4.9	–5.7	–7.5	–23.5
Expand Individual Retirement Accounts (IRAs)	.....	0.4	–0.3	–0.8	–1.0	–2.0	–3.8
Subtotal, Middle-income tax relief	.....	–3.8	–11.8	–12.4	–15.1	–19.6	–62.7
Modify earned income tax credit (EITC) eligibility rules:							
Deny EITC to undocumented workers/related compliance measures	.....	.....	0.1	0.1	0.1	0.1	0.4
Impose interest and dividend test on EITC recipients	.....	*	0.1	0.1	0.1	0.1	0.3
Subtotal, Modify EITC eligibility rules	.....	*	0.2	0.2	0.2	0.2	0.7
Deter expatriation tax avoidance	.....	0.1	0.2	0.3	0.4	0.5	1.5
Tighten rules for taxing foreign trusts	.....	0.3	0.4	0.4	0.5	0.5	2.0
Increase the number of empowerment zones	–0.1	–0.1	–0.1	–0.1	–0.1	–0.1	–0.7
Reduce excise taxes on certain vaccines [1]	.....	–0.1	–0.1	–0.1	–0.1	–0.1	–0.3
Expand fees collected under the securities laws	0.1	0.3	0.3	0.3	0.4	0.4	1.8
Assess fees for examination of FDIC-insured banks and bank holding companies (receipt effect)	.....	0.1	0.1	0.1	0.1	0.1	0.4
Modify Federal pay raise (receipt effect)	.....	–0.1	–0.2	–0.3	–0.4	–0.5	–1.3
Extend environmental tax on corporate taxable income [2]	.....	0.3	0.5	0.5	0.5	0.5	2.4
Total effect of proposals [1]	*****	**–3.0**	**–10.4**	**–10.9**	**–13.6**	**–18.1**	**–56.0**

* $50 million or less.

[1] Net of income offsets.

[2] Net of deductibility for income tax purposes.

TABLE 3–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	1994 actual	1995 estimate	1996 estimate
Individual income taxes (federal funds):			
Withheld	459,699	487,636	513,404
Proposed legislation (PAYGO)	.....	−38	−3,529
Other	160,433	183,595	199,985
Refunds	−77,077	−82,733	−86,488
Total net individual income taxes	**543,055**	**588,460**	**623,372**
Corporation income taxes:			
Federal funds:			
Gross collections	153,552	165,174	172,489
Proposed legislation (PAYGO)	.....	−15	−102
Refunds	−13,820	−14,910	−15,571
Total Federal funds net corporation income taxes	139,732	150,249	156,816
Trust funds:			
Gross collections (Hazardous substance superfund)	653	615	249
Proposed legislation (PAYGO)	.....	.....	384
Total net corporation income taxes	**140,385**	**150,864**	**157,449**
Social insurance taxes and contributions (trust funds):			
Employment taxes and contributions:			
Old-age and survivors insurance (Off-budget)	302,607	284,189	314,205
Disability insurance (Off-budget)	32,419	67,067	56,156
Hospital insurance	90,062	96,657	102,402
Railroad retirement:			
Social Security equivalent account	1,399	1,495	1,503
Rail pension and supplemental annuity	2,323	2,386	2,401
Total employment taxes and contributions	428,810	451,794	476,667
On-budget	93,784	100,538	106,306
Off-budget	335,026	351,256	370,361
Unemployment insurance:			
State taxes deposited in Treasury [1]	22,484	22,340	22,419
Federal unemployment tax receipts [1]	5,460	5,694	5,756
Railroad unemployment tax receipts [1]	27	23	23
Railroad debt repayment [1]	33	.....	.....
Total unemployment insurance	28,004	28,057	28,198
Other retirement contributions:			
Federal employees' retirement—employee contributions	4,563	4,462	4,430
Proposed legislation (non-PAYGO)	.....	.....	−75
Contributions for non-Federal employees [2]	98	96	96
Total other retirement contributions	4,661	4,558	4,451
Total social insurance taxes and contributions	**461,475**	**484,409**	**509,315**
On-budget	126,450	133,153	138,954
Off-budget	335,026	351,256	370,361
Excise taxes:			
Federal funds:			
Alcohol	7,539	7,551	7,514
Tobacco	5,691	5,657	5,633
Transportation fuels	9,402	8,132	6,607
Telephone and teletype services	3,526	3,720	3,921
Ozone depleting chemicals and products	761	717	214
Other Federal funds	4,307	3,215	2,415
Proposed legislation (PAYGO)	.....	.....	−24
Total Federal fund excise taxes	31,226	28,992	26,280
Trust funds:			
Highway	16,668	20,665	22,894
Airport and airway	5,189	5,562	5,877
Aquatic resources	301	301	311
Black lung disability insurance	567	636	645
Inland waterway	88	103	110
Hazardous substance superfund	807	842	850
Oil spill liability	48	204	.....
Vaccine injury compensation	179	140	140
Proposed legislation (PAYGO)	.....	.....	−70
Leaking underground storage tank	152	155	157
Total trust funds excise taxes	23,999	28,608	30,914
Total excise taxes	**55,225**	**57,600**	**57,194**
Estate and gift taxes	**15,225**	**15,587**	**16,760**
Customs duties:			
Federal funds	19,422	20,226	21,600
Trust funds	677	687	732
Total customs duties	**20,099**	**20,913**	**22,332**
MISCELLANEOUS RECEIPTS: [3]			
Miscellaneous taxes	163	179	188
United Mine Workers of America combined benefit fund	286	351	274
Deposit of earnings, Federal Reserve System	18,023	24,559	24,695
REGO proposal (PAYGO)	.....	.....	79
Fees for permits and regulatory and judicial services	1,845	1,867	1,938
Proposed legislation (PAYGO)	.....	81	310
Fines, penalties, and forfeitures	1,824	1,830	1,820
Restitutions, reparations, and recoveries under military occupation	7	6	6
Gifts and contributions	141	113	128
Refunds and recoveries	−6	−406	−405
Total miscellaneous receipts	**22,282**	**28,581**	**29,034**
Total budget receipts	**1,257,745**	**1,346,414**	**1,415,456**
On-budget	922,719	995,158	1,045,095
Off-budget	335,026	351,256	370,361
MEMORANDUM			
Federal funds	774,145	835,428	878,135
Trust funds	312,073	322,785	359,068
Interfund transactions	−163,499	−163,055	−192,107
Total on-budget	**922,719**	**995,158**	**1,045,095**
Off-budget (trust funds)	**335,026**	**351,256**	**370,361**
Total	**1,257,745**	**1,346,414**	**1,415,456**

[1] Deposits by States are State payroll taxes that cover benefit part of the program. Federal unemployment tax receipts cover administrative costs at both the Federal and State level. Railroad unemployment tax receipts cover both the benefits and adminstrative costs of the program for the railroads.

[2] Represents employer and employee contributions to the civil service retirement and disability fund for covered employees of Government-sponsored enterprises and the District of Columbia municipal government.

[3] Includes both Federal and trust funds. Trust fund amounts in miscellaneous receipts are 1994: $578 million, 1995: $650 million, and 1996: $596 million.

1996

4. USER FEES AND OTHER COLLECTIONS

USER FEES

The Federal Government earns income from its business-type activities as well as obtaining taxes and other governmental receipts by the exercise of its sovereign powers. It sells postage stamps and electricity, charges fees for admittance to national parks, collects premiums for deposit insurance, and obtains rents and royalties for the right to extract oil from the Outer Continental shelf.

These collections are subtracted from gross outlays rather than added to the taxes and other governmental receipts discussed in the previous chapter. Because they reduce outlays, they are called "offsetting collections." The purpose of this treatment is to produce budget totals for receipts, outlays, and budget authority in terms of the amount of resources allocated governmentally, through collective political choice rather than through the market.

Offsetting collections are classified into two major categories: offsetting receipts, which are deposited in receipt accounts; and offsetting collections credited to appropriations (expenditure) accounts, which are deposited directly in these accounts and usually can be spent without further action by the Congress. Both categories include collections from other accounts within the Government as well as the public. Chapter 25, "Budget System and Concepts," explains the budgetary treatment of these collections more fully.

The term "user charge" is not a budgetary category. It is a general term that refers to amounts assessed against identifiable recipients for special benefits derived from Federal activities beyond those received by the general public. Depending on whether the user charge is based on the Government's sovereign power or business-type activity, and on other considerations, it may be classified as a governmental receipt or an offsetting collection.

As shown in Table 4–1, total offsetting collections from the public (including those proposed in this budget) are estimated to be $203.4 billion in 1996. This is only 14 percent as large as the governmental receipts discussed in the previous chapter. Table 4–1 divides this total between offsetting receipts and offsetting collections credited to appropriations accounts and shows major subcategories of each. Table 4–3 provides more detail for offsetting receipts collected from the public together with detail for offsetting receipts collected from other accounts within the Government.

The budget contains a variety of user fee and other collections proposals that would yield $1.6 billion in 1996 and $12.9 billion over the years 1996 through 2000. These proposals establish or increase fees in order to recover more of the costs of providing Government services. Table 4–2 splits the proposals between discretionary and mandatory categories for the appropriate scoring under the Budget Enforcement Act of 1990 (BEA). It includes both offsetting collections and user charges classified as governmental receipts.

TABLE 4–1. OFFSETTING COLLECTIONS FROM THE PUBLIC

(In millions of dollars)

Type	1994 actual	Estimate	
		1995	1996
Collections deposited in receipt accounts:			
Medicare premiums	17,747	20,122	20,197
Military assistance trust fund property sales	13,036	13,350	13,370
Outer Continental Shelf payments, naval petroleum reserve lease and other undistributed offsetting receipts	3,002	2,692	6,014
Spectrum auction proceeds, undistributed	.....	4,375	4,575
Sale of property and services, interest income and all other collections deposited in receipt accounts	17,352	17,481	19,044
Subtotal, collections from the public deposited in receipt accounts	51,137	58,020	63,200
Collections credited to appropriations accounts:			
Postal Service Stamp sales and other collections	48,412	52,636	54,805
Deposit insurance funds	31,577	22,653	14,939
Tennessee Valley Authority and Power Administration collections	8,903	8,940	9,249
Commodity Credit Corporation loan repayments and other collections	7,560	10,660	9,930
Other loan repayments	9,139	8,755	7,308
Loan guaranty and other insurance premiums, interest income and all other collections credited to appropriations accounts	48,832	43,807	43,992
Subtotal, collections from the public credited to appropriation accounts	154,424	147,449	140,223
Offsetting collections from the public	205,561	205,469	203,423
Offsetting collections from the public excluding off-budget Postal Service collections	157,149	152,833	148,618

TABLE 4–2. PROPOSED USER FEES AND OTHER COLLECTIONS

(In millions of dollars)

	1996	1997	1998	1999	2000
User fees					
Discretionary:					
Department of Agriculture:					
Animal and Plant Health Inspection Service—inspection, licensing, and permit fees—Collections and spending authority	8	8	8	8	8
Grain Inspection—Packers and Stockyards Administration—standardization and licensing activities—Collections and spending authority	16	16	16	16	16
Food Safety and Inspection Service—meat and poultry/eggs overtime inspection fees—Collections and spending authority	107	107	107	107	107
Department of Energy: Decontamination and decommissioning fee extended to foreign purchasers of U.S. enrichment services—Collections	45	46	47	48	49
Department of Health and Human Services—Food and Drug Administration:					
Import user fee to cover inspection/regulatory compliance program—Collections and spending authority	15	15	16	16	17
Medical device review and approval—Collections and spending authority	24	24	25	26	27
Department of the Interior: Expand authority for Park Service fees:.					
Collections	32	36	42	46	52
Spending authority	.....	36	41	48	52
Army Corps of Engineers: Wetlands dredging permit application fees—Collections	6	12	12	12	12
Environmental Protection Agency: Registration fee for pesticide manufacturers—Collections	15	15	.....	.....	.....
Small Business Administration: Loan servicing fees for Small Business Investment Company and Certified Development Company programs—Collections and spending authority	3	3	3	3	3
Commodity Futures Trading Commission: Transaction fee to cover cost of regulatory activities—Collections and spending authority	60	60	60	60	60
Federal Maritime Commission: Tariff filing and other administrative fees—Collections and spending authority	2	2	2	2	2
Federal Emergency Management Agency: Fee to cover 100% of radiological emergency preparedness program—Collections	12	12	12	12	12
Nuclear Regulatory Commission: Extend fee to cover costs of regulation—Collections and spending authority	.....	.....	.....	312	306
Securities and Exchange Commission: Tier 3 fees credited to appropriation—Collections and spending authority	92	80	67	54	40
Subtotal, discretionary user fees:.					
Collections	437	437	418	723	711
Spending authority	327	353	346	653	638
Mandatory:					
Department of Agriculture: Recover costs for oversight of marketing agreements and orders—Collections and spending authority	10	10	10	10	10
Department of Commerce: Fisheries management program fees—Collections and spending authority	10	10	10	10	10
Departments of Justice and the Treasury: Immigration and Naturalization Service/Customs Service border services fee—Collections and spending authority	200	426	438	452	466
Department of Transportation: Railroad safety inspection fees—Collections	45	47	49	51	53
Environmental Protection Agency: Pesticide re-registration fee—Collections and spending authority	9	8	15	15	.....
Small Business Administration: Loan servicing fees for 7(a) program—Collections and spending authority	9	9	9	8	8
General Services Administration: Allow agencies to charge a commercial equivalent fee for parking provided to employees—Collections and spending authority	45	45	45	45	45
Federal Deposit Insurance Corporation/Federal Reserve Banks: Examination fees for FDIC-insured banks and bank holding companies—Collections [1]	184	193	201	208	216
Securities and Exchange Commission:					
Tier 1 fees—increases in existing fees—Collections [2]	59	62	66	69	73
Tier 2 fees—new permanent fees deposited in special fund—Collections and spending authority [2]	251	263	276	289	303
Subtotal, mandatory user fees:.					
Collections	821	1,073	1,118	1,157	1,184
Spending authority	533	771	802	829	842
Total, user fees:					
Collections	1,259	1,510	1,536	1,880	1,894
Spending authority	860	1,123	1,148	1,482	1,480
Other collections					
Federal Communications Commission: New auction authority and/or user fees	300	600	1,000	1,400	1,500
Total, user fees and other collections	1,559	2,110	2,536	3,280	3,394
Total, spending authority	860	1,123	1,148	1,482	1,480

[1] A portion of this total will be counted as governmental receipts.
[2] Governmental receipts.

Discretionary.—The following discretionary user fees are proposed as offsets to discretionary spending.

Department of Agriculture

Animal and Plant Health Inspection Service (APHIS) fees.—The budget proposes to establish three fees for certain APHIS activities:

- To cover APHIS' costs for providing animal welfare inspections, which would be charged to recipients of APHIS services such as animal research centers, humane societies and kennels.
- To cover APHIS' costs of issuance of biotechnology permits, which would be charged to firms that manufacture genetically engineered fruit and vegetable commodities, parasitic insects, and animals.
- To cover APHIS' costs of veterinary biologics licensing, inspection, and testing activities, which would be paid by veterinary biologics companies that specialize in the production and distribution of animal sperm.

Grain inspection standardization and packers and stockyards licensing fees.—The budget proposes to establish a fee for standardization activities of the Grain Inspection—Packers and Stockyards Administration, including maintaining uniform standards for grain quality, determining criteria and recommending specifications for grain inspection instrumentation and developing an agency-wide quality assurance program. Legislation will also be proposed to establish a licensing fee to fully cover the costs of administering meat packing and stockyard activities. The fee would be applied to livestock market agencies, livestock dealers, meat packers and live poultry dealers.

Meat, poultry, and egg overtime inspection fee.—Legislation will be proposed to charge fees for all overtime inspections of meat, poultry, and egg products at all establishments inspected by the Food Safety and Inspection Service (FSIS). Currently, fees to reimburse the cost of overtime inspection are required at some FSIS inspected establishments, but not at others. The Federal government would continue to pay the full cost for a primary, eight-hour inspection shift.

Department of Energy

Decontamination and decommissioning fee.—The budget includes a proposal to assess a fee on foreign customers of Government enrichment services, similar to the fee currently paid by domestic purchasers. The fee would be set at a comparable rate and would be used to offset the costs of environmental cleanup of the Government's three enrichment plants.

Department of Health and Human Services, Food and Drug Administration (FDA)

Import inspection fees.—Legislation will be proposed to assess food importers a fee for import entry inspections. FDA is responsible for inspection of imported food products at the port of entry. Fee proceeds would be used to improve the effectiveness of FDA's regulatory compliance program.

Medical device user fee.—Legislation will be proposed to assess fees on medical device manufacturers who present medical devices for pre-market review. The proceeds would be dedicated to expediting the device review and approval process.

Department of the Interior

National Park System fees.—Legislation will be proposed to expand authority for the Secretary of the Interior to charge entrance and use fees for the National Park System. The proceeds would be made available for expenditure by the National Park Service in the following year. Allowable expenditures include the costs of collection, park maintenance and rehabilitation, and some aspects of park operations.

Army Corps of Engineers

Wetlands permit fee.—Legislation will be proposed to increase fees for the issuance of wetlands regulatory permits for commercial activities. Authorizing legislation will be drafted in such a way as to have no PAYGO effect and will allow appropriations committees to establish annually the level of fees to be charged. The fees would be deposited in a special Treasury account and would be available to be used by the Regulatory Program to the extent provided in advance in appropriations acts.

Environmental Protection Agency (EPA)

Pesticide registration fee.—Legislation will be proposed to impose user fees on manufacturers of pesticides to recover the costs of the Pesticide Registration Program. Congressional action is required to activate a user fee rule promulgated by EPA that was subsequently suspended by Congress. After enactment of the authorization, appropriations language will be transmitted to set the level of the fees.

Small Business Administration (SBA)

Loan servicing fees.—The budget includes loan servicing fees for SBA's three major business loan programs. The fees would be paid by the lenders and used to supplement SBA's administrative costs for running the loan programs. For the Small Business Investment Company (SBIC) and Certified Development Company (CDC) programs, SBA proposes to continue its servicing fees authorized in appropriations language last year. These fees will be requested in appropriations language again this year, and if enacted, will be automatically available. Fees for the 7(a) loan program are discussed below under mandatory proposals.

Commodity Futures Trading Commission

Futures transaction fee.—Authorizing legislation will be proposed to establish a transaction fee on commodity futures and option contracts traded on futures exchanges to cover the cost of the Commodity Futures Trading Commission's regulatory activities. The collection and use of this fee, once authorized, will be contingent on appropriation action. For 1996, the fee would

be set at 10 cents per round turn transaction. Additional information on this fee can be found in the *Appendix.*

Federal Maritime Commission (FMC)

Tariff filing fee.—The Federal Maritime Commission proposes to collect new and increased fees to offset FMC's cost of providing services, including tariff filing and other administrative services. The fees collected are to be available to augment FMC's appropriation.

Federal Emergency Management Agency (FEMA)

Radiological emergency preparedness fee.—The budget includes appropriations language that would permit FEMA to assess fees on NRC licensees to cover 100 percent of the cost of providing site-specific services that directly contribute to the fulfillment of emergency preparedness requirements needed for NRC licensing. This proposal would extend the authority to collect these fees, which currently expires at the end of 1995. The proceeds would be deposited as offsetting receipts in the general fund of the Treasury and would not be available for expenditure by FEMA.

Nuclear Regulatory Commission (NRC)

Nuclear Regulatory Commission fees.—The budget includes a proposal to extend fees collected from nuclear facility license holders from 1998 through 2000. The collections would be used to offset NRC's costs.

Securities and Exchange Commission

Securities-related fees.—Legislation will be proposed to expand certain fees collected under the securities laws as part of a legislative package to provide the Securities and Exchange Commission (SEC) with a sound and stable long-term funding structure. Such legislation would stipulate three tiers of new fee income. Tier 1 would be composed of permanent increases in existing base receipts collected under the securities laws. This group of fees would be used for deficit reduction. Tier 2 would establish a set of new permanent fees in the securities laws. These fees would be deposited in a special fund of the U.S. Treasury and the SEC would have the authority to spend such sums as may be deposited in this fund. Tier 3 would provide the SEC's appropriators with authority to increase certain specified receipts collected under the securities laws and deposit such increments as offsetting collections to the SEC's appropriation. The collection and use of the Tier 3 fees would be contingent on appropriation action.

Mandatory.—The following mandatory user fee proposals would be scored as "pay-as-you-go" savings under the BEA's scoring rules.

Department of Agriculture

Agricultural Marketing Service fees.—The Administration proposes to recover USDA costs of oversight and support of marketing agreements and orders by increasing assessments on producers and handlers. These activities help stabilize market prices for milk, fruit, vegetables, and certain specialty crops, and they are presently funded from the Section 32 appropriation.

Department of Commerce

Fisheries management program fees.—The Administration's Magnuson Act reauthorization proposal will include a provision to raise fees to finance marine fisheries stewardship. Fees will be used for the development and implementation of fishery programs, including social and economic studies. Fees would be paid by commercial fisherman and would provide for fisheries management.

Department of Justice/Department of the Treasury

Immigration and Naturalization Service (INS)/Customs Service border services user fee.—Legislation will be proposed to collect $3.00 per vehicle and $1.50 per pedestrian crosser, with discounts to frequent crossers. These resources would be used to improve overall border management, increase facilitation of traffic, stem illegal immigration and stop cross-border drug smuggling. The Administration will consult with the governments of Mexico and Canada and other affected parties during the development and implementation of this fee.

Department of Transportation

Railroad safety inspection fee.—Legislation will be proposed to permanently extend the railroad safety inspection fees that were enacted in the Omnibus Budget Reconciliation Act of 1990. These fees cover the costs of the Federal rail safety program. Railroads are assessed fees according to a formula based on three criteria: road miles, as a measure of system size; train miles, as a measure of volume; and employee hours, as a measure of employee activity.

Environmental Protection Agency

Pesticide re-registration fee.—Legislation will be proposed to increase fees collected from pesticide manufacturers in support of re-registration of pesticides currently in use. The fees would also be extended beyond the current expiration date in order to fund timely completion of the re-registration program. Fees are paid by industry to offset costs incurred by the accelerated re-registration and expedited processing of pesticides.

Small Business Administration

Loan servicing fees.— For the 7(a) Guaranteed Loan program, the budget proposes an up-front ⅛ percent servicing fee on the guaranteed portion of loans made. This fee will be proposed in authorizing language. If enacted, the funds would be automatically available. Fees for the Certified Development Company (CDC) and Small Business Investment Company (SBIC) programs are discussed above under discretionary user fee proposals.

General Services Administration

Parking fees.—Legislation will be proposed to authorize Federal agencies to charge employees up to the commercial equivalent rate for parking and related services and retain these proceeds, in excess of actual management and maintenance costs, to finance employee transit benefit programs.

Federal Deposit Insurance Corporation (FDIC) and Federal Reserve Banks (Fed)

State bank examination fee.—Legislation will be proposed to require the FDIC and the Federal Reserve to assess fees for examinations of FDIC-insured banks and bank-holding companies. The costs of such examinations are currently funded from deposit insurance premiums and Fed earnings from monetary policy activities. The FDIC fee proceeds would be used to finance the examinations operation. The Fed proceeds would be transferred to Treasury annually in the form of surplus earnings.

OTHER COLLECTIONS

Federal Communications Commission (FCC)

New auction authority and/or user fees.—Legislation will be proposed to expand FCC authority to auction additional spectrum and other valuable public resources for private use. Alternatively, legislation will be proposed to grant the FCC authority to charge user fees for public resources that the Commission gives away for free.

OFFSETTING RECEIPTS

Table 4–3 itemizes all offsetting collections deposited in receipt accounts. These include payments from one part of the government to another, called intragovernmental transactions, and collections from the public. These receipts are offset (deducted) from outlays in the Federal budget. In total, offsetting receipts are estimated at $328.5 billion in 1996.

TABLE 4–3. OFFSETTING RECEIPTS BY TYPE

(In millions of dollars)

Source	1994 actual	1995 estimate	1996 estimate
INTRAGOVERNMENTAL TRANSACTIONS			
On-budget receipts:			
Federal intrafund transactions:			
Distributed by agency:			
Interest from the Federal Financing Bank	9,049	8,415	7,234
Interest on Government capital in enterprises	1,983	1,906	1,795
Other	1,182	879	1,013
Total Federal intrafunds	12,214	11,200	10,042
Trust intrafund transactions:			
Distributed by agency:			
Payments to railroad retirement	3,526	3,716	3,807
Other	1	1	1
Total trust intrafunds	3,527	3,717	3,808
Total intrafund transactions	15,741	14,917	13,850
Interfund transactions:			
Distributed by agency:			
Federal fund payments to trust funds:			
Contributions to insurance programs:			
Military retirement fund	11,908	11,470	12,102
Supplementary medical insurance	38,355	36,955	62,122
Hospital insurance	2,247	4,508	5,461
Railroad social security equivalent fund	3,075	3,153	3,223
Rail industry pension fund	384	178	200
Civilian supplementary retirement contributions	20,029	20,494	20,797
Unemployment insurance	3,321	1,311	736
National separation liability	104	91	87
Other	520	582	941
Miscellaneous payments:			
Other	546	611	564
Subtotal	80,489	79,352	106,233
Trust fund payments to Federal funds:			
Repayment of loans or advances to trust funds	2,921	3,024	3,846
Charges for services to trust funds	241	327	320
Quinquennial adjustment for military service credits	.....	.....	1,514
Interest payments to Treasury	.....	.....	18
Other	620	634	703
Subtotal	3,782	3,984	6,401
Total interfunds distributed by agency	84,272	83,337	112,634
Undistributed by agency:			
Employer share, employee retirement (on-budget): [2]			
Civil service retirement and disability insurance	7,892	7,693	7,770
CSRDI from Postal Service	5,114	5,493	5,499
Hospital insurance (contribution as employer) [1]	1,926	1,890	1,955
Postal employer contributions to FHI	514	562	590
Military retirement fund	12,808	12,130	11,123
Other Federal employees retirement	107	118	125
Total employer share, employee retirement (on-budget)	28,361	27,885	27,063
Interest received by on-budget trust funds	56,494	57,889	60,031
Total interfund transactions undistributed by agency	84,855	85,773	87,094
Total interfund transactions	169,127	169,110	199,729
Total on-budget receipts	184,868	184,027	213,579
Off-budget receipts:			
Interfund transactions:			
Distributed by agency:			
Federal fund payments to trust funds:			
Old-age, survivors, and disability insurance	5,678	4,858	6,706
Undistributed by agency:			
Employer share, employee retirement (off-budget)	6,409	6,441	6,864
Interest received by off-budget trust funds	29,203	33,576	38,102
Total off-budget receipts:	41,290	44,875	51,672
Total intragovernmental transactions	**226,158**	**228,902**	**265,251**
PROPRIETARY RECEIPTS FROM THE PUBLIC			
Distributed by agency:			
Interest:			
Interest on loans, Foreign Assistance Act	328	275	264
Other interest on foreign loans and deferred foreign collections	639	634	610
Interest on deposits in tax and loan accounts	634	960	1,000
Other interest (domestic—civil) [3]	1,132	1,706	2,968
Total interest	2,734	3,575	4,842
Rents:			
Rent and bonuses from land leases, etc	132	11	11
Rent of land and other real property	−12	80	88
Rent of equipment and other personal property	3	8	8
Total rents	123	100	107
Royalties	1,062	1,126	1,151
Sale of products:			
Sale of timber and other natural land products	771	743	755
Sale of minerals and mineral products	412	459	571
Sale of power and other utilities	758	829	828
Sale of other products [3]	22	54	44
Recovery of mint manufacturing expense	53	62	.....
Total sale of products	2,017	2,147	2,199
Fees and other charges for services and special benefits:			
Medicare premiums and other charges (trust funds)	17,747	20,122	20,197
Revenues for enrichment of uranium	9	.....	.....
Nuclear waste disposal revenues	396	555	591
Veterans life insurance (trust funds)	335	296	287
Other [3]	1,714	2,008	2,316
Total fees and other charges	20,202	22,981	23,390
Sale of Government property:			
Sale of land and other real property [3]	23	15	15
Sale of equipment and other personal property:			
Military assistance program sales (trust funds)	13,036	13,350	13,370

TABLE 4–3. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	1994 actual	1995 estimate	1996 estimate
Sale of scrap and salvage material	2	.....	.....
Total sale of Government property	13,060	13,365	13,385
Realization upon loans and investments:			
Dollar repayments of loans, Agency for International Development	540	547	532
Foreign military credit sales	545	566	655
Negative loan subsidies	926	567	872
Downward reestimates of subsidies	428	78	.....
Dollar conversion of foreign currency	23	23	23
Repayment of loans to United Kingdom	102	104	106
Other	220	176	171
Total realization upon loans and investments	2,783	2,061	2,359
Recoveries and refunds [3]	1,545	1,698	2,058
Miscellaneous receipt accounts [3]	2,477	1,493	1,454
Total proprietary receipts from the public distributed by agency	46,004	48,546	50,945
Undistributed by agency:			
Other interest: Interest received from Outer Continental Shelf escrow account	*	.....	993
Rents and royalties on the Outer Continental Shelf:			
Rents and bonuses	509	212	636
Royalties	2,493	2,480	2,400
Sale of major assets	.....	.....	885
Total proprietary receipts from the public undistributed by agency	3,002	2,692	4,914
Total proprietary receipts from the public undistributed by agency [4]	**49,006**	**51,238**	**55,859**
OFFSETTING GOVERNMENTAL RECEIPTS			
Distributed by agency:			
Defense cooperation	*	.....	.....
Other	2,131	2,407	2,766
Undistributed by agency:			
Spectrum auction proceeds	.....	4,375	4,575
Total offsetting governmental receipts	2,131	6,782	7,341
Total offsetting receipts	**277,296**	**286,921**	**328,451**

*$500 thousand or less.

[1] Interchange receipts between the social security and railroad retirement funds place the social security funds in the same position they would have been if there were no separate railroad retirement system.

[2] Includes provision for covered Federal civilian employees and military personnel.

[3] Includes both Federal funds and trust funds.

[4] Consists of:

	1994 actual	*1995 estimate*	*1996 estimate*
On-budget:			
Federal funds	16,720	16,225	20,708
Trust funds	32,274	35,000	35,139
Off-budget:			
Trust funds	11	12	12

ASSET SALES

The budget proposes the sale of a number of real assets. As shown in Table 4–4, the estimated gross proceeds from these sales is $9.1 billion. A provision in the Balanced Budget and Emergency Deficit Control Act of 1985 generally prohibits counting the proceeds of asset sales as offsets to spending. However, the budget proposes an exemption to the prohibition for these proposals. The legislation to implement each of these proposals will include a provision to allow the proceeds to be counted as offsets to spending if the President and Congress designate that they should be so counted.

Table 4–4 itemizes each asset sale proposal. It details gross proceeds, changes in offsetting collections as a result of selling the asset, administrative savings after the asset is sold, and the resulting net proceeds.

The Administration plans to privatize four Power Marketing Administrations (PMAs), the Naval Petroleum Reserves (NPR), the United States Enrichment Corporation (USEC), and the Helium Fund. In addition, it plans to sell excess uranium and a portion of the Strategic Petroleum Reserve (SPR). Proceeds from the sale of USEC will be earmarked for the Nuclear Waste Disposal Fund. SPR proceeds will be earmarked for the decommissioning of the Strategic Petroleum Reserve Weeks Island, Louisiana, site.

TABLE 4–4. PROCEEDS FROM PROPOSED ASSET SALES [1]

(in millions of dollars)

	1996	1997	1998	1999	2000	5-year total
Helium Fund:						
Gross proceeds from asset sale, mandatory	–4	–4	–4	–4	–4	–20
Loss of offsetting collections, mandatory	.....	9	9	9	9	36
Net proceeds [2]	–4	5	5	5	5	16
Excess uranium:						
Gross proceeds from asset sale, mandatory	–400	.....	.....	.....	.....	–400
Naval Petroleum Reserves (NPR):						
Gross proceeds, mandatory	.....	–2,600	.....	.....	.....	–2,600
Loss of offsetting collections, mandatory	.....	448	439	417	395	1,699
Administrative savings, discretionary	.....	–145	–185	–179	–166	–675
Net proceeds	.....	–2,297	254	238	229	–1,576
Power Marketing Administrations (PMAs):						
Gross proceeds from asset sale, mandatory	–85	–909	–3,475	.....	.....	–4,469
Loss of offsetting collections, mandatory	.....	11	182	672	679	1,543
Administrative savings, discretionary	.....	–4	–32	–359	–360	–755
Net proceeds	–85	–902	–3,325	313	319	–3,681
Strategic Petroleum Reserve (SPR):						
Gross proceeds from asset sale, discretionary	–100	.....	.....	.....	.....	–100
United States Enrichment Corporation (USEC):						
Gross proceeds from asset sale, mandatory	–400	–1,100	.....	.....	.....	–1,500
Loss of offsetting collections and mandatory costs	150	8	–10	–88	–159	–99
Administrative savings, discretionary	.....	.....	.....	.....	.....	.....
Net proceeds	–250	–1,092	–10	–88	–159	–1,599
Total gross proceeds from asset sales:						
Discretionary	–100	.....	.....	.....	.....	–100
Mandatory	–889	–4,604	–3,470	5	5	–8,953
Grand total of gross proceeds	**–989**	**–4,604**	**–3,470**	**5**	**5**	**–9,053**
Total loss of offsetting collections and mandatory costs	146	472	616	1,006	920	3,159
Total administrative savings, discretionary	.....	–149	–217	–538	–526	–1,430
Total net proceeds:						
Discretionary	–100	–149	–217	–538	–526	–1,530
Mandatory	–743	–4,132	–2,854	1,011	925	–5,794
Grand total	**–843**	**–4,281**	**–3,071**	**473**	**399**	**–7,324**

[1] All sales are part of Reinventing Government except USEC.
[2] Amounts do not include estimates of discretionary savings resulting from Federal agencies being authorized to purchase refined helium in the private market.

5. TAX EXPENDITURES

Tax expenditures are revenue losses due to preferential provisions of the Federal tax laws, such as special exclusions, exemptions, deductions, credits, deferrals, or tax rates. Tax expenditures are an alternative to other Government policy instruments, such as direct expenditures and regulations. The Congressional Budget Act of 1974 (Public Law 93–344) requires that a list of tax expenditures be included in the budget.

Tax expenditures relating to the individual and corporate income taxes are considered first in this chapter, followed by those relating to the unified transfer tax. The supplement at the end of the chapter presents major tax expenditures in the income tax ranked by revenue loss.

Tax expenditures are estimated for fiscal years 1994–2000 using three methods of accounting: revenue loss, outlay equivalent, and present value. The present value approach provides estimates of the revenue losses for tax expenditures that involve deferrals of tax payments into the future or have similar long-term effects.

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

The Treasury Department prepared all tax expenditure estimates presented here based upon income tax law enacted as of December 31, 1994. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity in years before 1994.

The total revenue loss estimates for tax expenditures for fiscal years 1994–2000 are displayed by the budget's functional categories in table 5–1. Descriptions of the specific tax expenditure provisions follow the tables of estimates and discussion of general features of the tax expenditure concept.

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

Table 5–2 reports the respective portions of the total revenue losses that arise under the individual and corporate income taxes. Listing revenue loss estimates under the individual and corporate headings does not imply that these categories of filers benefit from the special tax provisions in proportion to the respective tax expenditure amounts shown. Rather, these breakdowns show the specific tax accounts through which the various provisions are cleared. The ultimate beneficiaries of corporate tax expenditures, for example, could be stockholders, employees, customers, or others, depending on the circumstances.

Table 5–6 at the end of this chapter ranks the major tax expenditures by fiscal year 1996 revenue loss. This table merges several individual entries provided in table 5–1; for example, table 5–6 contains one merged entry for charitable contributions instead of the three separate entries found in table 5–1.

TABLE 5–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX

(In millions of dollars)

Provision	Total Revenue Loss							
	1994	1995	1996	1997	1998	1999	2000	1996–2000
National defense:								
Exclusion of benefits and allowances to armed forces personnel	2,000	2,005	2,020	2,030	2,045	2,065	2,085	10,245
International affairs:								
Exclusion of income earned abroad by United States citizens	1,900	2,010	2,125	2,250	2,385	2,525	2,670	11,955
Exclusion of income of foreign sales corporations	1,300	1,400	1,500	1,600	1,700	1,800	1,900	8,500
Inventory property sales source rules exception	1,200	1,300	1,400	1,500	1,600	1,700	1,800	8,000
Interest allocation rules exception for certain financial operations	95	95	95	95	95	95	95	475
Deferral of income from controlled foreign corporations (normal tax method)	1,600	1,700	1,800	2,000	2,200	2,400	2,600	11,000
General science, space, and technology:								
Expensing of research and experimentation expenditures (normal tax method)	2,235	2,390	2,560	2,735	2,930	3,135	3,355	14,715
Credit for increasing research activities	1,370	1,185	675	285	120	40	5	1,125
Suspension of the allocation of research and experimentation expenditures	325	325	.....	.....	.....	.....	.....	.....
Energy:								
Expensing of exploration and development costs:								
Oil and gas	–85	–70	–20	–50	85	165	215	395
Other fuels	15	15	20	20	20	20	20	100
Excess of percentage over cost depletion:								
Oil and gas	785	920	955	1,005	1,060	1,115	1,170	5,305
Other fuels	90	90	95	105	110	120	125	555
Alternative fuel production credit	900	970	1,000	990	940	880	820	4,630
Exception from passive loss limitation for working interests in oil and gas properties	90	100	110	120	130	145	160	665
Capital gains treatment of royalties on coal	10	15	15	15	15	15	15	75
Exclusion of interest on State and local IDBs for energy facilities	175	175	175	175	175	165	165	855
Enhanced oil recovery credit	85	85	80	80	80	75	75	390
New technology credit	60	95	115	125	135	140	150	665
Alcohol fuel credit [1]	15	35	45	50	50	50	50	245
Tax credit and deduction for clean-fuel burning vehicles and properties	50	65	65	65	75	80	85	370
Exclusion from income of conservation subsidies provided by public utilities	100	145	175	190	190	200	200	955
Natural resources and environment:								
Expensing of exploration and development costs, nonfuel minerals	45	45	45	45	50	50	50	240
Excess of percentage over cost depletion, nonfuel minerals	185	185	190	195	200	205	210	1,000
Capital gains treatment of iron ore	*	*	*	*	*	*	*	*
Special rules for mining reclamation reserves	50	50	50	50	50	50	50	250
Exclusion of interest on State and local IDBs for pollution control and sewage and waste disposal facilities	610	625	615	600	585	565	550	2,915
Capital gains treatment of certain timber income	10	15	15	15	15	15	15	75
Expensing of multiperiod timber growing costs	350	370	395	415	440	460	485	2,195
Investment credit and seven-year amortization for reforestation expenditures	40	40	40	45	45	50	50	230
Tax incentives for preservation of historic structures	130	125	125	120	115	115	110	585
Agriculture:								
Expensing of certain capital outlays	70	70	65	65	65	70	70	335
Expensing of certain multiperiod production costs	85	85	80	80	80	85	85	410
Treatment of loans forgiven solvent farmers as if insolvent	10	10	10	10	10	10	10	50
Capital gains treatment of certain income	120	125	125	160	135	140	140	700
Commerce and housing:								
Financial institutions and insurance:								
Exemption of credit union income	765	855	940	1,035	1,140	1,255	1,380	5,750
Excess bad debt reserves of financial institutions	50	55	60	65	70	75	80	350
Exclusion of interest on life insurance savings	9,410	10,365	11,160	12,000	12,900	13,870	14,910	64,840
Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25
Tax exemption of certain insurance companies	225	235	240	245	255	260	280	1,280
Small life insurance company deduction	110	110	115	120	130	135	140	640
Housing:								
Exclusion of interest on owner-occupied mortgage subsidy bonds	1,760	1,785	1,775	1,715	1,640	1,575	1,510	8,215
Exclusion of interest on State and local debt for rental housing	970	920	870	810	750	685	635	3,750
Deductibility of mortgage interest on owner-occupied homes	48,430	51,270	54,165	57,240	60,490	63,960	67,495	303,350
Deductibility of State and local property tax on owner-occupied homes	14,020	14,845	15,680	16,570	17,515	18,520	19,540	87,825
Deferral of income from post 1987 installment sales	915	935	950	965	980	995	1,010	4,900
Deferral of capital gains on home sales	16,640	17,140	17,850	18,180	18,725	19,290	19,870	93,915
Exclusion of capital gains on home sales for persons age 55 and over	4,690	4,820	4,920	5,010	5,070	5,125	5,120	25,245
Exception from passive loss rules for $25,000 of rental loss	4,765	4,255	4,170	4,120	4,085	4,065	4,055	20,495
Accelerated depreciation on rental housing (normal tax method)	1,145	1,290	1,425	1,580	1,735	1,895	2,055	8,690
Commerce:								
Cancellation of indebtedness	125	115	75	40	15	*	–10	120
Permanent exceptions from imputed interest rules	150	150	150	155	155	160	160	780

TABLE 5–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

Provision	Total Revenue Loss							
	1994	1995	1996	1997	1998	1999	2000	1996–2000
Capital gains (other than agriculture, timber, iron ore, and coal) (normal tax method)	5,745	6,135	6,205	6,335	6,545	6,710	6,865	32,660
Capital gains exclusion of small corporation stock	*	*	*	*	*	30	250	280
Step-up basis of capital gains at death	26,850	28,305	29,480	30,285	30,710	31,160	31,615	153,250
Carryover basis of capital gains on gifts	125	130	135	140	145	150	155	725
Ordinary income treatment of loss from small business corporation stock sale	30	30	35	35	35	35	40	180
Accelerated depreciation of buildings other than rental housing (normal tax method)	5,145	4,920	4,385	3,580	2,675	1,745	1,080	13,465
Accelerated depreciation of machinery and equipment (normal tax method)	17,620	19,400	20,850	21,885	23,215	25,815	28,295	120,060
Expensing of certain small investments (normal tax method)	1,690	1,335	1,070	815	585	425	295	3,190
Amortization of start-up costs (normal tax method)	185	185	190	195	200	200	200	985
Graduated corporation income tax rate (normal tax method)	3,775	3,960	4,120	4,240	4,360	4,510	4,760	21,990
Exclusion of interest on small issue IDBs	690	545	420	325	280	255	230	1,510
Deferral of gains from sale of broadcasting facilities to minority owned business	285	300	315	330	345	360	380	1,730
Treatment of Alaska Native Corporations	45	30	20	15	10	5	5	55
Transportation:								
Deferral of tax on shipping companies	15	15	15	15	15	15	15	75
Exclusion of reimbursed employee parking expenses	1,845	1,930	2,015	2,100	2,190	2,275	2,365	10,945
Exclusion for employer-provided transit passes	30	40	50	65	80	95	110	400
Community and regional development:								
Credit for low-income housing investments	1,925	2,260	2,600	2,945	3,270	3,500	3,560	15,875
Investment credit for rehabilitation of structures (other than historic)	90	80	80	80	70	70	70	370
Exclusion of interest on IDBs for airports, docks, and sports and convention facilities	785	830	870	915	960	1,005	1,050	4,800
Exemption of certain mutuals' and cooperatives' income	25	30	30	30	35	35	40	170
Empowerment zones	*	330	440	510	565	595	630	2,740
Education, training, employment, and social services:								
Education:								
Exclusion of scholarship and fellowship income (normal tax method)	795	825	835	845	850	860	870	4,260
Exclusion of interest on State and local student loan bonds	310	305	295	275	255	240	225	1,290
Exclusion of interest on State and local debt for private nonprofit educational facilities	735	750	770	785	810	845	885	4,095
Exclusion of interest on savings bonds transferred to educational institutions	5	5	5	10	10	15	15	55
Parental personal exemption for students age 19 or over	800	815	825	855	895	930	965	4,470
Deductibility of charitable contributions (education)	1,610	1,705	1,810	1,915	2,025	2,140	2,265	10,155
Exclusion of employer provided educational assistance	235	85	.....	.....	.....	.....	.....	.....
Training, employment, and social services:								
Targeted jobs credit	305	395	325	60	40	10	5	440
Exclusion of employer provided child care	675	725	775	830	890	955	1,025	4,475
Exclusion of employee meals and lodging (other than military)	515	545	575	605	640	675	710	3,205
Credit for child and dependent care expenses	2,820	2,900	2,995	3,060	3,135	3,195	3,245	15,630
Credit for disabled access expenditures	160	160	160	165	165	165	170	825
Expensing of costs of removing certain architectural barriers to the handicapped	20	20	20	20	20	20	20	100
Deductibility of charitable contributions, other than education and health	17,805	18,910	19,995	21,135	22,325	23,515	24,945	111,915
Exclusion of certain foster care payments	30	30	35	35	40	40	40	190
Exclusion of parsonage allowances	250	265	285	300	320	345	365	1,615
Health:								
Exclusion of employer contributions for medical insurance premiums and medical care	56,000	60,670	66,620	72,300	78,815	86,245	94,110	398,090
Deductibility of medical expenses	3,380	3,660	3,965	4,295	4,650	5,035	5,455	23,400
Exclusion of interest on State and local debt for private nonprofit health facilities	1,455	1,495	1,535	1,585	1,640	1,700	1,750	8,210
Deductibility of charitable contributions (health)	2,085	2,210	2,340	2,490	2,630	2,750	2,900	13,110
Tax credit for orphan drug research	*	15	.....	.....	.....	.....	.....	.....
Special Blue Cross/Blue Shield deduction	115	125	140	100	170	185	190	785
Income security:								
Exclusion of railroad retirement system benefits	425	425	425	430	435	440	440	2,170
Exclusion of workmen's compensation benefits	4,240	4,475	4,860	5,120	5,380	5,645	5,950	26,955
Exclusion of public assistance benefits (normal tax method)	530	570	590	635	695	740	795	3,455
Exclusion of special benefits for disabled coal miners	100	95	90	85	85	80	75	415
Exclusion of military disability pensions	130	130	130	130	130	130	130	650
Net exclusion of pension contributions and earnings:								
Employer plans	48,750	55,540	59,010	59,490	59,950	60,400	60,850	299,700
Individual Retirement Accounts	5,185	6,245	6,375	6,120	5,675	4,970	3,950	27,090
Keogh plans	3,915	4,435	4,825	5,195	5,595	6,025	6,485	28,125
Exclusion of employer provided death benefits	30	30	35	35	35	40	40	185
Exclusion of other employee benefits:								
Premiums on group term life insurance	2,750	2,880	3,020	3,170	3,325	3,485	3,660	16,660
Premiums on accident and disability insurance	140	150	155	165	175	185	195	875
Income of trusts to finance supplementary unemployment benefits	35	35	35	35	35	35	35	175
Special ESOP rules (other than investment credit)	2,155	1,830	1,680	1,575	1,440	1,310	1,190	7,195
Additional deduction for the blind	30	35	35	35	35	40	40	185

TABLE 5–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

Provision	Total Revenue Loss							
	1994	1995	1996	1997	1998	1999	2000	1996–2000
Additional deduction for the elderly	1,470	1,490	1,510	1,520	1,535	1,540	1,550	7,655
Tax credit for the elderly and disabled	55	55	60	60	65	65	70	320
Deductibility of casualty losses	715	450	315	315	315	315	315	1,575
Earned income credit [2]	4,020	5,110	5,740	6,440	6,715	7,025	7,325	33,245
Social Security:								
Exclusion of social security benefits:								
OASI benefits for retired workers	18,295	16,875	17,395	18,110	18,935	19,840	20,605	94,885
Disability insurance benefits	1,815	1,895	2,100	2,300	2,520	2,750	2,980	12,650
Benefits for dependents and survivors	3,620	3,610	3,730	3,940	4,150	4,365	4,590	20,775
Veterans benefits and services:								
Exclusion of veterans disability compensation	1,910	1,985	1,930	1,975	2,115	2,180	2,245	10,445
Exclusion of veterans pensions	80	75	70	70	75	80	90	385
Exclusion of GI bill benefits	55	70	75	80	85	90	95	425
Exclusion of interest on State and local debt for veterans housing	90	85	80	75	75	75	75	380
General purpose fiscal assistance:								
Exclusion of interest on public purpose State and local debt	11,970	12,350	12,690	13,085	13,535	14,040	14,590	67,940
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	25,745	27,250	28,795	30,425	32,155	34,000	35,880	161,255
Tax credit for corporations receiving income from doing business in U.S. possessions	2,890	2,630	2,680	2,735	2,815	2,960	3,110	14,300
Interest:								
Deferral of interest on savings bonds	1,250	1,360	1,470	1,600	1,730	1,880	2,040	8,720
Addendum—Aid to State and local governments:								
Deductibility of:								
Property taxes on owner-occupied homes	14,020	14,845	15,680	16,570	17,515	18,520	19,540	87,825
Nonbusiness State and local taxes other than on owner-occupied homes	25,745	27,250	28,795	30,425	32,155	34,000	35,880	161,255
Exclusion of interest on:								
Public purpose State and local debt	11,970	12,350	12,690	13,085	13,535	14,040	14,590	67,940
IDBs for certain energy facilities	175	175	175	175	175	165	165	855
IDBs for pollution control and sewage and waste disposal facilities	610	625	615	600	585	565	550	2,915
Small-issue IDBs	690	545	420	325	280	255	230	1,510
Owner-occupied mortgage revenue bonds	1,760	1,785	1,775	1,715	1,640	1,575	1,510	8,215
State and local debt for rental housing	970	920	870	810	750	685	635	3,750
IDBs for airports, docks, and sports and convention facilities	785	830	870	915	960	1,005	1,050	4,800
State and local student loan bonds	310	305	295	275	255	240	225	1,290
State and local debt for private nonprofit educational facilities	735	750	770	785	810	845	885	4,095
State and local debt for private nonprofit health facilities	1,455	1,495	1,535	1,585	1,640	1,700	1,750	8,210
State and local debt for veterans housing	90	85	80	75	75	75	75	380

* $2.5 million or less.

[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts for fiscal year 1996 of $725 million.

[2] The effect on outlays (in millions of dollars) is as follows: $10,990 in 1994; $16,845 in 1995; $20,230 in 1996; $22,755 in 1997; $23,850 in 1998; $25,000 in 1999; amd $26,035 in 2000.

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

All estimates have been rounded to the nearest $5 million. Totals for fiscal years 1996–2000 are computed after rounding for these years.

Figures in Table 5–1 are the arithmetic sums of corporate and individual income tax revenue loss estimates from table 5–2, and do not reflect possible interactions across these two taxes.

TABLE 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES

(In millions of dollars)

Provision	Revenue Loss													
	Corporations							Individuals						
	1994	1995	1996	1997	1998	1999	2000	1994	1995	1996	1997	1998	1999	2000
National defense:														
Exclusion of benefits and allowances to armed forces personnel	.....	.....	.....	.....	.....	.....	.....	2,000	2,005	2,020	2,030	2,045	2,065	2,085
International affairs:														
Exclusion of income earned abroad by United States citizens	.....	.....	.....	.....	.....	.....	.....	1,900	2,010	2,125	2,250	2,385	2,525	2,670
Exclusion of income of foreign sales corporations	1,300	1,400	1,500	1,600	1,700	1,800	1,900	.....	.....	.....	.....	.....	.....	.....
Inventory property sales source rules exception	1,200	1,300	1,400	1,500	1,600	1,700	1,800	.....	.....	.....	.....	.....	.....	.....
Interest allocation rules exception for certain financial operations	95	95	95	95	95	95	95	.....	.....	.....	.....	.....	.....	.....
Deferral of income from controlled foreign corporations (normal tax method)	1,600	1,700	1,800	2,000	2,200	2,400	2,600	.....	.....	.....	.....	.....	.....	.....
General science, space, and technology:														
Expensing of research and experimentation expenditures (normal tax method)	2,195	2,345	2,510	2,685	2,875	3,075	3,290	40	45	50	50	55	60	65
Credit for increasing research activities	1,340	1,155	665	285	120	40	5	30	30	10	.....	.....	.....	.....
Suspension of the allocation of research and experimentation expenditures	325	325	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Energy:														
Expensing of exploration and development costs:														
Oil and gas	–80	–60	–25	–50	70	135	175	–5	–10	5	*	15	30	40
Other fuels	10	10	15	15	15	15	15	5	5	5	5	5	5	5
Excess of percentage over cost depletion:														
Oil and gas	500	620	645	680	715	755	790	285	300	310	325	345	360	380
Other fuels	85	85	90	100	105	115	120	5	5	5	5	5	5	5
Alternative fuel production credit	760	820	850	840	800	750	700	140	150	150	150	140	130	120
Exception from passive loss limitation for working interests in oil and gas properties	.....	.....	.....	.....	.....	.....	.....	90	100	110	120	130	145	160
Capital gains treatment of royalties on coal	.....	.....	.....	.....	.....	.....	.....	10	15	15	15	15	15	15
Exclusion of interest on State and local IDBs for energy facilities	70	70	70	70	70	65	65	105	105	105	105	105	100	100
Enhanced oil recovery credit	80	80	75	75	75	70	70	5	5	5	5	5	5	5
New technology credit	60	95	115	125	135	140	150	*	*	*	*	*	*	*
Alcohol fuel credit [1]	5	5	5	5	5	5	5	10	30	40	45	45	45	45
Tax credit and deduction for clean-fuel burning vehicles and properties	45	55	55	55	60	60	60	5	10	10	10	15	20	25
Exclusion from income of conservation subsidies provided by public utilities	45	85	110	120	120	125	125	55	60	65	70	70	75	75
Natural resources and environment:														
Expensing of exploration and development costs, nonfuel minerals	35	35	35	35	40	40	40	10	10	10	10	10	10	10
Excess of percentage over cost depletion, nonfuel minerals	165	165	170	175	180	185	190	20	20	20	20	20	20	20
Capital gains treatment of iron ore	.....	.....	.....	.....	.....	.....	.....	*	*	*	*	*	*	*
Special rules for mining reclamation reserves	45	45	45	45	45	45	45	5	5	5	5	5	5	5
Exclusion of interest on State and local IDBs for pollution control and sewage and waste disposal facilities	245	250	245	240	235	225	220	365	375	370	360	350	340	330
Capital gains treatment of certain timber income	.....	.....	.....	.....	.....	.....	.....	10	15	15	15	15	15	15
Expensing of multiperiod timber growing costs	200	210	225	235	250	260	275	150	160	170	180	190	200	210
Investment credit and seven-year amortization for reforestation expenditures	15	15	15	20	20	20	20	25	25	25	25	25	30	30
Tax incentives for preservation of historic structures	25	25	25	25	25	25	20	105	100	100	95	90	90	90
Agriculture:														
Expensing of certain capital outlays	10	10	10	10	10	10	10	60	60	55	55	55	60	60
Expensing of certain multiperiod production costs	10	10	10	10	10	10	10	75	75	70	70	70	75	75
Treatment of loans forgiven solvent farmers as if insolvent	.....	.....	.....	.....	.....	.....	.....	10	10	10	10	10	10	10
Capital gains treatment of certain income	.....	.....	.....	.....	.....	.....	.....	120	125	125	160	135	140	140
Commerce and housing:														
Financial institutions and insurance:														
Exemption of credit union income	765	855	940	1,035	1,140	1,255	1,380	.....	.....	.....	.....	.....	.....	.....
Excess bad debt reserves of financial institutions	50	55	60	65	70	75	80	.....	.....	.....	.....	.....	.....	.....
Exclusion of interest on life insurance savings	265	290	310	335	360	390	415	9,145	10,075	10,850	11,665	12,540	13,480	14,495
Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	.....	.....	.....	.....	.....	.....	.....
Tax exemption of certain insurance companies	225	235	240	245	255	260	280	.....	.....	.....	.....	.....	.....	.....
Small life insurance company deduction	110	110	115	120	130	135	140	.....	.....	.....	.....	.....	.....	.....
Housing:														
Exclusion of interest on owner-occupied mortgage subsidy bonds	705	715	705	680	650	625	600	1,055	1,070	1,070	1,035	990	950	910
Exclusion of interest on State and local debt for rental housing	385	365	345	320	295	270	255	585	555	525	490	455	415	380
Deductibility of mortgage interest on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	48,430	51,270	54,165	57,240	60,490	63,960	67,495

TABLE 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

Provision	Revenue Loss													
	Corporations							Individuals						
	1994	1995	1996	1997	1998	1999	2000	1994	1995	1996	1997	1998	1999	2000
Deductibility of State and local property tax on owner-occupied homes	...	...	...	...	...	...	...	14,020	14,845	15,680	16,570	17,515	18,520	19,540
Deferral of income from post 1987 installment sales	225	235	240	245	250	255	260	690	700	710	720	730	740	750
Deferral of capital gains on home sales	...	...	...	...	...	...	...	16,640	17,140	17,850	18,180	18,725	19,290	19,870
Exclusion of capital gains on home sales for persons age 55 and over	...	...	...	...	...	...	...	4,690	4,820	4,920	5,010	5,070	5,125	5,120
Exception from passive loss rules for $25,000 of rental loss	...	...	...	...	...	...	...	4,765	4,255	4,170	4,120	4,085	4,065	4,055
Accelerated depreciation on rental housing (normal tax method)	705	795	880	975	1,070	1,170	1,270	440	495	545	605	665	725	785
Commerce:														
Cancellation of indebtedness	...	...	...	...	...	...	...	125	115	75	40	15	*	–10
Permanent exceptions from imputed interest rules	...	...	...	...	...	...	...	150	150	150	155	155	160	160
Capital gains (other than agriculture, timber, iron ore, and coal) (normal tax method)	...	...	...	...	...	...	...	5,745	6,135	6,205	6,335	6,545	6,710	6,865
Capital gains exclusion of small corporation stock	...	...	...	...	...	...	...	*	*	*	*	*	30	250
Step-up basis of capital gains at death	...	...	...	...	...	...	...	26,850	28,305	29,480	30,285	30,710	31,160	31,615
Carryover basis of capital gains on gifts	...	...	...	...	...	...	...	125	130	135	140	145	150	155
Ordinary income treatment of loss from small business corporation stock sale	...	...	...	...	...	...	...	30	30	35	35	35	35	40
Accelerated depreciation of buildings other than rental housing (normal tax method)	3,495	3,320	2,975	2,440	1,840	1,225	775	1,650	1,600	1,410	1,140	835	520	305
Accelerated depreciation of machinery and equipment (normal tax method)	14,765	16,120	17,105	17,815	18,830	20,805	22,480	2,855	3,280	3,745	4,070	4,385	5,010	5,815
Expensing of certain small investments (normal tax method)	1,035	825	665	510	370	280	210	655	510	405	305	215	145	85
Amortization of start-up costs (normal tax method)	85	85	85	90	90	90	90	100	100	105	105	110	110	110
Graduated corporation income tax rate (normal tax method)	3,775	3,960	4,120	4,240	4,360	4,510	4,760	...	...	...	...	...	...	...
Exclusion of interest on small issue IDBs	265	210	160	125	110	100	90	425	335	260	200	170	155	140
Deferral of gains from sale of broadcasting facilities to minority owned business	285	300	315	330	345	360	380	*	*	*	*	*	*	*
Treatment of Alaska Native Corporations	45	30	20	15	10	5	5	...	...	...	...	...	...	...
Transportation:														
Deferral of tax on shipping companies	15	15	15	15	15	15	15	...	...	...	...	...	...	...
Exclusion of reimbursed employee parking expenses	...	...	...	...	...	...	...	1,845	1,930	2,015	2,100	2,190	2,275	2,365
Exclusion for employer-provided transit passes	...	...	...	...	...	...	...	30	40	50	65	80	95	110
Community and regional development:														
Credit for low-income housing investments	385	450	520	590	655	700	710	1,540	1,810	2,080	2,355	2,615	2,800	2,850
Investment credit for rehabilitation of structures (other than historic)	20	15	15	15	15	15	15	70	65	65	65	55	55	55
Exclusion of interest on IDBs for airports, docks, and sports and convention facilities	315	335	350	370	385	405	425	470	495	520	545	575	600	625
Exemption of certain mutuals' and cooperatives' income	25	30	30	30	35	35	40	...	...	...	...	...	...	...
Empowerment zones	...	95	130	155	175	185	195	*	235	310	355	390	410	435
Education, training, employment, and social services:														
Education:														
Exclusion of scholarship and fellowship income (normal tax method)	...	...	...	...	...	...	...	795	825	835	845	850	860	870
Exclusion of interest on State and local student loan bonds	125	120	115	110	100	95	90	185	185	180	165	155	145	135
Exclusion of interest on State and local debt for private nonprofit educational facilities	295	300	310	315	325	340	360	440	450	460	470	485	505	525
Exclusion of interest on savings bonds transferred to educational institutions	...	...	...	...	...	...	...	5	5	5	10	10	15	15
Parental personal exemption for students age 19 or over	...	...	...	...	...	...	...	800	815	825	855	895	930	965
Deductibility of charitable contributions (education)	160	170	180	190	200	210	220	1,450	1,535	1,630	1,725	1,825	1,930	2,045
Exclusion of employer provided educational assistance	...	...	...	...	...	...	...	235	85	...	...	...	...	...
Training, employment, and social services:														
Targeted jobs credit	260	320	270	50	30	5	5	45	75	55	10	10	5	*
Exclusion of employer provided child care	...	...	...	...	...	...	...	675	725	775	830	890	955	1,025
Exclusion of employee meals and lodging (other than military)	...	...	...	...	...	...	...	515	545	575	605	640	675	710
Credit for child and dependent care expenses	...	...	...	...	...	...	...	2,820	2,900	2,995	3,060	3,135	3,195	3,245
Credit for disabled access expenditures	130	130	130	130	130	130	135	30	30	30	35	35	35	35
Expensing of costs of removing certain architectural barriers to the handicapped	15	15	15	15	15	15	15	5	5	5	5	5	5	5
Deductibility of charitable contributions, other than education and health	4,570	4,895	5,160	5,425	5,690	5,910	6,320	13,235	14,015	14,835	15,710	16,635	17,605	18,625
Exclusion of certain foster care payments	...	...	...	...	...	...	...	30	30	35	35	40	40	40
Exclusion of parsonage allowances	...	...	...	...	...	...	...	250	265	285	300	320	345	365

TABLE 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

Provision	Revenue Loss													
	Corporations							Individuals						
	1994	1995	1996	1997	1998	1999	2000	1994	1995	1996	1997	1998	1999	2000
Health:														
Exclusion of employer contributions for medical insurance premiums and medical care	...	...	...	...	...	...	...	56,000	60,670	66,620	72,300	78,815	86,245	9,410
Deductibility of medical expenses	...	...	...	...	...	...	...	3,380	3,660	3,965	4,295	4,650	5,035	5,455
Exclusion of interest on State and local debt for private nonprofit health facilities	585	600	615	635	660	685	700	870	895	920	950	980	1,015	1,050
Deductibility of charitable contributions (health)	605	640	680	710	750	780	825	1,480	1,570	1,660	1,780	1,880	1,970	2,075
Tax credit for orphan drug research	*	15	...	...	...	...	...	...	...	...	...	...	...	...
Special Blue Cross/Blue Shield deduction	115	125	140	100	170	185	190	...	...	...	...	...	...	...
Income security:														
Exclusion of railroad retirement system benefits	...	...	...	...	...	...	...	425	425	425	430	435	440	440
Exclusion of workmen's compensation benefits	...	...	...	...	...	...	...	4,240	4,475	4,860	5,120	5,380	5,645	5,950
Exclusion of public assistance benefits (normal tax method)	...	...	...	...	...	...	...	530	570	590	635	695	740	795
Exclusion of special benefits for disabled coal miners	...	...	...	...	...	...	...	100	95	90	85	85	80	75
Exclusion of military disability pensions	...	...	...	...	...	...	...	130	130	130	130	130	130	130
Net exclusion of pension contributions and earnings:														
Employer plans	...	...	...	...	...	...	...	48,750	55,540	59,010	59,490	59,950	60,400	60,850
Individual Retirement Accounts	...	...	...	...	...	...	...	5,185	6,245	6,375	6,120	5,675	4,970	3,950
Keogh plans	...	...	...	...	...	...	...	3,915	4,435	4,825	5,195	5,595	6,025	6,485
Exclusion of employer provided death benefits	...	...	...	...	...	...	...	30	30	35	35	35	40	40
Exclusion of other employee benefits:														
Premiums on group term life insurance	...	...	...	...	...	...	...	2,750	2,880	3,020	3,170	3,325	3,485	3,660
Premiums on accident and disability insurance	...	...	...	...	...	...	...	140	150	155	165	175	185	195
Income of trusts to finance supplementary unemployment benefits	...	...	...	...	...	...	...	35	35	35	35	35	35	35
Special ESOP rules (other than investment credit)	2,155	1,830	1,680	1,575	1,440	1,310	1,190	...	...	...	...	...	...	...
Additional deduction for the blind	...	...	...	...	...	...	...	30	35	35	35	35	40	40
Additional deduction for the elderly	...	...	...	...	...	...	...	1,470	1,490	1,510	1,520	1,535	1,540	1,550
Tax credit for the elderly and disabled	...	...	...	...	...	...	...	55	55	60	60	65	65	70
Deductibility of casualty losses	...	...	...	...	...	...	...	715	450	315	315	315	315	315
Earned income credit [2]	...	...	...	...	...	...	...	4,020	5,110	5,740	6,440	6,715	7,025	7,325
Social Security:														
Exclusion of social security benefits:														
OASI benefits for retired workers	...	...	...	...	...	...	...	18,295	16,875	17,395	18,110	18,935	19,840	20.605
Disability insurance benefits	...	...	...	...	...	...	...	1,815	1,895	2,100	2,300	2,520	2,750	2,980
Benefits for dependents and survivors	...	...	...	...	...	...	...	3,620	3,610	3,730	3,940	4,150	4,365	4,590
Veterans benefits and services:														
Exclusion of veterans disability compensation	...	...	...	...	...	...	...	1,910	1,985	1,930	1,975	2,115	2,180	2,245
Exclusion of veterans pensions	...	...	...	...	...	...	...	80	75	70	70	75	80	90
Exclusion of GI bill benefits	...	...	...	...	...	...	...	55	70	75	80	85	90	95
Exclusion of interest on State and local debt for veterans housing	35	35	30	30	30	30	30	55	50	50	45	45	45	45
General purpose fiscal assistance:														
Exclusion of interest on public purpose State and local debt	4,810	4,955	5,095	5,255	5,440	5,645	5,880	7,160	7,395	7,595	7,830	8,095	8,395	8,710
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	...	...	...	...	...	...	...	25,745	27,250	28,795	30,425	32,155	34,000	35,880
Tax credit for corporations receiving income from doing business in U.S. possessions	2,890	2,630	2,680	2,735	2,815	2,960	3,110	...	...	...	...	...	...	...
Interest:														
Deferral of interest on savings bonds	...	...	...	...	...	...	...	1,250	1,360	1,470	1,600	1,730	1,880	2,040
Addendum—Aid to State and local governments:														
Deductibility of:														
Property taxes on owner-occupied homes	...	...	...	...	...	...	...	14,020	14,845	15,680	16,570	17,515	18,520	19,540
Nonbusiness State and local taxes other than on owner-occupied homes	...	...	...	...	...	...	...	25,745	27,250	28,795	30,425	32,155	34,000	35,880
Exclusion of interest on:														
Public purpose State and local debt	4,810	4,955	5,095	5,255	5,440	5,645	5,880	7,160	7,395	7,595	7,830	8,095	8,395	8,710
IDBs for certain energy facilities	70	70	70	70	70	65	65	105	105	105	105	105	100	100
IDBs for pollution control and sewage and waste disposal facilities	245	250	245	240	235	225	220	365	375	370	360	350	340	330
Small-issue IDBs	265	210	160	125	110	100	90	425	335	260	200	170	155	140
Owner-occupied mortgage revenue bonds	705	715	705	680	650	625	600	1,055	1,070	1,070	1,035	990	950	910
State and local debt for rental housing	385	365	345	320	295	270	255	585	555	525	490	455	415	380
IDBs for airports, docks, and sports and convention facilities	315	335	350	370	385	405	425	470	495	520	545	575	600	625
State and local student loan bonds	125	120	115	110	100	95	90	185	185	180	165	155	145	135
State and local debt for private nonprofit educational facilities	295	300	310	315	325	340	360	440	450	460	470	485	505	525

TABLE 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

Provision	Revenue Loss													
	Corporations							Individuals						
	1994	1995	1996	1997	1998	1999	2000	1994	1995	1996	1997	1998	1999	2000
State and local debt for private nonprofit health facilities	585	600	615	635	660	685	700	870	895	920	950	980	1,015	1,050
State and local debt for veterans housing	35	35	30	30	30	30	30	55	50	50	45	45	45	45

* $2.5 million or less.
[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts for fiscal year 1996 of $725 million.
[2] The effect on outlays (in millions of dollars) is as follows: $10,990 in 1994; $16,845 in 1995; $20,230 in 1996; $22,755 in 1997; $23,850 in 1998; $25,000 in 1999; amd $26,035 in 2000.
Note: Provisions with estimates denoted normal tax method have no revenue loss under the reference tax law method.
All estimates have been rounded to the nearest $5 million.

Interpreting Tax Expenditure Estimates

Tax expenditure revenue loss estimates do not necessarily equal the increase in Federal revenues (or the reduction in budget deficits) that would result from repealing the special provisions, for the following reasons:

- *Eliminating a tax expenditure may have incentive effects that alter economic behavior.* These incentives can affect the resulting magnitudes of the formerly subsidized activity or of other tax preferences or Government programs. For example, if deductibility of mortgage interest were limited, some taxpayers would hold smaller mortgages, with a concomitantly smaller effect on the budget than if no such limits were in force.
- *Tax expenditures are interdependent even without incentive effects.* Repeal of a tax expenditure provision can increase or decrease the the revenue losses associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the revenue losses from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the revenue loss from other deductions if taxpayers are led to claim the standard deduction instead of itemizing. Similarly, if two provisions were repealed simultaneously, the increase in tax liability could be greater or less than the sum of the two separate tax expenditures, since each is estimated assuming that the other remains in force. In addition, the estimates reported in Table 5–1 are the totals of individual and corporate income tax revenue losses reported in Table 5–2 and do not reflect any possible interactions between the individual and corporate income tax receipts. For this reason, the figures in Table 5–1 (as well as those in Table 5–4, which are also based on summing individual and corporate estimates) should be regarded as approximations.
- *The annual value of tax expenditures for tax deferrals is reported on a cash basis in all tables except table 5–3.* Cash-based estimates reflect the difference between taxes deferred in the current year and incoming revenues that are received due to deferrals of taxes from prior years. While such estimates are useful as a measure of cash flows into the Government, they do not always accurately reflect the true economic cost of these provisions. For example, for a provision where activity levels have changed, so that incoming tax receipts from past deferrals are greater than deferred receipts from new activity, the cash-basis tax expenditure estimate can be negative, despite the fact that in present-value terms current deferrals do have a real cost to the Government. Alternatively, in the case of a newly enacted deferral provision, a cash-based estimate can overstate the real cost to the Government because the newly deferred taxes will ultimately be received. Present-value estimates, which are a useful supplement to the cash-basis estimates for provisions involving deferrals, are discussed below.
- *Repeal of some provisions could affect overall levels of income and rates of economic growth.* In principle, repeal of major tax provisions may have some impact on the budget economic assumptions. In general, however, most changes in particular provisions are unlikely to have significant macroeconomic effects.

Present-Value Estimates

Discounted present-value estimates of revenue losses are presented in table 5–3 for certain provisions that involve tax deferrals or similar long-term revenue effects. These estimates complement the cash-based tax expenditure estimates presented in the other tables.

The present-value estimates represent the revenue losses, net of future tax payments, that follow from activities undertaken during calendar year 1995 which cause the deferrals or related revenue effects. For instance, a pension contribution in 1995 would cause a deferral of tax payments on wages in 1995 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 1995 pension contribution and accrued earnings will be paid out and taxes will be due; these receipts are included in the present-value estimate. In general, this conceptual approach is similar to the one used for reporting the budgetary effects of credit programs, where direct loans and guarantees in a given year affect future cash flows.

The discount rate used for the present-value estimates is the interest rate on comparable maturity Treasury debt. As noted in the table, the estimates

Table 5–3. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 1995

(In millions of dollars)

Provision	Present Value of Revenue Loss
Deferral of income from controlled foreign corporations (normal tax method)	1,740
Expensing of research and experimentation expenditures (normal tax method)	2,460
Expensing of exploration and development costs—oil and gas	185
Expensing of exploration and development costs—other fuels	45
Expensing of exploration and development costs—nonfuels	65
Expensing of multiperiod timber growing costs	225
Expensing of certain multiperiod production costs—agriculture	85
Expensing of certain capital outlays—agriculture	65
Deferral of capital gains on home sales	16,455
Accelerated depreciation of rental housing (normal tax method)	1,805
Accelerated depreciation of buildings other than rental housing (normal tax method)	400
Accelerated depreciation of machinery and equipment (normal tax method)	18,745
Expensing of certain small investments (normal tax method)	1,220
Amortization of start-up costs (normal tax method)	160
Deferral of capital gains from sale of broadcasting facilities to minority-owned businesses	260
Deferral of tax on shipping companies	10
Credit for low-income housing investments	2,420
Exclusion of pension contributions and earnings—employer plans	47,895
Exclusion of IRA contributions and earnings	2,185
Exclusions of contribution and earnings for Keogh plans	3,065
Exclusion of interest on State and local public-purpose bonds	16,460
Exclusion of interest on State and local non-public purpose bonds	8,865
Deferral of interest on U.S. savings bonds	615

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

for several of the provisions have been made based on the normal tax baseline, as by definition these provisions would not be treated as tax expenditures under the reference tax law baseline.

Outlay Equivalents

The concept of ''outlay equivalents'' complements ''revenue losses'' as a measure of the budget effect of tax expenditures. It is the amount of outlay that would be required to provide the taxpayer the same after-tax income as would be received through the tax preference. The outlay equivalent measure allows a comparison of the cost of the tax expenditure with that of a direct Federal outlay. Outlay equivalents are reported in table 5–4.

The measure is larger than the revenue loss estimate when the tax expenditure is judged to function as a Government payment for service. This occurs because an outlay program would increase the taxpayer's pre-tax income. For some tax expenditures, however, the revenue loss equals the outlay equivalent measure. This occurs when the tax expenditure is judged to function like a price reduction or tax deferral that does not directly enter the taxpayer's pre-tax income.[1]

[1] Budget outlay figures generally reflect the pre-tax price of the resources. In some instances, however, Government purchases or subsidies are exempted from tax by a special tax provision. When this occurs, the outlay figure understates the resource cost of the program and is, therefore, not comparable with other outlay amounts. For example, the outlays for certain military personnel allowances are not taxed. If this form of compensation were treated as part of the employee's taxable income, the Defense Department would have to make larger cash payments to its military personnel to leave them as well off after tax as they are now. The tax subsidy must be added to the tax-exempt budget outlay to make this element of national defense expenditures comparable with other outlays.

TABLE 5–4. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX

(In millions of dollars)

Provision	Outlay Equivalents							
	1994	1995	1996	1997	1998	1999	2000	1996–2000
National defense:								
Exclusion of benefits and allowances to armed forces personnel	2,330	2,335	2,355	2,365	2,385	2,410	2,435	11,950
International affairs:								
Exclusion of income earned abroad by United States citizens	2,875	3,045	3,225	3,410	3,615	3,830	4,045	18,125
Exclusion of income of foreign sales corporations	2,000	2,155	2,310	2,460	2,615	2,770	2,925	13,080
Inventory property sales source rules exception	1,845	2,000	2,155	2,310	2,460	2,615	2,770	12,310
Interest allocation rules exception for certain financial operations	140	140	140	140	140	140	140	700
Deferral of income from controlled foreign corporations (normal tax method)	1,600	1,700	1,800	2,000	2,200	2,400	2,600	11,000
General science, space, and technology:								
Expensing of research and experimentation expenditures (normal tax method)	2,060	2,230	2,390	2,560	2,740	2,930	3,130	14,715
Credit for increasing research activities	2,110	1,820	1,040	440	185	60	10	1,735
Suspension of the allocation of research and experimentation expenditures	465	465	.....	.....	.....	.....	.....	.....
Energy:								
Expensing of exploration and development costs:								
Oil and gas	–85	–70	–20	–50	85	165	215	395
Other fuels	15	15	20	20	20	20	20	100
Excess of percentage over cost depletion:								
Oil and gas	1,130	1,290	1,345	1,420	1,495	1,570	1,645	7,475
Other fuels	130	130	140	150	165	175	185	815
Alternative fuel production credit	1,260	1,370	1,400	1,390	1,330	1,240	1,160	6,520
Exception from passive loss limitation for working interests in oil and gas properties	90	100	110	120	130	145	160	665
Capital gains treatment of royalties on coal	15	20	20	20	20	20	20	100
Exclusion of interest on State and local IDBs for energy facilities	245	250	255	250	245	240	240	1,230
New technology credit	90	150	175	185	200	210	230	1,000
Enhanced oil recovery credit	120	115	110	105	105	105	105	530
Alcohol fuel credit[1]	15	35	45	50	50	50	50	245
Tax credit and deduction for clean-fuel burning vehicles and properties	65	90	90	95	105	110	120	520
Exclusion from income of conservation subsidies provided by public utilities	140	205	245	265	265	280	280	1,335
Natural resources and environment:								
Expensing of exploration and development costs, nonfuel minerals	45	45	45	45	50	50	50	240
Excess of percentage over cost depletion, nonfuel minerals	260	260	265	270	280	285	290	1,390
Capital gains treatment of iron ore	*	*	*	*	*	*	*	*
Special rules for mining reclamation reserves	50	50	50	50	50	50	50	250
Exclusion of interest on State and local IDBs for pollution control and sewage and waste disposal facilities	885	895	885	865	840	815	790	4,195
Capital gains treatment of certain timber income	15	20	20	20	20	20	20	100
Expensing of multiperiod timber growing costs	350	370	395	415	440	460	485	2,195
Investment credit and seven-year amortization for reforestation expenditures	45	45	45	45	50	50	50	240
Tax incentives for preservation of historic structures	130	125	125	120	115	115	110	585
Agriculture:								
Expensing of certain capital outlays	70	65	65	60	65	70	70	330
Expensing of certain multiperiod production costs	90	85	80	80	80	85	85	410
Treatment of loans forgiven solvent farmers as if insolvent	10	10	10	10	10	10	10	50
Capital gains treatment of certain income	160	165	165	175	180	185	185	890
Commerce and housing:								
Financial institutions and insurance:								
Exemption of credit union income	975	1,090	1,200	1,320	1,450	1,595	1,755	7,320
Excess bad debt reserves of financial institutions	70	80	90	95	105	115	120	525
Exclusion of interest on life insurance savings	12,355	13,610	14,660	15,760	16,945	18,215	19,585	85,165
Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25
Tax exemption of certain insurance companies	315	330	340	345	365	380	395	1,825
Small life insurance company deduction	155	155	160	170	185	190	200	905
Housing:								
Exclusion of interest on owner-occupied mortgage revenue bonds	2,540	2,575	2,545	2,465	2,360	2,260	2,165	11,795

TABLE 5–4. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

Provision	Outlay Equivalents							
	1994	1995	1996	1997	1998	1999	2000	1996–2000
Exclusion of interest on State and local debt for rental housing	1,395	1,325	1,245	1,160	1,070	985	900	5,360
Deductibility of mortgage interest on owner-occupied homes	48,430	51,270	54,165	57,240	60,490	63,960	67,495	303,350
Deductibility of State and local property tax on owner-occupied homes	14,020	14,845	15,680	16,570	17,515	18,520	19,540	87,825
Deferral of income from post 1987 installment sales	915	935	950	965	980	995	1,010	4,900
Deferral of capital gains on home sales	16,640	17,140	17,650	18,180	18,725	19,290	19,870	93,715
Exclusion of capital gains on home sales for persons age 55 and over	6,255	6,425	6,580	6,680	6,760	6,835	6,945	33,800
Exception from passive loss rules for $25,000 of rental loss	4,765	4,255	4,170	4,120	4,085	4,065	4,055	20,495
Accelerated depreciation on rental housing (normal tax method)	1,140	1,285	1,430	1,580	1,735	1,890	2,055	8,690
Commerce:								
Cancellation of indebtedness	165	155	100	55	20	*	–15	160
Permanent exceptions from imputed interest rules	150	150	150	155	155	160	160	780
Capital gains (other than agriculture,timber, iron ore, and coal) (normal tax method)	7,680	8,180	8,275	8,445	8,725	8,945	9,155	43,545
Capital gains exclusion of small corporation stock	*	*	*	*	*	40	335	375
Step-up basis of capital gains at death	35,800	37,740	38,305	40,355	40,945	41,545	42,155	203,305
Carryover basis of capital gains on gifts	125	130	135	140	145	150	155	725
Ordinary income treatment of loss from small business corp. stock sale	40	40	50	50	50	50	55	255
Accelerated depreciation of buildings other than rental housing (normal tax method)	5,145	4,925	4,380	3,580	2,675	1,750	1,075	13,460
Accelerated depreciation of machinery and equipment (normal tax method)	17,625	19,400	20,855	21,885	23,210	25,815	28,295	120,060
Expensing of certain small investments (normal tax method)	1,690	1,335	1,070	815	585	420	300	3,190
Amortization of start-up costs (normal tax method)	200	200	210	215	220	225	230	1,100
Graduated corporation income tax rate (normal tax method)	5,395	5,655	5,885	6,060	6,230	6,440	6,800	31,415
Exclusion of interest on small issue industrial development bonds	985	770	595	465	400	370	335	2,165
Deferral of gains from sale of broadcasting facilities to minority owned business	285	300	315	330	345	360	380	1,730
Treatment of Alaska Native Corporations	45	30	20	15	10	5	5	55
Transportation:								
Deferral of tax on shipping companies	15	15	15	15	15	15	15	75
Exclusion of reimbursed employee parking expenses	2,400	2,510	2,625	2,735	2,845	2,960	3,080	14,245
Exclusion for employer-provided transit passes	35	50	65	80	100	115	135	495
Community and regional development:								
Credit for low-income housing investments	1,925	2,260	2,800	2,945	3,270	3,500	3,660	16,175
Investment credit for rehabilitation of structures (other than historic)	90	80	80	80	70	70	70	370
Exclusion of interest on IDBs for airports, docks, and sports and convention facilities	1,135	1,200	1,260	1,320	1,385	1,450	1,510	6,925
Exemption of certain mutuals' and cooperatives' income	25	30	30	30	35	35	40	170
Empowerment zones	*	330	440	510	565	600	630	2,745
Education, training, employment, and social services:								
Education:								
Exclusion of scholarship and fellowship income (normal tax method)	875	910	915	925	935	945	955	4,675
Exclusion of interest on State and local student loan bonds	445	440	420	395	370	345	320	1,850
Exclusion of interest on State and local debt for private nonprofit educational facilities	1,055	1,080	1,105	1,135	1,170	1,210	1,260	5,880
Exclusion of interest on savings bonds transferred to educational institutions	5	5	10	10	15	20	20	75
Parental personal exemption for students age 19 or over	890	905	920	955	995	1,035	1,075	4,980
Deductibility of charitable contributions (education)	2,145	2,270	2,415	2,555	2,700	2,855	3,020	13,545
Exclusion of employer provided educational assistance	275	100	.....	.....	.....	.....	.....	.....
Training, employment, and social services:								
Targeted jobs credit	305	395	325	60	40	20	5	450
Exclusion of employer provided child care	880	945	1,010	1,085	1,160	1,245	1,315	5,815
Exclusion of employee meals and lodging (other than military)	625	660	700	740	780	820	865	3,905
Credit for child and dependent care expenses	3,780	3,865	3,980	4,080	4,180	4,260	4,325	20,825
Credit for disabled access expenditures	210	210	210	215	215	215	220	1,075
Expensing of costs of removing certain architectural barriers to the handicapped	20	20	20	20	20	20	20	100

TABLE 5–4. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

Provision	Outlay Equivalents							
	1994	1995	1996	1997	1998	1999	2000	1996–2000
Deductibility of charitable contributions, other than education and health	23,740	25,040	26,520	28,040	29,625	31,235	33,040	148,460
Exclusion of certain foster care payments	40	40	45	45	50	50	50	240
Exclusion of parsonage allowances	305	325	350	375	400	425	455	2,005
Health:								
Exclusion of employer contributions for medical insurance premiums and medical care	71,150	77,340	85,065	92,470	100,975	100,675	120,975	500,160
Deductibility of medical expenses	3,380	3,660	3,965	4,295	4,650	5,035	5,455	23,400
Exclusion of interest on State and local debt for private non-profit health facilities	2,100	2,155	2,215	2,285	2,365	2,455	2,540	11,860
Deductibility of charitable contributions (health)	2,780	2,950	3,120	3,290	3,480	3,665	3,880	17,435
Tax credit for orphan drug research	20	*	.....	.....	.....	.....	.....	.....
Special Blue Cross/Blue Shield deduction	160	175	185	140	240	260	270	1,095
Income security:								
Exclusion of railroad retirement system benefits	425	425	425	430	435	440	440	2,170
Exclusion of workmen's compensation benefits	4,240	4,475	4,860	5,120	5,380	5,645	5,950	26,955
Exclusion of public assistance benefits (normal tax method)	530	570	590	635	695	740	795	3,455
Exclusion of special benefits for disabled coal miners	100	95	90	85	85	80	75	415
Exclusion of military disability pensions	130	130	130	130	130	130	130	650
Net exclusion of pension contributions and earnings:								
Employer plans	66,960	75,940	80,410	81,040	81,650	82,230	82,845	408,175
Individual Retirement Accounts	7,590	8,900	9,550	8,940	8,485	7,720	6,555	41,250
Keogh plans	5,295	6,000	6,525	7,030	7,565	8,145	8,770	38,035
Exclusion of employer provided death benefits	40	40	40	45	50	50	55	240
Exclusion of other employee benefits:								
Premiums on group term life insurance	3,570	3,745	3,925	4,120	4,320	4,530	4,755	21,650
Premiums on accident and disability insurance	180	190	200	210	225	235	245	1,115
Income of trusts to finance supplementary unemployment benefits	35	35	35	35	35	35	35	175
Special ESOP rules (other than investment credit)	3,080	2,610	2,400	2,250	2,055	1,870	1,700	10,275
Additional deduction for the blind	40	40	40	45	45	45	50	225
Additional deduction for the elderly	1,780	1,800	1,825	1,840	1,855	1,865	1,875	9,260
Tax credit for the elderly and disabled	70	70	75	75	80	80	85	395
Deductibility of casualty losses	930	585	405	405	405	405	405	2,025
Earned income credit[2]	4,465	5,680	6,380	7,155	7,460	7,805	8,140	36,940
Social Security:								
Exclusion of social security benefits:								
OASI benefits for retired workers	18,295	16,875	17,395	18,110	18,935	19,840	20,605	94,885
Disability insurance benefits	1,815	1,895	2,100	2,300	2,520	2,570	2,980	12,470
Benefits for dependents and survivors	3,620	3,610	3,730	3,940	4,150	4,365	4,590	20,775
Veterans benefits and services:								
Exclusion of veterans disability compensation	1,910	1,985	1,930	1,975	2,115	2,180	2,245	10,445
Exclusion of veterans pensions	80	75	70	70	75	80	90	385
Exclusion of GI bill benefits	55	70	75	80	85	90	95	425
Exclusion of interest on State and local debt for veterans housing	130	120	115	110	105	105	105	540
General purpose fiscal assistance:								
Exclusion of interest on public purpose State and local debt	17,265	17,800	18,295	18,870	19,525	20,250	21,010	97,950
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	25,745	27,250	28,795	30,425	32,155	34,000	35,880	161,255
Tax credit for corporations receiving income from doing business in U.S. possessions	4,160	3,810	3,885	3,960	4,085	4,295	4,510	20,735
Interest:								
Deferral of interest on savings bonds	1,250	1,360	1,470	1,600	1,730	1,880	2,040	8,720
Addendum—Aid to State and local governments:								
Deductibility of:								
Property taxes on owner-occupied homes	14,020	14,845	15,680	16,570	17,515	18,520	19,540	87,825
Nonbusiness State and local taxes other than on owner-occupied homes	25,745	27,250	28,795	30,425	32,155	34,000	35,880	161,255
Exclusion of interest on:								
Public purpose State and local debt	17,265	17,800	18,295	18,870	19,525	20,250	21,010	97,950
IDBs for certain energy facilities	245	250	255	250	245	240	240	1,230
IDBs for pollution control and sewage and waste disposal facilities	885	895	885	865	840	815	790	4,195
Small-issue IDBs	985	770	595	465	400	370	335	2,165

TABLE 5–4. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

Provision	Outlay Equivalents							
	1994	1995	1996	1997	1998	1999	2000	1996–2000
Owner-occupied mortgage revenue bonds	2,540	2,575	2,545	2,465	2,360	2,260	2,165	11,795
State and local debt for rental housing	1,395	1,325	1,245	1,160	1,070	985	900	5,360
IDBs for airports, docks, and sports and convention facilities	1,135	1,200	1,260	1,320	1,385	1,450	1,510	6,925
State and local student loan bonds	445	440	420	395	370	345	320	1,850
State and local debt for private nonprofit educational facilities	1,055	1,080	1,105	1,135	1,170	1,210	1,260	5,880
State and local debt for private nonprofit health facilities	2,100	2,155	2,215	2,285	2,365	2,455	2,540	11,860
State and local debt for veterans housing	130	120	115	110	105	105	105	540

* $2.5 million or less.
[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts for fiscal year 1996 of $725 million.
[2] The effect on outlays (in millions of dollars) is as follows: $10,990 in 1994; $16,845 in 1995; $20,230 in 1996; $22,755 in 1997; $23,850 in 1998; $25,010 in 1999; amd $26,035 in 2000.
Note: Provisions with estimates denoted "normal tax method" have outlay equivalents of zero under the reference tax law method.
All estimates have been rounded to the nearest $5 million.

Tax Expenditure Baselines

A tax expenditure is a preferential exception to the baseline provisions of the tax structure. The 1974 Congressional Budget Act does not, however, specify the baseline provisions of the tax law. Deciding whether provisions are preferential exceptions, therefore, is a matter of judgement. As in prior years, this year's tax expenditure estimates are presented using two baselines: the *normal tax baseline*, which is used by the Joint Committee on Taxation, and the *reference tax law baseline*, which has been used by the Administration since 1983.

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

The reference tax law baseline is closer to existing law. Reference law tax expenditures are limited to special exceptions in the tax code that serve programmatic functions. These functions correspond to specific budget categories such as national defense, agriculture, or health care. While tax expenditures under the reference law baseline are generally tax expenditures under the normal tax baseline, the reverse is not always true.

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

- *Income is taxable when realized in exchange.* Thus, neither the deferral of tax on unrealized capital gains nor the tax exclusion of imputed income (such as the rental value of owner-occupied housing or farmers' consumption of their own produce) is regarded as a tax expenditure. Both accrued and imputed income would be taxed under a comprehensive income tax.
- *There is a separate corporation income tax.* Under a comprehensive income tax corporate income would be taxed only once—at the shareholder level, whether or not distributed in the form of dividends.
- *Values of assets and debt are not adjusted for inflation.* A comprehensive income tax would adjust the cost basis of capital assets and debt for changes in the price level during the time the assets or debt are held. Thus, under a comprehensive income tax baseline the failure to take account of inflation in measuring depreciation, capital gains, and interest income would be regarded as a negative tax expenditure (i.e., a tax penalty), and failure to take account of inflation in measuring interest costs would be regarded as a positive tax expenditure (i.e., a tax subsidy).

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

- *Tax rates.* The separate schedules applying to the various taxpaying units are included in the reference law baseline. Thus, corporate tax rates below the maximum statutory rate do not give rise to a tax expenditure. The normal tax baseline is similar, except that it specifies the current maximum rate as the baseline for the corporate income tax. The lower tax rates applied to the first $10 million of corporate income are thus regarded as a tax expenditure. Similarly, under the reference law baseline, preferential tax rates for capital gains generally do not yield a tax expenditure; only capital gains treatment of otherwise "ordinary income," such as that from coal and iron ore royalties and the sale of timber and certain agricultural products, is considered a tax expenditure. The alternative minimum tax is treated as part of the baseline rate structure under both the reference and normal tax methods.
- *Income subject to the tax.* Income subject to tax is defined as gross income less the costs of earning that income. The Federal income tax defines gross income to include: (1) consideration received in the exchange of goods and services, including labor services or property; and (2) the taxpayer's share of gross or net income earned and/or reported by another entity (such as a partnership). Under the reference tax rules, therefore, gross income does not include gifts—defined as receipts of money or property that are not consideration in an exchange—or most transfer payments, which can be

thought of as gifts from the Government.[2] The normal tax baseline also excludes gifts between individuals from gross income. Under the normal tax baseline, however, all cash transfer payments from the Government to private individuals are counted in gross income, and exemptions of such transfers from tax are identified as tax expenditures. The costs of earning income are generally deductible in determining taxable income under both the reference and normal tax baselines.[3]

- *Capital recovery.* Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. Under the normal tax baseline, the depreciation allowance for machinery and equipment is determined using straight-line depreciation over tax lives equal to mid-values of the asset depreciation range (a depreciation system in effect from 1971 through 1980). The normal tax baseline for real property is computed using 40-year straight-line depreciation.
- *Treatment of foreign income.* Both the normal and reference tax baselines allow a tax credit for foreign income taxes paid (up to the amount of U.S. income taxes that would otherwise be due), which prevents double taxation of income earned abroad. Under the normal tax method, however, controlled foreign corporations (CFCs) are not regarded as entities separate from their controlling U.S. shareholders. Thus, the deferral of tax on income received by CFCs is regarded as a tax expenditure under this method. In contrast, except for tax haven activities, the reference law baseline follows current law in treating CFCs as separate taxable entities whose income is not subject to U.S. tax until distributed to U.S. taxpayers. Under this baseline, deferral of tax on CFC income is not a tax expenditure because U.S. taxpayers generally are not taxed on accrued, but unrealized, income.

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

Other Considerations

Additional tax expenditure analysis may be helpful to policy makers. For example, information on the programmatic and economic effects of tax expenditures could be useful. The outputs and efficiency of tax expenditures could then be compared more systematically with direct outlay programs.

In addition, the tax expenditure analysis could be extended beyond the income and transfer taxes to include payroll and excise taxes. The exclusion of certain forms of compensation from the wage base, for instance, reduces payroll taxes, as well as income taxes. Payroll tax exclusions are complex to analyze, however, because they also affect social insurance benefits. Certain targeted excise tax provisions might also be considered tax expenditures. In this case challenges include determining an appropriate baseline.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported upon in this chapter follow.

NATIONAL DEFENSE

Benefits and allowances to armed forces personnel.—The housing and meals provided military personnel, either in cash or in kind, are excluded from income subject to tax.

INTERNATIONAL AFFAIRS

Income earned abroad.—A U.S. citizen or resident alien who resides in a foreign country or who stays in one or more foreign countries for a minimum of 11 out of the past 12 months may exclude $70,000 per year of foreign-earned income. Eligible taxpayers also may exclude or deduct reasonable housing costs in excess of one-sixth of the salary of a civil servant at grade GS –14, step 1. These provisions do not apply to Federal employees working abroad; however, the tax expenditure estimate does reflect certain allowances that are excluded from their taxable income.

Income of Foreign Sales Corporations.—The Foreign Sales Corporation (FSC) provisions exempt from tax a portion of U.S. exporters' foreign trading income to reflect the FSC's sales functions as foreign corporations. These provisions conform to the General Agreement on Tariffs and Trade.

Source rule exceptions.—The worldwide income of U.S. persons is taxable by the United States and a credit for foreign taxes paid is allowed. The amount of foreign taxes that can be credited is limited to the pre-credit U.S. tax on the foreign source income. Two exceptions give rise to tax expenditures: sales of inventory property that reduces the U.S. tax of exporters; and, for financial institutions and certain financing operations of nonfinancial enterprises, an exception from the rules that require allocation of interest expenses between domestic and foreign activities of a U.S. taxpayer.

Income of U.S.-controlled foreign corporations.—The income of foreign corporations controlled by U.S. shareholders is not subject to U.S. taxation. The income becomes taxable only when the controlling U.S. shareholders receive dividends or other distributions from their foreign stockholding. Under the normal tax method, the currently attributable foreign source pre-tax income from such a controlling interest is subject to U.S.

[2] Gross income does, however, include transfer payments associated with past employment, such as social security benefits.

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

taxation, whether or not distributed. Thus, under the normal tax baseline the excess of controlled foreign corporation income over the amount distributed to a U.S. shareholder gives rise to a tax expenditure in the form of a tax deferral.

General Science, Space, and Technology

Expensing R&E expenditures.—Research and experimentation (R&E) projects can be viewed as investments because their benefits accrue for several years when they are successful. It is difficult, however, to identify whether a specific R&E project is completed and successful and, if it is successful, what its expected life will be. For these reasons, the statutory provision that these expenditures may be expensed is considered part of the reference law. Under the normal tax method, however, the expensing of R&E expenditures is viewed as a tax expenditure. The baseline assumed for the normal tax method is that all R&E expenditures are successful and have an expected life of five years.

R&E credit.—Under legislation that expires on July 1, 1995, the tax credit is 20 percent of the qualified expenditures in excess of each year's base amount. This threshold is determined by multiplying a "fixed-base percentage" (limited to a maximum of .16 for existing companies) by the average amount of the company's gross receipts for the four preceding years. The "fixed-base percentage" is the ratio of R&E expenses to gross receipts for the 1984 to 1988 period. Start-up companies that did not both incur qualified expenses and have gross receipts in at least three of the base years are assigned a "fixed-base percentage" of .03. A similar credit with its own separate threshold is provided for taxpayers' basic research grants to universities. Beginning in 1989, the otherwise deductible qualified R&E expenditures were reduced by the amount of the credit.

Allocation of R&E expenditures.—Regulations issued in 1977 were designed to achieve a reasonable allocation of R&E expenses between corporations' domestic and foreign activities, but successive legislative and administrative actions suspended this requirement. Under legislation that expires on July 31, 1995, 50 percent of both U.S.- and foreign-based R&E expenses were allocated to their respective income sources. The remaining R&E expenses then had to be allocated on the basis of gross sales or gross income.

Energy

Exploration and development costs.—In the case of successful investments in domestic oil and gas wells, intangible drilling costs, such as wages, the costs of using machinery for grading and drilling, and the cost of unsalvageable materials used in constructing wells, may be expensed rather than amortized over the productive life of the property.

Integrated oil companies may currently deduct only 70 percent of such costs and amortize the remaining 30 percent over five years. The same rule applies to the exploration and development costs of surface stripping and the construction of shafts and tunnels for other fuel minerals.

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

Alternative fuel production credit.—A nontaxable credit of $3 per barrel (in 1979 dollars) of oil-equivalent production is provided for several forms of alternative fuels. It is generally available as long as the price of oil stays below $29.50 (in 1979 dollars).

Oil and gas exception to passive loss limitation.—Although owners of working interests in oil and gas properties are subject to the alternative minimum tax, they are exempted from the "passive income" limitations. This means that the working interest-holder, who manages on behalf of himself and all other owners the development of wells and incurs all the costs of their operation, may aggregate negative taxable income from such interests with his income from all other sources. Thus, he will be relieved of the minimum tax rules limit on tax deferrals.

Capital gains treatment of royalties on coal.—Sales of certain coal under royalty contracts can be treated as capital gains. While the top statutory rate on ordinary income is 39.6 percent, the rates on capital gains are limited to 28 percent.

Tax-exempt bonds for energy facilities.—Certain energy facilities, such as municipal electric and gas utilities, may benefit from tax-exempt financing.

Enhanced oil recovery credit.—A credit is provided equal to 15 percent of the taxpayer's costs for tertiary oil recovery on projects in the United States. Qualifying costs include tertiary injectant expenses, intangible drilling and development costs on a qualified enhanced oil recovery project, and amounts incurred for tangible depreciable property.

New technology credits.—A credit of 10 percent is available for investment in solar and geothermal energy facilities. In addition, a credit of 1.5 cents is provided per kilowatt hour of electricity produced from renewable resources such as wind and biomass. The renewable resources credit applies only to electricity produced by a facility placed in service before July 1, 1999.

Alcohol fuel credit.—Gasohol, a motor fuel composed of at least 10 percent alcohol, is exempt from 5.4 of the 18.4 cents per gallon Federal excise tax on gasoline. Smaller exemptions are allowed for motor fuel with lower alcohol content. There is a corresponding income tax credit for alcohol used as a fuel in applications where the excise tax is not assessed. This credit, equal to a subsidy of 54 cents per gallon for alcohol used as a motor fuel, is intended to encourage substitution of alcohol for petroleum-based gasoline. In addition, small producers of ethanol are eligible for a 10 cent per gallon credit.

Credit and deduction for clean-fuel vehicles and property.—A tax credit of 10 percent is provided for electric vehicles. In addition, a deduction is provided for other clean-fuel burning vehicles as well as refueling property.

Exclusion of utility conservation subsidies.—Subsidies by public utilities for customer expenditures on energy conservation measures are excluded from the gross income of the customer.

Natural Resources and Environment

Exploration and development costs.—As is true for fuel minerals, certain capital outlays associated with exploration and development of nonfuel minerals may be expensed rather than depreciated over the life of the asset.

Percentage depletion.—Most nonfuel mineral extractors also make use of percentage depletion rather than cost depletion, with percentage depletion rates ranging from 22 percent for sulphur down to 5 percent for sand and gravel.

Capital gains treatment of iron ore and of certain timber income.—Iron ore and certain timber sold under a royalty contract can be treated as capital gains.

Mining reclamation reserves.—Taxpayers are allowed to establish reserves to cover certain costs of mine reclamation and of closing solid waste disposal properties. Net increases in reserves may be taken as a deduction against taxable income.

Tax-exempt bonds for pollution control and waste disposal.—Interest on State and local government debt issued to finance private pollution control and waste disposal facilities was excludable from income subject to tax. This authorization was repealed for pollution control equipment and limits placed on the amount of debt that can be issued for private waste disposal facilities by the Tax Reform Act of 1986.

Expensing multiperiod timber growing costs.—Generally, costs must be capitalized when goods are produced for inventory used in one's own trade or business, or under contract to another party. Timber production, however, was specifically exempted from these multiperiod cost capitalization rules, creating a special benefit derived from this deferral of taxable income.

Credit and seven-year amortization for reforestation.—A special 10 percent investment tax credit is allowed for up to $10,000 invested annually in clearing land and planting trees for the ultimate production of timber. The same amount of forestation investment may also be amortized over a seven-year period. Without this preference, the amount would have to be capitalized and could be recovered (deducted) only when the trees were sold or harvested 20 or more years later. Moreover, the amount of forestation investment that is amortizable is not reduced by any of the investment credit that is allowed.

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

Agriculture

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

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

Loans forgiven solvent farmers.—Farmers are granted special tax treatment by being forgiven the tax liability on certain forgiven debt. Normally, the amount of loan forgiveness is accounted for as a gain (income) of the debtor and he must either report the gain, or reduce his recoverable basis in the property to which the loan relates. If the debtor elects to reduce basis and the amount of forgiveness exceeds his basis in the property, the excess forgiveness is taxable. However, in the case of insolvent (bankrupt) debtors, the amount of loan forgiveness never results in an income

tax liability.[4] Farmers with forgiven debt are considered insolvent for tax purposes, and thus qualify for income tax forgiveness.

Capital gains treatment of certain income.—Certain agricultural income, such as unharvested crops, can be treated as capital gains.

COMMERCE AND HOUSING

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

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

Bad debt reserves.—Only commercial banks with less than $500 million in assets, mutual savings banks, and savings and loan associations are permitted to deduct additions to bad debt reserves in excess of actually experienced losses. The deduction for additions to loss reserves allowed qualifying mutual savings banks and savings and loan associations is 8 percent of otherwise taxable income. To qualify, the thrift institutions must maintain a specified fraction of their assets in the form of mortgages, primarily residential.

Interest on life insurance savings.—Savings in the form of policyholder reserves are accumulated from premium payments and interest is earned on the reserves. Such interest income is not taxed as it accrues nor when received by beneficiaries upon the death of the insured.

Small property and casualty insurance companies.— Insurance companies that have annual net premium incomes of less than $350,000 are exempted from tax; those with $350,000 to $2,100,000 of net premium incomes may elect to pay tax only on the income earned by their investment portfolio.

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

Mortgage housing bonds.—Interest on all mortgage revenue bonds issued by State and local governments is exempt from taxation. Proceeds are used to finance homes purchased by first-time buyers—with low to moderate incomes—of dwellings with prices under 90 percent of the average area purchase price.

There are limits imposed on the amount of tax-exempt State and local government bonds that could be issued to fund private activity. The volume cap for single-family mortgage revenue bonds and multifamily rental housing bonds is combined with the cap for student loans and industrial development bonds (IDBs). The cap is set at $50 per capita or a minimum of $150 million for each State.

States are authorized to issue mortgage credit certificates (MCCs) in lieu of qualified mortgage revenue bonds because the bonds are relatively inefficient subsidies to first-time home buyers. MCCs entitle home buyers to income tax credits for a specified percentage of interest on qualified mortgage loans. In this way, the entire amount of the subsidy flows directly to the home buyer without being partly diverted to financial middlemen or bondholders. A State cannot issue an aggregate annual amount of MCCs greater than 25 percent of its annual ceiling for qualified mortgage bonds. Because of the relationship between MCCs and qualified mortgage bonds, their estimates are presented as one line item in the tables.

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

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

Real property installment sales.—Dealers in real and personal property, i.e., sellers that regularly hold property for sale or resale, cannot defer taxable income from installment sales until the receipt of the loan repayment. Nondealers, defined as sellers of real property used in their business, are required to pay interest

[4] The insolvent taxpayer's carryover losses and unused credits are extinguished first, and then his basis in assets reduced to no less than amounts still owed creditors. Finally, the remainder of the forgiven debt is excluded from tax.

to the Federal Government on deferred taxes attributable to their total installment obligations in excess of $5 million. Only properties with sales prices exceeding $150,000 are includable in the total. The payment of a market rate of interest eliminates the benefit of the tax deferral. The tax exemption for nondealers with total installment obligations of less than $5,000,000 is, therefore, a tax expenditure.

Capital gains on home sales.—When a primary residence is sold, the homeowner can defer paying a capital gains tax on the proceeds by purchasing or constructing a home of value at least equal to that of the prior home (net of sales and qualified fix-up expenses) within two years. This deferral is a tax expenditure.

Capital gains on sales by owners aged 55 or older.—A taxpayer who is 55 years of age or older at the time of the sale of his residence may elect to exclude from tax up to $125,000 of the gain from its sale. This is a once-in-a-lifetime election. In effect, this provision converts some prior deferrals of tax into forgiveness of tax.

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

Accelerated depreciation of real property, machinery and equipment.—As previously noted, the tax depreciation allowance provisions are part of the reference law rules, and thus do not cause tax expenditures under the reference method. Under the normal tax method, however, a 40-year tax life for depreciable real property is the norm. So, the statutory depreciation period in effect from 1987 to 1993 for nonresidential properties of 31.5 years, and the 39-year period for property placed in service after February 25, 1993, give rise to tax expenditures. The statutory depreciation period for residential property is 27.5 years, which also results in tax expenditures. Statutory depreciation of machinery and equipment also is somewhat accelerated relative to the normal tax baseline. In addition, tax expenditures arise from pre-1987 tax allowances for real and personal property.

Cancellation of indebtedness.—Individuals are not required to report the cancellation of certain indebtedness as current income. However, if they do not, it would be included as an adjustment in the basis of the underlying property.

Imputed interest rules.—Under reference law rules commonly referred to as original issue discount (OID), both the holder and seller of a financial contract are generally required to report interest earned in the period it accrues, not when the contract payments are made. Moreover, the amount of interest accruable is determined by the actual price paid for the contract, not by the stated or nominal principal and interest stipulated in the contract.[5]

Exceptions to the general rules for accounting for interest expense or income include the following: (a) permission for the mortgagor of his personal residence to treat the discount from the nominal principal of his mortgage loan, commonly called "points," as prepaid interest which is deductible in the year paid, not the year accrued; and (b) sellers of farms and small businesses worth less than $1 million, in exchange for the purchaser's debt obligation, are exempted from the OID rules. This is $750,000 more than the $250,000 exemption that the reference tax law generally allows for such transactions.

Capital gains (other than agriculture, timber, iron ore and coal).—While the top statutory rate on ordinary income is 39.6 percent, the rates on capital gains are limited to 28 percent. This treatment is considered a tax expenditure under the normal tax method but not under the reference law method.

Capital gains exclusion for small business stock.—An exclusion of 50 percent is provided for capital gains from qualified small business stock held by individuals for more than 5 years. A qualified small business is a corporation whose gross assets do not exceed $50 million as of the date of issuance of the stock. Certain activities such as personal services and banking are ineligible for the exclusion.

Step-up in basis of capital gains at death.—Capital gains on assets held at the owner's death are not subject to capital gains taxes. The cost basis of the appreciated assets is adjusted upward to the market value at the owner's date of death. The step-up in the heir's cost basis means that, in effect, the capital gain is forgiven.

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

Ordinary income treatment of losses from sale of small business corporate stock shares.—Up to $100,000 in losses from the sale of such stock may be treated as ordinary losses, and therefore not be subject to the $3,000 annual capital loss write-off limit if the corporation's capitalization is less than $1 million.

Expensing of certain small investments.—Qualifying investments in tangible property up to $17,500 ($10,000 prior to 1993) can be expensed rather than depreciated over time. To the extent that qualifying

[5] Thus, when a borrower on December 31, 1994, issues a promise to pay $1,000 plus interest at 10 percent on December 30, 1995, for a total repayment of $1,100, and accepts $900 from a lender in exchange for the contract, the rules require that both parties: (a) recognize that $900 is the amount lent, so that the effective loan interest rate is not the nominal 10 percent rate but is 22.2 percent; and (b) both report $200 as interest paid or received in 1995, as the case may be.

investment during the year exceeds $200,000, the amount eligible for expensing is decreased. The amount expensed is completely phased out when qualifying investments exceed $217,500.

Business start-up costs.—When an individual or corporation acquires or otherwise enters into a new business, certain start-up expenses, such as the costs of investigating opportunities and legal services, are normally incurred. The taxpayer may elect to amortize these outlays over 60 months although they are similar to other payments he makes for nondepreciable intangible assets that are not recoverable until the business is sold. Under the normal tax method this gives rise to a tax expenditure, while under the reference method it does not.

Graduated corporation income tax rate schedule.—The schedule is graduated, with rates of 15 percent on the first $50,000 of taxable income, 25 percent on the next $25,000, 34 percent on the next $9.925 million, and a rate of 35 percent on income over $10 million. As compared with a flat 35 percent tax rate, the lower rates provide a $111,000 reduction in tax liability for corporations with taxable incomes of $10 million. This benefit is recaptured in the cases of corporations with taxable incomes exceeding $100,000. This is accomplished by (1) a 5 percent additional tax on corporate incomes in excess of $100,000, but less than $335,000 and (2) a 3 percent additional tax on income over $15 million but less than $18.33 million. At this point the $111,000 is fully recaptured. Since this rate schedule is part of the reference tax law, it does not give rise to a tax expenditure under the reference method. A flat corporation income tax rate is taken as the baseline under the normal tax method; therefore the lower rates do yield a tax expenditure under this concept.

Small issue industrial development bonds.—The interest on small issue industrial development bonds (IDBs) issued by State and local governments to finance private business property is excluded from income subject to tax. Depreciable property financed with small issue IDBs must be depreciated, however, using the straight-line method. The tax exemption of small issue bonds expired in 1986, except for small issue IDBs exclusively issued to finance manufacturing facilities for which the tax exemption is permanent. The annual volume of small issue IDBs is subject to the unified volume cap discussed in the mortgage housing bond section above.

Deferral of gains from sale of broadcasting facility to minority owned business.—The voluntary sale of assets generally requires the seller to pay tax on the gain that has accrued over the period of ownership. However, in the case of an involuntary sale, as when an owner's property must be sold in a condemnation preceding, or to implement a change in a government's regulatory policy, the owner is permitted to defer payment of tax, provided the proceeds are reinvested in similar property within a specified period. In 1979, the Federal Communications Commission instituted a policy of encouraging minority group ownership of broadcast licenses. Since that time, the tax laws have been interpreted to permit voluntary sellers of licensed broadcasting facilities to defer payment of capital gains tax when the buyer has been certified as a "minority business," in effect treating the sale as "involuntary."

Treatment of Alaskan Native Corporations losses.—Tax law restricts the ability of profitable corporations to reduce their tax liabilities by merging or buying corporations with accumulated net operating losses (NOLs) and as yet unrefunded claims to investment credits. Alaska Native Corporations have a limited exemption (fifteen years after the NOL or credit claim was first experienced) from these restrictions that includes NOLs and credits claimable prior to April 26, 1988.

TRANSPORTATION

Shipping companies that are U.S. flag carriers.—Certain companies that operate U.S. flag vessels receive a deferral of income taxes on that portion of their income used for shipping purposes, primarily construction, modernization and major repairs to ships, and repayment of loans to finance these qualified investments. Once indefinite, the deferral has been limited to 25 years since January 1, 1987.

Exclusion of reimbursed employee parking expenses.—Parking at or near an employer's business premises that is paid for by the employer is excludable from the income of the employee as a working condition fringe benefit. The maximum amount of the parking exclusion is $155 month (in 1993 dollars), indexed in $5 increments. The tax expenditure estimate does not include parking at facilities owned by the employer.

Exclusion of employer-provided transit passes.—Transit passes, tokens, and fare cards provided by an employer to defray an employee's commuting costs are excludable from the employee's income as a de minimis fringe benefit, if the total value of the benefit does not exceed $60 per month (in 1993 dollars), indexed in $5 increments.

COMMUNITY AND REGIONAL DEVELOPMENT

Low-income housing investment.—Through 1989, a tax credit for investment in new, substantially rehabilitated, and certain unrehabilitated low-income housing was structured to have a present value of 70 percent of construction or rehabilitation costs incurred and was allowed over 10 years. For Federally subsidized projects and those involving unrehabilitated existing low income housing, the credit was structured to have a present value of 30 percent. Beginning on January

1, 1990, the credit was extended at a present value of 70 percent, including projects financed with other Federal subsidies, but only if substantial rehabilitation was done. Notwithstanding the capital grant character of this subsidy, the investor's recoverable basis is not reduced by the substantial credit allowed.

Rehabilitation of structures.—A 10 percent investment tax credit is available for the rehabilitation of buildings that are used for business or productive activities and that were erected before 1936 for other than residential purposes. A full reduction by the amount of the credit is required in the taxpayer's recoverable basis.

Tax-exempt bonds for airports and similar facilities.—Government-owned airports, docks and wharves, as well as high-speed rail facilities that need not be government-owned, may be financed with tax-exempt bonds. These bonds are not covered by a volume cap.

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

Empowerment zones—Qualifying businesses in designated economically depressed areas can receive tax benefits such as an employer wage credit, increasing expensing of investment in equipment, tax-exempt financing, and accelerated depreciation. In addition, a tax credit for contributions to certain community development corporations can be available.

EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES

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

Tax-exempt bonds for educational purposes.—Interest on State and local government debt issued to finance student loans or the construction of facilities used by private nonprofit educational institutions is excluded from income subject to tax. The aggregate volume of such private activity bonds that each State may issue during any calendar year is limited.

U.S. savings bonds for education.—Interest on U.S. savings bonds, issued after December 31, l989, may be excluded from tax if the bonds, plus accrued interest, are transferred to an educational institution as payment for educational expenses. The exclusion from tax is phased out for joint returns with adjusted gross incomes of $63,450 to $93,450 and $42,300 to $57,300 for single and head of household returns in 1994.

Dependent students age 19 or older.—Taxpayers can claim personal exemptions for dependent children age 19 or over who receive parental support payments of $1,000 or more per year, are full-time students, and do not claim a personal exemption on their own tax returns. This preferential arrangement usually generates tax savings because the students' marginal tax rates are more often than not lower than their parents' marginal tax rates.

Charitable contributions.—Contributions to charitable, religious, and certain other nonprofit organizations are allowed as an itemized deduction for individuals, generally up to 50 percent of adjusted gross income. Taxpayers who donate capital assets to charitable or educational organizations can deduct the assets' current value without the taxation of any appreciation in value. Corporations can also deduct charitable contributions up to 10 percent of their pre-tax income. Tax expenditures resulting from the deductibility of contributions are shown separately for educational and other institutions. Contributions to health institutions are reported under the health function.

Employer provided benefits.—Many employers provide employee benefits that are not counted in employee income. The employers' costs for these benefits are deductible business expenses. The exclusion from an employee's income of the value of educational assistance, child care, meals and lodging, as well as ministers' housing allowances and the rental value of parsonages are tax expenditures. The exclusion for educational assistance expired on December 31, 1994. Health and other insurance benefits are reported under the health and income security functions. Certain parking and transit benefits are reported under the transportation function.

Targeted jobs credit.—Employers may claim a tax credit for qualified wages paid to individuals who began work before January 1, 1995, and who are certified as members of various targeted groups. The amount of the credit that may be claimed is 40 percent of the first $3,000 paid during the first year of employment. The 40 percent credit also applies to the summer employment wages paid 16 and 17 year old youths who are members of low income families. Employers must

reduce their deduction for wages paid by the amount of the credit claimed.

Child and dependent care expenses.—A tax credit may be claimed by married couples for child and dependent care expenses incurred when one spouse works full time and the other works at least part time or goes to school. The credit may also be claimed by divorced or separated parents who have custody of children, and by single parents. Expenditures up to a maximum $2,400 for one dependent and $4,800 for two or more dependents are eligible for the credit. The credit is equal to 30 percent of qualified expenditures for taxpayers with incomes of $10,000 or less. The credit is reduced to a minimum of 20 percent by one percentage point for each $2,000 of income between $10,000 and $28,000.

Disabled access expenditures.—A credit is provided of 50 percent of eligible disabled access expenditures in excess of $250. The credit is limited to $5,000.

Costs of removing architectural barriers to the handicapped.—The investment cost of making any business accessible to persons suffering physical or mental disabilities may be deducted, rather than capitalized as part of the taxpayer's basis in such property and recovered by subsequent depreciation allowances, as is generally required.

Foster care payments.—Foster parents provide a home and care for children who are wards of the State, under contract with the State. Compensation received for this service is explicitly excluded from the gross incomes of foster parents, making the expenses they incur nondeductible. This activity is, in effect, tax-exempt.

HEALTH

Employer paid medical insurance and expenses.—Employee compensation, in the form of payments by employers for health insurance premiums and other medical expenses, is deducted as a business expense by employers, but it is not included in employee gross income.

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

Tax-exempt bonds for hospital construction.—Interest earned on State and local government debt issued to finance hospital construction is excluded from income subject to tax.

Charitable contributions to health institutions.—Contributions to nonprofit health institutions are allowed as a deduction for individuals and corporations. Tax expenditures resulting from the deductibility of contributions to other charitable institutions are listed under the education, training, employment, and social services function.

Orphan drugs.—To encourage the development of drugs for the treatment of rare diseases or physical conditions, a tax credit is granted equal to 50 percent of the costs for clinical testing that has to be completed before manufacture and distribution are approved by the Food and Drug Administration. Because the drug firm is not required to reduce its deduction for testing expenses (an R&D expenditure) by the amount of this credit, the private cost of clinically testing orphan drugs is reduced substantially. This tax expenditure expired December 31, 1994.

Blue Cross and Blue Shield.—Although these organizations are not qualified as exempt, they are provided exceptions from otherwise applicable insurance company income tax accounting rules that effectively eliminate their tax liabilities.

INCOME SECURITY

Railroad retirement benefits.—These benefits are not generally subject to the income tax unless the recipient's gross income reaches a certain threshold discussed more fully under the social security function.

Workmen's compensation benefits.—Workmen's compensation provides payments to disabled workers. These benefits, although income to the recipients, are a tax preference because they are not subject to the income tax.

Public assistance benefits.—The exclusion from taxable income of public assistance benefits received by individuals is listed as a tax expenditure under the normal tax method because, under this method, cash transfers from government are included in gross income. In contrast, gifts not conditioned on the performance of services, including transfers from government, are not taxable under the reference law. Therefore, under the reference tax method, the tax exclusion for public assistance benefits is not shown as a tax expenditure.

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

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

Pension contributions and earnings.—Certain employer contributions to pension plans, along with individual contributions to individual retirement accounts (IRAs) and amounts set aside by the self-employed, are excluded from adjusted gross income in the year of contribution. The investment income earned by pension funds and other qualifying retirement plans is not tax-

able when earned, and this deferral is, therefore, also a tax expenditure.

Limited amounts ($9,240 in 1995) can be excluded from an employee's adjusted gross income under a qualified cash or deferred arrangement with the employer (401(k) plan). An employee's own contribution of no more than $9,500 or the 401(k) limitation (whichever is greater) may be excluded annually from an employee's adjusted gross income when placed in a tax-sheltered annuity (403(b) plan).

Employees may deduct annual contributions to an IRA of $2,000 (or 100 percent of compensation, if less), or $2,250 on a joint return with only one spouse earning income, if: (a) neither the individual or spouse is an active participant in an employer-provided retirement plan; or (b) their adjusted gross income falls below $40,000 ($25,000 for a single taxpayer). The allowable IRA deduction is phased out between $40,000 and $50,000 for a joint return and $25,000 and $35,000 for a single return. Beyond these income limits, non-deductible contributions to IRAs are available to taxpayers who are active participants in employer-provided retirement plans. Self-employed persons can make deductible contributions to their own retirement (Keogh) plans equal to 25 percent of their income, up to a maximum of $30,000 per year.

Employer provided insurance benefits.—Many employers cover part or all the cost of premiums or payments for: (a) employees' life insurance benefits; (b) accident and disability benefits; (c) death benefits; and (d) supplementary unemployment benefits. The amounts are deductible by the employers and are excluded as well from employees' gross incomes for tax purposes.

Employer Stock Ownership Plan (ESOP) provisions.—A special type of employee benefit plan, organized as a trust, is tax-exempt. Employer-paid contributions (the value of stock issued to the ESOP) are deductible by the employer as part of employee compensation costs. They are not included in the employees' gross income for tax purposes, however, until they are paid out as benefits. The following special income tax provisions for ESOPs are intended to increase ownership of corporations by their employees: (1) annual employer contributions are subject to less restrictive limitations (percentages of employees' cash compensation); (2) ESOPs may borrow to purchase employer stock, guaranteed by their agreement with the employer that the debt will be serviced by his payment (deductible by him) of a portion of wages (excludable by the employees) to service the loan; (3) ESOPs' lenders may exclude half the interest from their gross income; (4) employees who sell appreciated company stock to the ESOP may defer any taxes due until they withdraw benefits; and (5) dividends paid to ESOP-held stock are deductible by the employer.

Support of the aged and the blind.—Taxpayers who are blind or 65 years of age or older may take an additional $950 standard deduction if single, or $750 if married. In addition, individuals who are 65 years of age or older, or who are permanently disabled, can take a tax credit equal to 15 percent of the sum of their earned and retirement income. Qualified income is limited to no more than $2,500 for single individuals or married couples filing a joint return where only one spouse is 65 years of age or older, and up to $3,750 for joint returns where both spouses are 65 years of age or older. These limits are reduced by one-half of the taxpayer's adjusted gross income over $7,500 for single individuals and $10,000 for married couples filing a joint return.

Casualty losses.—Neither the purchase of property nor insurance premiums to protect its value are deductible as costs of earning income; therefore, reimbursement for insured loss of such property is not reportable as a part of gross income. However, a special provision permits relief for taxpayers suffering an uninsured loss. They may deduct casualty and theft losses of more than $100 each, but only to the extent that total losses during the year exceed 10 percent of adjusted gross income.

Earned income credit.—This credit may be claimed by low income workers. For a family with one qualifying child, the credit is 34 percent of the first $6,160 of earned income in 1995. The credit is 36 percent of the first $8,640 of income for a family with two or more qualifying children. When the taxpayer's income exceeds $11,290, the credit is phased out at the rate of 15.98 percent (20.22 percent if two or more qualifying children are present). It is completely phased out at $24,396 of adjusted gross income ($26,673 if two or more qualifying children are present).

Beginning in 1994, the credit may also be claimed by workers who do not have children living with them. Qualifying workers must be at least age 25 and may not be claimed as a dependent on another taxpayer's return. The credit is not available to workers age 65 or older. In 1995, the credit is 7.65 percent of the first $4,100 of earned income. When the taxpayer's income exceeds $5,130, the credit is phased out at the rate of 7.65 percent. It is completely phased out at $9,230 of adjusted gross income.

For workers with or without children, the income level at which the credit's phase-outs begin and the maximum amounts of income on which the credit can be taken are adjusted for inflation. Earned income tax credits in excess of tax liabilities are refundable to individuals, and as such are paid by the Federal Government. This portion of the credit is included in outlays, while the amount that offsets tax liabilities is shown as a tax expenditure.

SOCIAL SECURITY

Old Age and Survivors Insurance (OASI) benefits for retired workers.—Social security benefits that exceed the beneficiary's contributions out of taxed income are deferred employee compensation and the de-

ferral of tax on that compensation is a tax expenditure. These additional retirement benefits are paid for partly by employers' contributions that were not included in employees' taxable compensation. Portions (reaching as much as 85 percent) of recipients' social security and tier 1 railroad retirement benefits are included in the income tax base, however, if the recipient's provisional income exceeds certain base amounts. Provisional income is equal to adjusted gross income plus foreign or U.S. possession income and tax-exempt interest, and one half of social security and tier 1 railroad retirement benefits. The tax expenditure is limited to the portion of the benefits received by taxpayers who are below the base amounts at which 85 percent of the benefits are taxable.

Social Security benefits for the disabled, dependents and survivors.—Benefit payments from the Social Security Trust Fund, for disability and for dependents and survivors, are excluded from the beneficiaries' gross incomes, and thus give rise to tax expenditures.

VETERANS BENEFITS AND SERVICES

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

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

GENERAL GOVERNMENT

Public purpose State and local debt.—Interest on State and local government debt, issued to finance government activities, is excluded from Federal taxation. State and local governments, therefore, can sell debt obligations at a lower interest cost than would be possible if such interest were subject to tax. Only the excluded interest on bonds for public purposes, such as schools, roads, and sewers, is included here.

Nonbusiness State and local taxes excluding home-owner property taxes.—The deductibility of nonbusiness State and local income and personal property taxes gives indirect assistance to these governments by reducing the costs of the services they provide.

Business income earned in U.S. possessions.—Under certain conditions, U.S. corporations receiving income from an active trade or business, or from investments located in a U.S. possession, can claim a special credit against U.S. tax otherwise due.

INTEREST

U.S. savings bonds.—The interest on U.S. savings bonds is not taxable until the bonds are redeemed, thereby deferring tax liability. The deferral is equivalent to an interest-free loan and, therefore, it is a tax expenditure.

TAX EXPENDITURES IN THE UNIFIED TRANSFER TAX

Exceptions to the general terms of the Federal unified transfer tax favor particular transferees or dispositions of transferors, similar to Federal direct expenditure or loan programs. The transfer tax provisions identified as tax expenditures satisfy the reference law criteria for inclusion in the tax expenditure budget that were described above. There is no generally accepted normal tax baseline for transfer taxes.

Unified Transfer Tax Reference Rules

The reference tax rules for the unified transfer tax from which departures represent tax expenditures include:

- *Definition of the taxpaying unit.* The payment of the tax is the liability of the transferor whether the transfer of cash or property was made by gift or bequest.
- *Definition of the tax base.* The base for the tax is the transferor's cumulative, taxable lifetime gifts made plus the net estate at death. Gifts in the tax base are all annual transfers in excess of $10,000 to any donee except the donor's spouse. Excluded are, however, payments on behalf of family members' educational and medical expenses, as well as the cost of ceremonial gatherings and celebrations that are not in honor of the donor.
- *Property valuation.* In general, property is valued at its fair market value at the time it is transferred. This is not necessarily the case in the valuation of property for transfer tax purposes. Executors of estates are provided the option to value assets at the time of the testator's death or up to six months later.
- *Tax rate schedule.* A single graduated tax rate schedule applies to all taxable transfers. This is reflected in the name of the "unified transfer tax" that has replaced the former separate gift and estate taxes. The tax rates vary from 18 percent on the first $10,000 of aggregate taxable transfers, to 55 percent on amounts exceeding $3 million. A $192,800 lifetime credit is provided against the tax in determining the final amount of transfer taxes that are due and payable. This allows each

taxpayer to make a $600,000 tax-free transfer of assets that otherwise would be liable to the unified transfer tax.[6]

- *Time when tax is due and payable.* Donors are required to pay the tax annually as gifts are made. The generation-skipping transfer tax is payable by the donees whenever they accede to the gift. The net estate tax liability is due and payable within nine months after the decedent's death. The Internal Revenue Service may grant an extension of up to 10 years for a reasonable cause. Interest is charged on the unpaid tax liability at a rate equal to the cost of Federal short-term borrowing, plus three percentage points.

Tax Expenditures by Function

The estimates of tax expenditures in the Federal unified transfer tax for fiscal years 1994–2000 are displayed by functional category in table 5–5. Outlay equivalent estimates are similar to revenue loss estimates for transfer tax expenditures and, therefore, are not shown separately. A description of the provisions follows.

Natural Resources and Environment

Donations of conservation easements.—Bequests for conservation are excluded from taxable estates. A conservation bequest is the value of property and easements (in perpetuity) to such property the use of which is restricted to any one or more of the following: the public for outdoor recreation; protection of the natural habitats of fish, wildlife, plants, etc.; scenic enjoyment of the public; and preservation of historic land areas and structures. Similar conservation gifts are excluded from the gift tax base and are also deductible from the donor's otherwise taxable income in the year of the gift.

Agriculture

Special use valuation of farms.—Farmland owned and operated by a decedent and/or a member of the family may be valued for estate tax purposes on the basis of its "continued use" as a farm if: the farmland is at least 25 percent of the decedent's gross estate; the entire value of all farm property is at least 50 percent of the gross estate; and family heirs to the farm agree to continue to operate the property as a farm for at least 10 years. Since continued use valuation of farmland is frequently substantially less than the fair market value, the resulting reduction in tax liability serves as a subsidy to the continued operation of family farms.

Tax deferral of closely held farms.—Decedents' estates may use a preferential, extended installment payment period of five to 15 years to discharge estate tax liabilities if the value of the farm properties exceeds 35 percent of the net estates. The interest charged is only 4 percent for the first five years, rather than the standard Federal short-term borrowing rate plus three percentage points, which applies during the last 10 years of the repayment period.

Commerce and Housing Credit

Special use valuation of closely held businesses.—The two estate tax incentives to family farming are also available to the estates of owners of nonfarm family businesses. If the same three conditions previously described are met, the real property in their estates is eligible for continued use valuation.

Tax deferral of closely held businesses.—Nonfarm family businesses that satisfy the net estate requirements qualify for preferential 15 year deferred estate

[6] An additional tax, at a flat rate of 55 percent, is imposed on lifetime, generation-skipping transfers in excess of $1 million. It is considered a generation-skipping transfer whenever the transferee is at least two generations younger than the transferor, as it would be in the case of transfers to grandchildren or great-grandchildren. The liability of this tax is on the recipients of the transfer.

TABLE 5–5. REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE FEDERAL UNIFIED TRANSFER TAX

(In millions of dollars)

Provision	Fiscal Years							
	1994	1995	1996	1997	1998	1999	2000	1996–2000
Natural Resources and Environment:								
Deductions for donations of conservation easements	*	*	*	*	*	*	*	*
Agriculture:								
Special use valuation of farm real property	70	75	80	85	90	95	100	450
Tax deferral of closely held farms	55	60	65	70	75	80	85	375
Commerce:								
Special use valuation of real property used in closely held businesses	20	20	20	25	25	25	25	120
Tax deferral of closely held business	10	10	10	10	15	15	15	65
Education, training, employment, and social services:								
Deduction for charitable contributions (education)	530	580	620	660	700	750	800	3,530
Deduction for charitable contributions (other than education and health)	1,565	1,700	1,820	1,945	2,065	2,200	2,350	10,380
Health:								
Deduction for charitable contributions (health)	480	525	565	610	650	700	755	3,280
General government:								
Credit for State death taxes	2,975	3,275	3,525	3,800	4,090	4,380	4,695	20,490

* $2.5 million or less.
Note: All estimates have been rounded to the nearest $5 million.

tax payment. To be eligible for this special provision, the value of stock in closely held corporations must exceed 35 percent of the decedent's gross estate, less debt and funeral expenses.

Education, Training, Employment, and Social Services

Bequests to tax-exempt organizations.—These bequests are deductible from decedent's otherwise taxable lifetime transfers.

Health

Bequests to health providers.—Such bequests, that are exempt from the income tax, are deductible from otherwise taxable lifetime transfers of decedents.

General Government

State and local death taxes.—A credit is allowed for state death taxes against any Federal estate tax that otherwise would be due. The amount of the state death tax credit is determined by a rate schedule that reaches a limit of 16 percent of the taxable estate in excess of $60,000.

TABLE 5–6. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 1996 REVENUE LOSS

(In millions of dollars)

Provision	1996	1996–2000
Exclusion of employer contributions for medical insurance premiums and medical care	66,620	398,090
Net exclusion of employer pension plan contributions and earnings	59,010	299,700
Deductibility of mortgage interest on owner-occupied homes	54,165	303,350
Step-up basis of capital gains at death	29,480	153,250
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	28,795	161,255
Deductibility of charitable contributions (all types)	24,145	135,180
Accelerated depreciation of machinery and equipment (normal tax method)	20,850	120,060
Deferral of capital gains on home sales	17,850	93,915
Exclusion of OASI benefits for retired workers	17,395	94,885
Deductibility of State and local property tax on owner-occupied homes	15,680	87,825
Exclusion of interest on public purpose State and local debt	12,690	67,940
Exclusion of interest on life insurance savings	11,160	64,840
Exclusion of interest on State and local debt for various non-public purposes	7,405	36,020
Net exclusion of Individual Retirement Account conbtributions and earnings	6,375	27,090
Capital gains (other than agriculture, timber, iron ore, and coal) (normal tax method)	6,205	32,660
Earned income credit [1]	5,740	33,245
Exclusion of capital gains on home sales for persons age 55 and over	4,920	25,245
Exclusion of workmen's compensation benefits	4,860	26,955
Net exclusion of Keogh plan contributions and earnings	4,825	28,125
Accelerated depreciation of buildings other than rental housing (normal tax method)	4,385	13,465
Exception from passive loss rules for $25,000 of rental loss	4,170	20,495
Graduated corporation income tax rate (normal tax method)	4,120	21,990
Deductibility of medical expenses	3,965	23,400
Exclusion of social security benefits for dependents and survivors	3,730	20,775
Premiums on group term life insurance	3,020	16,660
Credit for child and dependent care expenses	2,995	15,630
Tax credit for corporations receiving income from doing business in U.S. possessions	2,680	14,300
Credit for low-income housing investments	2,600	15,875
Expensing of research and experimentation expenditures (normal tax method)	2,560	14,715
Exclusion of income earned abroad by United States citizens	2,125	11,955
Exclusion of social security disability insurance benefits	2,100	12,650
Exclusion of benefits and allowances to armed forces personnel	2,020	10,245
Exclusion of reimbursed employee parking expenses	2,015	10,945
Exclusion of veterans disability compensation	1,930	10,445
Deferral of income from controlled foreign corporations (normal tax method)	1,800	11,000
Special ESOP rules (other than investment credit)	1,680	7,195
Additional deduction for the elderly	1,510	7,655
Exclusion of income of foreign sales corporations	1,500	8,500
Deferral of interest on savings bonds	1,470	8,720
Accelerated depreciation on rental housing (normal tax method)	1,425	8,690
Inventory property sales source rules exception	1,400	8,000
Excess of percentage over cost depletion (fuel and nonfuel minerals)	1,240	6,860
Expensing of certain small investments (normal tax method)	1,070	3,190
Alternative fuel production credit	1,000	4,630
Deferral of income from post 1987 installment sales	950	4,900
Exemption of credit union income	940	5,750
Exclusion of scholarship and fellowship income (normal tax method)	835	4,260
Parental personal exemption for students age 19 or over	825	4,470
Exclusion of employer provided child care	775	4,475
Credit for increasing research activities	675	1,125
Exclusion of public assistance benefits (normal tax method)	590	3,455
Exclusion of employee meals and lodging (other than military)	575	3,205
Empowerment zones	440	2,740
Exclusion of railroad retirement system benefits	425	2,170
Expensing of multiperiod timber growing costs	395	2,195
Targeted jobs credit	325	440
Deferral of gains from sale of broadcasting facilities to minority owned business	315	1,730
Deductibility of casualty losses	315	1,575
Exclusion of parsonage allowances	285	1,615
Tax exemption of certain insurance companies	240	1,280
Amortization of start-up costs (normal tax method)	190	985
Exclusion from income of conservation subsidies provided by public utilities	175	955
Credit for disabled access expenditures	160	825
Premiums on accident and disability insurance	155	875
Permanent exceptions from imputed interest rules	150	780
Special Blue Cross/Blue Shield deduction	140	785
Carryover basis of capital gains on gifts	135	725
Exclusion of military disability pensions	130	650
Capital gains treatment of certain agricultural income	125	700

TABLE 5–6. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 1996 REVENUE LOSS—Continued

(In millions of dollars)

Provision	1996	1996–2000
Tax incentives for preservation of historic structures	125	585
New technology credit	115	665
Small life insurance company deduction	115	640
Exception from passive loss limitation for working interests in oil and gas properties	110	665
Interest allocation rules exception for certain financial operations	95	475
Exclusion of special benefits for disabled coal miners	90	415
Expensing of certain multiperiod production costs	80	410
Enhanced oil recovery credit	80	390
Investment credit for rehabilitation of structures (other than historic)	80	370
Exclusion of GI bill benefits	75	425
Cancellation of indebtedness	75	120
Exclusion of veterans pensions	70	385
Tax credit and deduction for clean-fuel burning vehicles and properties	65	370
Expensing of certain capital outlays	65	335
Excess bad debt reserves of financial institutions	60	350
Tax credit for the elderly and disabled	60	320
Exclusion for employer-provided transit passes	50	400
Special rules for mining reclamation reserves	50	250
Expensing of exploration and development costs (fuel and nonfuel minerals)	45	735
Alcohol fuel credit [2]	45	245
Investment credit and seven-year amortization for reforestation expenditures	40	230
Exclusion of certain foster care payments	35	190
Additional deduction for the blind	35	185
Exclusion of employer provided death benefits	35	185
Ordinary income treatment of loss from small business corporation stock sale	35	180
Income of trusts to finance supplementary unemployment benefits	35	175
Exemption of certain mutuals' and cooperatives' income	30	170
Expensing of costs of removing certain architectural barriers to the handicapped	20	100
Treatment of Alaska Native Corporations	20	55
Capital gains treatment of certain timber income	15	75
Deferral of tax on shipping companies	15	75
Capital gains treatment of royalties on coal	15	75
Treatment of loans forgiven solvent farmers as if insolvent	10	50
Exclusion of interest on savings bonds transferred to educational institutions	5	55
Special alternative tax on small property and casualty insurance companies	5	25
Capital gains exclusion of small corporation stock	*	280

* $2.5 million or less.
[1] The effect of the earned income tax credit on outlays is $20,230 million in 1996 and $117,870 million for 1996–2000.
[2] In addition, the partial exemption from the excide tax for alcohol fuels results in a reduction in excise tax receipts for 1996 of $725 million.
Note: Provisions with estimates denoted normal tax method have no revenue loss under the reference tax law method.
All estimates have been rounded to the nearest $5 million.
Figures in table 5–6 are the arithmetic sums of corporate and individual income tax revenue loss estimates from table 6–2, and do not reflect possible interactions across these two taxes.

3. FEDERAL RECEIPTS

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

Growth in receipts.—Total receipts in 1997 are estimated to be $1,495.2 billion, an increase of $68.5 billion or 4.8 percent relative to 1996. This increase is largely due to assumed increases in incomes resulting from both real economic growth and inflation. Receipts are projected to grow at an average annual rate of 5.0 percent between 1997 and 2002, rising to $1912.2 billion.

As a share of GDP, receipts are projected to remain fairly constant, declining from 19.0 percent in 1996 to 18.9 percent in 2002.

Table 3–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	1995 actual	Estimate						
		1996	1997	1998	1999	2000	2001	2002
Individual income taxes	590.2	630.9	645.1	683.4	714.2	748.7	790.0	834.5
Corporation income taxes	157.0	167.1	185.0	201.7	212.7	225.4	236.7	245.8
Social insurance taxes and contributions	484.5	507.5	536.2	560.9	589.4	618.8	647.0	679.5
(On-budget)	(133.4)	(140.1)	(148.2)	(154.6)	(161.6)	(168.8)	(175.8)	(184.8)
(Off-budget)	(351.1)	(367.4)	(388.0)	(406.3)	(427.8)	(450.0)	(471.2)	(494.6)
Excise taxes	57.5	53.9	59.6	60.4	61.7	62.8	64.2	65.6
Estate and gift taxes	14.8	15.9	17.1	18.1	19.5	20.9	22.5	24.1
Customs duties	19.3	19.3	20.5	20.8	20.9	21.9	22.4	24.3
Miscellaneous receipts	31.9	32.1	31.8	32.7	34.2	35.3	37.1	38.4
Total receipts	**1,355.2**	**1,426.8**	**1,495.2**	**1,577.9**	**1,652.5**	**1,733.8**	**1,819.8**	**1,912.2**
(On-budget)	*(1,004.1)*	*(1,059.3)*	*(1,107.2)*	*(1,171.6)*	*(1,224.8)*	*(1,283.9)*	*(1,348.6)*	*(1,417.6)*
(Off-budget)	*(351.1)*	*(367.4)*	*(388.0)*	*(406.3)*	*(427.8)*	*(450.0)*	*(471.2)*	*(494.6)*

Table 3–2. CHANGES IN RECEIPTS

(In billions of dollars)

	Estimate						
	1996	1997	1998	1999	2000	2001	2002
Receipts under tax rates and structure in effect January 1, 1996 [1]	1,423.6	1,495.8	1,569.0	1,640.2	1,719.4	1,800.3	1,886.0
Telecommunications Act of 1996	4.3	4.7	5.5	6.3	7.0	7.7	7.9
Social security (OASDI) taxable earnings base increases:.							
$62,700 to $65,100 on Jan. 1, 1997	.....	1.0	2.8	3.1	3.5	3.9	4.3
$65,100 to $68,100 on Jan. 1, 1998	.....	.....	1.3	3.5	3.9	4.3	4.9
$68,100 to $71,100 on Jan. 1, 1999	.....	.....	.....	1.3	3.5	3.9	4.3
$71,100 to $74,100 on Jan. 1, 2000	.....	.....	.....	.....	1.3	3.5	3.9
$74,100 to $76,800 on Jan. 1, 2001	.....	.....	.....	.....	.....	1.2	3.2
$76,800 to $80,100 on Jan. 1, 2002	.....	.....	.....	.....	.....	.....	1.4
Proposals [2]	–1.6	–11.7	–6.3	–7.8	–11.0	–11.6	–10.7
Extension of expired trust fund excise taxes [2]	0.5	5.5	5.7	6.0	6.3	6.7	7.0
Total, receipts under existing and proposed legislation	**1,426.8**	**1,495.2**	**1,577.9**	**1,652.5**	**1,733.8**	**1,819.8**	**1,912.2**

[1] These estimates assume a social security taxable earnings base of $62,700 through 2002.
[2] Net of income offsets.

ENACTED LEGISLATION

Self-Employed Health Insurance Act.—This Act restored the 25 percent health insurance deduction for the self-employed for 1994 and increased it to 30 percent thereafter. The associated revenue losses were more than offset by other revenue and outlay provisions. The major provisions of the Act that affected receipts are described below.

Restore and increase deduction for health insurance costs of self-employed individuals.—The 25 percent health insurance deduction for self-employed individuals and their dependents, which had expired for taxable years beginning after December 31, 1993, was retroactively reinstated. In addition, the deduction was permanently increased to 30 percent for taxable years beginning after December 31, 1994.

Repeal special rules applicable to Federal Communications Commission (FCC) certified sales of broadcast property.—Under prior law, sellers of FCC-licensed broadcast facilities were allowed to defer taxes on gains realized in the sale or exchange of FCC-licensed broadcast properties to minority owners. Such deferrals were executed through FCC-issued tax certificates. Under this Act, deferral was repealed effective for all sales and exchanges on or after January 17, 1995 and for all sales and exchanges occuring before that date for which the FCC tax certificate was issued on or after January 17, 1995. The repeal did not apply to binding written contracts for which the seller had applied to the FCC for a certificate of deferral before January 17, 1995.

Modify earned income tax credit (EITC) eligibility.—Effective for taxable years beginning after December 31, 1995, taxpayers with annual aggregate interest, dividend, tax-exempt interest and net rental and royalty income exceeding $2,350 would no longer be eligible for the EITC.

Prohibit nonrecognition of gain on involuntary conversions in certain related-party transactions.—Section 1033 of the Internal Revenue Code allows certain taxpayers to defer a gain realized from certain involuntary conversions of property if the taxpayer purchases similar or related property within a specified period. Under this Act, taxpayers would no longer be allowed to defer gain on involuntary conversions occurring on or after February 6, 1995 if the replacement property or stock were purchased from a related person.

Extend New York State hospital surcharge provision.—Under the Omnibus Budget Reconciliation Act of 1993, certain employers were prohibited from receiving a Federal tax deduction for health insurance expenses if they failed to comply with New York State's hospital rate-setting/surcharge laws. This provision, which expired on May 12, 1995, was extended through December 31, 1995.

Telecommunications Act of 1996.—This Act, which provided for a major restructuring of the Nation's communications laws, fulfilled this Administration's promise to reform telecommunications laws in a manner that leads to competition and private investment, promotes universal service and open access to information networks, and provides for flexible government regulation. Under the Act, all interstate telecommunications carriers would be required to contribute funds, as prescribed by the FCC, to the preservation and advancement of universal service. The contributions would be used to provide and upgrade facilities and services, as prescribed by the FCC. Telecommunications carriers would receive credit toward their contribution by providing discount service to schools, libraries, and health care providers in rural areas. Because the amounts collected would be spent, the net budget effect would be zero.

ADMINISTRATION PROPOSALS

Provide Tax Relief

The President's plan targets tax relief to middle-income Americans through his Middle Class Bill of Rights, which was originally proposed in last year's budget. His plan also includes estate tax relief for small businesses and family farms, expanded expensing for small businesses, pension simplification, and initiatives for economically distressed areas.

Middle Class Bill of Rights.—The Administration is again proposing the three features of its Middle Class Bill of Rights designed to give middle-income families the tax relief they need to help them raise their children, save for the future and pay for postsecondary education. These provisions would be subject to trigger-off (that is, would cease to be effective) on January 1, 2001 in the event that the Federal budget deficit is not at least $20 billion below the Congressional Budget Office's (CBO's) estimate for the year 2000.

Provide tax credit for dependent children.—A non-refundable credit would be allowed for each dependent child under the age of 13. The credit would equal $300 for 1996, 1997 and 1998, and would rise to $500 for 1999 and subsequent years. The credit would be phased out for taxpayers with adjusted gross income (AGI) between $60,000 and $75,000. Both the credit amount and the phase-out range would be indexed for inflation beginning in 2000. The credit would be applied before the earned income tax credit but could not be used to offset alternative minimum tax liability.

Expand Individual Retirement Accounts (IRAs).—Under present law, eligibility for deductible IRAs is phased out for single taxpayers with AGI between $25,000 and $35,000 and for couples filing a joint return with AGI between $40,000 and $50,000, if the

individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan. Under the Administration's proposal, the AGI thresholds and phase-out ranges would be doubled over time. For 1996 through 1998, eligibility would be phased out for single taxpayers with AGI between $45,000 and $65,000, and for couples filing a joint return with AGI between $70,000 and $90,000. For 1999 and later years, eligibility would be phased out for single taxpayers with AGI between $50,000 and $70,000 and for couples filing a joint return with AGI between $80,000 and $100,000. These thresholds and the present law annual contribution limit of $2,000 would be indexed for inflation. Withdrawals from IRAs would not be subject to the 10 percent early withdrawal tax if the proceeds were used to pay post-secondary education costs, to buy or build a first home, to cover living expenses if unemployed for at least 12 consecutive weeks, or to pay catastrophic medical expenses (including nursing home or other costs associated with caring for an incapacitated parent or grandparent). In addition, each individual eligible for a deductible IRA would have the option of contributing an amount up to the contribution limit to a traditional deductible IRA or to a new back-loaded special IRA. Contributions to this special IRA would not be tax deductible, but distributions of the contributions would be tax-free. If the contributions remained in the account for at least five years, earnings on the contributions also would be tax-free when withdrawn. Withdrawals of account balances from special IRAs during the five-year period would be subject to ordinary income tax and a 10 percent early withdrawal tax. However, withdrawals during the five-year period for the purposes described above (or upon death or disability of the taxpayer) would not be subject to the early withdrawal tax. Individuals whose AGI for a year fell within the eligibility thresholds would be allowed to convert an existing IRA into a special IRA, and for conversions before 1998, income inclusion would be spread over four years.

Provide tax incentive for education and training.—Effective January 1, 1996, a deduction would be permitted for up to $5,000 in expenditures on post-secondary school education and training for the taxpayer, the taxpayer's spouse and dependents. The maximum allowable deduction would increase to $10,000 effective January 1, 1999. The maximum allowable deduction would be phased out for taxpayers filing a joint return with AGI (before the proposed deduction) between $100,000 and $120,000. For taxpayers filing a head-of-household or single return, the maximum allowable deduction would be phased out for those with AGI between $70,000 and $90,000. The phase-out ranges would be indexed for inflation beginning in 2000. Qualifying education expenses are those related to post-secondary education paid to institutions and programs eligible for Federal assistance. Deductible expenses would include tuition and fees, but would not include meals, lodging, books or transportation.

Increase deduction for self-employed health insurance.—For a discussion of this proposal, see "Other Provisions" category below.

Increase expensing for small business.—In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $17,500 of the cost of qualifying property placed in service during the taxable year. The amount of tangible depreciable property that small businesses can expense each year would be increased to $25,000 under the Administration's proposal. The increase would be effective for property placed in service in taxable years beginning after December 31, 1995 and would be phased in, starting at $19,000 in 1996, and then increasing over a six-year period in annual increments of $1,000. This provision would be subject to trigger-off (that is, the amount of tangible depreciable property that small businesses can expense each year would revert to $17,500) on January 1, 2001 in the event that the Federal budget deficit is not at least $20 billion below CBO's estimate for the year 2000.

Provide estate tax relief for small business.—Estate tax attributable to certain interests in closely held businesses may be paid in installments over a period of up to 14 years. A special four percent interest rate is provided for the tax deferred on the first $1 million of value. The $1 million cap has been in effect since 1976. To address the liquidity problems that may arise upon the death of a farmer or small business owner, and to adjust for inflation, the Administration proposes to increase the amount of property eligible for the special interest rate from $1 million to $2.5 million. The proposal also simplifies current law by eliminating distinctions based on the form of ownership, providing alternatives to the estate tax lien, and reducing the interest rate by 50 percent or more in exchange for making the interest payments nondeductible. The proposal would be effective for decedents who die after December 31, 1996.

Simplify pension plan rules.—The Administration proposes to simplify the design and administration of retirement plans sponsored by businesses of all sizes, nonprofit organizations, and State and local governments, as well as for multiemployer plans. These measures not only would simplify the rules governing these plans, but also would potentially expand pension coverage and stimulate private savings, particularly for employees of small firms. These measures include, a new, simple retirement savings plan (the National Employee Savings Trust or the NEST) for small businesses. It combines the most attractive features of the IRA and the 401(k) plan, minimizes administrative and compliance costs, and eliminates the need for employer involvement with the Government. The NEST is designed to encourage retirement savings by middle- and low-income workers, not only the highly paid, without complicated forms or calculations.

Provide tax incentives for distressed areas.—The Administration is proposing tax incentives for the cleanup of polluted urban and rural areas and is proposing an expansion of the empowerment zone and enterprise community program, as described below. The proposal would be subject to trigger-off for qualified expenses incurred after December 31, 2000 in the event that the Federal budget deficit is not at least $20 billion below CBO's estimate for the year 2000.

Provide tax incentives to clean up environmentally contaminated areas known as brownfields in distressed communities.—To encourage the cleanup of polluted urban and rural areas known as brownfields, the Administration proposes to allow certain nondeductible costs incurred by businesses to remediate environmentally contaminated land in certain areas to be capitalized and amortized over a 60-month period. Qualified sites generally would be limited to those properties located in high-poverty areas, Federal empowerment zones and enterprise communities, and areas subject to current Environmental Protection Agency (EPA) Brownfields Pilots. To claim this incentive, taxpayers would be required to obtain from the appropriate State or local agency, or the EPA in certain circumstances, verification that the site satisfies the geographic requirement. The proposal would be effective for qualified expenses incurred after the date of enactment.

Expand Empowerment Zone and Enterprise Community program.—Under the Omnibus Budget Reconciliation Act of 1993, certain tax incentives were provided for nine empowerment zones and 95 enterprise communities. The tax incentives were a 20-percent employer wage credit, increased Section 179 expensing, and a new category of tax-exempt financing. Qualifying businesses in empowerment zones were eligible for all three incentives, while businesses in enterprise communities were eligible for the tax-exempt financing. Over 500 communities submitted applications for these 104 designations that were announced in December 1994. The Administration proposes a three-part expansion of this program. First, the designation of two additional urban empowerment zones would be authorized, to be made within 180 days of enactment. Second, the restrictions on the tax-exempt financing would be loosened to make this incentive more accessible. Third, the designation of 40 additional empowerment zones and 65 additional enterprise communities would be authorized. Businesses in the new enterprise communities would be eligible for the current-law tax-exempt financing, as revised, as well as the brownfields tax incentive described above on an additional 500 acres. Businesses in the new empowerment zones would be eligible for the current-law section 179 expensing, the brownfields tax incentive on an additional 1,000 acres, and tax-exempt financing that would not be subject to the current-law State volume caps, but rather would only be subject to zone-by-zone volume caps. The current-law wage credit would not be applicable in any of the new zones and communities. The designations of these new zones and communities would be required to occur before 1998, and the designations would generally be effective for 10 years.

Provide tax relief for troops involved in the Bosnian peacekeeping operations.—For a discussion of this proposal, see "Other Provisions" category below.

Eliminate Unwarranted Benefits and Adopt Other Revenue Measures

The President's plan cuts unwarranted corporate tax subsidies, closes tax loopholes, improves tax compliance and adopts other revenue measures. These reforms, which are estimated to save $43.6 billion during the 7-year period, 1996–2002, are described below.

Disallow interest deduction for corporate-owned life insurance (COLI) policy loans.—Under existing law, a company that sets up a COLI program may borrow against the cash value of the life insurance contracts on the lives of its employees. The interest paid on such loans generally is deductible by the company, subject to certain limitations. However, the earnings credited to the COLI policies are not subject to current tax. In addition, benefits that the company receives upon the deaths of insured employees are not taxed, ensuring that the income credited under the contracts is never subject to tax. To restrict further this tax-arbitrage opportunity, the Administration proposes to phase out the deduction of interest on COLI contracts. The proposal generally would be effective with respect to interest paid or accrued after December 31, 1995.

Deny interest deduction on certain debt instruments.—If an instrument qualifies as equity, the issuer generally does not receive a deduction for dividends paid. If an instrument qualifies as debt, the issuer may receive a deduction for accrued interest and the holder generally includes interest in income, subject to certain limitations. The line between debt and equity is uncertain and it has proven difficult to formulate general rules of classification. Taxpayers have exploited this lack of guidance by issuing instruments that have substantial equity features, but for which they claim interest deductions. Generally effective for instruments issued on or after December 7, 1995, subject to certain transition rules, the Administration proposes that no deduction be allowed for interest or original issue discount (OID) on an instrument issued by a corporation that has a maximum term of more than 40 years, or is payable in stock of the issuer or a related party. The proposal also modifies the rules for indebtedness that is reflected as equity on the issuer's financial statements.

Defer original issue discount deduction on convertible debt.—If a debt instrument is convertible into stock and provides no payment of, or adjustment for, accrued interest on conversion, no deduction is allowed for accrued but unpaid stated interest. In contrast, the accrued but unpaid discount on a convertible debt instrument with OID generally is deductible, even if the

instrument is converted before the issuer pays any OID. The Administration proposal would defer the deduction for OID on convertible debt until payment and would be effective for convertible debt issued on or after December 7, 1995, subject to certain transition rules.

Reduce dividends-received deduction to 50 percent.—A corporate holder of stock generally is entitled to a deduction for dividends received on stock in the following amounts: 70 percent if the recipient owns less than 20 percent of the stock of the payor, 80 percent if the recipient owns 20 percent or more of the stock, and 100 percent if the recipient owns 80 percent or more of the stock. The Administration proposes to reduce the deduction to 50 percent for corporations owning less than 20 percent of the stock of a U.S. corporation because the existing 70-percent deduction is too generous for corporations that do not have a sufficient ownership interest in the issuing corporation. The proposal would be effective for dividends paid or accrued more than 30 days after the date of enactment.

Modify holding period for dividends-received deduction.—The dividends-received deduction is allowed to a corporate shareholder only if the shareholder satisfies a 46-day holding period for the dividend-paying stock or a 91-day period for certain dividends on preferred stock. The 46- or 91-day holding period generally does not include any time in which the shareholder is protected from the risk of loss otherwise inherent in the ownership of an equity interest. However, the holding period requirement does not have to be proximate to the time the dividend distribution is made. Effective for dividends paid or accrued more than 30 days after the date of enactment, the Administration proposes that in order for a dividend to be eligible for the dividends-received deduction, the holding period requirement must be satisfied with respect to that dividend over a period immediately before or immediately after the taxpayer becomes entitled to receive the dividend.

Extend pro rata disallowance of tax-exempt interest expense to all corporations.—No income tax deduction is allowed for interest on debt used directly or indirectly to acquire or hold investments the income on which is tax-exempt. The determination of whether debt is used to acquire or hold tax-exempt investments depends on the holder of the instrument. For financial institutions and dealers in tax-exempt investments, debt generally is treated as financing all of the taxpayer's assets proportionately. For corporations, other than financial institutions and dealers, and for individuals, deductions are disallowed only when indebtedness is incurred or continued for the purpose of purchasing or carrying tax-exempt investments. These corporations are therefore able to reduce their tax liabilities inappropriately through the double Federal tax benefits of interest expense deductions and tax-exempt interest income. Effective for taxable years beginning after the date of enactment, with respect to obligations acquired after December 7, 1995, the Administration proposes that all corporations other than insurance companies be treated the same as financial institutions are treated under current law with regard to deductions for interest on debt used directly or indirectly to acquire or hold tax-exempt obligations. The proposal also would expressly apply these rules to related parties, by treating all members of a consolidated group (other than members that are insurance companies) as a single entity and by tracing debt and tax-exempt holdings among other related parties.

Require average-cost basis for stocks, securities, etc.—A taxpayer who sells stock or other securities is allowed to account for the transaction by specifically identifying the stock or securities or by using an accounting system such as first-in, first-out or last-in, first-out. The Administration proposes to require taxpayers to determine their basis in substantially identical securities using the average of all their holdings in the securities. Holding period would be determined on a first-in, first-out basis. The method of determining basis and holding period would apply to all securities, including stocks, notes, bonds, and derivative financial instruments. A special rule would allow the Treasury to treat securities that are substantially identical as not subject to the average-cost rule if they have a special status under a provision of the Code (such as built-in gain with respect to a partnership). Securities not subject to average cost under this rule would be treated as sold on a first-in, first-out basis. The proposal would be effective 30 days after the date of enactment.

Require recognition of gain on certain stocks, indebtedness and partnership interests.—Gain and loss are generally taken into account for tax purposes when realized. Gain or loss is usually realized with respect to a capital asset at the time the asset is sold. Many transactions designed to reduce or eliminate risk of loss and opportunity for gain on financial assets generally do not cause realization. For example, taxpayers may lock in gain on securities by entering into a "short against the box," that is, the taxpayer owns securities that are the same as or substantially identical to the securities borrowed and sold short. It is inappropriate for taxpayers to be able to dispose of the economic risks and rewards of owning appreciated property without realizing income for tax purposes. Therefore, the Administration proposes to require a taxpayer to recognize gain (but not loss) upon entering into a constructive sale of any appreciated position in stock, a debt instrument, or a partnership interest. A taxpayer would be treated as making a constructive sale of an appreciated position when the taxpayer (or in certain limited circumstances, a person related to the taxpayer) substantially eliminates risk of loss and opportunity for gain by entering into one or more positions with respect to the same or substantially identical property. The proposal would generally be effective for constructive sales entered into after the date of enactment.

Change the treatment of gains and losses on extinguishment.—The tax law distinguishes between the sale of a right or obligation to a third party and the extinguishment or retirement of the right or obligation. A sale to a third party can give rise to capital treatment while an extinguishment is ordinary. Extinguishment treatment has been eliminated for all debt instruments except those issued by natural persons and for most options and other positions in actively traded property. The application of the extinguishment doctrine in other contexts is unclear. The extinguishment doctrine allows taxpayers to control whether gain or loss is capital or ordinary by deciding whether to sell or extinguish a contract. The Administration proposes to eliminate the remaining portions of the extinguishment doctrine so that gain or loss attributable to the cancellation, lapse, expiration, or other termination of any right or obligation with respect to property that is or would be a capital asset in the hands of the taxpayer would be treated as gain or loss from the sale or exchange of a capital asset. In addition, the proposal would repeal the natural person exception for debt instruments. The proposal would be effective 30 days after the date of enactment.

Require reasonable payment assumptions for interest accruals on certain debt instruments.—The original issue discount (OID) rules do not measure income appropriately for certain debt instruments that are prepayable. If the instruments are held in large pools, it can be statistically predicted that a certain portion will prepay. Prepayment assumptions are used to account for certain debt instruments with payments based on mortgages, but the OID rules otherwise ignore these probabilities. The proposal would require taxpayers that hold prepayable debt instruments in large pools to use prepayment assumptions similar to the rules that apply for debt instruments with payments based on mortgages. The proposal would be effective for taxable years beginning after the date of enactment.

Require gain recognition for certain extraordinary dividends.—A corporate shareholder is generally allowed to deduct a percentage of dividends received from another domestic corporation. Certain dividends and dividend equivalent transactions are treated as "extraordinary" dividends. If a corporate shareholder receives an extraordinary dividend, the corporate shareholder must reduce the basis of the stock to which the distribution relates by the amount of the nontaxed portion of the dividend (generally the amount of the dividend that was deducted). If the nontaxed portion of the dividend exceeds the basis of the stock, the excess is deferred and recognized on a later disposition of the stock. If a shareholder's stock is redeemed, the redemption may be treated as a dividend if the shareholder's interest in the corporation has not been meaningfully reduced. In determining if a shareholder's interest has been meaningfully reduced, the ownership of options to purchase stock may be treated as actual stock ownership. The exclusion of a substantial portion of the amount received by a corporate shareholder on the redemption of its stock is inappropriate in certain cases when options are used to create stock ownership. Also, it is inappropriate to defer gain recognition when the portion of the distribution that is excluded due to the dividends received deduction exceeds the basis of the stock with respect to which the extraordinary dividend is received. The Administration proposes that corporate shareholders will recognize gain on redemptions of stock that are treated as dividends because of options when the nontaxed portion of the dividend exceeds the basis of the shares surrendered. In addition, immediate gain recognition would be required whenever the basis of stock with respect to which any extraordinary dividend was received was reduced below zero. The proposed change generally would be effective for distributions after May 3, 1995.

Repeal percentage depletion for non-fuel minerals mined on Federal and formerly Federal lands.—Taxpayers are allowed to deduct a reasonable allowance for depletion relating to certain mineral deposits. The depletion deduction for any taxable year is calculated under either the cost depletion method or the percentage depletion method, whichever results in the greater allowance for depletion for the year. The percentage depletion method is viewed as an incentive for mineral production rather than as a normative rule for recovering the taxpayer's investment in the property. This incentive is excessive with respect to minerals mined on Federal and formerly Federal lands under the 1872 mining act, in light of the minimal costs of acquiring the mining rights ($5.00 or less per acre). Effective for taxable years beginning after the date of enactment, the Administration proposes to repeal percentage depletion for non-fuel minerals mined on lands where the mining rights were originally acquired under the 1872 law.

Modify loss carryback and carryforward rules.—Net operating losses (NOLs) generally can be used to offset taxable income from the prior three taxable years (carrybacks) and the succeeding 15 taxable years (carryforwards). Because of the increased complexity and administrative burden associated with carrybacks, the carryback period should be shortened. The carryforward period could be lengthened, however, to allow taxpayers more time to utilize their NOLs without increasing either complexity or administrative burdens. The Administration proposes to limit carrybacks of NOLs to one year and to extend carryforwards to 20 years, effective for NOLs arising in taxable years beginning after the date of enactment.

Treat certain preferred stock as "boot."—In reorganization transactions, no gain or loss is recognized except to the extent "other property" (boot) is received; that is, property other than certain stock, including preferred stock. Upon the receipt of "other property," gain but not loss can be recognized. Because preferred stock has an enhanced likelihood of recovery of prin-

cipal or of maintaining a dividend or both, such tax-free treatment is inappropriate. The Administration therefore proposes to treat certain preferred stock as "other property," subject to certain exceptions. The proposal generally would be effective for transactions after December 7, 1995.

Repeal tax-free conversions of large C corporations to S corporations.—A corporation can avoid the existing two-tier tax by electing to be treated as an S corporation or by converting to a partnership. Converting to a partnership is a taxable event that generally requires the corporation to recognize any built-in gain on its assets and requires the shareholders to recognize any built-in gain on their stock. By contrast, the conversion to an S corporation is generally tax-free, except that the S corporation generally must recognize the built-in gain on assets held at the time of conversion if the assets are sold within 10 years. Under the Administration's proposal, the conversion of a C corporation with a value of more than $5 million into an S corporation would be treated as a liquidation of the C corporation followed by a contribution of the assets to an S corporation by the recipient shareholders. Thus, the proposal would require immediate gain recognition by both the corporation (with respect to its appreciated assets) and its shareholders (with respect to their stock). This proposal makes the tax treatment of conversions to an S corporation generally consistent with conversions to a partnership. The proposal would apply to elections that are first effective for a taxable year beginning after January 1, 1997 and to acquisitions of a C corporation by an S corporation made after December 31, 1996.

Require gain recognition on certain distributions of controlled corporation stock.—A corporation is generally required to recognize gain on a distribution of property (including stock of a controlled corporation) unless the distribution meets certain requirements. If various requirements are met, including restrictions relating to acquisitions and dispositions of stock of the distributing corporation or the controlled corporation, a distribution of the stock of a controlled corporation will be tax-free to the distributing corporation. Certain distributions may effectively be dispositions of a business, in which case tax-free treatment for the distributing corporation is inappropriate. Accordingly, the Administration proposes to adopt additional restrictions on acquisitions and dispositions of the stock of a distributing corporation or controlled corporation that are related to the distribution. Under this proposal, the distributing corporation would recognize gain on the distribution of the stock of the controlled corporation if the shareholders of the distributing corporation do not retain a sufficient stock interest (generally 50 percent) in the distributing and controlled corporations during the four-year period commencing two years prior to the distribution. For this purpose, unrelated transactions (such as public trading on the stock market) would be disregarded. This proposal would be effective generally for distributions occurring after the date of announcement.

Reform the treatment of certain stock transfers.—Certain sales of stock to a related corporation are treated as the payment of a dividend by the purchaser. In cases where the seller is a corporation that does not actually own stock in the purchaser, taxpayers may take the position that the transaction produces tax benefits that would be unavailable if the purchaser distributed a dividend to its actual shareholders. For example, if a foreign-controlled domestic corporation sells the stock of a subsidiary to a foreign sister corporation, the domestic corporation may take the position that it is entitled to credit foreign taxes that were paid by the foreign sister corporation. In such cases, the Administration proposes to limit the amount treated as a dividend (and the associated foreign tax credits) from the purchaser to the amount of the purchaser's earnings and profits attributable to stock owned by U.S. persons related to the seller. If the purchaser is a domestic corporation, taxpayers may take the position that stock basis need not be reduced by the nontaxed portion of the dividend. The proposal would also clarify that a deemed dividend from a purchaser that is a domestic corporation should generally be treated as an extraordinary dividend requiring a basis reduction. The proposal would further require gain recognition to the extent that the nontaxed portion exceeds the basis of the shares transferred. The proposal generally would be effective for transactions after the date of announcement.

Reformulate Puerto Rico and possessions tax credit.—Domestic corporations with business operations in U.S. possessions may elect the Section 936 credit, which generally eliminates the U.S. tax on certain income that is related to their possession-based operations. Income exempt from U.S. tax under this provision falls into two broad categories: (1) possession business income derived from the active conduct of a trade or business within a possession or from the sale or exchange of substantially all of the assets used in such a trade or business; and (2) possession source investment income (QPSII), which is attributable to investment in the possession or in certain Caribbean Basin countries. The amount of the credit attributable to possession business income is subject to limitations enacted under the Omnibus Budget Reconciliation Act of 1993; Section 936 companies may elect either a reduced percentage of the profits-based credit as allowed under prior law (60 percent in 1994, phasing down to 40 percent beginning in 1998), or a limitation based on the company's economic activity in the possessions (measured by wages and other compensation, depreciation, and certain taxes paid). To provide a more efficient tax incentive for the economic development of Puerto Rico and other U.S. possessions, and to continue the effort toward this goal that was begun in the 1993 Act, the Administration proposes to (1) phase out the profits-based branch of the active-business portion of

the credit over five years, beginning in 1997, and (2) allow excess amounts of economic-activity limitation to be carried foward for up to five years. The proposal would retain the economic-activity limitation on the active-business portion of the credit, as well as the passive-income portion of the credit for taxes otherwise payable on QPSII, as under present law. Revenues raised would be made available to Puerto Rico for programs under the Social Security Act and to promote job creation.

Expand Subpart F provisions regarding income from notional principal contracts and stock lending transactions.—Subpart F income includes income from notional principal contracts referenced to foreign currency, commodities, or interest rates, or to indices based thereon. It also includes income with respect to the lending of debt securities. Subpart F income does not include income from equity swaps or other types of notional principal contracts or income from transfers of equities. Subpart F income should include income from all types of notional principal contracts and from stock-lending transactions, because such income is indistinguishable on policy grounds from other types of highly mobile income already targeted by Subpart F. The Administration is proposing to include in Subpart F income the net income from equity swaps and certain categories of notional principal contracts that are not reached by current law, as well as income from stock lending transactions. An ordinary-course-of-business exception would be provided for regular dealers in property, forwards, options, notional principal contracts, and similar financial instruments. The proposal would be effective for taxable years beginning after the date of enactment.

Modify taxation of captive "insurance" companies.—For tax purposes, "insurance" has been defined by the courts to require "risk shifting" or "risk distribution." In the case of a "captive" insurance company, one court has held that risk-shifting and risk-distribution requirements are satisfied even if the captive's "related person insurance income" accounts for nearly 70 percent of its total business. The Administration proposes that an insurance arrangement between a captive insurer and a large shareholder of the captive generally would not be respected as a valid insurance arrangement if more than 50 percent of the captive's net written premiums were attributable to the insurance or reinsurance of large-shareholder risks. In addition, such a captive would not be considered an insurance company for tax purposes. The proposal would be effective generally for the first taxable year beginning after the date of enactment.

Reform foreign tax credit.—The Administration proposes the following foreign tax credit reforms.

Eliminate interest allocation exception for certain nonfinancial corporation.—For foreign tax credit purposes, taxpayers generally are required to allocate and apportion interest expense between U.S. and foreign source income based on the proportion of the taxpayer's total assets in each location. Such allocation and apportionment is required to be made for affiliated groups as a whole rather than on a subsidiary-by-subsidiary basis. However, certain types of financial institutions that are members of an affiliated group are treated as members of a separate affiliated group for purposes of the allocation and apportionment of interest expense. The Tax Reform Act of 1986 included a targeted rule that treats a certain corporation as a financial institution for this purpose. The Administration believes that this relief should not be provided. The proposal would repeal the targeted exception provided by the Tax Reform Act of 1986, effective for taxable years beginning after the date of enactment.

Modify foreign tax credit carryback and carryforward rules.—The United States permits taxpayers to credit income taxes paid to a foreign government against U.S. tax on foreign source income. Through the foreign tax credit limitations, the Code prevents the use of foreign tax credits to reduce U.S. tax on U.S. source income. Under the foreign tax credit mechanism, current foreign income taxes in excess of the relevant current-year foreign tax credit limitation are not creditable against current U.S. tax liabilities. However, such excess foreign tax credits generally may be carried back for two years and carried forward for five years, and used as a credit to the extent there is excess foreign tax credit limitation (that is, an excess of the foreign tax credit limitation over creditable foreign taxes) in any of those years. Experience over the years has shown, however, that carrybacks are associated with increased complexity and administrative burdens as compared to carryforwards. Therefore, to reduce such complexity and burdens, the proposal would limit foreign tax credit carrybacks to one year and extend foreign tax credit carryforwards to seven years. The proposal would be effective for foreign taxes paid or accrued or deemed paid or accrued in taxable years beginning after December 31, 1996.

Modify rules relating to foreign oil and gas extraction income.—To be eligible for the U.S. foreign tax credit, a foreign levy must be the substantial equivalent of an income tax in the U.S. sense, regardless of the label the foreign government attaches to it. Under regulations, a foreign levy is a tax if it is a compulsory payment under the authority of a foreign government to levy taxes and is not compensation for a specific economic benefit provided by the foreign country. Taxpayers that are subject to a foreign levy and that also receive (directly or indirectly) a specific economic benefit from the levying country are referred to as "dual capacity" taxpayers and may not claim a credit for that portion of the foreign levy paid as compensation for the specific economic benefit received. The proposal would treat as taxes payments by a dual-capacity taxpayer to a foreign country that would otherwise qualify as income taxes or "in lieu of" taxes, only if there is a "generally applicable income tax" in that country. For this purpose, a generally applicable income tax is

an income tax (or a series of income taxes) that applies to trade or business income from sources in that country, so long as the levy has substantial application both to non-dual-capacity taxpayers and to persons who are citizens or residents of that country. Where the foreign country does generally impose an income tax, as under present law, credits would be allowed up to the level of taxation that would be imposed under that general tax, so long as the tax satisfies the new statutory definition of a "generally applicable income tax." The proposal would treat foreign oil and gas income as Subpart F income. It also would create a new foreign tax credit basket within Section 904 for foreign oil and gas income. The proposal would be effective for taxable years beginning after the date of enactment. The proposal would yield to U.S. treaty obligations that allow a credit for taxes paid or accrued on certain oil or gas income.

Require thrifts to account for bad debts in the same manner as banks.—A thrift institution that holds at least 60 percent of its portfolio in home mortgages, cash, and government obligations is permitted to maintain a reserve for bad debts. Annual additions to its bad debt reserve may be calculated under either the "percentage of taxable income" method or the "experience" method. These methods can be more generous than the rules applicable to commercial banks. As a result of the increasing convergence of the banking and thrift industries, the special rules applicable to thrifts are no longer warranted. The Administration proposes that effective for taxable years beginning after the date of enactment, thrifts must account for bad debts in the same manner as banks. Specifically, the percentage-of-taxable-income method of computing bad debt reserves would no longer be available; thrifts with $500 million or less of adjusted bases in their assets would be permitted to use the experience method and thrifts with greater than $500 million in adjusted bases in their assets would be required to use the specific charge-off method. Post-1987 reserves would be recaptured over six years, unless the former thrift meets mortgage loan requirements, in which case recapture would be delayed up to two years.

Reform depreciation under the income forecast method.—All estimated income from the use of property or the sale of merchandise would be taken into account in determining depreciation under the income forecast method. This change, which would generally be effective for property placed in service after September 13, 1995, would eliminate the inappropriate acceleration of depreciation of the cost of motion picture films, video tapes, sound recordings, and other similar property that occurs under current law. Interest would be charged or credited to compensate for errors in estimates.

Phase out preferential tax deferral for certain large farm corporations required to use accrual accounting.—Under the Revenue Act of 1987, family farm corporations were required to change to the accrual method of accounting if their gross receipts exceeded $25 million in any taxable year beginning after 1985. However, in lieu of including in gross income the entire amount of the adjustment attributable to the change in accounting method, a family farm corporation could establish a suspense account. The amount of the suspense account was to be included in gross income if the corporation ceased to be a family corporation or to the extent the gross receipts of the corporation from farming declined. To eliminate the potential indefinite deferral of the adjustment, the Administration proposes to repeal the ability of family farm corporations to establish such suspense accounts. Any taxpayer subsequently required to change to the accrual method of accounting would be required to take the adjustment into account generally over a ten-year period. Any existing suspense accounts would be restored to income ratably over a ten-year period, or sooner to the extent provided under existing law. This provision would be effective for taxable years beginning after September 13, 1995.

Repeal lower of cost or market inventory accounting method.—Taxpayers required to maintain inventories are permitted to use a variety of methods to determine the cost of their ending inventories, including the last-in, first-out (LIFO) method, the first-in, first-out (FIFO) method, and the retail method. Taxpayers not using a LIFO method may determine the carrying values of their inventories by applying the lower of cost or market (LCM) method and by writing down the cost of goods that are unsalable at normal prices or unusable in the normal way because of damage, imperfection or other causes (subnormal goods method). The allowance of write-downs under the LCM and subnormal goods methods is essentially a one-way mark-to-market method that understates taxable income. The Administration proposes to repeal the LCM and subnormal goods methods, effective for taxable years beginning after the date of enactment.

Repeal components of cost inventory accounting method.—Taxpayers that use the LIFO method to determine the cost of their ending inventories may use a variety of dollar-value methods, including double extension, link-chain and other index methods, in order to determine whether an increment has occurred and the cost of that increment. Certain taxpayers are permitted to use simplified LIFO methods based on externally developed price indexes. Some taxpayers that use a dollar-value, double-extension method make their computations with respect to the three components of cost (materials, labor and overhead) of their finished goods and work-in-process inventories (the COC method), rather than the aggregate cost of these goods (the total product cost method). The COC method, in many cases, does not adequately account for technological efficiencies in which skilled labor is substituted for less-skilled labor or where overhead costs replace direct labor costs. The Administration is proposing to repeal

the COC method effective for taxable years beginning after the date of enactment.

Modify basis adjustment rules under Section 1033.—The Administration proposes that when a taxpayer acquires a controlling interest in the stock of a corporation as replacement property after an involuntary conversion, the corporation must be required to reduce its adjusted bases in its assets by the same amount as the taxpayer is required to reduce its basis in the acquired stock. The corporation's adjusted bases in its assets would not be reduced, in the aggregate, below the taxpayer's basis in its stock. In addition, the basis of any individual asset would not be reduced below zero. This proposal, which would allow deferral of gain recognition, but not the avoidance of that gain, would generally be effective for involuntary conversions occurring after September 13, 1995.

Expand requirement that involuntarily converted property be replaced with property acquired from an unrelated party.—Gain realized by taxpayers from certain involuntary conversions is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within a specified period of time. C corporations (and partnerships with one or more corporate partners that own more than 50 percent of the capital or profits interest in the partnership) generally are not entitled to defer gain if the replacement property is purchased from a related person. The Administration proposes to extend this rule to any other taxpayer, including an individual, that acquires replacement property from a related person, unless the taxpayer has an aggregate realized gain of $100,000 or less during the year as a result of involuntary conversions. In the case of a partnership or S corporation, the $100,000 annual limitation would apply to the entity and each partner or shareholder. The proposal would generally be effective for involuntary conversions occurring after September 13, 1995.

Place further restrictions on like-kind exchanges involving personal property.—An exchange of property, like a sale, is generally a taxable transaction. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a like kind that is to be held for productive use in a trade or business or for investment. In general, any kind of real estate is treated as of a like kind with other real property; however real property located in the United States and real property located outside the United State are not of a like kind. For personal property, property of a "like class" is treated as being of a like kind; no restrictions apply with regard to location in or outside the United States. To conform the limitations on exchanges of personal property to the limitations on exchanges of real property, the Administration proposes that effective generally for exchanges after December 6, 1995, personal property located in the United States and personal property located outside the United States would not be treated as like kind.

Disallow rollover and one-time exclusion on sale of residence to the extent of previously claimed depreciation.—Generally, under Section 1034, no gain is recognized on the sale or exchange of a principal residence to the extent that the amount of the sales price is reinvested in a new residence within a specified period. In addition, Section 121 generally provides a taxpayer with a one-time election to exclude from gross income up to $125,000 of gain from the sale of a principal residence if the taxpayer has attained the age of 55 before the sale and has used the residence as a principal residence for three or more of the five years preceding the sale. Because depreciation is allowed with respect to a portion of a residence when that portion is used for business purposes and those deductions reduce the owner's basis in the residence, the Administration is proposing to require gain recognition on the sale of a principal residence to the extent of any depreciation allowable after December 31, 1995. Similarly, the amount of otherwise allowable one-time exclusion would be reduced to the extent of depreciation allowable after December 31, 1995.

Require registration of certain confidential corporate tax shelters.—Many corporate tax shelters are not registered with the Internal Revenue Service (IRS). Requiring registration of corporate tax shelters would allow the IRS to make better informed judgments regarding the audit of corporate tax returns and to monitor whether legislation or administrative action is necessary regarding the type of transactions being registered. The Administration is therefore proposing the registration of any investment, plan, arrangement or transaction: (1) a significant purpose of the structure of which is tax avoidance or evasion by a corporate participant, (2) that is offered to any potential participant under conditions of confidentiality, and (3) for which the tax shelter promoter may receive total fees in excess of $100,000. The proposal would be effective for any tax shelter offered to potential participants after the date the Secretary of the Treasury prescribes guidance regarding the filing requirements.

Require reporting of payments to corporations rendering services to Federal agencies.—All persons engaged in a trade or business and making payments of $600 or more to another person in remuneration for services generally must report those payments to the IRS and to the recipient. No reporting is required if the recipient is a corporation, permitting significant amounts of income to escape the tax system. To ensure that corporations that do business with the Federal Government appropriately report as income their payments from the Federal Government, the Administration proposes to require executive agencies to report payments of $600 or more made to corporations for services rendered. The proposal would be effective for

returns the due date of which is more than 90 days after the date of enactment.

Increase penalties for failure to file correct information returns.—All persons engaged in a trade or business and making payments of $600 or more to another person in remuneration for services generally must report those payments to the IRS. Any person who fails to report such payments in a timely manner or incorrectly reports such payments is subject to penalties. For taxpayers filing large volumes of information returns or reporting significant payments, existing penalties ($15 per return, not to exceed $75,000 if corrected within 30 days; $30 per return not to exceed $150,000 if corrected by August 1; and $50 per return if not corrected at all) may not be sufficient to encourage timely and accurate reporting. The Administration proposes to increase the general penalty amount to the greater of $50 per return or five percent of the total amount required to be reported. The increased penalty would not apply if the aggregate amount actually reported by the taxpayer on all returns filed for that calendar year was at least 97 percent of the amount required to be reported. The increased penalty would be effective for returns the due date for which is more than 90 days after the date of enactment.

Extend Internal Revenue Service (IRS) user fees.—The IRS provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS responds to these inquiries through the issuance of letter rulings, determination letters, and opinion letters. The authority to charge fees for these requests, which is scheduled to expire effective with requests made after September 30, 2000, is proposed to be extended for two years through September 30, 2002.

Apply failure-to-pay penalty to substitute returns.—The failure-to-pay penalty, which is a percentage of the tax due, generally runs from the due date of a return until the tax is paid. If, however, a taxpayer fails to file a return, and the Commissioner prepares a substitute return for the taxpayer, then the tax on which the penalty is measured is considered a deficiency and the penalty begins to run only ten days after the IRS sends the taxpayer notice and demand for payment of the tax. There is no reason to treat a taxpayer for whom the Commissioner prepares a substitute return more favorably than taxpayers who pay late but nevertheless file their own returns. Therefore, the proposal would require that the failure-to-pay penalty apply to taxpayers for whom the Commissioner prepares substitute returns, in the same manner as it applies to delinquent taxpayers (that is, that the penalty commences running from the due date of the return). The proposal would be effective for returns due after the date of enactment.

Repeal exemption for withholding on gambling winnings from bingo and keno in excess of $5,000.—Proceeds of most wagers with odds of less than 300 to 1 are exempt from withholding, as are all bingo and keno winnings. The proposal would impose withholding on proceeds of bingo or keno in excess of $5,000 at a rate of 28 percent, regardless of the odds of the wager, effective for payments made after the date of enactment.

Require tax reporting for payments to attorneys.—Tax information reporting is required for persons engaged in a trade or business making payments in the course of the trade or business of rent, salaries, wages, or other fixed or determinable income. Treasury regulations require a payor to report payments of attorney's fees if the payments are made in the course of a trade or business, although generally a payor is not required to report payments made to corporations. If a payment to an attorney is a gross amount, and it cannot be determined what portion is the attorney's fee (as in the case of lump-sum judgments or settlements made jointly payable to a lawyer and a plaintiff), then no reporting is required. The Administration proposes requiring that any person making a payment in the course of a trade or business to a lawyer or a law firm, whether as sole or joint payee, report the payment to the IRS. When the portion that constitutes fees cannot be determined, the amount paid would be reported as gross proceeds. A lawyer receiving a payment would be required to provide his or her taxpayer identification number to the payor or be subject to applicable penalties and backup withholding. The exception for payments to corporations would not apply to payments of attorney's fees. The proposal would be effective for payments made after December 31, 1996.

Repeal advance refunds of diesel fuel tax for diesel cars and light trucks.—The first purchaser of a diesel-powered automobile or light truck is entitled to a payment in the nature of an advance refund of the difference between the diesel fuel excise tax and the gasoline excise tax. The amount of the refund typically is small, not warranting the resources required to effectively administer the procedure. Accordingly, the Administration proposes to repeal the provision allowing these payments, effective for vehicles purchased after the date of enactment.

Extend oil spill excise tax.—Before January 1, 1995, a five-cents-per-barrel excise tax was imposed on domestic crude oil and imported petroleum products. The tax was dedicated to the Oil Spill Liability Trust Fund to finance the cleanup of oil spills and was not imposed for a calendar quarter if the unobligated balance in the Trust Fund exceeded $1 billion at the close of the preceding quarter. The Administration proposes to reinstate this tax for the period after the date of enactment and before October 1, 2006. The tax would be suspended for a given calendar quarter if the unobli-

gated Trust Fund balances at the end of the preceding quarter exceeded $2.5 billion.

Impose excise taxes on kerosene as diesel fuel.—A 24.3-cents-per-gallon excise tax is imposed on diesel fuel upon removal from a registered terminal facility unless the fuel is indelibly dyed and is destined for a nontaxable use. Treasury regulations provide that kerosene is not treated as a diesel fuel for this purpose; thus, undyed kerosene is not subject to the diesel fuel excise tax when it is removed from a terminal. Undyed kerosene is subject to tax, however, when it is blended with diesel fuel. Distributors of this blended fuel frequently do not pay the tax, thereby placing complying taxpayers at a competitive disadvantage and resulting in revenue losses to the Federal government. Effective July 1, 1997, the Administration proposes to tax kerosene as diesel fuel when it is removed from a terminal, unless the kerosene qualifies as aviation fuel. Exceptions would be provided for aviation fuel and, to the extent provided in regulations, for feedstock uses. In addition, special refund rules would apply in certain cases of kerosene used for heating purposes.

Permanently extend luxury excise tax on passenger vehicles.—A 10 percent luxury excise tax is levied on the retail price of passenger vehicles in excess of an inflation-adjusted threshold ($34,000 in 1996). The Administration proposes to permanently extend this tax, which is scheduled to expire after December 31, 1999.

Extend and modify Federal Unemployment Act (FUTA) provisions.—The temporary unemployment surtax of 0.2 percent imposed on employers, which is scheduled to expire with respect to wages paid after December 31, 1998, is proposed to be extended through December 31, 2006. Beginning in 2002, the Administration proposes to require an employer to pay Federal and State unemployment taxes monthly (instead of quarterly) in a given year, if the employer's FUTA tax liability in the immediately prior year was $1,100 or more.

Other Provisions That Affect Receipts

Assess fees for examination of FDIC-insured banks and bank holding companies (receipt effect).—The Administration proposes to require the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve to assess fees for examination of FDIC-insured banks and bank holding companies. The Federal Reserve currently funds the costs of such examinations from earnings; therefore, deposits of earnings by the Federal Reserve, which are classified as governmental receipts, will increase by the amount of the fees.

Expand fees collected under the securities laws.—The Administration proposes to expand certain fees collected under the securities laws as part of a legislative package to provide the Securities and Exchange Commission with a sound and stable long term funding structure. The Administration intends to work with Congress to secure early enactment of such a legislative proposal.

Establish IRS continuous levy.—The Administration seeks to strengthen the enforcement tools available to the IRS to recover delinquent tax debt. New authority is proposed for the IRS to effect a continuous levy on non-means tested Federal payments, such as Federal salaries and pensions, received by individuals who owe delinquent tax debt.

Extend the Generalized System of Preferences (GSP) and modify other trade provisions.—Under GSP duty-free access is provided to over 4,000 items from about 142 eligible developing countries that meet certain worker rights and other criteria. This program is proposed to apply retroactively to July 31, 1995, when it expired, and to be extended through September 30, 2000. The Administration also proposes to provide expanded trade benefits mainly on textiles and apparel to Caribbean Basin countries who meet new eligibility criteria needed to prepare for a future free trade agreement with the U.S. The program is proposed to expire on September 30, 2001.

Increase deduction for self-employed health insurance.—The Administration proposes to increase the 30 percent deduction for health insurance expenses of self-employed individuals and their dependents to 35 percent for 1996 and 1997, 40 percent for 1998, 45 percent for 1999, and 50 percent for 2000 and subsequent years. The increased deduction would be subject to trigger-off (that is, the deductible percentage would revert to 30 percent) on January 1, 2001 in the event that the Federal budget deficit is not at least $20 billion below CBO's estimate for the year 2000.

Increase employee contributions to the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS).—The Administration proposes to increase employee contributions to CSRS and FERS by 0.5 percent of base pay in three steps. Contributions would increase by 0.25 percent of base pay on April 1, 1996, another 0.15 percent on January 1, 1997 and a final 0.10 percent on January 1, 1998. These higher contribution rates would be effective through 2002; on January 1, 2003, contribution rates would return to the levels in effect on March 31, 1996.

Deter expatriation tax avoidance.—The United States requires U.S. citizens and residents to pay tax on their worldwide income. However, some U.S. taxpayers relinquish their U.S. citizenship or residence and thereby avoid future U.S. tax on unrealized gains. To ensure that these individuals pay their fair share of U.S. tax, when a U.S. citizen renounces U.S. citizenship or when a noncitizen who has been a lawful permanent resident of the United States for at least 10

years becomes a nonresident of the United States, the Administration is proposing that such individual's assets be deemed to be disposed of and reacquired at their fair market value in a transaction in which gain or loss is recognized. There would be an exemption for up to $600,000 of gain and for U.S. real property interests. The provision would apply to any expatriation after February 6, 1995.

Tighten rules for taxing foreign trusts.—Some U.S. taxpayers avoid paying applicable U.S. tax on their share of income earned by foreign trusts. To ensure that U.S. tax is collected on this income, the Administration is proposing enhanced information reporting requirements for assets transferred to foreign trusts, effective generally for taxable years beginning after the date of enactment. In addition, under current law, distributions received by U.S. taxpayers from certain foreign trusts may be treated as nontaxable gifts. The Administration is proposing that, effective generally on the date of enactment, U.S. taxpayers who receive such distributions pay U.S. tax on the distributions that represent trust income, unless U.S. law treats a U.S taxpayer as owning the trust assets.

Extend environmental tax on corporate taxable income deposited in the Hazardous Substance Superfund Trust Fund.—A tax equal to 0.12 percent of alternative minimum taxable income in excess of $2 million is levied on all corporations and deposited in the Hazardous Substance Superfund Trust Fund. The Administration proposes to reinstate this tax, which expired on December 31, 1995, for taxable years beginning after December 31, 1995 and before January 1, 2007.

Improve compliance by tax-exempt entities through intermediate sanctions and other measures.—The Administration proposes to add new excise taxes on parties that use their control over charitable and nonprofit organizations to extract benefits without providing property or services of at least equal value in return (effective generally for transactions occurring on or after September 14, 1995). In addition, the Administration is proposing to expand the reporting and disclosure requirements that relate to information returns filed by tax-exempt organizations and to increase the penalties for failure to comply with these requirements, generally effective 90 days after the date of enactment.

Modify Federal pay raise (receipt effect).—The Administration is proposing a pay raise of 3 percent for 1997, less than the raise that would take effect under normal operation of the law. This 3 percent raise would cover both the national schedule and the locality pay adjustments. The lower proposed pay raise affects Federal employees' contributions to CSRS and FERS.

Provide tax relief for troops involved in the Bosnia peacekeeping operations.—The Administration is proposing tax relief for troops involved in the Bosnia peacekeeping operations. All of the military pay of enlisted personnel and part of the pay of officers would be exempt from income tax, and filing deadlines would be extended, similar to the relief afforded personnel in the Persian Gulf. The Bosnia peacekeeping operation involves the dangers of combat situations; this benefit is proposed in recognition of our troops' sacrifice. The Administration will work with Congress to ensure early enactment of tax relief for these troops.

Modify Earned Income Tax Credit

Modify earned income tax credit (EITC).—The Administration is proposing the following modifications designed to target the EITC to intended recipients: (1) Individuals who are living in the U.S. illegally or who do not have proper documentation for employment purposes would not be eligible to claim the EITC. (2) The IRS would be allowed to use mathematical error procedures to deny claims for the EITC and the dependency exemption. (3) The definition of adjusted gross income used for phasing out the credit would be modified to disregard net capital losses, net losses from nonbusiness rents and royalties, net losses from trusts and estates, and 50 percent of net losses from sole proprietorships, partnerships and S corporations. (4) The definition of disqualified income for purposes of determining eligibility for the EITC would be expanded to include net passive income that is not included in self-employment income and net capital gain; in addition, the disqualified income threshold would be lowered to $2,200 in 1996 and indexed for inflation in subsequent years. (5) Demonstration projects in up to four states would be authorized to test the provision of advance payment of the EITC through State agencies, generally effective 90 days after the date of enactment.

Extend Expired Trust Fund Excise Taxes

The President's plan includes extension of the following excise taxes that have been previously reflected in the baseline.

Extend excise taxes deposited in the Hazardous Substance Superfund Trust Fund.—The excise taxes that are levied on petroleum, chemicals, and imported substances and deposited in the Hazardous Substance Superfund Trust Fund, are proposed to be reinstated for the period after the date of enactment and before October 1, 2006. These taxes expired on December 31, 1995.

Extend excise taxes deposited in the Airport and Airway Trust Fund.—The excise taxes that are levied on domestic air passenger tickets, international departures, domestic air cargo and non-commercial aviation fuels and deposited in the Airport and Airway Trust Fund, are proposed to be reinstated for the period after the date of enactment and before October 1, 2006. These taxes (except for 14 cents per gallon of the tax

on gasoline used in non-commercial aviation, which is being deposited in the Highway Trust Fund absent authority to transfer the tax to the Airport and Airway Trust Fund) expired on December 31, 1995.

Extend excise taxes deposited in the Leaking Underground Storage Tank (LUST) Trust Fund.—The excise taxes that are levied on gasoline, other motor fuels, methanol and ethanol fuels, and on fuels used in inland waterways and deposited in the LUST Trust Fund, expired on December 31, 1995. The Administration proposes to reinstate these taxes for the period after the date of enactment and before October 1, 2006.

Other Expired Provisions

A number of tax provisions have expired. The Administration supports the revenue-neutral extension of these provisions as discussed below and looks forward to working with the Congress to achieve that goal. These provisions include the following:

Exclusion for employer-provided educational assistance.—Certain amounts paid by an employer for educational assistance provided to an employee are excluded from the employee's gross income for income and payroll tax purposes. This exclusion expired with respect to amounts paid after December 31, 1994. The Administration has previously proposed permanent extension of this provision.

Targeted jobs tax credit.—A tax credit, generally equal to 40 percent of up to $6,000 of qualified first year wages, is provided to employers who hire individuals from several targeted groups. The credit expired with respect to individuals hired after December 31, 1994. The Administration strongly supports the goals of this program but has serious concerns over the cost-effectiveness of its current design. The Administration would support extension if the problems undermining the credit's effectiveness are addressed.

Research and experimentation (R&E) tax credit.—The 20 percent tax credit provided for certain research and experimentation expenditures expired with respect to expenditures made after June 30, 1995. The Administration has previously proposed permanent extension of this provision.

Tax credit for orphan drug clinical testing expenses.—A 50 percent non-refundable tax credit is allowed for a taxpayer's qualified clinical testing expenses paid or incurred in the testing of certain drugs, generally referred to as orphan drugs, for rare diseases or conditions. This credit expired with respect to expenses incurred after December 31, 1994.

Tax deduction for contributions to private foundations.—The deduction for a contribution to a private foundation is generally limited to the adjusted basis of the contributed property. However, a taxpayer who contributed qualified appreciated stock to a private foundation before January 1, 1995 was allowed to deduct the full fair market value of the stock, rather than the adjusted basis of the contributed stock.

Tax Simplification and Taxpayers' Rights

The Administration continues to support revenue-neutral initiatives designed to promote sensible and equitable administration of the tax laws. These include simplification, technical corrections, and taxpayer compliance measures. In addition to legislative initiatives, such as the pension simplification proposals described above, the Administration is committed to taking appropriate administrative action to simplify tax laws and enhance procedural safeguards for taxpayers. For instance, the Administration recently has announced its intent to simplify the current complex rules for classifying business organizations as either corporations or partnerships for Federal income tax purposes. In addition, the Administration recently has adopted administratively a number of measures included in pending Taxpayer Bill of Rights legislation.

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS

(In billions of dollars)

	Estimate							
	1996	1997	1998	1999	2000	2001	2002	1996–2002
Provide tax relief:								
Middle Class Bill of Rights:								
Provide tax credit for dependent children	–1.1	–9.7	–7.0	–8.9	–10.7	–10.7	–10.6	–58.6
Expand Individual Retirement Accounts (IRAs)	.....	–1.4	–0.4	–0.7	–1.1	–1.6	–2.5	–7.7
Provide tax incentive for education and training	–0.2	–5.8	–5.6	–6.2	–7.5	–7.8	–8.0	–41.2
Subtotal, Middle Class Bill of Rights	–1.3	–17.0	–13.0	–15.8	–19.3	–20.0	–21.1	–107.5
Increase expensing for small business	.....	–0.6	–0.5	–0.6	–0.7	–0.9	–0.8	–4.1
Provide estate tax relief for small business	.....	.....	–0.2	–0.2	–0.2	–0.2	–0.2	–1.0
Simplify pension plan rules [1]	*	–*	–0.1	–0.3	–0.3	–0.3	–0.3	–1.4
Provide tax incentives for distressed areas	–*	–*	–0.3	–0.6	–0.8	–0.9	–0.8	–3.4
Subtotal, Provide tax relief	–1.3	–17.6	–14.1	–17.5	–21.4	–22.4	–23.2	–117.4
Eliminate unwarranted benefits and adopt other revenue measures:								
Disallow interest deduction for corporate-owned life insurance policy loans	.....	0.6	0.5	0.6	0.7	0.7	0.8	3.9

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

(In billions of dollars)

	Estimate							
	1996	1997	1998	1999	2000	2001	2002	1996–2002
Deny interest deduction on certain debt instruments	.....	0.1	0.1	0.2	0.2	0.3	0.4	1.3
Defer original issue discount deduction on convertible debt	.....	*	*	*	*	*	0.1	0.2
Limit dividends-received deduction (DRD):								
Reduce DRD to 50 percent	.....	0.2	0.4	0.4	0.4	0.4	0.4	2.0
Modify holding period for DRD	.....	*	*	*	*	*	*	0.2
Interaction	.....	–*	–*	–*	–*	–*	–*	–*
Extend pro rata disallowance of tax-exempt interest expense to all corporations	.....	*	0.1	0.1	0.1	0.1	0.1	0.5
Require average-cost basis for stocks, securities, etc.	.....	0.6	0.7	0.6	0.7	0.7	0.7	4.1
Require recognition of gain on certain stocks, indebtedness and partnership interests	.....	0.2	–*	0.1	0.1	0.1	0.1	0.4
Change the treatment of gains and losses on extinguishment	.....	*	*	*	*	*	*	*
Require reasonable payment assumptions for interest accruals on certain debt instruments	.....	0.1	0.2	0.3	0.3	0.2	0.1	1.1
Require gain recognition for certain extraordinary dividends	.....	–0.1	0.1	0.1	0.1	0.1	0.1	0.3
Repeal percentage depletion for non-fuel minerals mined on Federal and formerly Federal lands	.....	0.1	0.1	0.1	0.1	0.1	0.1	0.5
Modify loss carryback and carryforward rules	–*	*	0.7	0.8	0.7	0.6	0.6	3.4
Treat certain preferred stock as ''boot''	.....	0.2	0.2	0.2	0.2	0.1	*	0.9
Repeal tax-free conversions of large C corporations to S corporations	.....	*	*	*	*	*	0.1	0.2
Require gain recognition in certain distributions of controlled corporation stock	.....	0.1	0.1	0.1	0.1	0.1	0.1	0.5
Reform treatment of certain stock transfers	.....	0.1	0.1	0.1	0.1	0.1	0.2	0.8
Reformulate Puerto Rico and possessions tax credit	.....	0.1	0.2	0.5	0.8	1.0	1.1	3.7
Expand Subpart F provisions regarding certain income	.....	*	*	*	*	*	*	0.2
Modify taxation of captive ''insurance'' companies	.....	*	*	*	*	*	*	0.1
Reform foreign tax credit	.....	0.2	0.9	1.1	1.0	0.9	0.9	4.9
Modify rules relating to foreign oil and gas extraction income	.....	*	*	0.1	0.1	0.1	0.1	0.4
Require thrifts to account for bad debts in same manner as banks	.....	0.2	0.2	0.3	0.3	0.3	0.3	1.6
Reform depreciation under the income forecast method	.....	0.1	0.1	0.1	*	*	*	0.3
Phase out preferential tax deferral for certain large farm corporations required to use accrual accounting	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.8
Initiate inventory reform:								
Repeal lower of cost or market method	.....	0.2	0.3	0.3	0.3	0.1	*	1.2
Repeal components of cost method	.....	0.2	0.2	0.2	0.2	0.2	0.2	1.1
Modify basis adjustment rules under Section 1033	*	*	*	*	*	*	*	0.1
Expand requirement that involuntarily converted property be replaced with property acquired from an unrelated party	.....	*	*	*	*	*	*	*
Place further restrictions on like-kind exchanges involving personal property	.....	*	*	*	*	*	*	0.1
Disallow rollover and one-time exclusion on sale of residence to the extent of previously claimed depreciation	.....	*	*	*	*	*	*	*
Require registration of certain corporate tax shelters	.....	.....	*	*	*	*	*	*
Require reporting of payments to corporations rendering services to Federal agencies	.....	*	*	*	*	0.1	0.1	0.3
Increase penalties for failure to file correct information returns	.....	*	*	*	*	*	*	0.1
Extend IRS user fees	.....	.....	.....	.....	.....	*	*	0.1
Apply failure-to-pay penalty to substitute returns	*	*	*	*	*	*	*	0.1
Repeal exemption for withholding on gambling winnings from bingo and keno in excess of $5,000	*	*	*	*	*	*	*	*
Require tax reporting for payments to attorneys	.....	.....	*	*	*	*	*	*
Repeal advance refunds of diesel fuel tax for diesel cars and light trucks [1]	*	*	*	*	*	*	*	0.1
Extend oil spill excise tax [1]	*	0.2	0.2	0.2	0.2	0.2	0.2	1.4
Impose excise taxes on kerosene as diesel fuel [1]	.....	*	*	*	*	*	*	0.2
Permanently extend luxury excise tax on passenger vehicles [1]	.....	.....	.....	.....	0.2	0.3	0.3	0.7
Extend and modify FUTA provisions:								
Extend FUTA surtax [1]	.....	.....	.....	0.8	1.2	1.2	1.2	4.4
Accelerate deposit of unemployment insurance taxes	.....	.....	.....	.....	.....	.....	1.3	1.3
Subtotal, Eliminate unwarranted benefits	0.1	3.8	5.6	7.5	8.3	8.5	9.9	43.6
Other provisions that affect receipts:								
Assess fees for examination of FDIC-insured banks and bank holding companies (receipt effect) [1]	.....	0.1	0.1	0.1	0.1	0.1	0.1	0.5
Expand fees collected under the securities laws	.....	0.3	0.3	0.3	0.3	0.4	0.4	2.0
Establish IRS continuous levy	.....	0.4	0.4	0.4	0.3	0.2	0.1	1.8
Extend GSP and modify other trade provisions [1]	–0.6	–0.6	–0.5	–0.6	–0.6	–0.3	.....	–3.2
Increase deduction for self-employed health insurance	–*	–0.1	–0.1	–0.2	–0.4	–0.5	–0.5	–1.9
Increase employee contributions to CSRS and FERS	0.1	0.4	0.5	0.6	0.6	0.6	0.6	3.4
Deter expatriation tax avoidance	*	0.2	0.2	0.4	0.4	0.5	0.5	2.3
Tighten rules for taxing foreign trusts	0.1	0.3	0.3	0.3	0.3	0.3	0.3	2.1
Extend corporate environmental tax [2]	.....	1.0	0.6	0.7	0.7	0.7	0.8	4.5
Improve compliance by tax-exempt entities through intermediate sanctions and other measures	*	*	*	*	*	*	*	*

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

(In billions of dollars)

	Estimate							
	1996	1997	1998	1999	2000	2001	2002	1996–2002
Modify Federal pay raise (receipt effect)	.....	–0.1	–0.1	–0.1	–0.1	–0.1	–0.1	–0.8
Provide tax relief to troops in Bosnia	–*	–*	.....	.....	.....	.....	.....	–*
Subtotal, Other	–0.4	1.8	1.8	1.8	1.7	1.9	2.2	10.7
Subtotal, Eliminate unwarranted benefits and other provisions that affect receipts	–0.3	5.6	7.3	9.3	10.0	10.3	12.1	54.3
Modify earned income tax credit (EITC)	*	0.3	0.4	0.4	0.4	0.4	0.4	2.3
Total effect of proposals [1]	**–1.6**	**–11.7**	**–6.3**	**–7.8**	**–11.0**	**–11.6**	**–10.7**	**–60.8**
Extend expired trust fund excise taxes:								
Extend superfund trust fund excise taxes [1]	0.1	0.7	0.7	0.7	0.7	0.7	0.7	4.2
Extend airport and airway trust fund taxes [1]	0.4	4.7	4.9	5.2	5.5	5.9	6.2	32.8
Extend LUST trust fund taxes [1]	*	0.1	0.1	0.1	0.1	0.1	0.1	0.8
Total effect of extending expired trust fund excise taxes [1]	0.5	5.5	5.7	6.0	6.3	6.7	7.0	37.7

*$50 million or less.
[1] Net of income offsets.
[2] Net of deductibility for income tax purposes.

Table 3–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	1995 actual	1996 estimate	1997 estimate
Individual income taxes (federal funds):			
Withheld	499,927	535,566	567,153
Proposed Legislation (PAYGO)	.....	−1,285	−17,201
Other	175,855	186,071	187,818
Refunds	−85,538	−89,479	−92,668
Total net individual income taxes	**590,244**	**630,873**	**645,102**
Corporation income taxes:			
Federal funds:			
Gross Collections	173,810	184,632	200,143
Proposed Legislation (PAYGO)	.....	136	2,113
Refunds	−17,418	−18,019	−18,510
Total Federal funds net corporation income taxes	156,392	166,749	183,746
Trust funds:			
Gross Collections (Hazardous substance superfund)	612	359	10
Proposed Legislation (PAYGO)	.....	.....	1,222
Total net corporation income taxes	**157,004**	**167,108**	**184,978**
Social insurance taxes and contributions (trust funds):			
Employment taxes and contributions:			
Old-age and survivors insurance (Off-budget)	284,091	311,713	333,335
Disability insurance (Off-budget)	66,988	55,728	54,680
Hospital insurance	96,024	101,848	108,770
Railroad retirement:			
Social Security equivalent account	1,518	1,498	1,508
Rail pension and supplemental annuity	2,424	2,399	2,451
Total employment taxes and contributions	451,045	473,186	500,744
On-budget	99,966	105,745	112,729
Off-budget	351,079	367,441	388,015
Unemployment insurance:			
State taxes deposited in Treasury [1]	23,158	24,047	25,006
Federal unemployment tax receipts [1]	5,696	5,739	5,806
Railroad unemployment tax receipts [1]	24	24	29
Total unemployment insurance	28,878	29,810	30,841
Other retirement contributions:			
Federal employees' retirement—employee contributions	4,461	4,359	4,144
Proposed Legislation (PAYGO)	.....	90	356
Contributions for non-Federal employees [2]	89	89	88
Proposed Legislation (PAYGO)	.....	1	2
Total other retirement contributions	4,550	4,539	4,590
Total social insurance taxes and contributions	**484,473**	**507,535**	**536,175**
On-budget	133,394	140,094	148,160
Off-budget	351,079	367,441	388,015
Excise taxes:			
Federal funds:			
Alcohol taxes	7,216	7,189	7,173
Tobacco taxes	5,878	5,872	5,796
Transportation fuels tax	8,491	6,920	7,162
Telephone and teletype services	3,794	4,010	4,241
Ozone depleting chemicals and products	616	205	13
Other Federal fund excise taxes	946	1,598	1,520
Proposed Legislation (PAYGO)	.....	−382	5
Total Federal fund excise taxes	26,941	25,412	25,910
Trust funds:			
Highway	22,611	24,564	24,900
Proposed Legislation (PAYGO)	.....	−10	4
Airport and airway	5,534	1,383	.....
Proposed Legislation (PAYGO)	.....	898	6,251
Aquatic resources	306	320	325
Black lung disability insurance	608	620	633
Inland waterway	103	125	131
Hazardous substance superfund	867	261	.....
Proposed Legislation (PAYGO)	.....	102	883
Oil spill liability	211	.....	.....
Proposed Legislation (PAYGO)	.....	34	294
Vaccine injury compensation	138	123	123
Leaking underground storage tank	165	41	.....
Proposed Legislation (PAYGO)	.....	13	174
Total trust funds excise taxes	30,543	28,474	33,718
Total excise taxes	**57,484**	**53,886**	**59,628**
Estate and gift taxes	**14,763**	**15,924**	**17,067**
Proposed Legislation (PAYGO)	.....	.....	**10**
Total estate and gift taxes	**14,763**	**15,924**	**17,077**
Customs duties:			
Federal funds	18,573	19,231	20,253
Proposed Legislation (PAYGO)	.....	−706	−675
Trust funds	728	788	876
Total customs duties	**19,301**	**19,313**	**20,454**
MISCELLANEOUS RECEIPTS: [3]			
Miscellaneous taxes	138	149	153
United Mine Workers of America combined benefit fund	336	281	251
Deposit of earnings, Federal Reserve System	23,378	23,752	22,580
Proposed Legislation (PAYGO)	.....	.....	92
Fees for permits and regulatory and judicial services	6,180	6,233	6,690
Proposed Legislation (PAYGO)	.....	.....	307
Fines, penalties, and forfeitures	1,781	1,580	1,598
Restitutions, reparations, and recoveries under military occupation	.....	7	7
Gifts and contributions	131	139	151
Refunds and recoveries	.....	−5	−5
Total miscellaneous receipts	**31,944**	**32,136**	**31,824**
Total budget receipts	**1,355,213**	**1,426,775**	**1,495,238**
On-budget	1,004,134	1,059,334	1,107,223
Off-budget	351,079	367,441	388,015
MEMORANDUM			
Federal funds	842,214	893,132	926,831
Trust funds	326,739	355,579	377,918
Interfund transactions	−164,819	−189,377	−197,526
Total on-budget	**1,004,134**	**1,059,334**	**1,107,223**
Off-budget (trust funds)	**351,079**	**367,441**	**388,015**

Table 3–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	1995 actual	1996 estimate	1997 estimate
Total	**1,355,213**	**1,426,775**	**1,495,238**

[1] Deposits by States are State payroll taxes that cover the benefit part of the program. Federal unemployment tax receipts cover administrative costs at both the Federal and State level. Railroad unemployment tax receipts cover both the benefits and adminstrative costs of the program for the railroads.

[2] Represents employer and employee contributions to the civil service retirement and disability fund for covered employees of Government-sponsored, privately owned enterprises and the District of Columbia municipal government.

[3] Includes both Federal and trust funds. Trust fund amounts in miscellaneous receipts are 1995: $619 million; 1996: $575 million; and 1997: $571 million.

4. USER FEES AND OTHER COLLECTIONS

In addition to collecting taxes and other governmental receipts by the exercise of its sovereign powers, the Federal Government earns income from its various business-type activities. Examples of this income include the sale of postage stamps and electricity, the collection of fees for admittance to national parks, premiums for deposit insurance, and rents and royalties for the right to extract oil from the Outer Continental shelf. Because these collections stem from business-type activities, as opposed to exercise of sovereign powers, they are subtracted from gross outlays rather than added to the taxes and other governmental receipts discussed in the previous chapter. Because these collections reduce outlays, they are called "offsetting collections." The purpose of this treatment is to produce budget totals for receipts, outlays, and budget authority in terms of the amount of resources allocated governmentally, through collective political choice rather than through the market.

Offsetting collections are classified into two major categories: offsetting receipts, which are deposited in receipt accounts; and offsetting collections credited to appropriations (expenditure) accounts, which are deposited directly in these accounts and usually can be spent without further action by the Congress. Both categories include collections from other accounts within the Government as well as the public. Chapter 24, "Budget System and Concepts," explains the budgetary treatment of these collections more fully.

The term ***"user fee"*** is not a budgetary category. It is a general term that refers to amounts assessed against identifiable recipients for special benefits derived from Federal activities beyond those received by the general public. Depending primarily on whether the user charge is based on the Government's sovereign power or business-type activity, it may be classified as a governmental receipt or an offsetting collection.

As shown in Table 4–1, total offsetting collections from the public (including those proposed in this budget) are estimated to be $190.4 billion in 1997. This is only 13 percent as large as the governmental receipts discussed in the previous chapter. Table 4–1 divides this total between offsetting receipts and offsetting collections credited to appropriations accounts and shows major subcategories of each. Table 4–3 provides more detail for offsetting receipts collected from the public and offsetting receipts collected from other accounts within the Government.

The budget contains a variety of user fee and other collections proposals that would yield $1.4 billion in 1997 and $11.2 billion from 1997 through 2002. These proposals establish, increase, or extend fees in order to recover more of the costs of providing government services. Table 4–2 splits the proposals between discretionary and mandatory categories for the appropriate scoring under the Budget Enforcement Act of 1990 (BEA). It includes offsetting collections and user fees classified as governmental receipts.

Table 4–1. OFFSETTING COLLECTIONS FROM THE PUBLIC

(In millions of dollars)

Type	1995 actual	Estimate	
		1996	1997
Collections deposited in receipt accounts:			
Medicare premiums	20,241	19,842	20,287
Military assistance trust fund property sales	12,469	13,020	12,230
Outer Continental Shelf payments, naval petroleum reserve lease and other undistributed offsetting receipts	2,419	4,489	4,098
Spectrum auction proceeds, undistributed	7,644	4,350	3,600
Sale of property and services, interest income and all other collections deposited in receipt accounts	20,343	21,710	20,129
Subtotal, collections from the public deposited in receipt accounts	63,116	63,411	60,344
Collections credited to appropriations accounts:			
Postal Service stamp sales and other collections	53,311	55,779	57,724
Deposit insurance funds	26,272	16,715	5,483
Tennessee Valley Authority and Power Administration collections	8,956	9,040	9,006
Commodity Credit Corporation loan repayments and other collections	10,824	7,257	7,604
Other loan repayments	7,028	7,967	7,069
Loan guaranty and other insurance premiums, interest income and all other collections credited to appropriations accounts	45,335	43,681	43,201
Subtotal, collections from the public credited to appropriation accounts	151,726	140,439	130,087
Offsetting collections from the public	214,842	203,850	190,431
Offsetting collections from the public excluding off-budget Postal Service collections	161,531	148,071	132,707

Table 4–2. PROPOSED USER FEES AND OTHER COLLECTIONS

(In millions of dollars)

	1997	1998	1999	2000	2001	2002
User fees						
Discretionary:						
Department of Agriculture:						
Animal and Plant Health Inspection Service—inspection, licensing, and permit fees—Collections and spending authority	8	8	8	8	8	8
Grain Inspection—Packers and Stockyards Administration—standardization and licensing activities: Collections and spending authority	18	18	18	18	18	18
Food Safety and Inspection Service—meat, poultry and eggs overtime inspection fees: Collections and spending authority	109	109	109	109	109	109
Department of Energy:						
Decontamination and decommissioning fee extended to foreign purchasers of U.S. enrichment services—Collections	46	46	46	46	46	46
Department of Health and Human Services—Food and Drug Administration:						
Import user fee to cover inspection/regulatory compliance program—Collections and spending authority	15	15	15	15	15	15
Medical device review and approval—Collections and spending authority	24	24	24	24	24	24
Department of Transportation:						
Aviation-related user fees—Collections and spending authority	150	150	150	150	150	150
Surface Transportation Board—Collections and spending authority	15	15	15	15	15	15
Army Corps of Engineers: Wetlands dredging permit application fees—Collections	7	7	7	7	7	7
Environmental Protection Agency: Registration fee for pesticide manufacturers—Collections	15	.....	.....	.....	.....	.....
Securities and Exchange Commission: Tier 3 fees credited to appropriation—Collections and spending authority	49	49	49	49	49	49
Subtotal, discretionary user fees:						
Collections	456	441	441	441	441	441
Spending authority	388	388	388	388	388	388
Net savings	68	53	53	53	53	53
Mandatory:						
Department of Agriculture: Recover costs for oversight of marketing agreements and orders—Collections and spending authority	10	11	11	11	11	11
Department of Commerce:						
Fisheries management program fees—Collections and spending authority	10	10	10	10	10	10
Patent and Trademark Office surcharges—Collections	.....	.....	119	119	119	119
Department of Education:						
Federal Family Education Loan Program fees:						
Secondary market offset fee—Collections and spending authority	35	35	32	33	34	36
Lender and holder subsidy rebate—Collections and spending authority	27	24	22	22	23	25
Increase lender origination fee—Collections and spending authority	45	52	42	40	49	53
Department of the Interior:						
Expand authority for Park Service, BLM and Forest Service fees:						
Collections	12	17	27	33	43	47
Spending authority	.....	11	16	25	31	40
Hetch Hetchy Dam rental payments—Collections	1	1	1	1	1	1
Hardrock mining claim and location fee extension—Collections	1	2	34	36	37	38
Department of Transportation:						
Oil Spill Liability Trust Fund excise tax—Collections	294	294	296	298	299	300
Railroad safety inspection fees—Collections	47	49	51	53	55	57
Vessel tonnage fees—Collections and spending authority	.....	.....	.....	62	62	62
Department of the Treasury: Internal Revenue Service letter ruling fees extension—Collections	.....	.....	.....	.....	31	31
Department of Veterans Affairs: Nonservice-connected medical copayments and per diems extension—Collections	.....	.....	39	41	42	43
Environmental Protection Agency: Pesticide reregistration fee—Collections and spending authority	5	19	19	14	.....	.....
Federal Deposit Insurance Corporation/Federal Reserve: Examination fees for FDIC-insured banks and bank holding companies:						
Bank Insurance Fund—Collections and spending authority	75	79	82	86	89	93
Federal Reserve—Collections [1]	92	96	100	104	109	114
Federal Emergency Management Agency: Fee to cover 100% of radiological emergency preparedness program—Collections	12	12	12	12	12	12
Nuclear Regulatory Commission: Nuclear facility fees—Collections and spending authority	.....	.....	310	310	310	310
Securities and Exchange Commission:						
Tier 1 fees—increases in existing fees—Collections [1]	47	48	49	50	52	53
Tier 2 fees—new permanent fees deposited in special fund—Collections and spending authority [1]	260	270	281	292	304	316
Subtotal, mandatory user fees:						
Collections	973	1,019	1,537	1,627	1,692	1,731
Spending authority	467	511	515	595	613	646
Net savings	506	508	1,022	1,032	1,079	1,085
Total, user fees:						
Collections	1,429	1,460	1,978	2,068	2,133	2,172
Spending authority	855	899	903	983	1,001	1,034
Net savings	574	561	1,075	1,085	1,132	1,138

[1] Governmental receipts.

Discretionary: The following proposed fees are classified as discretionary because action is required by the Appropriations Committees. In most cases, the proposed levels are tied to the appropriations requests for the specific activity.

Department of Agriculture

Animal and Plant Health Inspection Service (APHIS) fees.—The budget proposes to establish three fees for certain APHIS activities:

- Fees to cover cost of providing animal welfare inspections would be charged to recipients of APHIS services such as animal research centers, humane societies and kennels.
- Fees to cover cost of issuance of biotechnology permits would be charged to firms that manufacture genetically engineered fruit and vegetable commodities, parasitic insects, and animals.
- Fees to cover cost of veterinary biologic licensing, inspection, and testing activities would be paid by veterinary biologic companies that specialize in the production and distribution of animal sperm.

Grain inspection standardization and packers and stockyards licensing fees.—The Administration proposes to allow the Grain Inspection, Packers and Stockyards Administration to charge a fee for equipment testing, quality control, and other services necessary to maintain uniform grain standards. In addition, a licensing fee is proposed to be charged to livestock market dealers and market agencies, meat packers, and live poultry dealers equal to the cost of administering programs under the Packers and Stockyards Act.

Meat, poultry, and egg overtime inspection fee.—The budget includes a proposal to require the meat, poultry, and egg industries to reimburse the Federal Government for the cost of all overtime inspections provided by the Food Safety and Inspection Service. Currently, such fees are required at some FSIS-inspected establishments, but not at others. The Government would continue to pay the full cost of a primary, eight-hour shift.

Department of Energy

Decontamination and decommissioning fee.—The budget includes a proposal to assess a fee on foreign customers of Government enrichment services, similar to the fee paid by domestic purchasers. The fees would be deposited in the Uranium Enrichment Decontamination and Decommissioning fund to carry out environmental cleanup of the Government's three uranium enrichment plants.

Department of Health and Human Services, Food and Drug Administration (FDA)

Import inspection fees.—Legislation will be proposed to assess food importers a fee for import entry inspections. FDA is responsible for inspection of imported food products at the port of entry. Fee proceeds would be used to improve the effectiveness of FDA's regulatory compliance program.

Medical device user fee.—Legislation will be proposed to assess fees on medical device manufacturers who present medical devices for pre-market review. The proceeds would be used to expedite the device review and approval process.

Department of Transportation

Aviation-related user fees.—Legislation will be proposed to establish fees for services or products provided by the Federal Aviation Administration. These fees would be used to offset the cost of supporting the operation and maintenance of a continued safe and efficient National Airspace System.

Surface Transportation Board.—The Administration proposes to create a fee mechanism to completely offset the expenses of the Surface Transportation Board (STB), the successor to the Interstate Commerce Commission (ICC). The fees would be collected from those who benefit from the continuation of the ICC functions transferred to the STB, i.e., railroads and shippers.

Army Corps of Engineers

Wetlands permit fees.—Legislation will be proposed to increase fees for the issuance of wetlands regulatory permits for commercial activities. The fees would be deposited in a special Treasury account and would be available to be used for the regulatory program to the extent provided in appropriations acts.

Environmental Protection Agency (EPA)

Pesticide registration fee.—Legislation will be proposed to impose fees on manufacturers of pesticides to recover the cost of the Pesticide Registration program. Congressional action is required to activate a user fee rule promulgated by EPA that was subsequently suspended by Congress through 1997. The proceeds would be subject to appropriations.

Mandatory fees: The following fees are classified as mandatory because they will be included in authorizing legislation.

Department of Agriculture

Agricultural Marketing Service (AMS) fees.—The Administration proposes to authorize local marketing administrators to collect fees to recover AMS' cost of administering commodity marketing orders and agreements. Marketing orders help stabilize market prices for milk, fruit, and other specialty crops by prescribing certain sale, quality, and quantity guidelines. Currently, costs at the local level are financed by assessments on commodity producers and handlers, while costs of these orders at the national level are funded through appropriations. The proposal would increase the existing assessments.

Department of Commerce

Fisheries management program fees.—The Administration proposes to require the Secretary of Commerce to collect fees from holders of fishing quotas. The fees would be set as percentages of the authorized harvest and would be used for the development and implementation of fishery programs, including social and economic studies, and fisheries management.

Extend surcharge on patent fees.—The budget proposes to extend the Patent and Trademark Office's authority to collect the patent surcharge fee through 2002. The current authority expires in 1998. The fee is charged to patent applicants to pay for processing applications and granting patents.

Department of Education

Federal Family Education Loan (FFEL) program lender and secondary market fees.—The budget includes a proposal to establish two new fees to offset the generous profits lenders and secondary markets achieve through participation in the FFEL program. These fees are (1) a monthly fee on all secondary markets that hold Federally guaranteed student loans, equivalent to the fee that the Student Loan Marketing Association is now required to pay; and (2) a lender and holder subsidy rebate, paid to the Secretary twice each year, based on the unpaid principal amount of each loan held. Legislation will also be proposed to increase the current lender origination fee.

Department of the Interior

Admission, recreation, and commercial user fees.—The budget proposes to authorize the National Park Service to increase certain admission, recreation, and commercial user fees. In addition, eighty percent of new receipts collected by the National Park Service, Bureau of Land Management, and Forest Service would be automatically available to the bureau collecting the fees in the following year, beginning in fiscal year 1998, for visitor services and facilities.

Hetch Hetchy Dam rental payments.—The budget includes a proposal to raise the annual rental for the use of land within Yosemite National Park by the City of San Francisco for a dam and reservoir that supplies drinking water to the city. The amount would be determined annually by the Secretary of the Interior, but must not be less than $597,000. The collections would be placed in a separate fund, to be used subject to appropriations for the annual operation of Yosemite or other national parks in California.

Hardrock mining fees.—The Administration proposes to extend, beyond 1998, the $100 hardrock claim maintenance fee and the $25 location fee assessed on hardrock mine claimants on Federal lands. These fees were initially established in the Omnibus Budget Reconciliation Act of 1993. In addition, the fees would be adjusted annually based on the Consumer Price Index. The fees are used to offset the cost associated with operating the mining law program. They are subject to appropriation.

Department of Transportation

Oil Spill Liability Trust Fund.—The budget proposes to reauthorize the Oil Spill Liability Trust Fund excise tax of $.05/barrel that expired on December 31, 1994. In addition to reauthorizing the tax, the proposal lifts the cap on the fund from $1.0 billion to $2.5 billion. The proceeds of the tax on oil importers are used to fund numerous activities related to oil spill prevention and clean-up. Some of these activities, such as Coast Guard operations funding, are subject to appropriation, while others, such as emergency clean-up are automatically available. The fund balance, (currently over $1.0 billion) is maintained to be available for clean-up in case of a major oil spill.

Railroad safety inspection fee.—Legislation will be proposed to permanently extend the railroad safety inspection fees that were enacted in the Omnibus Budget Reconciliation Act of 1990. This fee offsets the costs incurred by the Federal Railroad Administration for inspection, enforcement, and related activities to ensure the safe operation of passenger and freight railroads. The fee expired at the end of 1995.

Vessel tonnage fees.—The budget proposes to extend fees collected by the Customs Service based on the cargo-carrying capacity of a vessel entering a U.S. port. These fees were set to expire at the end of 1998. The collections are credited to the Department of Transportation to offset costs incurred by the Coast Guard for services provided to the Merchant Marine industry.

Department of the Treasury—Internal Revenue Service

Internal Revenue Service fees.—The Administration proposes to extend the IRS' authority to charge fees for letter rulings, determination letters, and opinion letters. The IRS provides written responses to questions from individuals, corporations and organizations relating to their tax status or the effects of particular transactions for tax purposes. The fees charged for these requests, which are scheduled to expire on September 30, 2000, are proposed to be extended through September 30, 2002.

Department of Veterans Affairs

Medical care prescription co-payments and per diems.—The budget proposes to permanently extend VA's authority to collect prescription co-payments and per diems for hospital and nursing home visits from veterans for the treatment of nonservice-connected disabilities. The current authority expires in 1998.

Environmental Protection Agency

Pesticide reregistration fee.—Legislation will be proposed to increase fees collected from pesticide manufacturers in support of re-registration of pesticides currently in use. The fees would also be extended beyond the current expiration date in order to fund timely completion of the reregistration program. Fees are paid by industry to offset costs incurred by the accelerated reregistration and expedited processing of pesticides.

Federal Deposit Insurance Corporation (FDIC) and Federal Reserve (Fed)

State bank examination fee.—The Administration proposes to require the FDIC and the Federal Reserve to assess fees for examinations of FDIC-insured banks and bank-holding companies. The costs of such examinations are currently funded from deposit insurance premiums and Fed earnings from monetary policy activities. The FDIC fee proceeds would be used to finance the examinations operation. The Fed proceeds would be transferred to Treasury annually in the form of surplus earnings.

Federal Emergency Management Agency (FEMA)

Radiological emergency preparedness fee.—The budget includes a proposal to reauthorize FEMA's assessments on Nuclear Regulatory Commission (NRC) licensees to cover 100 percent of the cost of providing site-specific services that directly contribute to the fulfillment of emergency preparedness requirements needed for NRC licensing. This proposal would extend the authority through 2002.

Nuclear Regulatory Commission

Nuclear Regulatory Commission (NRC) fees.—Under current law, the NRC must recover 100% of its costs from licensing, inspection and annual fees charged to its applicants and licensees through 1998. Unless the law is extended, the fee coverage requirement will revert to 33 percent of NRC costs. The budget includes a proposal to extend the fees at 100 percent of NRC's cost of operations through 2002.

Securities and Exchange Commission

Securities-related fees.—The Administration proposes to increase certain fees collected under the securities laws as part of a legislative package to provide the Securities and Exchange Commission (SEC) with a sound and stable funding structure. This proposal calls for three tiers of fee income. Tier 1 would be comprised of permanent increases in existing registration and tender offer receipts collected under the securities laws. Tier 2 would establish a new set of permanent transaction fees in the securities laws affecting the over-the-counter market and certain bonds. These fees would be credited to a special fund in the Treasury and the SEC would have authority to spend such sums as may be deposited in this fund. The authority for Tiers 1 and 2 is mandatory. Tier 3 would provide the appropriations committee with authority to increase certain specified receipts collected under the securities laws, which would be deposited as offsetting collections to the SEC's appropriation. The collection and use of the Tier 3 fees are discretionary, and thus would be contingent on appropriation action.

OFFSETTING RECEIPTS

Table 4–3 itemizes all offsetting collections deposited in receipt accounts. These include payments from one part of the Government to another, called intragovernmental transactions, and collections from the public. These receipts are offset (deducted) from outlays in the Federal budget. In total, offsetting receipts are estimated at $328.4 billion in 1997.

Table 4–3. OFFSETTING RECEIPTS BY TYPE

(In millions of dollars)

Source	1995 actual	1996 estimate	1997 estimate
INTRAGOVERNMENTAL TRANSACTIONS			
On-budget receipts:			
Federal intrafund transactions:			
Distributed by agency:			
Interest from the Federal Financing Bank	7,422	6,116	4,702
Interest on Government capital in enterprises	1,828	1,729	1,545
Other	997	1,074	1,058
Proposed Legislation (PAYGO)	.....	37	.....
Total Federal intrafunds	10,247	8,956	7,305
Trust intrafund transactions:			
Distributed by agency:			
Payments to railroad retirement	4,120	3,770	3,838
Other	1	67	−13
Total trust intrafunds	4,121	3,837	3,825
Total intrafund transactions	14,368	12,793	11,130
Interfund transactions:			
Distributed by agency:			
Federal fund payments to trust funds:			
Contributions to insurance programs:			
Military retirement fund	11,470	10,699	11,181
Supplementary medical insurance	36,988	61,331	59,456
Proposed Legislation (non-PAYGO)	.....	.....	7,867
Hospital insurance	4,504	4,627	4,973
Railroad social security equivalent fund	3,126	3,239	3,305
Rail industry pension fund	177	181	186
Civilian supplementary retirement contributions	20,277	20,900	21,316
Proposed Legislation (PAYGO)	.....	.....	−23
Unemployment insurance	1,233	675	687
Other contributions	706	955	886
Miscellaneous payments	505	544	580
Subtotal	78,986	103,151	110,414
Trust fund payments to Federal funds:			
Repayment of loans or advances to trust funds	3,024	3,081	3,195
Quinquennial adjustment for military service credits	.....	332	.....
Other	976	1,035	993
Subtotal	4,000	4,448	4,188
Total interfunds distributed by agency	82,986	107,599	114,602
Undistributed by agency:			
Employer share, employee retirement (on-budget): [2]			
Civil service retirement and disability insurance	7,732	7,767	7,927
CSRDI from Postal Service	5,431	5,637	5,825
Hospital insurance (contribution as employer) [1]	1,885	1,817	1,868
Postal employer contributions to FHI	564	549	562
Military retirement fund	12,238	11,250	11,192
Other Federal employees retirement	111	118	125
Total employer share, employee retirement (on-budget)	27,961	27,138	27,499
Interest received by on-budget trust funds	59,867	61,163	61,066
Proposed Legislation (non-PAYGO)	.....	−5	746
Total interfund transactions undistributed by agency	87,828	88,296	89,311
Total interfund transactions	170,814	195,895	203,913
Total on-budget receipts	185,182	208,688	215,043
Off-budget receipts:			
Interfund transactions:			
Distributed by agency:			
Federal fund payments to trust funds:			
Old-age, survivors, and disability insurance	5,475	6,103	7,019
Undistributed by agency:			
Employer share, employee retirement (off-budget)	6,432	6,291	6,664
Interest received by off-budget trust funds	33,305	36,440	39,361
Total off-budget receipts:	45,212	48,834	53,044
Total intragovernmental transactions	**230,394**	**257,522**	**268,087**
PROPRIETARY RECEIPTS FROM THE PUBLIC			
Distributed by agency:			
Interest:			
Interest on foreign loans and deferred foreign collections	1,018	679	644
Interest on deposits in tax and loan accounts	946	933	1,078
Other interest (domestic—civil) [3]	3,010	2,077	3,188
Total interest	4,974	3,689	4,910
Royalties and rents	1,090	1,138	1,154
Proposed Legislation (PAYGO)	.....	.....	1
Sale of products:			
Sale of timber and other natural land products	564	824	816
Sale of minerals and mineral products	423	572	416
Proposed Legislation (PAYGO)	.....	21	79
Sale of power and other utilities	737	796	852
Other [3]	102	47	39
Total sale of products	1,826	2,260	2,202
Fees and other charges for services and special benefits:			
Medicare premiums and other charges (trust funds)	20,241	19,842	20,287
Proposed Legislation (PAYGO)	.....	.....	−288
Nuclear waste disposal revenues	597	630	637
Veterans life insurance (trust funds)	272	281	258
Other [3]	2,095	2,010	2,135
Proposed Legislation (PAYGO)	.....	.....	57
Total fees and other charges	23,205	22,763	23,086
Sale of Government property:			
Military assistance program sales (trust funds)	12,469	13,020	12,230
Other	57	38	39
Total sale of Government property	12,526	13,058	12,269
Realization upon loans and investments:			
Dollar repayments of loans, Agency for International Development	539	.....	.....
Foreign military credit sales	674	634	613
Negative subsidies and downward reestimates	1,087	3,364	1,593
Proposed Legislation (non-PAYGO)	.....	161	260
Proposed Legislation (PAYGO)	.....	1,386	.....
Repayment of loans to United Kingdom	104	106	108
Other	162	123	128
Total realization upon loans and investments	2,566	5,774	2,702

Table 4–3. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	1995 actual	1996 estimate	1997 estimate
Recoveries and refunds [3]	1,932	1,717	1,877
Proposed Legislation (non-PAYGO)	.....	11	49
Proposed Legislation (PAYGO)	.....	.....	100
Miscellaneous receipt accounts [3]	2,304	1,572	1,547
Proposed Legislation (non-PAYGO)	.....	.....	7
Total proprietary receipts from the public distributed by agency	50,423	51,982	49,904
Undistributed by agency:			
Other interest: Interest received from Outer Continental Shelf escrow account	1	.....	905
Rents and royalties on the Outer Continental Shelf:			
Rents and bonuses	414	401	839
Royalties	2,004	2,288	2,269
Sale of major assets	.....	.....	85
Proposed Legislation (PAYGO)	.....	1,800	.....
Total proprietary receipts from the public undistributed by agency	2,419	4,489	4,098
Total proprietary receipts from the public [4]	**52,842**	**56,471**	**54,002**

Source	1995 actual	1996 estimate	1997 estimate
OFFSETTING GOVERNMENTAL RECEIPTS			
Distributed by agency:			
Regulatory fees	2,565	2,505	2,598
Proposed Legislation (non-PAYGO)	.....	.....	22
Proposed Legislation (PAYGO)	.....	22	59
Other	65	63	63
Undistributed by agency:			
Spectrum auction proceeds	7,644	4,200	1,600
Proposed Legislation (PAYGO)	.....	150	2,000
Total offsetting governmental receipts	**10,274**	**6,940**	**6,342**
Total offsetting receipts	**293,510**	**320,933**	**328,431**

[1] Interchange receipts between the social security and railroad retirement funds place the social security funds in the same position they would have been if there were no separate railroad retirement system.
[2] Includes provision for covered Federal civilian employees and military personnel.
[3] Includes both Federal funds and trust funds.
[4] Consists of:

	1995 actual	*1996 estimate*	*1997 estimate*
On-budget:			
Federal funds	18,389	22,259	20,452
Trust funds	34,444	34,200	33,538
Off-budget:			
Trust funds	9	12	12

1997

5. TAX EXPENDITURES

Tax expenditures are revenue losses due to preferential provisions of the Federal tax laws, such as special exclusions, exemptions, deductions, credits, deferrals, or tax rates. Tax expenditures are an alternative to other Government policy instruments, such as direct expenditures and regulations. The Congressional Budget Act of 1974 (Public Law 93–344) requires that a list of tax expenditures be included in the budget.

Tax expenditures relating to the individual and corporate income taxes are considered first in this chapter, followed by those relating to the unified transfer tax. The supplement at the end of the chapter presents major tax expenditures in the income tax ranked by revenue loss.

Tax expenditures are estimated for fiscal years 1995–2001 using three methods of accounting: revenue loss, outlay equivalent, and present value. The present value approach provides estimates of the revenue losses for tax expenditures that involve deferrals of tax payments into the future or have similar long-term effects.

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

The Treasury Department prepared all tax expenditure estimates presented here based upon income tax law enacted as of December 31, 1995. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 1995.

The total revenue loss estimates for tax expenditures for fiscal years 1995–2001 are displayed by the budget's functional categories in table 5–1. Descriptions of the specific tax expenditure provisions follow the tables of estimates and discussion of general features of the tax expenditure concept.

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

Table 5–2 reports the respective portions of the total revenue losses that arise under the individual and corporate income taxes. Listing revenue loss estimates under the individual and corporate headings does not imply that these categories of filers benefit from the special tax provisions in proportion to the respective tax expenditure amounts shown. Rather, these breakdowns show the specific tax accounts through which the various provisions are cleared. The ultimate beneficiaries of corporate tax expenditures, for example, could be stockholders, employees, customers, or others, depending on the circumstances.

Table 5–6 at the end of this chapter ranks the major tax expenditures by fiscal year 1997 revenue loss. This table merges several individual entries provided in table 5–1; for example, table 5–6 contains one merged entry for charitable contributions instead of the three separate entries found in table 5–1.

TABLE 5–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX

(In millions of dollars)

Provision	Total Revenue Loss							
	1995	1996	1997	1998	1999	2000	2001	1997–2001
National defense:								
Exclusion of benefits and allowances to armed forces personnel	2,000	2,060	2,080	2,095	2,120	2,140	2,160	10,595
International affairs:								
Exclusion of income earned abroad by United States citizens	1,670	1,870	2,100	2,355	2,645	2,965	3,330	13,395
Exclusion of income of foreign sales corporations	1,400	1,500	1,600	1,700	1,800	1,900	2,000	9,000
Inventory property sales source rules exception	1,300	1,400	1,500	1,600	1,700	1,800	1,900	8,500
Interest allocation rules exception for certain financial operations	95	95	95	95	95	95	95	475
Deferral of income from controlled foreign corporations (normal tax method)	1,700	1,800	2,000	2,200	2,400	2,600	2,900	12,100
General science, space, and technology:								
Expensing of research and experimentation expenditures (normal tax method)	1,635	1,740	1,840	1,945	2,065	2,190	2,320	10,360
Credit for increasing research activities	1,185	675	285	120	40	5	.....	450
Suspension of the allocation of research and experimentation expenditures	325	.....	.....	.....	.....	.....	.....	.....
Energy:								
Expensing of exploration and development costs:								
Oil and gas	–300	–255	–165	–75	0	95	80	–65
Other fuels	15	15	15	15	15	15	20	80
Excess of percentage over cost depletion:								
Oil and gas	945	985	1,020	1,060	1,105	1,145	1,195	5,525
Other fuels	120	120	125	140	140	155	155	715
Alternative fuel production credit	970	1,000	990	940	880	820	760	4,390
Exception from passive loss limitation for working interests in oil and gas properties	55	60	60	65	65	70	75	335
Capital gains treatment of royalties on coal	15	15	15	15	15	15	15	75
Exclusion of interest on State and local IDBs for energy facilities	175	180	180	175	175	165	160	855
New technology credit	140	140	145	155	165	175	185	825
Alcohol fuel credit [1]	10	10	10	10	10	10	10	50
Tax credit and deduction for clean-fuel burning vehicles and properties	65	65	65	75	80	85	90	395
Exclusion from income of conservation subsidies provided by public utilities	130	155	165	165	155	155	145	785
Natural resources and environment:								
Expensing of exploration and development costs, nonfuel minerals	35	35	35	35	35	35	35	175
Excess of percentage over cost depletion, nonfuel minerals	220	225	235	240	245	245	255	1,220
Capital gains treatment of iron ore	0	0	0	0	0	0	0	0
Special rules for mining reclamation reserves	50	50	50	50	50	50	50	250
Exclusion of interest on State and local IDBs for pollution control and sewage and waste disposal facilities	635	630	615	605	600	575	555	2,950
Capital gains treatment of certain timber income	15	15	15	15	15	15	15	75
Expensing of multiperiod timber growing costs	370	395	415	440	460	485	505	2,305
Investment credit and seven-year amortization for reforestation expenditures	45	45	50	50	50	50	50	250
Tax incentives for preservation of historic structures	125	125	120	115	115	110	105	565
Agriculture:								
Expensing of certain capital outlays	70	65	65	65	70	70	70	340
Expensing of certain multiperiod production costs	85	80	80	80	85	85	85	415
Treatment of loans forgiven solvent farmers as if insolvent	10	10	10	10	10	10	10	50
Capital gains treatment of certain income	145	145	140	145	145	150	155	735
Commerce and housing:								
Financial institutions and insurance:								
Exemption of credit union income	630	650	710	780	860	940	1,030	4,320
Excess bad debt reserves of financial institutions	95	105	115	125	135	150	160	685
Exclusion of interest on life insurance savings	9,905	10,670	11,470	12,340	13,260	14,255	14,950	66,275
Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25
Tax exemption of certain insurance companies	235	240	245	255	260	280	300	1,340
Small life insurance company deduction	110	115	120	130	135	140	145	670
Housing:								
Exclusion of interest on owner-occupied mortgage subsidy bonds	1,810	1,810	1,770	1,710	1,655	1,605	1,540	8,280
Exclusion of interest on State and local debt for rental housing	925	875	815	760	700	630	545	3,450
Deductibility of mortgage interest on owner-occupied homes	48,080	50,575	53,075	55,750	58,590	61,655	64,915	293,985
Deductibility of State and local property tax on owner-occupied homes	15,275	16,070	16,860	17,710	18,615	19,590	20,620	93,395
Deferral of income from post 1987 installment sales	935	955	975	995	1,015	1,035	1,055	5,075
Deferral of capital gains on home sales	14,180	14,605	15,040	15,490	15,955	16,435	16,930	79,850
Exclusion of capital gains on home sales for persons age 55 and over	5,160	5,185	5,075	5,465	5,280	5,755	5,480	27,055
Exception from passive loss rules for $25,000 of rental loss	4,515	4,235	3,985	3,745	3,520	3,305	3,070	17,625
Accelerated depreciation on rental housing (normal tax method)	1,045	1,170	1,305	1,485	1,675	2,165	2,455	9,085
Commerce:								
Cancellation of indebtedness	105	70	40	15	0	–10	–5	40
Permanent exceptions from imputed interest rules	150	150	155	155	160	160	160	790
Capital gains (other than agriculture, timber, iron ore, and coal) (normal tax method)	7,125	7,000	6,920	7,035	7,195	7,385	7,560	36,095
Capital gains exclusion of small corporation stock	0	0	0	5	30	70	110	215

TABLE 5–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

Provision	Total Revenue Loss							
	1995	1996	1997	1998	1999	2000	2001	1997–2001
Step-up basis of capital gains at death	28,305	29,480	30,265	30,710	31,160	31,615	32,075	155,825
Carryover basis of capital gains on gifts	130	140	150	160	170	180	190	850
Ordinary income treatment of loss from small business corporation stock sale	105	215	305	370	380	355	305	1,715
Accelerated depreciation of buildings other than rental housing (normal tax method)	7,440	6,735	5,720	4,590	3,410	2,420	1,600	17,740
Accelerated depreciation of machinery and equipment (normal tax method)	24,460	27,160	29,500	31,210	33,030	33,575	32,240	159,555
Expensing of certain small investments (normal tax method)	1,815	1,520	1,120	795	600	320	155	2,990
Amortization of start-up costs (normal tax method)	185	195	200	205	210	210	220	1,045
Graduated corporation income tax rate (normal tax method)	4,105	4,435	4,730	5,015	5,345	5,710	6,085	26,885
Exclusion of interest on small issue IDBs	555	435	345	295	280	265	260	1,445
Deferral of gains from sale of broadcasting facilities to minority owned business	285	.....	.....	.....	.....	.....	.....	.....
Treatment of Alaska Native Corporations	30	20	15	10	5	5	5	40
Transportation:								
Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
Exclusion of reimbursed employee parking expenses	1,215	1,255	1,290	1,330	1,370	1,410	1,455	6,855
Exclusion for employer-provided transit passes	35	50	60	70	85	100	120	435
Community and regional development:								
Credit for low-income housing investments	2,260	2,600	2,945	3,270	3,500	3,595	3,445	16,755
Investment credit for rehabilitation of structures (other than historic)	80	80	80	70	70	70	65	355
Exclusion of interest on IDBs for airports, docks, and sports and convention facilities	855	910	965	1,025	1,090	1,145	1,205	5,430
Exemption of certain mutuals' and cooperatives' income	50	50	50	55	55	60	60	280
Empowerment zones	250	330	385	425	450	475	490	2,225
Education, training, employment, and social services:								
Education:								
Exclusion of scholarship and fellowship income (normal tax method)	825	835	845	850	860	870	875	4,300
Exclusion of interest on State and local student loan bonds	315	305	290	275	260	250	240	1,315
Exclusion of interest on State and local debt for private nonprofit educational facilities	770	795	830	870	910	955	990	4,555
Exclusion of interest on savings bonds transferred to educational institutions	5	5	10	10	15	15	15	65
Parental personal exemption for students age 19 or over	820	825	835	870	905	955	1,015	4,580
Deductibility of charitable contributions (education)	1,780	1,870	1,965	2,065	2,165	2,275	2,385	10,855
Exclusion of employer provided educational assistance	100	.....	.....	.....	.....	.....	.....	.....
Training, employment, and social services:								
Targeted jobs credit	395	325	60	40	20	5	.....	125
Exclusion of employer provided child care	725	775	830	890	955	1,025	1,100	4,800
Exclusion of employee meals and lodging (other than military)	545	570	600	630	665	700	735	3,330
Credit for child and dependent care expenses	2,730	2,865	3,005	3,155	3,315	3,480	3,655	16,610
Credit for disabled access expenditures	160	160	165	165	165	170	170	835
Expensing of costs of removing certain architectural barriers to the handicapped	20	20	20	20	20	20	20	100
Deductibility of charitable contributions, other than education and health	19,565	20,565	21,600	22,675	23,815	25,000	26,240	119,330
Exclusion of certain foster care payments	30	30	35	35	35	40	40	185
Exclusion of parsonage allowances	265	285	300	320	345	365	390	1,720
Health:								
Exclusion of employer contributions for medical insurance premiums and medical care	59,440	64,520	70,490	77,040	84,125	91,620	99,925	423,200
Deductibility of medical expenses	3,495	3,785	4,125	4,510	4,930	5,395	5,895	24,855
Exclusion of interest on State and local debt for private nonprofit health facilities	1,535	1,595	1,675	1,750	1,845	1,935	2,015	9,220
Deductibility of charitable contributions (health)	2,280	2,395	2,510	2,630	2,755	2,885	3,020	13,800
Tax credit for orphan drug research	15	.....	.....	.....	.....	.....	.....	.....
Special Blue Cross/Blue Shield deduction	125	140	100	170	185	220	280	955
Income security:								
Exclusion of railroad retirement system benefits	430	445	450	455	460	465	470	2,300
Exclusion of workmen's compensation benefits	4,475	4,855	5,050	5,255	5,515	5,800	6,205	27,825
Exclusion of public assistance benefits (normal tax method)	570	590	635	695	740	795	850	3,715
Exclusion of special benefits for disabled coal miners	95	90	85	85	80	75	70	395
Exclusion of military disability pensions	130	130	130	130	130	130	130	650
Net exclusion of pension contributions and earnings:								
Employer plans	52,070	55,370	55,770	56,205	56,625	57,045	57,470	283,115
Individual Retirement Accounts	7,720	7,830	7,940	8,335	8,420	8,455	8,490	41,640
Keogh plans	3,315	3,345	3,580	3,780	3,935	4,090	4,240	19,625
Exclusion of employer provided death benefits	30	35	35	35	40	40	45	195
Exclusion of other employee benefits:								
Premiums on group term life insurance	2,880	3,020	3,170	3,325	3,485	3,660	3,865	17,505
Premiums on accident and disability insurance	150	155	165	175	185	195	205	925
Income of trusts to finance supplementary unemployment benefits	20	20	20	20	20	20	20	100
Special ESOP rules (other than investment credit)	2,125	1,745	1,540	1,405	1,280	1,170	1,065	6,460
Additional deduction for the blind	25	25	25	25	25	30	30	135
Additional deduction for the elderly	1,305	1,320	1,340	1,355	1,365	1,375	1,385	6,820

TABLE 5–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

Provision	Total Revenue Loss							
	1995	1996	1997	1998	1999	2000	2001	1997–2001
Tax credit for the elderly and disabled	50	55	55	60	60	65	65	305
Deductibility of casualty losses	800	445	465	490	515	540	570	2,580
Earned income credit [2]	4,920	5,670	6,250	6,460	6,820	7,105	7,510	34,145
Social Security:								
Exclusion of social security benefits:								
OASI benefits for retired workers	16,015	16,465	17,285	18,080	18,880	19,525	20,515	94,285
Disability insurance benefits	1,975	2,180	2,375	2,580	2,800	3,030	3,265	14,050
Benefits for dependents and survivors	3,630	3,820	4,030	4,245	4,470	4,695	4,935	22,375
Veterans benefits and services:								
Exclusion of veterans disability compensation	2,665	2,820	2,985	3,160	3,335	3,515	3,720	16,715
Exclusion of veterans pensions	75	70	70	70	75	85	90	390
Exclusion of GI bill benefits	50	65	70	80	90	95	100	435
Exclusion of interest on State and local debt for veterans housing	85	80	80	80	85	85	90	420
General purpose fiscal assistance:								
Exclusion of interest on public purpose State and local debt	12,700	13,175	13,775	14,455	15,195	15,905	16,535	75,865
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	27,735	29,175	30,620	32,160	33,800	35,570	37,445	169,595
Tax credit for corporations receiving income from doing business in U.S. possessions	2,745	2,795	2,855	3,025	3,205	3,400	3,600	16,085
Interest:								
Deferral of interest on savings bonds	1,100	1,160	1,210	1,280	1,340	1,410	1,480	6,720
Addendum—Aid to State and local governments:								
Deductibility of:								
Property taxes on owner-occupied homes	15,275	16,070	16,860	17,710	18,615	19,590	20,620	93,395
Nonbusiness State and local taxes other than on owner-occupied homes	27,735	29,175	30,620	32,160	33,800	35,570	37,445	169,595
Exclusion of interest on:								
Public purpose State and local debt	12,700	13,175	13,775	14,455	15,195	15,905	16,535	75,865
IDBs for certain energy facilities	175	180	180	175	175	165	160	855
IDBs for pollution control and sewage and waste disposal facilities	635	630	615	605	600	575	555	2,950
Small-issue IDBs	555	435	345	295	280	265	260	1,445
Owner-occupied mortgage revenue bonds	1,810	1,810	1,770	1,710	1,655	1,605	1,540	8,280
State and local debt for rental housing	925	875	815	760	700	630	545	3,450
IDBs for airports, docks, and sports and convention facilities	855	910	965	1,025	1,090	1,145	1,205	5,430
State and local student loan bonds	315	305	290	275	260	250	240	1,315
State and local debt for private nonprofit educational facilities	770	795	830	870	910	955	990	4,555
State and local debt for private nonprofit health facilities	1,535	1,595	1,675	1,750	1,845	1,935	2,015	9,220
State and local debt for veterans housing	85	80	80	80	85	85	90	420

[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 1995: $615; 1996: $645; 1997: $665; 1998: $685; 1999: $705; 2000: $730; and 2001: $750.

[2] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1995: $15,245; 1996: $18,655; 1997: $20,450; 1998: $21,255; 1999: $22,175; 2000: $23,210; and 2001: $24,115.

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

All estimates have been rounded to the nearest $5 million.

Figures in table 5–1 are the arithmetic sums of corporate and individual income tax revenue loss estimates from table 5–2, and do not reflect possible interactions across these two taxes.

TABLE 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES

(In millions of dollars)

Provision	Revenue Loss													
	Corporations							Individuals						
	1995	1996	1997	1998	1999	2000	2001	1995	1996	1997	1998	1999	2000	2001
National defense:														
Exclusion of benefits and allowances to armed forces personnel	...	...	...	...	...	...	...	2,000	2,060	2,080	2,095	2,120	2,140	2,160
International affairs:														
Exclusion of income earned abroad by United States citizens	...	...	...	...	...	...	...	1,670	1,870	2,100	2,355	2,645	2,965	3,330
Exclusion of income of foreign sales corporations	1,400	1,500	1,600	1,700	1,800	1,900	2,000	...	...	...	...	...	...	...
Inventory property sales source rules exception	1,300	1,400	1,500	1,600	1,700	1,800	1,900	...	...	...	...	...	...	...
Interest allocation rules exception for certain financial operations	95	95	95	95	95	95	95	...	...	...	...	...	...	...
Deferral of income from controlled foreign corporations (normal tax method)	1,700	1,800	2,000	2,200	2,400	2,600	2,900	...	...	...	...	...	...	...
General science, space, and technology:														
Expensing of research and experimentation expenditures (normal tax method)	1,605	1,705	1,805	1,910	2,025	2,150	2,275	30	35	35	35	40	40	45
Credit for increasing research activities	1,155	665	285	120	40	5	...	30	10	...	...	...	...	...
Suspension of the allocation of research and experimentation expenditures	325	...	...	...	...	...	...	...	...	...	...	...	...	...
Energy:														
Expensing of exploration and development costs:														
Oil and gas	–225	–190	–125	–55	0	70	60	–75	–65	–40	–20	0	25	20
Other fuels	10	10	10	10	10	10	15	5	5	5	5	5	5	5
Excess of percentage over cost depletion:														
Oil and gas	710	740	765	795	830	860	895	235	245	255	265	275	285	300
Other fuels	90	90	95	105	105	115	115	30	30	30	35	35	40	40
Alternative fuel production credit	820	850	840	800	750	700	650	150	150	150	140	130	120	110
Exception from passive loss limitation for working interests in oil and gas properties	...	...	...	...	...	...	...	55	60	60	65	65	70	75
Capital gains treatment of royalties on coal	...	...	...	...	...	...	...	15	15	15	15	15	15	15
Exclusion of interest on State and local IDBs for energy facilities	70	70	70	70	70	65	65	105	110	110	105	105	100	95
New technology credit	140	140	145	155	165	175	185	0	0	0	0	0	0	0
Alcohol fuel credit [1]	5	5	5	5	5	5	5	5	5	5	5	5	5	5
Tax credit and deduction for clean-fuel burning vehicles and properties	55	55	55	60	60	60	65	10	10	10	15	20	25	25
Exclusion from income of conservation subsidies provided by public utilities	80	100	105	100	90	85	75	50	55	60	65	65	70	70
Natural resources and environment:														
Expensing of exploration and development costs, nonfuel minerals	25	25	25	25	25	25	25	10	10	10	10	10	10	10
Excess of percentage over cost depletion, nonfuel minerals	165	170	175	180	185	185	190	55	55	60	60	60	60	65
Capital gains treatment of iron ore	...	...	...	...	...	...	...	0	0	0	0	0	0	0
Special rules for mining reclamation reserves	45	45	45	45	45	45	45	5	5	5	5	5	5	5
Exclusion of interest on State and local IDBs for pollution control and sewage and waste disposal facilities	255	250	245	240	235	230	220	380	380	370	365	365	345	335
Capital gains treatment of certain timber income	...	...	...	...	...	...	...	15	15	15	15	15	15	15
Expensing of multiperiod timber growing costs	210	225	235	250	260	275	285	160	170	180	190	200	210	220
Investment credit and seven-year amortization for reforestation expenditures	20	20	20	20	20	20	20	25	25	30	30	30	30	30
Tax incentives for preservation of historic structures	25	25	25	25	25	20	20	100	100	95	90	90	90	85
Agriculture:														
Expensing of certain capital outlays	10	10	10	10	10	10	10	60	55	55	55	60	60	60
Expensing of certain multiperiod production costs	10	10	10	10	10	10	10	75	70	70	70	75	75	75
Treatment of loans forgiven solvent farmers as if insolvent	...	...	...	...	...	...	...	10	10	10	10	10	10	10
Capital gains treatment of certain income	...	...	...	...	...	...	...	145	145	140	145	145	150	155
Commerce and housing:														
Financial institutions and insurance:														
Exemption of credit union income	630	650	710	780	860	940	1,030	...	...	...	...	...	...	...
Excess bad debt reserves of financial institutions	95	105	115	125	135	150	160	...	...	...	...	...	...	...
Exclusion of interest on life insurance savings	275	295	320	340	375	400	415	9,630	10,375	11,150	12,000	12,885	13,855	14,535
Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	...	...	...	...	...	...	...
Tax exemption of certain insurance companies	235	240	245	255	260	280	300	...	...	...	...	...	...	...
Small life insurance company deduction	110	115	120	130	135	140	145	...	...	...	...	...	...	...
Housing:														
Exclusion of interest on owner-occupied mortgage subsidy bonds	725	720	705	680	660	635	610	1,085	1,090	1,065	1,030	995	970	930
Exclusion of interest on State and local debt for rental housing	365	345	320	300	275	245	215	560	530	495	460	425	385	330
Deductibility of mortgage interest on owner-occupied homes	...	...	...	...	...	...	...	48,080	50,575	53,075	55,750	58,590	61,655	64,915
Deductibility of State and local property tax on owner-occupied homes	...	...	...	...	...	...	...	15,275	16,070	16,860	17,710	18,615	19,590	20,620
Deferral of income from post 1987 installment sales	235	245	255	265	275	285	295	700	710	720	730	740	750	760
Deferral of capital gains on home sales	...	...	...	...	...	...	...	14,180	14,605	15,040	15,490	15,955	16,435	16,930
Exclusion of capital gains on home sales for persons age 55 and over	...	...	...	...	...	...	...	5,160	5,185	5,075	5,465	5,280	5,755	5,480
Exception from passive loss rules for $25,000 of rental loss	...	...	...	...	...	...	...	4,515	4,235	3,985	3,745	3,520	3,305	3,070
Accelerated depreciation on rental housing (normal tax method)	660	735	820	945	1,080	1,495	1,730	385	435	485	540	595	670	725

TABLE 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

Provision	Revenue Loss													
	Corporations							Individuals						
	1995	1996	1997	1998	1999	2000	2001	1995	1996	1997	1998	1999	2000	2001
Commerce:														
Cancellation of indebtedness	.....	.....	.....	.....	.....	.....	.....	105	70	40	15	0	–10	–5
Permanent exceptions from imputed interest rules	.....	.....	.....	.....	.....	.....	.....	150	150	155	155	160	160	160
Capital gains (other than agriculture, timber, iron ore, and coal) (normal tax method)	.....	.....	.....	.....	.....	.....	.....	7,125	7,000	6,920	7,035	7,195	7,385	7,560
Capital gains exclusion of small corporation stock	.....	.....	.....	.....	.....	.....	.....	0	0	0	5	30	70	110
Step-up basis of capital gains at death	.....	.....	.....	.....	.....	.....	.....	28,305	29,480	30,265	30,710	31,160	31,615	32,075
Carryover basis of capital gains on gifts	.....	.....	.....	.....	.....	.....	.....	130	140	150	160	170	180	190
Ordinary income treatment of loss from small business corporation stock sale	.....	.....	.....	.....	.....	.....	.....	105	215	305	370	380	355	305
Accelerated depreciation of buildings other than rental housing (normal tax method)	5,270	4,730	4,000	3,200	2,380	1,735	1,150	2,170	2,005	1,720	1,390	1,030	685	450
Accelerated depreciation of machinery and equipment (normal tax method)	19,760	21,575	23,235	24,460	25,790	26,115	25,040	4,700	5,585	6,265	6,750	7,240	7,460	7,200
Expensing of certain small investments (normal tax method)	1,120	930	685	500	385	220	135	695	590	435	295	215	100	20
Amortization of start-up costs (normal tax method)	85	90	90	95	95	95	100	100	105	110	110	115	115	120
Graduated corporation income tax rate (normal tax method)	4,105	4,435	4,730	5,015	5,345	5,710	6,085	.....	.....	.....	.....	.....	.....	.....
Exclusion of interest on small issue IDBs	215	165	135	115	110	105	105	340	270	210	180	170	160	155
Deferral of gains from sale of broadcasting facilities to minority owned business	285	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Treatment of Alaska Native Corporations	30	20	15	10	5	5	5	.....	.....	.....	.....	.....	.....	.....
Transportation:														
Deferral of tax on shipping companies	20	20	20	20	20	20	20	.....	.....	.....	.....	.....	.....	.....
Exclusion of reimbursed employee parking expenses	.....	.....	.....	.....	.....	.....	.....	1,215	1,255	1,290	1,330	1,370	1,410	1,455
Exclusion for employer-provided transit passes	.....	.....	.....	.....	.....	.....	.....	35	50	60	70	85	100	120
Community and regional development:														
Credit for low-income housing investments	450	520	590	655	700	720	690	1,810	2,080	2,355	2,615	2,800	2,875	2,755
Investment credit for rehabilitation of structures (other than historic)	15	15	15	15	15	15	15	65	65	65	55	55	55	50
Exclusion of interest on IDBs for airports, docks, and sports and convention facilities	345	365	390	415	440	460	485	510	545	575	610	650	685	720
Exemption of certain mutuals' and cooperatives' income	50	50	50	55	55	60	60	.....	.....	.....	.....	.....	.....	.....
Empowerment zones	75	100	120	135	140	150	150	175	230	265	290	310	325	340
Education, training, employment, and social services:														
Education:														
Exclusion of scholarship and fellowship income (normal tax method)	.....	.....	.....	.....	.....	.....	.....	825	835	845	850	860	870	875
Exclusion of interest on State and local student loan bonds	125	120	115	110	105	100	95	190	185	175	165	155	150	145
Exclusion of interest on State and local debt for private nonprofit educational facilities	310	320	335	350	365	385	400	460	475	495	520	545	570	590
Exclusion of interest on savings bonds transferred to educational institutions	.....	.....	.....	.....	.....	.....	.....	5	5	10	10	15	15	15
Parental personal exemption for students age 19 or over	.....	.....	.....	.....	.....	.....	.....	820	825	835	870	905	955	1,015
Deductibility of charitable contributions (education)	170	180	190	200	210	220	230	1,610	1,690	1,775	1,865	1,955	2,055	2,155
Exclusion of employer provided educational assistance	.....	.....	.....	.....	.....	.....	.....	100	.....	.....	.....	.....	.....	.....
Training, employment, and social services:														
Targeted jobs credit	320	270	50	30	15	5	.....	75	55	10	10	5	.....	.....
Exclusion of employer provided child care	.....	.....	.....	.....	.....	.....	.....	725	775	830	890	955	1,025	1,100
Exclusion of employee meals and lodging (other than military)	.....	.....	.....	.....	.....	.....	.....	545	570	600	630	665	700	735
Credit for child and dependent care expenses	.....	.....	.....	.....	.....	.....	.....	2,730	2,865	3,005	3,155	3,315	3,480	3,655
Credit for disabled access expenditures	130	130	130	130	130	135	135	30	30	35	35	35	35	35
Expensing of costs of removing certain architectural barriers to the handicapped	15	15	15	15	15	15	15	5	5	5	5	5	5	5
Deductibility of charitable contributions, other than education and health	4,895	5,160	5,425	5,695	5,985	6,280	6,580	14,670	15,405	16,175	16,980	17,830	18,720	19,660
Exclusion of certain foster care payments	.....	.....	.....	.....	.....	.....	.....	30	30	35	35	35	40	40
Exclusion of parsonage allowances	.....	.....	.....	.....	.....	.....	.....	265	285	300	320	345	365	390
Health:														
Exclusion of employer contributions for medical insurance premiums and medical care	.....	.....	.....	.....	.....	.....	.....	59,440	64,520	70,490	77,040	84,125	91,620	99,925
Deductibility of medical expenses	.....	.....	.....	.....	.....	.....	.....	3,495	3,785	4,125	4,510	4,930	5,395	5,895
Exclusion of interest on State and local debt for private nonprofit health facilities	615	640	675	705	745	780	810	920	955	1,000	1,045	1,100	1,155	1,205
Deductibility of charitable contributions (health)	640	670	700	730	760	790	820	1,640	1,725	1,810	1,900	1,995	2,095	2,200
Tax credit for orphan drug research	15	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Special Blue Cross/Blue Shield deduction	125	140	100	170	185	220	280	.....	.....	.....	.....	.....	.....	.....
Income security:														
Exclusion of railroad retirement system benefits	.....	.....	.....	.....	.....	.....	.....	430	445	450	455	460	465	470

TABLE 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

Provision	Revenue Loss													
	Corporations							Individuals						
	1995	1996	1997	1998	1999	2000	2001	1995	1996	1997	1998	1999	2000	2001
Exclusion of workmen's compensation benefits	.....	.....	.....	.....	.....	.....	.....	4,475	4,855	5,050	5,255	5,515	5,800	6,205
Exclusion of public assistance benefits (normal tax method)	.....	.....	.....	.....	.....	.....	.....	570	590	635	695	740	795	850
Exclusion of special benefits for disabled coal miners	.....	.....	.....	.....	.....	.....	.....	95	90	85	85	80	75	70
Exclusion of military disability pensions	.....	.....	.....	.....	.....	.....	.....	130	130	130	130	130	130	130
Net exclusion of pension contributions and earnings:														
Employer plans	.....	.....	.....	.....	.....	.....	.....	52,070	55,370	55,770	56,205	56,625	57,045	57,470
Individual Retirement Accounts	.....	.....	.....	.....	.....	.....	.....	7,720	7,830	7,940	8,335	8,420	8,455	8,490
Keogh plans	.....	.....	.....	.....	.....	.....	.....	3,315	3,345	3,580	3,780	3,935	4,090	4,240
Exclusion of employer provided death benefits	.....	.....	.....	.....	.....	.....	.....	30	35	35	35	40	40	45
Exclusion of other employee benefits:														
Premiums on group term life insurance	.....	.....	.....	.....	.....	.....	.....	2,880	3,020	3,170	3,325	3,485	3,660	3,865
Premiums on accident and disability insurance	.....	.....	.....	.....	.....	.....	.....	150	155	165	175	185	195	205
Income of trusts to finance supplementary unemployment benefits	.....	.....	.....	.....	.....	.....	.....	20	20	20	20	20	20	20
Special ESOP rules (other than investment credit)	2,125	1,745	1,540	1,405	1,280	1,170	1,065	.....	.....	.....	.....	.....	.....	.....
Additional deduction for the blind	.....	.....	.....	.....	.....	.....	.....	25	25	25	25	25	30	30
Additional deduction for the elderly	.....	.....	.....	.....	.....	.....	.....	1,305	1,320	1,340	1,355	1,365	1,375	1,385
Tax credit for the elderly and disabled	.....	.....	.....	.....	.....	.....	.....	50	55	55	60	60	65	65
Deductibility of casualty losses	.....	.....	.....	.....	.....	.....	.....	800	445	465	490	515	540	570
Earned income credit [2]	.....	.....	.....	.....	.....	.....	.....	4,920	5,670	6,250	6,460	6,820	7,105	7,510
Social Security:														
Exclusion of social security benefits:														
OASI benefits for retired workers	.....	.....	.....	.....	.....	.....	.....	16,015	16,465	17,285	18,080	18,880	19,525	20,515
Disability insurance benefits	.....	.....	.....	.....	.....	.....	.....	1,975	2,180	2,375	2,580	2,800	3,030	3,265
Benefits for dependents and survivors	.....	.....	.....	.....	.....	.....	.....	3,630	3,820	4,030	4,245	4,470	4,695	4,935
Veterans benefits and services:														
Exclusion of veterans disability compensation	.....	.....	.....	.....	.....	.....	.....	2,665	2,820	2,985	3,160	3,335	3,515	3,720
Exclusion of veterans pensions	.....	.....	.....	.....	.....	.....	.....	75	70	70	70	75	85	90
Exclusion of GI bill benefits	.....	.....	.....	.....	.....	.....	.....	50	65	70	80	90	95	100
Exclusion of interest on State and local debt for veterans housing	35	30	30	30	35	35	35	50	50	50	50	50	50	55
General purpose fiscal assistance:														
Exclusion of interest on public purpose State and local debt	5,100	5,300	5,545	5,820	6,120	6,395	6,645	7,600	7,875	8,230	8,635	9,075	9,510	9,890
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	27,735	29,175	30,620	32,160	33,800	35,570	37,445
Tax credit for corporations receiving income from doing business in U.S. possessions	2,745	2,795	2,855	3,025	3,205	3,400	3,600	.....	.....	.....	.....	.....	.....	.....
Interest:														
Deferral of interest on savings bonds	.....	.....	.....	.....	.....	.....	.....	1,100	1,160	1,210	1,280	1,340	1,410	1,480
Addendum—Aid to State and local governments:														
Deductibility of:														
Property taxes on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	15,275	16,070	16,860	17,710	18,615	19,590	20,620
Nonbusiness State and local taxes other than on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	27,735	29,175	30,620	32,160	33,800	35,570	37,445
Exclusion of interest on:														
Public purpose State and local debt	5,100	5,300	5,545	5,820	6,120	6,395	6,645	7,600	7,875	8,230	8,635	9,075	9,510	9,890
IDBs for certain energy facilities	70	70	70	70	70	65	65	105	110	110	105	105	100	95
IDBs for pollution control and sewage and waste disposal facilities	255	250	245	240	235	230	220	380	380	370	365	365	345	335
Small-issue IDBs	215	165	135	115	110	105	105	340	270	210	180	170	160	155
Owner-occupied mortgage revenue bonds	725	720	705	680	660	635	610	1,085	1,090	1,065	1,030	995	970	930
State and local debt for rental housing	365	345	320	300	275	245	215	560	530	495	460	425	385	330
IDBs for airports, docks, and sports and convention facilities	345	365	390	415	440	460	485	510	545	575	610	650	685	720
State and local student loan bonds	125	120	115	110	105	100	95	190	185	175	165	155	150	145
State and local debt for private nonprofit educational facilities	310	320	335	350	365	385	400	460	475	495	520	545	570	590
State and local debt for private nonprofit health facilities	615	640	675	705	745	780	810	920	955	1,000	1,045	1,100	1,155	1,205
State and local debt for veterans housing	35	30	30	30	35	35	35	50	50	50	50	50	50	55

[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 1995: $615; 1996: $645; 1997: $665; 1998: $685; 1999: $705; 2000: $730; and 2001: $750.

[2] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1995: $15,245; 1996: $18,655; 1997: $20,450; 1998: $21,255; 1999: $22,175; 2000: $23,210; and 2001: $24,115.

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

All estimates have been rounded to the nearest $5 million.

Interpreting Tax Expenditure Estimates

Tax expenditure revenue loss estimates do not necessarily equal the increase in Federal revenues (or the reduction in budget deficits) that would result from repealing the special provisions, for the following reasons:

- *Eliminating a tax expenditure may have incentive effects that alter economic behavior.* These incentives can affect the resulting magnitudes of the formerly subsidized activity or of other tax preferences or Government programs. For example, if deductibility of mortgage interest were limited, some taxpayers would hold smaller mortgages, with a concomitantly smaller effect on the budget than if no such limits were in force.
- *Tax expenditures are interdependent even without incentive effects.* Repeal of a tax expenditure provision can increase or decrease the revenue losses associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the revenue losses from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the revenue loss from other deductions if taxpayers are led to claim the standard deduction instead of itemizing. Similarly, if two provisions were repealed simultaneously, the increase in tax liability could be greater or less than the sum of the two separate tax expenditures, since each is estimated assuming that the other remains in force. In addition, the estimates reported in Table 5–1 are the totals of individual and corporate income tax revenue losses reported in Table 5–2 and do not reflect any possible interactions between the individual and corporate income tax receipts. For this reason, the figures in Table 5–1 (as well as those in Table 5–4, which are also based on summing individual and corporate estimates) should be regarded as approximations.
- *The annual value of tax expenditures for tax deferrals is reported on a cash basis in all tables except table 5–3.* Cash-based estimates reflect the difference between taxes deferred in the current year and incoming revenues that are received due to deferrals of taxes from prior years. While such estimates are useful as a measure of cash flows into the Government, they do not always accurately reflect the true economic cost of these provisions. For example, for a provision where activity levels have changed, so that incoming tax receipts from past deferrals are greater than deferred receipts from new activity, the cash-basis tax expenditure estimate can be negative, despite the fact that in present-value terms current deferrals do have a real cost to the Government. Alternatively, in the case of a newly enacted deferral provision, a cash-based estimate can overstate the real cost to the Government because the newly deferred taxes will ultimately be received. Present-value estimates, which are a useful supplement to the cash-basis estimates for provisions involving deferrals, are discussed below.
- *Repeal of some provisions could affect overall levels of income and rates of economic growth.* In principle, repeal of major tax provisions may have some impact on the budget economic assumptions. In general, however, most changes in particular provisions are unlikely to have significant macroeconomic effects.

Present-Value Estimates

Discounted present-value estimates of revenue losses are presented in table 5–3 for certain provisions that involve tax deferrals or similar long-term revenue effects. These estimates complement the cash-based tax expenditure estimates presented in the other tables.

The present-value estimates represent the revenue losses, net of future tax payments, that follow from activities undertaken during calendar year 1996 which cause the deferrals or related revenue effects. For instance, a pension contribution in 1996 would cause a deferral of tax payments on wages in 1996 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 1996 pension contribution and accrued earnings will be paid out and taxes will be due; these receipts are included in the present-value estimate. In general, this conceptual approach is similar to the one used for reporting the budgetary effects of credit programs, where direct loans and guarantees in a given year affect future cash flows.

TABLE 5–3. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 1996

(In millions of dollars)

Provision	Present Value of Revenue Loss
Deferral of income from controlled foreign corporations (normal tax method)	1,700
Expensing of research and experimentation expenditures (normal tax method)	2,035
Expensing of exploration and development costs—oil and gas	140
Expensing of exploration and development costs—other fuels	10
Expensing of exploration and development costs—nonfuels	50
Expensing of multiperiod timber growing costs	135
Expensing of certain multiperiod production costs—agriculture	80
Expensing of certain capital outlays—agriculture	65
Deferral of capital gains on home sales	14,395
Accelerated depreciation of rental housing (normal tax method)	1,800
Accelerated depreciation of buildings other than rental housing (normal tax method)	415
Accelerated depreciation of machinery and equipment (normal tax method)	23,535
Expensing of certain small investments (normal tax method)	1,735
Amortization of start-up costs (normal tax method)	175
Deferral of tax on shipping companies	10
Credit for low-income housing investments	2,850
Exclusion of pension contributions and earnings—employer plans	50,885
Exclusion of IRA contributions and earnings	2,240
Exclusions of contribution and earnings for Keogh plans	3,465
Exclusion of interest on State and local public-purpose bonds	16,140
Exclusion of interest on State and local non-public purpose bonds	8,780
Deferral of interest on U.S. savings bonds	330

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

Outlay Equivalents

The concept of "outlay equivalents" complements "revenue losses" as a measure of the budget effect of tax expenditures. It is the amount of outlay that would be required to provide the taxpayer the same after-tax income as would be received through the tax preference. The outlay equivalent measure allows a comparison of the cost of the tax expenditure with that of a direct Federal outlay. Outlay equivalents are reported in table 5–4.

The measure is larger than the revenue loss estimate when the tax expenditure is judged to function as a Government payment for service. This occurs because an outlay program would increase the taxpayer's pre-tax income. For some tax expenditures, however, the revenue loss equals the outlay equivalent measure. This occurs when the tax expenditure is judged to function like a price reduction or tax deferral that does not directly enter the taxpayer's pre-tax income.[1]

[1] Budget outlay figures generally reflect the pre-tax price of the resources. In some instances, however, Government purchases or subsidies are exempted from tax by a special tax provision. When this occurs, the outlay figure understates the resource cost of the program and is, therefore, not comparable with other outlay amounts. For example, the outlays for certain military personnel allowances are not taxed. If this form of compensation were treated as part of the employee's taxable income, the Defense Department would have to make larger cash payments to its military personnel to leave them as well off after tax as they are now. The tax subsidy must be added to the tax-exempt budget outlay to make this element of national defense expenditures comparable with other outlays.

TABLE 5–4. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX

(In millions of dollars)

Provision	Outlay Equivalents							
	1995	1996	1997	1998	1999	2000	2001	1997–2001
National defense:								
Exclusion of benefits and allowances to armed forces personnel	2,335	2,405	2,425	2,445	2,470	2,495	2,520	12,355
International affairs:								
Exclusion of income earned abroad by United States citizens	2,170	2,435	2,730	3,060	3,435	3,855	4,325	17,405
Exclusion of income of foreign sales corporations	2,155	2,310	2,460	2,615	2,770	2,925	3,075	13,845
Inventory property sales source rules exception	2,000	2,155	2,310	2,460	2,615	2,770	2,925	13,080
Interest allocation rules exception for certain financial operations	140	140	140	140	140	140	140	700
Deferral of income from controlled foreign corporations (normal tax method)	1,700	1,800	2,000	2,200	2,400	2,600	2,900	12,100
General science, space, and technology:								
Expensing of research and experimentation expenditures (normal tax method)	1,635	1,740	1,840	1,945	2,065	2,190	2,320	10,360
Credit for increasing research activities	1,820	1,040	440	185	60	10	.....	695
Suspension of the allocation of research and experimentation expenditures	465	.....	.....	.....	.....	.....	.....	.....
Energy:								
Expensing of exploration and development costs:								
Oil and gas	–300	–255	–165	–75	0	95	80	–65
Other fuels	15	15	15	15	15	15	20	80
Excess of percentage over cost depletion:								
Oil and gas	1,335	1,385	1,440	1,495	1,560	1,615	1,680	7,790
Other fuels	165	175	180	195	200	215	220	1,010
Alternative fuel production credit	1,370	1,400	1,390	1,330	1,240	1,160	1,080	6,200
Exception from passive loss limitation for working interests in oil and gas properties	55	60	60	65	65	70	75	335
Capital gains treatment of royalties on coal	20	20	20	20	20	20	20	100
Exclusion of interest on State and local IDBs for energy facilities	255	260	260	255	250	245	230	1,240
New technology credit	195	195	205	220	230	245	260	1,160
Alcohol fuel credit [1]	10	10	10	10	10	10	10	50
Tax credit and deduction for clean-fuel burning vehicles and properties	90	90	95	105	110	120	125	555
Exclusion from income of conservation subsidies provided by public utilities	175	210	225	220	210	205	195	1,055
Natural resources and environment:								
Expensing of exploration and development costs, nonfuel minerals	35	35	35	35	35	35	35	175
Excess of percentage over cost depletion, nonfuel minerals	295	320	325	335	345	345	355	1,705
Capital gains treatment of iron ore	0	0	0	0	0	0	0	0
Special rules for mining reclamation reserves	50	50	50	50	50	50	50	250
Exclusion of interest on State and local IDBs for pollution control and sewage and waste disposal facilities	910	905	890	875	850	830	800	4,245
Capital gains treatment of certain timber income	20	20	20	20	20	20	20	100
Expensing of multiperiod timber growing costs	370	395	415	440	460	485	505	2,305
Investment credit and seven-year amortization for reforestation expenditures	65	65	65	75	75	75	75	365
Tax incentives for preservation of historic structures	125	125	120	115	115	110	105	565
Agriculture:								
Expensing of certain capital outlays	70	65	65	65	70	70	70	340
Expensing of certain multiperiod production costs	85	80	80	80	85	85	85	415
Treatment of loans forgiven solvent farmers as if insolvent	10	10	10	10	10	10	10	50
Capital gains treatment of certain income	195	195	185	195	195	200	205	980
Commerce and housing:								
Financial institutions and insurance:								
Exemption of credit union income	805	825	905	995	1,090	1,195	1,310	5,495
Excess bad debt reserves of financial institutions	145	160	175	190	205	225	240	1,035
Exclusion of interest on life insurance savings	13,010	14,015	15,065	16,210	17,415	18,725	19,645	87,060
Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25
Tax exemption of certain insurance companies	330	340	345	365	380	395	420	1,905
Small life insurance company deduction	155	160	170	185	190	200	205	950
Housing:								
Exclusion of interest on owner-occupied mortgage subsidy bonds	2,610	2,600	2,540	2,455	2,380	2,305	2,215	11,895
Exclusion of interest on State and local debt for rental housing	1,330	1,250	1,170	1,085	1,005	900	780	4,940
Deductibility of mortgage interest on owner-occupied homes	48,080	50,575	53,075	55,750	58,590	61,655	64,915	293,985
Deductibility of State and local property tax on owner-occupied homes	15,275	16,070	16,860	17,710	18,615	19,590	20,620	93,395
Deferral of income from post 1987 installment sales	935	955	975	995	1,015	1,035	1,055	5,075
Deferral of capital gains on home sales	14,180	14,605	15,040	15,490	15,955	16,435	16,930	79,850
Exclusion of capital gains on home sales for persons age 55 and over	6,880	6,915	6,765	7,285	7,040	7,675	7,305	36,070
Exception from passive loss rules for $25,000 of rental loss	4,515	4,235	3,985	3,745	3,520	3,305	3,070	17,625
Accelerated depreciation on rental housing (normal tax method)	1,045	1,170	1,305	1,485	1,675	2,165	2,455	9,085
Commerce:								
Cancellation of indebtedness	140	90	50	20	0	–15	–10	45
Permanent exceptions from imputed interest rules	150	150	155	155	160	160	160	790
Capital gains (other than agriculture, timber, iron ore, and coal)	9,500	9,335	9,215	9,380	9,595	9,845	10,080	48,115
Capital gain exclusion of small corporation stock	0	0	0	5	40	95	145	285

TABLE 5–4. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

Provision	Outlay Equivalents							
	1995	1996	1997	1998	1999	2000	2001	1997–2001
Step-up basis of capital gains at death	37,740	39,305	40,355	40,945	41,545	42,155	42,765	207,765
Carryover basis of capital gains on gifts	130	140	150	160	170	180	190	850
Ordinary income treatment of loss from small business corporation stock sale	40	45	50	50	50	55	55	260
Accelerated depreciation of buildings other than rental housing (normal tax method)	7,440	6,735	5,720	4,590	3,410	2,420	1,600	17,740
Accelerated depreciation of machinery and equipment (normal tax method)	24,460	27,160	29,500	31,210	33,030	33,575	32,240	159,555
Expensing of certain small investments (normal tax method)	1,815	1,520	1,120	795	600	320	155	2,990
Amortization of start-up costs (normal tax method)	185	195	200	205	210	210	220	1,045
Graduated corporation income tax rate (normal tax method)	5,865	6,335	6,760	7,165	7,635	8,155	8,690	38,405
Exclusion of interest on small issue IDBs	785	615	490	425	400	385	375	2,075
Deferral of gains from sale of broadcasting facilities to minority owned business	285	.....	.....	.....	.....	.....	.....	.....
Treatment of Alaska Native Corporations	30	20	15	10	5	5	5	40
Transportation:								
Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
Exclusion of reimbursed employee parking expenses	1,585	1,630	1,680	1,730	1,780	1,835	1,895	8,920
Exclusion for employer-provided transit passes	50	65	80	100	115	135	165	595
Community and regional development:								
Credit for low-income housing investments	2,260	2,600	2,945	3,270	3,500	3,595	3,445	16,755
Investment credit for rehabilitation of structures (other than historic)	80	80	80	70	70	70	65	355
Exclusion of interest on IDBs for airports, docks, and sports and convention facilities	1,240	1,315	1,395	1,480	1,570	1,655	1,735	7,835
Exemption of certain mutuals' and cooperatives' income	50	50	50	55	55	60	60	280
Empowerment zones	250	330	385	425	450	475	490	2,225
Education, training, employment, and social services:								
Education:								
Exclusion of scholarship and fellowship income (normal tax method)	910	915	925	935	945	955	965	4,725
Exclusion of interest on State and local student loan bonds	455	440	415	395	375	360	345	1,890
Exclusion of interest on State and local debt for private nonprofit educational facilities	1,110	1,150	1,200	1,255	1,315	1,375	1,430	6,575
Exclusion of interest on savings bonds transferred to educational institutions	5	10	10	15	20	20	20	85
Parental personal exemption for students age 19 or over	910	915	925	960	1,000	1,060	1,125	5,070
Deductibility of charitable contributions (education)	2,370	2,485	2,610	2,735	2,870	3,005	3,155	14,375
Exclusion of employer provided educational assistance	125	.....	.....	.....	.....	.....	.....	.....
Training, employment, and social services:								
Targeted jobs credit	395	325	60	40	20	5	.....	125
Exclusion of employer provided child care	965	1,035	1,105	1,185	1,275	1,365	1,465	6,395
Exclusion of employee meals and lodging (other than military)	665	695	730	770	810	855	900	4,065
Credit for child and dependent care expenses	3,640	3,820	4,005	4,205	4,420	4,640	4,875	22,145
Credit for disabled access expenditures	240	240	250	250	250	255	255	1,260
Expensing of costs of removing certain architectural barriers to the handicapped	20	20	20	20	20	20	20	100
Deductibility of charitable contributions, other than education and health	26,085	27,395	28,770	30,215	31,735	33,325	35,000	159,045
Exclusion of certain foster care payments	35	40	40	45	45	50	50	230
Exclusion of parsonage allowances	325	350	375	400	425	455	485	2,140
Health:								
Exclusion of employer contributions for medical insurance premiums and medical care	75,630	82,230	89,985	98,510	107,755	117,545	128,420	542,215
Deductibility of medical expenses	3,495	3,785	4,125	4,510	4,930	5,395	5,895	24,855
Exclusion of interest on State and local debt for private nonprofit health facilities	2,215	2,305	2,410	2,530	2,665	2,795	2,915	13,315
Deductibility of charitable contributions (health)	3,040	3,190	3,350	3,520	3,695	3,880	4,075	18,520
Tax credit for orphan drug research	25	.....	.....	.....	.....	.....	.....	.....
Special Blue Cross/Blue Shield deduction	175	185	140	240	260	310	395	1,345
Income security:								
Exclusion of railroad retirement system benefits	430	445	450	455	460	465	470	2,300
Exclusion of workmen's compensation benefits	4,475	4,855	5,050	5,255	5,515	5,800	6,205	27,825
Exclusion of public assistance benefits (normal tax method)	570	590	635	695	740	795	850	3,715
Exclusion of special benefits for disabled coal miners	95	90	85	85	80	75	70	395
Exclusion of military disability pensions	130	130	130	130	130	130	130	650
Net exclusion of pension contributions and earnings:								
Employer plans	72,145	76,390	76,990	77,570	78,120	78,705	79,295	390,680
Individual Retirement Accounts	10,600	10,895	11,190	11,765	11,945	12,105	12,225	59,230
Keogh plans	4,365	4,405	4,715	4,980	5,180	5,385	5,590	25,850
Exclusion of employer provided death benefits	40	40	45	50	50	55	60	260
Exclusion of other employee benefits:								
Premiums on group term life insurance	3,745	3,925	4,120	4,320	4,530	4,755	5,020	22,745
Premiums on accident and disability insurance	190	200	210	225	235	250	260	1,180
Income of trusts to finance supplementary unemployment benefits	20	20	20	20	20	20	20	100
Special ESOP rules (other than investment credit)	3,035	2,490	2,200	2,005	1,830	1,675	1,525	9,235
Additional deduction for the blind	30	30	30	30	35	35	35	165
Additional deduction for the elderly	1,575	1,600	1,620	1,635	1,650	1,660	1,675	8,240

TABLE 5–4. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

Provision	Outlay Equivalents							
	1995	1996	1997	1998	1999	2000	2001	1997–2001
Tax credit for the elderly and disabled	65	65	70	75	75	80	80	380
Deductibility of casualty losses	1,040	580	605	635	670	705	740	3,355
Earned income credit [2]	5,470	6,300	6,945	7,180	7,580	7,895	8,345	37,945
Social Security:								
Exclusion of social security benefits:								
OASI benefits for retired workers	16,015	16,465	17,285	18,080	18,880	19,525	20,515	94,285
Disability insurance benefits	1,975	2,180	2,375	2,580	2,800	3,030	3,265	14,050
Benefits for dependents and survivors	3,630	3,820	4,030	4,245	4,470	4,695	4,935	22,375
Veterans benefits and services:								
Exclusion of veterans disability compensation	2,665	2,820	2,985	3,160	3,335	3,515	3,720	16,715
Exclusion of veterans pensions	75	70	70	70	75	85	90	390
Exclusion of GI bill benefits	50	65	70	80	90	95	100	435
Exclusion of interest on State and local debt for veterans housing	125	115	115	115	115	120	125	590
General purpose fiscal assistance:								
Exclusion of interest on public purpose State and local debt	18,315	19,010	19,885	20,870	21,940	22,955	23,855	109,505
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	27,735	29,175	30,620	32,160	33,800	35,570	37,445	169,595
Tax credit for corporations receiving income from doing business in U.S. possessions	3,920	3,995	4,075	4,320	4,580	4,855	5,145	22,975
Interest:								
Deferral of interest on savings bonds	1,100	1,160	1,210	1,280	1,340	1,410	1,480	6,720
Addendum—Aid to State and local governments:								
Deductibility of:								
Property taxes on owner-occupied homes	15,275	16,070	16,860	17,710	18,615	19,590	20,620	93,395
Nonbusiness State and local taxes other than on owner-occupied homes	27,735	29,175	30,620	32,160	33,800	35,570	37,445	169,595
Exclusion of interest on:								
Public purpose State and local debt	18,315	19,010	19,885	20,870	21,940	22,955	23,855	109,505
IDBs for certain energy facilities	255	260	260	255	250	245	230	1,240
IDBs for pollution control and sewage and waste disposal facilities	910	905	890	875	850	830	800	4,245
Small-issue IDBs	785	615	490	425	400	385	375	2,075
Owner-occupied mortgage revenue bonds	2,610	2,600	2,540	2,455	2,380	2,305	2,215	11,895
State and local debt for rental housing	1,330	1,250	1,170	1,085	1,005	900	780	4,940
IDBs for airports, docks, and sports and convention facilities	1,240	1,315	1,395	1,480	1,570	1,655	1,735	7,835
State and local student loan bonds	455	440	415	395	375	360	345	1,890
State and local debt for private nonprofit educational facilities	1,110	1,150	1,200	1,255	1,315	1,375	1,430	6,575
State and local debt for private nonprofit health facilities	2,215	2,305	2,410	2,530	2,665	2,795	2,915	13,315
State and local debt for veterans housing	125	115	115	115	115	120	125	590

[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 1995: $615; 1996: $645; 1997: $665; 1998: $685; 1999: $705; 2000: $730; and 2001: $750.

[2] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1995: $15,245; 1996: $18,655; 1997: $20,450; 1998: $21,255; 1999: $22,175; 2000: $23,210; and 2001: $24,115.

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

All estimates have been rounded to the nearest $5 million.

Tax Expenditure Baselines

A tax expenditure is a preferential exception to the baseline provisions of the tax structure. The 1974 Congressional Budget Act does not, however, specify the baseline provisions of the tax law. Deciding whether provisions are preferential exceptions, therefore, is a matter of judgement. As in prior years, this year's tax expenditure estimates are presented using two baselines: the normal tax baseline, which is used by the Joint Committee on Taxation, and the reference tax law baseline, which has been used by the Administration since 1983.

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

The reference tax law baseline is also pattered on a comprehensive income tax, but in practice is closer to existing law. Reference law tax expenditures are limited to special exceptions in the tax code that serve programmatic functions. These functions correspond to specific budget categories such as national defense, agriculture, or health care. While tax expenditures under the reference law baseline are generally tax expenditures under the normal tax baseline, the reverse is not always true.

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

- *Income is taxable when realized in exchange.* Thus, neither the deferral of tax on unrealized capital gains nor the tax exclusion of imputed income (such as the rental value of owner-occupied hous-

ing or farmers' consumption of their own produce) is regarded as a tax expenditure. Both accrued and imputed income would be taxed under a comprehensive income tax.

- *There is a separate corporation income tax.* Under a comprehensive income tax corporate income would be taxed only once—at the shareholder level, whether or not distributed in the form of dividends.
- *Values of assets and debt are not adjusted for inflation.* A comprehensive income tax would adjust the cost basis of capital assets and debt for changes in the price level during the time the assets or debt are held. Thus, under a comprehensive income tax baseline the failure to take account of inflation in measuring depreciation, capital gains, and interest income would be regarded as a negative tax expenditure (i.e., a tax penalty), and failure to take account of inflation in measuring interest costs would be regarded as a positive tax expenditure (i.e., a tax subsidy).

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

- *Tax rates.* The separate schedules applying to the various taxpaying units are included in the reference law baseline. Thus, corporate tax rates below the maximum statutory rate do not give rise to a tax expenditure. The normal tax baseline is similar, except that it specifies the current maximum rate as the baseline for the corporate income tax. The lower tax rates applied to the first $10 million of corporate income are thus regarded as a tax expenditure. Similarly, under the reference law baseline, preferential tax rates for capital gains generally do not yield a tax expenditure; only capital gains treatment of otherwise "ordinary income," such as that from coal and iron ore royalties and the sale of timber and certain agricultural products, is considered a tax expenditure. The alternative minimum tax is treated as part of the baseline rate structure under both the reference and normal tax methods.
- *Income subject to the tax.* Income subject to tax is defined as gross income less the costs of earning that income. The Federal income tax defines gross income to include: (1) consideration received in the exchange of goods and services, including labor services or property; and (2) the taxpayer's share of gross or net income earned and/or reported by another entity (such as a partnership). Under the reference tax rules, therefore, gross income does not include gifts—defined as receipts of money or property that are not consideration in an exchange—or most transfer payments, which can be thought of as gifts from the Government.[2] The normal tax baseline also excludes gifts between individuals from gross income. Under the normal tax baseline, however, all cash transfer payments from the Government to private individuals are counted in gross income, and exemptions of such transfers from tax are identified as tax expenditures. The costs of earning income are generally deductible in determining taxable income under both the reference and normal tax baselines.[3]
- *Capital recovery.* Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. Under the normal tax baseline, the depreciation allowance for machinery and equipment is determined using straight-line depreciation over tax lives equal to mid-values of the asset depreciation range (a depreciation system in effect from 1971 through 1980). The normal tax baseline for real property is computed using 40-year straight-line depreciation.
- *Treatment of foreign income.* Both the normal and reference tax baselines allow a tax credit for foreign income taxes paid (up to the amount of U.S. income taxes that would otherwise be due), which prevents double taxation of income earned abroad. Under the normal tax method, however, controlled foreign corporations (CFCs) are not regarded as entities separate from their controlling U.S. shareholders. Thus, the deferral of tax on income received by CFCs is regarded as a tax expenditure under this method. In contrast, except for tax haven activities, the reference law baseline follows current law in treating CFCs as separate taxable entities whose income is not subject to U.S. tax until distributed to U.S. taxpayers. Under this baseline, deferral of tax on CFC income is not a tax expenditure because U.S. taxpayers generally are not taxed on accrued, but unrealized, income.

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

Performance Measures and the Economic Effects of Tax Expenditures

Under the Government Performance and Results Act of 1993 (GPRA), Federal agencies, in conjunction with the Office of Management and Budget, are directed to develop performance goals, performance measures, and strategic plans for their functions and programs. Consistent with this effort, OMB and the Department of the Treasury have started to develop a framework for evaluating the performance and economic effects of tax expenditures; the discussion here summarizes the initial work on this issue. This framework is expected to evolve over coming years based on additional work within the Executive branch and consultation with Con-

[2] Gross income does, however, include transfer payments associated with past employment, such as social security benefits.

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

gressional units, including the Joint Committee on Taxation and the General Accounting Office.

Tax expenditures have a variety of objectives and effects. These include promoting certain types of activities (e.g., investment in low-income housing); influencing individual behavior (e.g., encouraging saving for retirement); and reducing the tax burden on individuals in adverse situations (e.g., those claiming casualty losses or large medical expenses).

Performance measurement is generally concerned with inputs, outputs, and outcomes. In the case of tax expenditures, the principal input is likely to be the tax revenue loss. Outputs are quantitative or qualitative measures of goods and services, or changes in income and investment, directly attributable to these inputs. Outcomes, in turn, represent the changes in the economy, society, or environment that are the ultimate goals of programs. Thus, for a provision that reduces taxes on investment in a certain activity, an increase in the amount of investment in that activity would likely be a key output. The resulting production from that investment, and, in turn, the associated net changes (positive or negative) in national income, economic welfare, or security, could be the outcomes of interest.

Estimation of these performance indicators and economic effects may be pursued using economic modeling and quantitative analysis. It is anticipated that OMB, Treasury, and other agencies will work together, as appropriate, on determining a set of useful measures and quantifying the effects of tax expenditures, as well as on conceptual issues such as the identification and measurement of tax expenditures.

The discussion below considers the types of measures that might be useful for some major programmatic groups of tax expenditures. The discussion is merely intended to be illustrative.

A major set of tax expenditures benefits retirement savings, through employer-provided pensions, individual retirement accounts, and Keogh plans. These provisions might be evaluated in terms of their effects on boosting retirement savings.

Individuals also benefit from favorable treatment of employer-provided health insurance. These benefits could be evaluated in terms of their impact on health insurance coverage and the corresponding improvements in health status.

Other provisions principally have income distribution, rather than incentive, effects. For example, tax-favored treatment of social security benefits provides increased incomes to low-income retirees. This provision could be evaluated by measuring the effects on the income of the elderly and their well-being. The earned-income tax credit, in contrast, should probably be evaluated both for its effects on labor force participation as well as its income redistribution properties.

Housing investment also benefits from tax expenditures such as the mortgage interest deduction and preferential treatment of capital gains on housing. Measures of the effectiveness of these provisions could include consideration of their effects on increasing home ownership and the quality of housing. Deductibility of State and local property taxes might be evaluated in terms of its effect on making housing more affordable as well as easing the cost of providing community services.

The above illustrative discussion, while broad, is nevertheless incomplete, both for the provisions mentioned and the many that are not explicitly cited. Developing a framework which is appropriately comprehensive, accurate, and flexible to reflect the objectives and effects of the wide range of tax expenditures will be a significant challenge. It is expected that this framework will evolve and improve over the next several years with the objective of eventually producing appropriate quantitative analyses.

Other Considerations

The tax expenditure analysis could be extended beyond the income and transfer taxes to include payroll and excise taxes. The exclusion of certain forms of compensation from the wage base, for instance, reduces payroll taxes, as well as income taxes. Payroll tax exclusions are complex to analyze, however, because they also affect social insurance benefits. Certain targeted excise tax provisions might also be considered tax expenditures. In this case challenges include determining an appropriate baseline.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported upon in this chapter follow.

NATIONAL DEFENSE

Benefits and allowances to armed forces personnel.—The housing and meals provided military personnel, either in cash or in kind, are excluded from income subject to tax.

INTERNATIONAL AFFAIRS

Income earned abroad.—A U.S. citizen or resident alien who resides in a foreign country or who stays in one or more foreign countries for a minimum of 11 out of the past 12 months may exclude $70,000 per year of foreign-earned income. Eligible taxpayers also may exclude or deduct reasonable housing costs in excess of one-sixth of the salary of a civil servant at grade GS–14, step 1. These provisions do not apply to Federal employees working abroad; however, the tax expenditure estimate does reflect certain allowances that are excluded from their taxable income.

Income of Foreign Sales Corporations.—The Foreign Sales Corporation (FSC) provisions exempt from tax a portion of U.S. exporters' foreign trading income to reflect the FSC's sales functions as foreign corporations. These provisions conform to the General Agreement on Tariffs and Trade.

Source rule exceptions.—The worldwide income of U.S. persons is taxable by the United States and a credit for foreign taxes paid is allowed. The amount of foreign taxes that can be credited is limited to the pre-credit U.S. tax on the foreign source income. Two exceptions give rise to tax expenditures: sales of inventory property that reduces the U.S. tax of exporters; and, for financial institutions and certain financing operations of nonfinancial enterprises, an exception from the rules that require allocation of interest expenses between domestic and foreign activities of a U.S. taxpayer.

Income of U.S.-controlled foreign corporations.—The income of foreign corporations controlled by U.S. shareholders is not subject to U.S. taxation. The income becomes taxable only when the controlling U.S. shareholders receive dividends or other distributions from their foreign stockholding. Under the normal tax method, the currently attributable foreign source pre-tax income from such a controlling interest is subject to U.S. taxation, whether or not distributed. Thus, under the normal tax baseline the excess of controlled foreign corporation income over the amount distributed to a U.S. shareholder gives rise to a tax expenditure in the form of a tax deferral.

General Science, Space, and Technology

Expensing R&E expenditures.—Research and experimentation (R&E) projects can be viewed as investments because their benefits accrue for several years when they are successful. It is difficult, however, to identify whether a specific R&E project is completed and successful and, if it is successful, what its expected life will be. For these reasons, the statutory provision that these expenditures may be expensed is considered part of the reference law. Under the normal tax method, however, the expensing of R&E expenditures is viewed as a tax expenditure. The baseline assumed for the normal tax method is that all R&E expenditures are successful and have an expected life of five years.

R&E credit.—Under legislation that expired on July 1, 1995, the tax credit was 20 percent of the qualified expenditures in excess of each year's base amount. This threshold was determined by multiplying a "fixed-base percentage" (limited to a maximum of .16 for existing companies) by the average amount of the company's gross receipts for the four preceding years. The "fixed-base percentage" was the ratio of R&E expenses to gross receipts for the 1984 to 1988 period. Start-up companies that did not both incur qualified expenses and had gross receipts in at least three of the base years were assigned a "fixed-base percentage" of .03. A similar credit with its own separate threshold was provided for taxpayers' basic research grants to universities. Beginning in 1989, the otherwise deductible qualified R&E expenditures were reduced by the amount of the credit.

Allocation of R&E expenditures.—Regulations issued in 1977 were designed to achieve a reasonable allocation of R&E expenses between corporations' domestic and foreign activities, but successive legislative and administrative actions suspended this requirement. Under legislation that expired on July 31, 1995, 50 percent of both U.S.- and foreign-based R&E expenses were allocated to their respective income sources. The remaining R&E expenses then had to be allocated on the basis of gross sales or gross income.

Energy

Exploration and development costs.—In the case of successful investments in domestic oil and gas wells, intangible drilling costs, such as wages, the costs of using machinery for grading and drilling, and the cost of unsalvageable materials used in constructing wells, may be expensed rather than amortized over the productive life of the property.

Integrated oil companies may currently deduct only 70 percent of such costs and amortize the remaining 30 percent over five years. The same rule applies to the exploration and development costs of surface stripping and the construction of shafts and tunnels for other fuel minerals.

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

Alternative fuel production credit.—A nontaxable credit of $3 per barrel (in 1979 dollars) of oil-equivalent production is provided for several forms of alternative fuels. It is generally available as long as the price of oil stays below $29.50 (in 1979 dollars).

Oil and gas exception to passive loss limitation.—Although owners of working interests in oil and gas properties are subject to the alternative minimum tax, they are exempted from the "passive income" limitations. This means that the working interest-holder, who manages on behalf of himself and all other owners the development of wells and incurs all the costs of their operation, may aggregate negative taxable income

from such interests with his income from all other sources. Thus, he will be relieved of the minimum tax rules limit on tax deferrals.

Capital gains treatment of royalties on coal.—Sales of certain coal under royalty contracts can be treated as capital gains. While the top statutory rate on ordinary income is 39.6 percent, the rates on capital gains are limited to 28 percent.

Tax-exempt bonds for energy facilities.—Certain energy facilities, such as municipal electric and gas utilities, may benefit from tax-exempt financing.

Enhanced oil recovery credit.—A credit is provided equal to 15 percent of the taxpayer's costs for tertiary oil recovery on projects in the United States. Qualifying costs include tertiary injectant expenses, intangible drilling and development costs on a qualified enhanced oil recovery project, and amounts incurred for tangible depreciable property.

New technology credits.—A credit of 10 percent is available for investment in solar and geothermal energy facilities. In addition, a credit of 1.5 cents is provided per kilowatt hour of electricity produced from renewable resources such as wind and biomass. The renewable resources credit applies only to electricity produced by a facility placed in service before July 1, 1999.

Alcohol fuel credit.—Gasohol, a motor fuel composed of at least 10 percent alcohol, is exempt from 5.4 of the 18.4 cents per gallon Federal excise tax on gasoline. Smaller exemptions are allowed for motor fuel with lower alcohol content. There is a corresponding income tax credit for alcohol used as a fuel in applications where the excise tax is not assessed. This credit, equal to a subsidy of 54 cents per gallon for alcohol used as a motor fuel, is intended to encourage substitution of alcohol for petroleum-based gasoline. In addition, small producers of ethanol are eligible for a 10 cent per gallon credit.

Credit and deduction for clean-fuel vehicles and property.—A tax credit of 10 percent is provided for electric vehicles. In addition, a deduction is provided for other clean-fuel burning vehicles as well as refueling property.

Exclusion of utility conservation subsidies.—Subsidies by public utilities for customer expenditures on energy conservation measures are excluded from the gross income of the customer.

Natural Resources and Environment

Exploration and development costs.—As is true for fuel minerals, certain capital outlays associated with exploration and development of nonfuel minerals may be expensed rather than depreciated over the life of the asset.

Percentage depletion.—Most nonfuel mineral extractors also make use of percentage depletion rather than cost depletion, with percentage depletion rates ranging from 22 percent for sulphur down to 5 percent for sand and gravel.

Capital gains treatment of iron ore and of certain timber income.—Iron ore and certain timber sold under a royalty contract can be treated as capital gains.

Mining reclamation reserves.—Taxpayers are allowed to establish reserves to cover certain costs of mine reclamation and of closing solid waste disposal properties. Net increases in reserves may be taken as a deduction against taxable income.

Tax-exempt bonds for pollution control and waste disposal.—Interest on State and local government debt issued to finance private pollution control and waste disposal facilities was excludable from income subject to tax. This authorization was repealed for pollution control equipment and limits placed on the amount of debt that can be issued for private waste disposal facilities by the Tax Reform Act of 1986.

Expensing multiperiod timber growing costs.—Generally, costs must be capitalized when goods are produced for inventory used in one's own trade or business, or under contract to another party. Timber production, however, was specifically exempted from these multiperiod cost capitalization rules, creating a special benefit derived from this deferral of taxable income.

Credit and seven-year amortization for reforestation.—A special 10 percent investment tax credit is allowed for up to $10,000 invested annually in clearing land and planting trees for the ultimate production of timber. The same amount of forestation investment may also be amortized over a seven-year period. Without this preference, the amount would have to be capitalized and could be recovered (deducted) only when the trees were sold or harvested 20 or more years later. Moreover, the amount of forestation investment that is amortizable is not reduced by any of the investment credit that is allowed.

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

Agriculture

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

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

Loans forgiven solvent farmers.—Farmers are granted special tax treatment by being forgiven the tax liability on certain forgiven debt. Normally, the amount of loan forgiveness is accounted for as a gain (income) of the debtor and he must either report the gain, or reduce his recoverable basis in the property to which the loan relates. If the debtor elects to reduce basis and the amount of forgiveness exceeds his basis in the property, the excess forgiveness is taxable. However, in the case of insolvent (bankrupt) debtors, the amount of loan forgiveness never results in an income tax liability.[4] Farmers with forgiven debt are considered insolvent for tax purposes, and thus qualify for income tax forgiveness.

Capital gains treatment of certain income.—Certain agricultural income, such as unharvested crops, can be treated as capital gains.

COMMERCE AND HOUSING

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

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

Bad debt reserves.—Only commercial banks with less than $500 million in assets, mutual savings banks, and savings and loan associations are permitted to deduct additions to bad debt reserves in excess of actually experienced losses. The deduction for additions to loss reserves allowed qualifying mutual savings banks and savings and loan associations is 8 percent of otherwise taxable income. To qualify, the thrift institutions must maintain a specified fraction of their assets in the form of mortgages, primarily residential.

Interest on life insurance savings.—Savings in the form of policyholder reserves are accumulated from premium payments and interest is earned on the reserves. Such interest income is not taxed as it accrues nor when received by beneficiaries upon the death of the insured.

Small property and casualty insurance companies.— Insurance companies that have annual net premium incomes of less than $350,000 are exempted from tax; those with $350,000 to $2,100,000 of net premium incomes may elect to pay tax only on the income earned by their investment portfolio.

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

Mortgage housing bonds.—Interest on all mortgage revenue bonds issued by State and local governments is exempt from taxation. Proceeds are used to finance homes purchased by first-time buyers—with low to moderate incomes—of dwellings with prices under 90 percent of the average area purchase price.

There are limits imposed on the amount of tax-exempt State and local government bonds that could be issued to fund private activity. The volume cap for single-family mortgage revenue bonds and multifamily rental housing bonds is combined with the cap for student loans and industrial development bonds (IDBs). The cap is set at $50 per capita or a minimum of $150 million for each State.

States are authorized to issue mortgage credit certificates (MCCs) in lieu of qualified mortgage revenue bonds because the bonds are relatively inefficient subsidies to first-time home buyers. MCCs entitle home buyers to income tax credits for a specified percentage of interest on qualified mortgage loans. In this way, the entire amount of the subsidy flows directly to the home buyer without being partly diverted to financial middlemen or bondholders. A State cannot issue an aggregate annual amount of MCCs greater than 25 percent of its annual ceiling for qualified mortgage bonds. Because of the relationship between MCCs and qualified mortgage bonds, their estimates are presented as one line item in the tables.

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

[4]The insolvent taxpayer's carryover losses and unused credits are extinguished first, and then his basis in assets reduced to no less than amounts still owed creditors. Finally, the remainder of the forgiven debt is excluded from tax.

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

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

Capital gains on home sales.—When a primary residence is sold, the homeowner can defer paying a capital gains tax on the proceeds by purchasing or constructing a home of value at least equal to that of the prior home (net of sales and qualified fix-up expenses) within two years. This deferral is a tax expenditure.

Capital gains on sales by owners aged 55 or older.—A taxpayer who is 55 years of age or older at the time of the sale of his residence may elect to exclude from tax up to $125,000 of the gain from its sale. This is a once-in-a-lifetime election. In effect, this provision converts some prior deferrals of tax into forgiveness of tax.

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

Accelerated depreciation of real property, machinery and equipment.—As previously noted, the tax depreciation allowance provisions are part of the reference law rules, and thus do not cause tax expenditures under the reference method. Under the normal tax method, however, a 40-year tax life for depreciable real property is the norm. So, the statutory depreciation period in effect from 1987 to 1993 for nonresidential properties of 31.5 years, and the 39-year period for property placed in service after February 25, 1993, give rise to tax expenditures. The statutory depreciation period for residential property is 27.5 years, which also results in tax expenditures. Statutory depreciation of machinery and equipment also is somewhat accelerated relative to the normal tax baseline. In addition, tax expenditures arise from pre-1987 tax allowances for real and personal property.

Cancellation of indebtedness.—Individuals are not required to report the cancellation of certain indebtedness as current income. However, if they do not, it would be included as an adjustment in the basis of the underlying property.

Imputed interest rules.—Under reference law rules commonly referred to as original issue discount (OID), both the holder and seller of a financial contract are generally required to report interest earned in the period it accrues, not when the contract payments are made. Moreover, the amount of interest accruable is determined by the actual price paid for the contract, not by the stated or nominal principal and interest stipulated in the contract.[5]

Exceptions to the general rules for accounting for interest expense or income include the following: (a) permission for the mortgagor of his personal residence to treat the discount from the nominal principal of his mortgage loan, commonly called "points," as prepaid interest which is deductible in the year paid, not the year accrued; and (b) sellers of farms and small businesses worth less than $1 million, in exchange for the purchaser's debt obligation, are exempted from the OID rules. This is $750,000 more than the $250,000 exemption that the reference tax law generally allows for such transactions.

Capital gains (other than agriculture, timber, iron ore and coal).—While the top statutory rate on ordinary income is 39.6 percent, the rates on capital gains are limited to 28 percent. This treatment is considered a tax expenditure under the normal tax method but not under the reference law method.

Capital gains exclusion for small business stock.—An exclusion of 50 percent is provided for capital gains from qualified small business stock held by individuals for more than 5 years. A qualified small business is a corporation whose gross assets do not exceed $50 million as of the date of issuance of the stock. Certain activities such as personal services and banking are ineligible for the exclusion.

Step-up in basis of capital gains at death.—Capital gains on assets held at the owner's death are not

[5]Thus, when a borrower on December 31, 1995, issues a promise to pay $1,000 plus interest at 10 percent on December 30, 1996, for a total repayment of $1,100, and accepts $900 from a lender in exchange for the contract, the rules require that both parties: (a) recognize that $900 is the amount lent, so that the effective loan interest rate is not the nominal 10 percent rate but is 22.2 percent; and (b) both report $200 as interest paid or received in 1996, as the case may be.

subject to capital gains taxes. The cost basis of the appreciated assets is adjusted upward to the market value at the owner's date of death. The step-up in the heir's cost basis means that, in effect, the capital gain is forgiven.

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

Ordinary income treatment of losses from sale of small business corporate stock shares.—Up to $100,000 in losses from the sale of such stock may be treated as ordinary losses, and therefore not be subject to the $3,000 annual capital loss write-off limit if the corporation's capitalization is less than $1 million.

Expensing of certain small investments.—Qualifying investments in tangible property up to $17,500 ($10,000 prior to 1993) can be expensed rather than depreciated over time. To the extent that qualifying investment during the year exceeds $200,000, the amount eligible for expensing is decreased. The amount expensed is completely phased out when qualifying investments exceed $217,500.

Business start-up costs.—When an individual or corporation acquires or otherwise enters into a new business, certain start-up expenses, such as the costs of investigating opportunities and legal services, are normally incurred. The taxpayer may elect to amortize these outlays over 60 months although they are similar to other payments he makes for nondepreciable intangible assets that are not recoverable until the business is sold. Under the normal tax method this gives rise to a tax expenditure, while under the reference method it does not.

Graduated corporation income tax rate schedule.—The schedule is graduated, with rates of 15 percent on the first $50,000 of taxable income, 25 percent on the next $25,000, 34 percent on the next $9.925 million, and a rate of 35 percent on income over $10 million. As compared with a flat 35 percent tax rate, the lower rates provide a $111,000 reduction in tax liability for corporations with taxable incomes of $10 million. This benefit is recaptured in the cases of corporations with taxable incomes exceeding $100,000. This is accomplished by (1) a 5 percent additional tax on corporate incomes in excess of $100,000, but less than $335,000 and (2) a 3 percent additional tax on income over $15 million but less than $18.33 million. At this point the $111,000 is fully recaptured. Since this rate schedule is part of the reference tax law, it does not give rise to a tax expenditure under the reference method. A flat corporation income tax rate is taken as the baseline under the normal tax method; therefore the lower rates do yield a tax expenditure under this concept.

Small issue industrial development bonds.—The interest on small issue industrial development bonds (IDBs) issued by State and local governments to finance private business property is excluded from income subject to tax. Depreciable property financed with small issue IDBs must be depreciated, however, using the straight-line method. The tax exemption of small issue bonds expired in 1986, except for small issue IDBs exclusively issued to finance manufacturing facilities for which the tax exemption is permanent. The annual volume of small issue IDBs is subject to the unified volume cap discussed in the mortgage housing bond section above.

Deferral of gains from sale of broadcasting facility to minority owned business.—The voluntary sale of assets generally requires the seller to pay tax on the gain that has accrued over the period of ownership. However, in the case of an involuntary sale, as when an owner's property must be sold in a condemnation preceding, or to implement a change in a government's regulatory policy, the owner is permitted to defer payment of tax, provided the proceeds are reinvested in similar property within a specified period. In 1979, the Federal Communications Commission instituted a policy of encouraging minority group ownership of broadcast licenses. Since that time, the tax laws have been interpreted to permit voluntary sellers of licensed broadcasting facilities to defer payment of capital gains tax when the buyer has been certified as a "minority business," in effect treating the sale as "involuntary."

Treatment of Alaskan Native Corporations losses.—Tax law restricts the ability of profitable corporations to reduce their tax liabilities by merging or buying corporations with accumulated net operating losses (NOLs) and as yet unrefunded claims to investment credits. Alaska Native Corporations have a limited exemption (fifteen years after the NOL or credit claim was first experienced) from these restrictions that includes NOLs and credits claimable prior to April 26, 1988.

TRANSPORTATION

Shipping companies that are U.S. flag carriers.—Certain companies that operate U.S. flag vessels receive a deferral of income taxes on that portion of their income used for shipping purposes, primarily construction, modernization and major repairs to ships, and repayment of loans to finance these qualified investments. Once indefinite, the deferral has been limited to 25 years since January 1, 1987.

Exclusion of reimbursed employee parking expenses.—Parking at or near an employer's business premises that is paid for by the employer is excludable

from the income of the employee as a working condition fringe benefit. The maximum amount of the parking exclusion is $155 month (in 1993 dollars), indexed in $5 increments. The tax expenditure estimate does not include parking at facilities owned by the employer.

Exclusion of employer-provided transit passes.—Transit passes, tokens, and fare cards provided by an employer to defray an employee's commuting costs are excludable from the employee's income as a de minimis fringe benefit, if the total value of the benefit does not exceed $60 per month (in 1993 dollars), indexed in $5 increments.

Community and Regional Development

Low-income housing investment.—Through 1989, a tax credit for investment in new, substantially rehabilitated, and certain unrehabilitated low-income housing was structured to have a present value of 70 percent of construction or rehabilitation costs incurred and was allowed over 10 years. For Federally subsidized projects and those involving unrehabilitated existing low income housing, the credit was structured to have a present value of 30 percent. Beginning on January 1, 1990, the credit was extended at a present value of 70 percent, including projects financed with other Federal subsidies, but only if substantial rehabilitation was done. Notwithstanding the capital grant character of this subsidy, the investor's recoverable basis is not reduced by the substantial credit allowed.

Rehabilitation of structures.—A 10 percent investment tax credit is available for the rehabilitation of buildings that are used for business or productive activities and that were erected before 1936 for other than residential purposes. A full reduction by the amount of the credit is required in the taxpayer's recoverable basis.

Tax-exempt bonds for airports and similar facilities.—Government-owned airports, docks and wharves, as well as high-speed rail facilities that need not be government-owned, may be financed with tax-exempt bonds. These bonds are not covered by a volume cap.

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

Empowerment zones.—Qualifying businesses in designated economically depressed areas can receive tax benefits such as an employer wage credit, increasing expensing of investment in equipment, tax-exempt financing, and accelerated depreciation. In addition, a tax credit for contributions to certain community development corporations can be available.

Education, Training, Employment, and Social Services

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

Tax-exempt bonds for educational purposes.—Interest on State and local government debt issued to finance student loans or the construction of facilities used by private nonprofit educational institutions is excluded from income subject to tax. The aggregate volume of such private activity bonds that each State may issue during any calendar year is limited.

U.S. savings bonds for education.—Interest on U.S. savings bonds, issued after December 31, 1989, may be excluded from tax if the bonds, plus accrued interest, are transferred to an educational institution as payment for educational expenses. The exclusion from tax is phased out for joint returns with adjusted gross incomes of $65,250 to $95,250 and $43,500 to $58,500 for single and head of household returns in 1995.

Dependent students age 19 or older.—Taxpayers can claim personal exemptions for dependent children age 19 or over who receive parental support payments of $1,000 or more per year, are full-time students, and do not claim a personal exemption on their own tax returns. This preferential arrangement usually generates tax savings because the students' marginal tax rates are more often than not lower than their parents' marginal tax rates.

Charitable contributions.—Contributions to charitable, religious, and certain other nonprofit organizations are allowed as an itemized deduction for individuals, generally up to 50 percent of adjusted gross income. Taxpayers who donate capital assets to charitable or educational organizations can deduct the assets' current value without the taxation of any appreciation in value. Corporations can also deduct charitable contributions up to 10 percent of their pre-tax income. Tax expenditures resulting from the deductibility of contributions are shown separately for educational and other institutions. Contributions to health institutions are reported under the health function.

Employer provided benefits.—Many employers provide employee benefits that are not counted in employee income. The employers' costs for these benefits are deductible business expenses. The exclusion from an employee's income of the value of educational assistance, child care, meals and lodging, as well as ministers' housing allowances and the rental value of parsonages are tax expenditures. The exclusion for educational assistance expired on December 31, 1994. Health and other insurance benefits are reported under the health and income security functions. Certain parking and transit benefits are reported under the transportation function.

Targeted jobs credit.—Employers could claim a tax credit for qualified wages paid to individuals who began work before January 1, 1995, and who were certified as members of various targeted groups. The amount of the credit that could be claimed was 40 percent of the first $3,000 paid during the first year of employment. The 40 percent credit also applied to the summer employment wages paid to 16 and 17 year old youths who were members of low income families. Employers had to reduce their deduction for wages paid by the amount of the credit claimed.

Child and dependent care expenses.—A tax credit may be claimed by married couples for child and dependent care expenses incurred when one spouse works full time and the other works at least part time or goes to school. The credit may also be claimed by divorced or separated parents who have custody of children, and by single parents. Expenditures up to a maximum $2,400 for one dependent and $4,800 for two or more dependents are eligible for the credit. The credit is equal to 30 percent of qualified expenditures for taxpayers with incomes of $10,000 or less. The credit is reduced to a minimum of 20 percent by one percentage point for each $2,000 of income between $10,000 and $28,000.

Disabled access expenditures.—A credit is provided of 50 percent of eligible disabled access expenditures in excess of $250. The credit is limited to $5,000.

Costs of removing architectural barriers to the handicapped.—The investment cost of making any business accessible to persons suffering physical or mental disabilities may be deducted, rather than capitalized as part of the taxpayer's basis in such property and recovered by subsequent depreciation allowances, as is generally required.

Foster care payments.—Foster parents provide a home and care for children who are wards of the State, under contract with the State. Compensation received for this service is explicitly excluded from the gross incomes of foster parents, making the expenses they incur nondeductible. This activity is, in effect, tax-exempt.

HEALTH

Employer paid medical insurance and expenses.—Employee compensation, in the form of payments by employers for health insurance premiums and other medical expenses, is deducted as a business expense by employers, but it is not included in employee gross income.

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

Tax-exempt bonds for hospital construction.—Interest earned on State and local government debt issued to finance hospital construction is excluded from income subject to tax.

Charitable contributions to health institutions.—Contributions to nonprofit health institutions are allowed as a deduction for individuals and corporations. Tax expenditures resulting from the deductibility of contributions to other charitable institutions are listed under the education, training, employment, and social services function.

Orphan drugs.—To encourage the development of drugs for the treatment of rare diseases or physical conditions, a tax credit was granted equal to 50 percent of the costs for clinical testing that must be completed before manufacture and distribution are approved by the Food and Drug Administration. Because the drug firm was not required to reduce its deduction for testing expenses (an R&D expenditure) by the amount of this credit, the private cost of clinically testing orphan drugs was reduced substantially. This tax expenditure expired December 31, 1994.

Blue Cross and Blue Shield.—Although these organizations are not qualified as exempt, they are provided exceptions from otherwise applicable insurance company income tax accounting rules that effectively eliminate their tax liabilities.

INCOME SECURITY

Railroad retirement benefits.—These benefits are not generally subject to the income tax unless the recipient's gross income reaches a certain threshold discussed more fully under the social security function.

Workmen's compensation benefits.—Workmen's compensation provides payments to disabled workers. These benefits, although income to the recipients, are a tax preference because they are not subject to the income tax.

Public assistance benefits.—The exclusion from taxable income of public assistance benefits received by individuals is listed as a tax expenditure under the normal tax method because, under this method, cash

transfers from government are included in gross income. In contrast, gifts not conditioned on the performance of services, including transfers from government, are not taxable under the reference law. Therefore, under the reference tax method, the tax exclusion for public assistance benefits is not shown as a tax expenditure.

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

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

Pension contributions and earnings.—Certain employer contributions to pension plans, along with individual contributions to individual retirement accounts (IRAs) and amounts set aside by the self-employed, are excluded from adjusted gross income in the year of contribution. The investment income earned by pension funds and other qualifying retirement plans is not taxable when earned, and this deferral is, therefore, also a tax expenditure.

Limited amounts ($9,500 in 1996) can be excluded from an employee's compensation under a qualified cash or deferred arrangement with the employer (401(k) plan) or tax-sheltered annuity (403(b) plan).

Employees may deduct annual contributions to an IRA of $2,000 (or 100 percent of compensation, if less), or $2,250 on a joint return with only one spouse earning income, if: (a) neither the individual or spouse is an active participant in an employer-provided retirement plan; or (b) their adjusted gross income falls below $40,000 ($25,000 for a single taxpayer). The allowable IRA deduction is phased out between $40,000 and $50,000 for a joint return and $25,000 and $35,000 for a single return. Beyond these income limits, nondeductible contributions to IRAs are available to taxpayers who are active participants in employer-provided retirement plans. Self-employed persons can make deductible contributions to their own retirement (Keogh) plans equal to 25 percent of their income, up to a maximum of $30,000 per year.

Employer provided insurance benefits.—Many employers cover part or all the cost of premiums or payments for: (a) employees' life insurance benefits; (b) accident and disability benefits; (c) death benefits; and (d) supplementary unemployment benefits. The amounts are deductible by the employers and are excluded as well from employees' gross incomes for tax purposes.

Employer Stock Ownership Plan (ESOP) provisions.—A special type of employee benefit plan, organized as a trust, is tax-exempt. Employer-paid contributions (the value of stock issued to the ESOP) are deductible by the employer as part of employee compensation costs. They are not included in the employees' gross income for tax purposes, however, until they are paid out as benefits. The following special income tax provisions for ESOPs are intended to increase ownership of corporations by their employees: (1) annual employer contributions are subject to less restrictive limitations (percentages of employees' cash compensation); (2) ESOPs may borrow to purchase employer stock, guaranteed by their agreement with the employer that the debt will be serviced by his payment (deductible by him) of a portion of wages (excludable by the employees) to service the loan; (3) ESOPs' lenders may exclude half the interest from their gross income; (4) employees who sell appreciated company stock to the ESOP may defer any taxes due until they withdraw benefits; and (5) dividends paid to ESOP-held stock are deductible by the employer.

Support of the aged and the blind.—Taxpayers who are blind or 65 years of age or older may take an additional $1,000 standard deduction if single, or $800 if married. In addition, individuals who are 65 years of age or older, or who are permanently disabled, can take a tax credit equal to 15 percent of the sum of their earned and retirement income. Qualified income is limited to no more than $2,500 for single individuals or married couples filing a joint return where only one spouse is 65 years of age or older, and up to $3,750 for joint returns where both spouses are 65 years of age or older. These limits are reduced by one-half of the taxpayer's adjusted gross income over $7,500 for single individuals and $10,000 for married couples filing a joint return.

Casualty losses.—Neither the purchase of property nor insurance premiums to protect its value are deductible as costs of earning income; therefore, reimbursement for insured loss of such property is not reportable as a part of gross income. However, a special provision permits relief for taxpayers suffering an uninsured loss. They may deduct casualty and theft losses of more than $100 each, but only to the extent that total losses during the year exceed 10 percent of adjusted gross income.

Earned income credit.—This credit may be claimed by low income workers. For a family with one qualifying child, the credit is 34 percent of the first $6,330 of earned income in 1996. The credit is 40 percent of the first $8,890 of income for a family with two or more qualifying children. When the taxpayer's income exceeds $11,610, the credit is phased out at the rate of 15.98 percent (21.06 percent if two or more qualifying children are present). It is completely phased out at $25,078 of adjusted gross income ($28,495 if two or more qualifying children are present).

The credit may also be claimed by workers who do not have children living with them. Qualifying workers must be at least age 25 and may not be claimed as a dependent on another taxpayer's return. The credit is not available to workers age 65 or older. In 1996, the credit is 7.65 percent of the first $4,220 of earned

income. When the taxpayer's income exceeds $5,280, the credit is phased out at the rate of 7.65 percent. It is completely phased out at $9,500 of adjusted gross income.

For workers with or without children, the income level at which the credit's phase-outs begin and the maximum amounts of income on which the credit can be taken are adjusted for inflation. Earned income tax credits in excess of tax liabilities are refundable to individuals, and as such are paid by the Federal Government. This portion of the credit is included in outlays, while the amount that offsets tax liabilities is shown as a tax expenditure.

SOCIAL SECURITY

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

Social Security benefits for the disabled, dependents and survivors.—Benefit payments from the Social Security Trust Fund, for disability and for dependents and survivors, are excluded from the beneficiaries' gross incomes, and thus give rise to tax expenditures.

VETERANS BENEFITS AND SERVICES

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

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

GENERAL GOVERNMENT

Public purpose State and local debt.—Interest on State and local government debt, issued to finance government activities, is excluded from Federal taxation. State and local governments, therefore, can sell debt obligations at a lower interest cost than would be possible if such interest were subject to tax. Only the excluded interest on bonds for public purposes, such as schools, roads, and sewers, is included here.

Nonbusiness State and local taxes excluding home-owner property taxes.—The deductibility of nonbusiness State and local income and personal property taxes gives indirect assistance to these governments by reducing the costs of the services they provide.

Business income earned in U.S. possessions.—Under certain conditions, U.S. corporations receiving income from an active trade or business, or from investments located in a U.S. possession, can claim a special credit against U.S. tax otherwise due.

INTEREST

U.S. savings bonds.—The interest on U.S. savings bonds is not taxable until the bonds are redeemed, thereby deferring tax liability. The deferral is equivalent to an interest-free loan and, therefore, it is a tax expenditure.

TAX EXPENDITURES IN THE UNIFIED TRANSFER TAX

Exceptions to the general terms of the Federal unified transfer tax favor particular transferees or dispositions of transferors, similar to Federal direct expenditure or loan programs. The transfer tax provisions identified as tax expenditures satisfy the reference law criteria for inclusion in the tax expenditure budget that were described above. There is no generally accepted normal tax baseline for transfer taxes.

Unified Transfer Tax Reference Rules

The reference tax rules for the unified transfer tax from which departures represent tax expenditures include:

- *Definition of the taxpaying unit.* The payment of the tax is the liability of the transferor whether the transfer of cash or property was made by gift or bequest.
- *Definition of the tax base.* The base for the tax is the transferor's cumulative, taxable lifetime

gifts made plus the net estate at death. Gifts in the tax base are all annual transfers in excess of $10,000 to any donee except the donor's spouse. Excluded are, however, payments on behalf of family members' educational and medical expenses, as well as the cost of ceremonial gatherings and celebrations that are not in honor of the donor.

- *Property valuation.* In general, property is valued at its fair market value at the time it is transferred. This is not necessarily the case in the valuation of property for transfer tax purposes. Executors of estates are provided the option to value assets at the time of the testator's death or up to six months later.
- *Tax rate schedule.* A single graduated tax rate schedule applies to all taxable transfers. This is reflected in the name of the "unified transfer tax" that has replaced the former separate gift and estate taxes. The tax rates vary from 18 percent on the first $10,000 of aggregate taxable transfers, to 55 percent on amounts exceeding $3 million. A $192,800 lifetime credit is provided against the tax in determining the final amount of transfer taxes that are due and payable. This allows each taxpayer to make a $600,000 tax-free transfer of assets that otherwise would be liable to the unified transfer tax.[6]
- *Time when tax is due and payable.* Donors are required to pay the tax annually as gifts are made. The generation-skipping transfer tax is payable by the donees whenever they accede to the gift. The net estate tax liability is due and payable within nine months after the decedent's death. The Internal Revenue Service may grant an extension of up to 10 years for a reasonable cause. Interest is charged on the unpaid tax liability at a rate equal to the cost of Federal short-term borrowing, plus three percentage points.

[6]An additional tax, at a flat rate of 55 percent, is imposed on lifetime, generation-skipping transfers in excess of $1 million. It is considered a generation-skipping transfer whenever the transferee is at least two generations younger than the transferor, as it would be in the case of transfers to grandchildren or great-grandchildren. The liability of this tax is on the recipients of the transfer.

Tax Expenditures by Function

The estimates of tax expenditures in the Federal unified transfer tax for fiscal years 1995–2001 are displayed by functional category in table 5–5. Outlay equivalent estimates are similar to revenue loss estimates for transfer tax expenditures and, therefore, are not shown separately. A description of the provisions follows.

Natural Resources and Environment

Donations of conservation easements.—Bequests for conservation are excluded from taxable estates. A conservation bequest is the value of property and easements (in perpetuity) to such property the use of which is restricted to any one or more of the following: the public for outdoor recreation; protection of the natural habitats of fish, wildlife, plants, etc.; scenic enjoyment of the public; and preservation of historic land areas and structures. Similar conservation gifts are excluded from the gift tax base and are also deductible from the donor's otherwise taxable income in the year of the gift.

Agriculture

Special use valuation of farms.—Farmland owned and operated by a decedent and/or a member of the family may be valued for estate tax purposes on the

TABLE 5–5. REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE FEDERAL UNIFIED TRANSFER TAX

(In millions of dollars)

Description	Fiscal Years							
	1995	1996	1997	1998	1999	2000	2001	1997–2001
Natural Resources and Environment:								
Deductions for donations of conservation easements	0	0	0	0	0	0	0	0
Agriculture:								
Special use valuation of farm real property	70	75	80	85	90	95	100	450
Tax deferral of closely held farms	55	60	65	70	75	80	85	375
Commerce:								
Special use valuation of real property used in closely held businesses	20	20	20	25	25	25	25	120
Tax deferral of closely held business	10	10	10	10	15	15	15	65
Education, training, employment, and social services:								
Deduction for charitable contributions (education)	515	565	600	640	680	730	775	3,425
Deduction for charitable contributions (other than education and health)	1,520	1,650	1,765	1,885	2,005	2,135	2,280	10,070
Health:								
Deduction for charitable contributions (health)	465	510	550	590	630	680	730	3,180
General government:								
Credit for State death taxes	2,885	3,175	3,420	3,685	3,965	4,250	4,555	19,875

Note: All estimates have been rounded to the nearest $5 million.

basis of its "continued use" as a farm if: the farmland is at least 25 percent of the decedent's gross estate; the entire value of all farm property is at least 50 percent of the gross estate; and family heirs to the farm agree to continue to operate the property as a farm for at least 10 years. Since continued use valuation of farmland is frequently substantially less than the fair market value, the resulting reduction in tax liability serves as a subsidy to the continued operation of family farms.

Tax deferral of closely held farms.—Decedents' estates may use a preferential, extended installment payment period of five to 15 years to discharge estate tax liabilities if the value of the farm properties exceeds 35 percent of the net estates. The interest charged is only 4 percent for the first five years, rather than the standard Federal short-term borrowing rate plus three percentage points, which applies during the last 10 years of the repayment period.

Commerce and Housing Credit

Special use valuation of closely held businesses.—The two estate tax incentives to family farming are also available to the estates of owners of nonfarm family businesses. If the same three conditions previously described are met, the real property in their estates is eligible for continued use valuation.

Tax deferral of closely held businesses.—Nonfarm family businesses that satisfy the net estate requirements qualify for preferential 15 year deferred estate tax payment. To be eligible for this special provision, the value of stock in closely held corporations must exceed 35 percent of the decedent's gross estate, less debt and funeral expenses.

Education, Training, Employment, and Social Services

Bequests to tax-exempt organizations.—These bequests are deductible from decedent's otherwise taxable lifetime transfers.

Health

Bequests to health providers.—Such bequests, that are exempt from the income tax, are deductible from otherwise taxable lifetime transfers of decedents.

General Government

State and local death taxes.—A credit is allowed for state death taxes against any Federal estate tax that otherwise would be due. The amount of the state death tax credit is determined by a rate schedule that reaches a limit of 16 percent of the taxable estate in excess of $60,000.

TABLE 5–6. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 1997 REVENUE LOSS

(In millions of dollars)

Provision	1997	1997–2001
Exclusion of employer contributions for medical insurance premiums and medical care	70,490	423,200
Net exclusion of employer pension plan contributions and earnings	55,770	283,115
Deductibility of mortgage interest on owner-occupied homes	53,075	293,985
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	30,620	169,595
Step-up basis of capital gains at death	30,265	155,825
Accelerated depreciation of machinery and equipment (normal tax method)	29,500	159,555
Deductibility of charitable contributions (all types)	26,075	143,985
Exclusion of OASI benefits for retired workers	17,285	94,285
Deductibility of State and local property tax on owner-occupied homes	16,860	93,395
Deferral of capital gains on home sales	15,040	79,850
Exclusion of interest on public purpose State and local debt	13,775	75,865
Exclusion of interest on life insurance savings	11,470	66,275
Net exclusion of Individual Retirement Account contributions and earnings	7,940	41,640
Exclusion of interest on State and local debt for various non-public purposes	7,565	37,920
Capital gains (other than agriculture, timber, iron ore, and coal) (normal tax method)	6,920	36,095
Earned income credit [1]	6,250	34,145
Accelerated depreciation of buildings other than rental housing (normal tax method)	5,720	17,740
Exclusion of capital gains on home sales for persons age 55 and over	5,075	27,055
Exclusion of workmen's compensation benefits	5,050	27,825
Graduated corporation income tax rate (normal tax method)	4,730	26,885
Deductibility of medical expenses	4,125	24,855
Exclusion of social security benefits for dependents and survivors	4,030	22,375
Exception from passive loss rules for $25,000 of rental loss	3,985	17,625
Net exclusion of Keogh plan contributions and earnings	3,580	19,625
Premiums on employer-provided group term life insurance	3,170	17,505
Credit for child and dependent care expenses	3,005	16,610
Exclusion of veterans disability compensation	2,985	16,715
Credit for low-income housing investments	2,945	16,755
Tax credit for corporations receiving income from doing business in U.S. possessions	2,855	16,085
Exclusion of social security disability insurance benefits	2,375	14,050
Exclusion of income earned abroad by United States citizens	2,100	13,395
Exclusion of benefits and allowances to armed forces personnel	2,080	10,595
Deferral of income from controlled foreign corporations (normal tax method)	2,000	12,100
Expensing of research and experimentation expenditures (normal tax method)	1,840	10,360
Exclusion of income of foreign sales corporations	1,600	9,000
Special ESOP rules (other than investment credit)	1,540	6,460
Inventory property sales source rules exception	1,500	8,500
Additional deduction for the elderly	1,340	6,820
Accelerated depreciation on rental housing (normal tax method)	1,305	9,085
Exclusion of reimbursed employee parking expenses	1,290	6,855
Deferral of interest on savings bonds	1,210	6,720
Excess of percentage over cost depletion (oil, gas, and other fuels)	1,145	6,240
Expensing of certain small investments (normal tax method)	1,120	2,990
Alternative fuel production credit	990	4,390
Deferral of income from post 1987 installment sales	975	5,075
Exclusion of scholarship and fellowship income (normal tax method)	845	4,300
Parental personal exemption for students age 19 or over	835	4,580
Exclusion of employer provided child care	830	4,800
Exemption of credit union income	710	4,320
Exclusion of public assistance benefits (normal tax method)	635	3,715
Exclusion of employee meals and lodging (other than military)	600	3,330
Deductibility of casualty losses	465	2,580
Exclusion of railroad retirement system benefits	450	2,300
Expensing of multiperiod timber growing costs	415	2,305
Empowerment zones	385	2,225
Ordinary income treatment of loss from small business corporation stock sale	305	1,715
Exclusion of parsonage allowances	300	1,720
Credit for increasing research activities	285	450
Tax exemption of certain insurance companies	245	1,340
Excess of percentage over cost depletion, nonfuel minerals	235	1,220
Amortization of start-up costs (normal tax method)	200	1,045
Exclusion from income of conservation subsidies provided by public utilities	165	785
Premiums on employer-provided accident and disability insurance	165	925
Credit for disabled access expenditures	165	835
Permanent exceptions from imputed interest rules	155	790
Carryover basis of capital gains on gifts	150	850
New technology credit	145	825
Capital gains treatment of certain income	140	735
Exclusion of military disability pensions	130	650

TABLE 5–6. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 1997 REVENUE LOSS—Continued

(In millions of dollars)

Provision	1997	1997–2001
Small life insurance company deduction	120	670
Tax incentives for preservation of historic structures	120	565
Excess bad debt reserves of financial institutions	115	685
Enhanced oil recovery credit	100	520
Special Blue Cross/Blue Shield deduction	100	955
Interest allocation rules exception for certain financial operations	95	475
Exclusion of special benefits for disabled coal miners	85	395
Expensing of certain multiperiod production costs	80	415
Investment credit for rehabilitation of structures (other than historic)	80	355
Exclusion of veterans pensions	70	390
Exclusion of GI bill benefits	70	435
Expensing of certain capital outlays	65	340
Tax credit and deduction for clean-fuel burning vehicles and properties	65	395
Exclusion for employer-provided transit passes	60	435
Targeted jobs credit	60	125
Exception from passive loss limitation for working interests in oil and gas properties	60	335
Tax credit for the elderly and disabled	55	305
Investment credit and seven-year amortization for reforestation expenditures	50	250
Exemption of certain mutuals' and cooperatives' income	50	280
Special rules for mining reclamation reserves	50	250
Cancellation of indebtedness	40	40
Exclusion of certain foster care payments	35	185
Expensing of exploration and development costs, nonfuel minerals	35	175
Exclusion of employer provided death benefits	35	195
Additional deduction for the blind	25	135
Income of trusts to finance supplementary unemployment benefits	20	100
Deferral of tax on shipping companies	20	100
Expensing of costs of removing certain architectural barriers to the handicapped	20	100
Capital gains treatment of royalties on coal	15	75
Treatment of Alaska Native Corporations	15	40
Capital gains treatment of certain timber income	15	75
Exclusion of interest on savings bonds transferred to educational institutions	10	65
Alcohol fuel credit [2]	10	50
Treatment of loans forgiven solvent farmers as if insolvent	10	50
Special alternative tax on small property and casualty insurance companies	5	25
Capital gains exclusion of small corporation stock	0	215

[1] The effect of the earned income tax credit on outlays is $20,450 million in 1997 and $111,205 million for 1997–2001.
[2] In addition, the partial exemption from the excide tax for alcohol fuels results in a reduction in excise tax receipts for 1997 of $665 million and $3,535 million for 1997–2001.
Note: Provisions with estimates denoted normal tax method have no revenue loss under the reference tax law method.
All estimates have been rounded to the nearest $5 million.
Figures in table 5–6 are the arithmetic sums of corporate and individual income tax revenue loss estimates from table 5–2, and do not reflect possible interactions across these two taxes.

3. FEDERAL RECEIPTS

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

Growth in receipts.—Total receipts in 1998 are estimated to be $1,566.8 billion, an increase of $61.4 billion or 4.1 percent relative to 1997. This increase is largely due to assumed increases in incomes resulting from both real economic growth and inflation. Receipts are projected to grow at an average annual rate of 4.9 percent between 1998 and 2002, rising to $1896.7 billion.

As a share of GDP, receipts are projected to remain fairly constant, declining from 19.1 percent in 1998 to 19.0 percent in 2002.

Table 3–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	1996 actual	Estimate					
		1997	1998	1999	2000	2001	2002
Individual income taxes	656.4	672.7	691.2	721.6	755.6	795.2	839.8
Corporation income taxes	171.8	176.2	189.7	199.6	212.0	220.5	227.8
Social insurance taxes and contributions	509.4	535.8	557.8	585.2	614.4	642.2	673.1
(On-budget)	(141.9)	(146.9)	(152.8)	(160.0)	(167.5)	(174.5)	(183.2)
(Off-budget)	(367.5)	(388.9)	(404.9)	(425.2)	(446.9)	(467.6)	(489.9)
Excise taxes	54.0	57.2	61.2	64.5	64.9	66.2	67.4
Estate and gift taxes	17.2	17.6	18.8	20.0	21.4	22.9	24.6
Customs duties	18.7	17.3	18.3	18.5	19.6	20.5	22.0
Miscellaneous receipts	25.5	28.6	29.8	34.0	39.4	40.8	42.0
Total receipts	**1,453.1**	**1,505.4**	**1,566.8**	**1,643.3**	**1,727.3**	**1,808.3**	**1,896.7**
(On-budget)	*(1,085.6)*	*(1,116.5)*	*(1,161.9)*	*(1,218.1)*	*(1,280.4)*	*(1,340.7)*	*(1,406.8)*
(Off-budget)	*(367.5)*	*(388.9)*	*(404.9)*	*(425.2)*	*(446.9)*	*(467.6)*	*(489.9)*

Table 3–2. CHANGES IN RECEIPTS

(In billions of dollars)

	Estimate					
	1997	1998	1999	2000	2001	2002
Receipts under tax rates and structure in effect January 1, 1997 [1]	1,503.8	1,572.4	1,639.7	1,722.5	1,801.4	1,884.7
Social security (OASDI) taxable earnings base increases:.						
$65,400 to $68,700 on Jan. 1, 1998	.....	1.4	3.8	4.2	4.6	5.1
$68,700 to $71,400 on Jan. 1, 1999	.....	.....	1.1	3.1	3.4	3.8
$71,400 to $74,100 on Jan. 1, 2000	.....	.....	.....	1.2	3.1	3.4
$74,100 to $76,800 on Jan. 1, 2001	.....	.....	.....	.....	1.2	3.2
$76,800 to $79,800 on Jan. 1, 2002	.....	.....	.....	.....	.....	1.3
Proposals [2]	1.6	–7.0	–1.4	–3.7	–5.5	–4.9
Total, receipts under existing and proposed legislation	**1,505.4**	**1,566.8**	**1,643.3**	**1,727.3**	**1,808.3**	**1,896.7**

[1] These estimates assume a social security taxable earnings base of $65,400 through 2002.
[2] Net of income offsets.

ENACTED LEGISLATION

Several laws were enacted in 1996 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

Tax Benefits for Members of the Armed Forces Performing Peacekeeping Services in Bosnia and Hercegovina, Croatia, and Macedonia.—Current law provides various forms of tax relief to military personnel serving in combat zones. Under this Act that relief is extended to military personnel serving in and around the former republic of Yugoslavia. Such tax relief includes the exclusion from income of all of the military pay of enlisted personnel and part of the pay of officers serving in the former republic of Yugoslavia, and the extension of filing and payment deadlines. The Act also extends for three years, through September 30, 2003, the Internal Revenue Service's (IRS') authority to charge fees for written responses to questions from individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. These fees were scheduled to expire effective with requests made after September 30, 2000.

Taxpayer Bill of Rights 2.—This Act contains a number of provisions that provide taxpayers with increased protection in their dealings with the IRS. Taxpayer protection provisions include the establishment of a taxpayer advocate within IRS; modification of installment agreement provisions when agreements are terminated; expansion of IRS' authority to abate interest, and to award costs and certain fees in taxpayer disputes; and relief from retroactive regulations. To offset the receipt losses associated with these provisions, changes are provided in the "failure to pay" penalty assessed against taxpayers who fail to file a tax return and penalties are imposed on tax-exempt organizations under certain circumstances.

Personal Responsibility and Work Opportunity Reconciliation Act.—This Act provides an historic opportunity to transform our broken welfare system in a manner that promotes work, responsibility, and dignity. The major provisions of the Act that affect receipts include changes designed to improve earned income tax credit (EITC) compliance and to target EITC benefits to needy working families. These provisions, which are generally effective for taxable years beginning after December 31, 1995, are described below.

Deny EITC to individuals not authorized to be employed in the United States.—Individuals who do not have proper documentation for employment purposes are not eligible to claim the EITC.

Allow the IRS to use mathematical error procedures for certain EITC-related errors.—The IRS is permitted to use mathematical error procedures to deny claims for the EITC if a correct taxpayer identification number is not provided. The IRS can also use mathematical error procedures to impose the proper amount of self-employment tax if it is not paid on net self-employment earnings used to claim the credit.

Modify the definition of adjusted gross income (AGI) for phasing out the EITC.—The definition of AGI used for phasing out the credit is modified by disregarding net capital losses, net losses from trusts and estates, net losses from royalties, and 50 percent of net losses from businesses and rents.

Expand the definition of disqualified income for purposes of determining eligibility for the EITC.—Under prior law, taxpayers with more than $2,350 in taxable investment income were disqualifed from claiming the EITC. This Act lowers the limit to $2,200 and expands the definition of investment income to include capital gain net income and net passive income. The threshold is indexed for inflation beginning in 1997.

Health Insurance Portability and Accountability Act.—This Act, which represents an important step toward strengthening the health security of the American people, improves the portability of health insurance and makes a number of changes designed to simplify the administration of health insurance and to reduce waste, fraud, and abuse in health insurance and health care delivery. A number of tax incentives, which are offset by revenue increases, are also provided. The major changes that affect receipts are described below.

Increase deductibility of health insurance premiums for self-employed individuals.—The 30-percent deduction for health insurance expenses of self-employed individuals and their dependents is increased to 40 percent in 1997, 45 percent in 1998, 50 percent in 2003, 60 percent in 2004, 70 percent in 2005 and 80 percent in 2006 and later years.

Establish a four-year medical savings account (MSA) demonstration project.—Beginning January 1, 1997, MSAs are available to individuals who are covered by a high deductible health plan and who either are self-employed or are employed in a firm with 50 or fewer employees. The four-year demonstration project is limited to 750,000 policies for individuals who had health insurance and who work for a small employer or are self-employed. Contributions to an MSA (whether made by an employer, employee or self-employed individual) generally are deductible, up to a maximum of 65 percent of the deductible for high-deductible individual coverage and 75 percent of the deductible for high-deductible family coverage. Contributions to an MSA made by an employer on behalf of an employee up to the same limits are excluded from the employee's wages for income and payroll tax purposes. Earnings on amounts in an MSA and distributions from an MSA for medical expenses are generally excluded from gross income. Distributions for non-medical expenses are taxed and are subject to a 15-percent additional tax unless made after age 65, or for reasons of death or disability. Unless Congress votes to expand the program, no new contributions may be made to MSAs after

December 31, 2000 except by or on behalf of individuals who previously had MSA contributions and individuals employed by certain participating employers. Self-employed individuals who made contributions prior to December 31, 2000 also may continue to make contributions after that date.

Clarify taxation of qualified long-term care insurance premiums, expenses and benefits.—Effective with respect to contracts issued after December 31, 1996, a qualified long-term care insurance contract generally is treated as an accident and health insurance contract. Provisions include the following: (1) Amounts (other than policyholder dividends or premium refunds) received under a qualified long-term care insurance contract generally are excluded from gross income, subject to a cap of $175 per day, or $63,875 annually in the case of a per diem policy. Beginning in 1998, the per diem cap is indexed annually for inflation based on the medical care cost component of the consumer price index. (2) The cost of employer-provided qualified long-term care insurance generally is deductible for the employer and excluded from the employee's gross income. (3) Unreimbursed expenses for qualified long-term care services are deductible as medical expenses, subject to the present-law floor of 7.5 percent of adjusted gross income (AGI). (4) Qualified long-term care insurance premiums (subject to specified dollar limits) are deductible as medical expenses, subject to the present-law floor of 7.5 percent of AGI. Beginning in 1998, the dollar limits are indexed annually for inflation based on the medical care cost component of the consumer price index. (5) Self-employed individuals are able to deduct the cost of qualified long-term care insurance premiums up to the limit for health insurance.

Modify taxation of accelerated death benefits under life insurance contracts.—An exclusion from gross income is provided to an insured individual who is terminally or chronically ill for (1) amounts received under a life insurance contract and (2) amounts received for the sale or assignment of a life insurance contract to a qualified viatical settlement provider. For chronically ill individuals, the exclusion is limited to $175 per day or $63,875 annually, or the individual's costs for qualified long-term care services. The exclusion is effective with respect to amounts received after December 31, 1996.

Modify taxation of State-sponsored organizations providing health coverage for high-risk individuals and workers' compensation reinsurance.—An exemption from income tax is provided to any membership organization that is established by a State exclusively to provide coverage for medical care on a nonprofit basis to certain high-risk individuals, provided certain criteria are satisfied. The provision applies to taxable years beginning after December 31, 1996. In addition, tax-exempt status is provided to any membership organization that is establised by a State before June 1, 1996 exclusively to reimburse its members for workers' compensation insurance losses, and that satisfies certain other conditions. The provision applies to taxable years ending after August 21, 1996.

Extend special tax rules provided under Section 833 to certain health insurance organizations.—Under prior law a special deduction equal to 25 percent of the claims and expenses incurred during the year, less the adjusted surplus at the beginning of the year, was provided to certain eligible health organizations. Eligible organizations included: (1) Blue Cross or Blue Shield organizations existing on August 16, 1986, which had not experienced a material change in structure or operation since that date. (2) Other organizations that met certain community-service-related requirements and substantially all of whose activities involved the provision of health insurance. Effective for taxable years ending after December 31, 1996, these special rules are applied to any organization that (1) is not a Blue Cross or Blue Shield organization existing on August 16, 1986 and (2) otherwise meets the requirements of Section 833, including the requirement of no material change in operations or structure since August 16, 1986. An organization qualifies for this treatment only if it is not a health maintenance organization and it is organized under and governed by State laws specifically and exclusively applicable to not-for-profit health insurance or health service type organizations.

Allow penalty-free withdrawals from individual retirement accounts (IRAs) for medical expenses.—Effective for taxable years beginning after December 31, 1996, penalty-free withdrawals are permitted from IRAs for medical expenses in excess of 7.5 percent of AGI. Penalty-free withdrawals generally are also permitted for medical insurance premiums (without regard to the 7.5 percent floor) of individuals unemployed for at least 12 consecutive weeks.

Expand penalties provided under the Consolidated Omnibus Budget Reconciliation Act of 1995 (COBRA) to enforce group health plan portability, access, and renewability requirements.—Under COBRA, most employer-sponsored group health plans must offer qualified beneficiaries the opportunity to continue to participate for a specified period of time after the occurrence of certain events (such as termination of employment) that otherwise would have terminated such participation. A tax is imposed on the failure of a plan to satisfy these health care continuation rules. Effective for taxable years beginning after December 31, 1996, the tax for failure to satisfy health continuation rules is extended to apply to failure to satisfy the expanded coverage provisions provided in this Act.

Disallow the deductibility of interest on corporate owned life insurance (COLI) policy loans.—Generally, for interest paid or accrued after December 31, 1995, no deduction is allowed for interest on any COLI policy loan, except for "key person policies" that cover up to 20 key persons. Interest with respect to key person policies is deductible only to the extent the rate of interest does not exceed Moody's Corporate Bond Yield Average-Monthly Average Corporates for each month interest is paid or accrued. Special phase-in rules are

provided with respect to any otherwise deductible interest paid or accrued after October 13, 1995 and before January 1, 1999 with respect to debt incurred before January 1 1996. An exception from the general disallowance is also provided to interest on debt with respect to contracts purchased on or before June 20, 1986.

Eliminate the interest allocation exception for certain nonfinancial corporations.—For foreign tax credit purposes, taxpayers generally are required to allocate and apportion interest expenses between U.S. and foreign source income based on the proportion of the taxpayer's total assets in each location. Such allocation and apportionment is required to be made for affiliated groups as a whole rather than on a subsidiary-by-subsidiary basis. However, certain types of financial institutions that are members of an affiliated group are treated as members of a separate affiliated group for purposes of the allocation and apportionment of interest expense. The Tax Reform Act of 1986 included a targeted rule that treated certain nonfinancial corporations as financial institutions for this purpose. The targeted exception for certain nonfinancial corporations is repealed, generally effective for taxable years beginning after the date of enactment.

Modify expatriation tax.—Under prior law, citizens who relinquished their citizenship for tax avoidance purposes were subject to special tax provisions for ten years after such loss of citizenship. This Act expands the prior law provisions in several ways, generally with respect to individuals who expatriate on or after February 6, 1995: (1) The provision subjecting U.S. citizens to tax for ten years following expatriation is extended to apply to certain long-term residents whose residency is terminated. A long-term resident generally is any individual who was a lawful permanent resident of the United States for at least eight out of the 15 taxable years ending with the year in which termination occurs. (2) Certain individuals are subject to the expatriation tax without inquiry as to their motive for losing U.S. citizenship or residency, but certain categories of citizens are allowed to show an absence of tax-avoidance motive if they request a ruling from the IRS as to whether the loss of citizenship had a principal purpose of tax avoidance. (3) The categories of income and gain that are treated as U.S. source (and, therefore, subject to tax) is expanded and the ability to engage in transactions that partially or completely circumvent the ten-year reach of the law is curtailed. (4) Relief from double taxation is provided in circumstances where another country imposes tax on items that would be subject to U.S. tax under the expatriation tax provisions. (5) Information reporting requirements are applied to U.S. citizens and long-term residents whose citizenship or residency is terminated.

Small Business Job Protection Act of 1996.—This Act increases the minimum wage and makes numerous changes in the tax code to provide relief to small businesses, simplify pension plans, and extend certain expiring provisions. The reduction in receipts associated with these changes is offset by a number of revenue increases. The major provisions of the Act affecting receipts are described below.

Increase expensing for small business.—The amount of depreciable tangible personal property that a small business can elect to expense each year is increased from $17,500 in 1996 to $18,000 in 1997, $18,500 in 1998, $19,000 in 1999, $20,000 in 2000, $24,000 in 2001, and to $25,000 in 2003 and later years. The amount that a small business may elect to expense is reduced by the amount by which the cost of qualifying property exceeds $200,000.

Simplify and expand pension plans.—The major provisions affecting pension plans include the following: (1) Effective for taxable years beginning after December 31, 1999, lump-sum distributions from qualified plans are no longer eligible for special five-year forward averaging. (2) The $5,000 exclusion provided employer-provided death benefits is repealed, effective with respect to decedents dying after the date of enactment. (3) The method for determining the taxable portion of qualified annuity payments is simplified, effective with respect to annuity starting dates beginning 90 days after the date of enactment. (4) Employees (other than 5 percent owners) who continue working after age 70½ can delay beginning their pensions until they actually retire. (5) A simplified retirement plan for small business, called the savings incentive match plan for employees (SIMPLE) is created. A SIMPLE plan can either provide an individual retirement account (IRA) for each employee or be part of a qualified cash or deferred arrangement (401(k) plan). SIMPLE plans use lower contribution limits than regular 401(k) plans and Salary Reduction Simplified Employee Pensions (SARSEPs), and specify employer contribution levels in lieu of the nondiscrimination and top-heavy rules that normally apply to employer retirement plans. All contributions to the plan are fully vested. Contributions to a SIMPLE plan generally are deductible by the employer and excluded from the employee's income. The rules regarding the availability and taxation of distributions from a SIMPLE IRA or SIMPLE 401(k) plan are the same as the rules that apply to distributions from regular IRAs or 401(k) plans, respectively, except that during the first two years after the individual first participates in any SIMPLE IRA maintained by the individual's employer, rollovers to regular IRAs are not available and the additional tax on early distributions is increased from 10 percent to 25 percent. SIMPLE IRA plans are subject to simplified reporting requirements. SIMPLE plans are available for plan years beginning after December 31, 1996. (6) Effective for plan years beginning after December 31, 1996, tax-exempt organizations (including Indian tribal governments) are permitted to establish qualified cash or deferred arrangements. (7) The availability of spousal IRAs is increased by permitting deductible IRA contributions of up to $2,000 on behalf of each spouse if the combined compensation of both spouses is at least equal to the contributed amount. This provision is effective for taxable years beginning after December 31, 1996. (8) Non-

discrimination rules are modified by simplifying the definitions of highly compensated employees, compensation and retirement age; changing the minimum participation rule; and modifying the nondiscrimination tests applicable to qualified cash or deferred arrangements and matching contributions. (9) Effective for plan years beginning after December 31, 1998, instead of applying nondiscrimination tests, employers may use simple safe harbors for certain 401(k) plans under which the employer contributes at least a stated minimum to each employee account. (10) The rules that apply to nonqualified plans for tax-exempt and governmental employers have been simplified and, in the case of governmental employers, the assets under those plans must be kept in trust. (11) The vesting period for multiemployer plans is reduced from ten to five years for plan years beginning after December 31, 1996. (12) The combined plan limit is repealed, effective with respect to limitation years beginning after December 31, 1998, and the excise tax on large distributions is suspended for the years 1997 through 1999. (13) The excise tax applicable to prohibited transactions is increased from five percent to ten percent. (14) Alternative nondiscrimination tests are provided to certain plans that allow employees to participate before they complete one year of service or reach age 21. These tests promote pension portability by encouraging employers to offer pensions to new hires.

Simplify tax laws affecting Subchapter S (closely-held) corporations.—A number of changes in the tax laws affecting Subchapter S corporations are provided. The major changes increase the maximum number of shareholders in an S corporation from 35 to 75, permit S corporations to hold subsidiaries, allow financial institutions to qualify as S corporations, and permit certain tax-exempt organizations to be S corporation shareholders.

Provide adoption assistance.—Effective for taxable years beginning after December 31, 1996, the following adoption assistance is provided: (1) A maximum nonrefundable tax credit of $5,000 per child ($6,000 per child in the case of domestic special needs adoptions) is provided for qualified adoption expenses paid or incurred by the taxpayer. The credit for adoptions other than domestic special needs adoptions expires with respect to expenses paid or incurred after December 31, 2001. (2) A maximum exclusion from income of $5,000 per child ($6,000 per child in the case of domestic special needs adoptions) is provided for certain employer-paid adoption expenses. The exclusion is repealed with respect to employer-paid adoption expenses provided after December 31, 2001. Both the credit and exclusion are phased out ratably for taxpayers with modified adjusted gross income above $75,000 and are fully phased out at $115,000 of modified adjusted gross income.

Replace targeted jobs tax credit with a temporary work opportunity tax credit.—Prior to January 1, 1995, the targeted jobs tax credit was available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The credit generally was equal to 40 percent of up to $6,000 in qualified first-year wages, for a maximum credit of $2,400 per employee. The targeted jobs tax credit of prior law is replaced with the work opportunity tax credit effective for wages incurred or paid to a qualified individual who begins work after September 30, 1996 and before October 1, 1997. The new credit is available on an elective basis for employers hiring individuals from one or more of seven targeted groups and is generally equal to 35 percent of the first $6,000 in qualified first-year wages. No credit is allowed for wages paid unless the eligible individual is employed by the employer for at least 180 days (20 days in the case of a qualified summer youth employee) or 400 hours (120 hours in the case of a qualified summer youth employee).

Extend exclusion for employer-provided educational assistance.—For taxable years beginning before January 1, 1995, certain amounts paid by an employer for educational assistance provided to an employee were excluded from the employee's gross income for income and payroll tax purposes. The exclusion was limited to $5,250 of educational assistance with respect to an individual during a calendar year and applied whether or not the education was job related. The exclusion is extended to apply to undergraduate courses beginning after December 31, 1994 and before mid-1997; for graduate courses, the exclusion applies to courses beginning after December 31, 1994 and before mid-1996.

Extend research and experimentation tax credit with modifications.—Under prior law, a 20 percent tax credit was provided for certain research and experimentation expenditures made before July 1, 1995. This credit is extended, with modifications, to apply to expenditures paid or incurred during the 11-month period July 1, 1996 through May 31, 1997.

Extend orphan drug tax credit.—Prior to January 1, 1995, a 50-percent nonrefundable tax credit was provided for qualified clinical testing expenses paid or incurred in the testing of certain drugs for rare diseases or conditions (generally known as "orphan drugs"). The credit is extended for 11 months to apply to qualified expenses paid or incurred from July 1, 1996 through May 31, 1997.

Extend deduction for contributions of stock to private foundations.—The deduction for a contribution to a private foundation is generally limited to the adjusted basis of the contributed property. However, under prior law, a taxpayer who contributed qualified appreciated stock to a private foundation before January 1, 1995 was allowed to deduct the full fair market value of the stock, rather than the adjusted basis of the contributed stock. The special rule for contributions of qualified appreciated stock to private foundations is extended to apply to contributions made during the period July 1, 1996 through May 31, 1997.

Extend tax credit for producing fuel from a nonconventional source.—Certain fuels produced from nonconventional sources and sold to unrelated parties are eligible for an income tax credit equal to $3 per barrel or BTU oil barrel equivalent. Qualified fuels must be

produced within the United States and include: (1) oil produced from shale and tar sands; (2) gas produced from geopressured brine, Devonian shale, coal seams, tight formations, or biomass; and (3) liquid, gaseous, or solid synthethic fuels produced from coal (including lignite). The credit generally is availabe only with respect to qualified fuels produced and sold before January 1, 2003 from wells drilled or facilities placed in service after December 31, 1979 and before January 1, 1993. Under prior law, an exception allowed the credit to be claimed for gas from biomass and synthetic fuel from coal produced or sold before January 1, 2008 from facilities placed in service before January 1, 1997, pursuant to a binding contract entered into before January 1, 1996. This Act extends both the binding contract date and the placed in service date for facilities producing synthetic fuels from coal and gas from biomass. Specifically, synthetic fuels from coal and gas from biomass produced or sold before January 1, 2008 are eligible for the credit if produced from facilities placed in service before July 1, 1998, pursuant to a binding contract entered into before January 1, 1997.

Suspend imposition of excise tax on diesel fuel used in recreational motorboats.—The 24.4-cents-per-gallon excise tax on diesel fuel used in recreational motorboats is suspended during the period beginning on August 27, 1996 through December 31, 1997.

Permanently extend the Federal Unemployment Tax (FUTA) exemption for alien agricultural workers.—Generally, the Federal unemployment tax is imposed on farm operators who (1) employ 10 or more agricultural workers for some portion of 20 different days, each being in a different calendar week or (2) have a quarterly payroll for agricultural services of at least $20,000. Under prior law, effective for labor performed before January 1, 1995, an exclusion from FUTA was provided for labor performed by an alien admitted to the United States to perform agricultural labor under the Immigration and Nationality Act. The exemption from FUTA for alien agricultural workers is permanently extended, effective with respect to labor performed on or after January 1, 1995.

Extend Generalized System of Preferences (GSP).—Under GSP, duty-free access is provided to over 4,000 items from eligible developing countries that meet certain worker rights, intellectual property protection, and other criteria. This program, which had expired after July 31, 1995, is temporarily extended for the period August 1, 1995 through May 31, 1997.

Extend airport and airway excise taxes.—The excise taxes levied on domestic air passenger tickets, international departures, domestic air cargo and noncommercial aviation fuels, which had expired after December 31, 1995 under prior law, are reinstated effective August 27, 1996 through December 31, 1996.

Extend and phase out the excise tax on luxury automobiles.—Under prior law, the ten-percent luxury excise tax levied on the retail price of a passenger vehicle in excess of an inflation-adjusted threshold ($34,000 in 1996) was scheduled to expire after December 31, 1999. The tax is extended through December 31, 2002, at the following rates: 1996 (effective August 28, 1996), nine percent; 1997, eight percent; 1998, seven percent; 1999, six percent; 2000, five percent; 2001, four percent; and 2002, three percent.

Modify Puerto Rico and possessions tax credit.—Under prior law, domestic corporations with business operations in U.S. possessions were allowed to elect the Section 936 credit, which generally eliminated the U.S. tax on certain income related to their possession-based operations. Income exempt from U.S. tax under this provision fell into two broad categories: (1) possession business income derived from the active conduct of a trade or business within a possession or from the sale or exchange of substantially all of the assets used in such a trade or business; and (2) possession source investment income (QPSII) attributable to investment in the possession or in certain Caribbean Basin countries. The credit attributable to QPSII is repealed, effective for QPSII earned after June 30, 1996. The credit with respect to possession business income also generally is repealed, effective with respect to taxable years beginning after December 31, 1995. However, grandfather rules are provided under which a corporation that elected the credit by October 13, 1995 is eligible to claim credits with respect to possession business income during a transition period effective for taxable years beginning after December 31, 1995 and before January 1, 2006. The credit is eliminated for taxable years beginning after December 31, 2005.

Repeal 50-percent interest exclusion for financial institution loans to employee stock option plans (ESOPs).—Under prior law a bank, insurance company, regulated investment company, or a corporation actively engaged in the business of lending money was generally allowed to exclude from gross income 50 percent of interest received on an ESOP loan. The 50-percent exclusion generally is repealed, effective with respect to loans made after the date of enactment, other than loans made pursuant to a written binding contract in effect before June 10, 1996.

Reform depreciation under the income forecast method.—All estimated income from the use of property or the sale of merchandise is to be taken into account in determining depreciation under the income forecast method. In applying this rule, income expected to be generated after the close of the tenth taxable year after the year the propery is placed in service generally need not be taken into account. In the case of a film, television show or similar property, such income includes, but is not necessarily limited to, income from foreign and domestic theatrical, television, and other releases and syndications; and video tape releases, sales, rentals, and syndications. In the case of television and motion picture films, the income from the property shall include income from the financial exploitation of characters, designs, scripts, scores, and other incidental income associated with such films, but only to the extent income is earned in connection with the ultimate use of such items by, or the ultimate sale of mechandise

to, persons who are not related to the taxpayer. These changes generally are effective for property placed in service after September 13, 1995.

Modify exclusion of damages received on account of personal injury or sickness.—The Act specifies that the exclusion from gross income of damages received on account of personal injury or sickness does not apply to compensatory damages received on account of nonphysical personal injury or sickness or to punitive damages received in connection with a personal injury or sickness. This change generally applies with respect to amounts received after August 20, 1996.

Modify basis adjustment rules under Section 1033.—When a taxpayer acquires a controlling interest in the stock of a corporation as replacement property after an involuntary conversion, the corporation generally will reduce its adjusted bases in its assets by the same amount as the taxpayer is required to reduce its basis in the acquired stock. The corporation's adjusted bases in its assets will not be reduced, in the aggregate, below the taxpayer's basis in its stock. In addition, the basis of any individual asset will not be reduced below zero. This provision, which allows deferral of gain recognition, but not the avoidance of that gain, is generally effective with respect to involuntary conversions occurring after August 20, 1996.

Allow the IRS to use mathematical error procedures to deny dependency exemptions.—If an individual fails to provide a correct taxpayer identification number (TIN) for a dependent, the IRS is allowed to use mathematical error procedures to deny the dependency exemption. This change generally is effective for tax returns for which the due date (without regard to extensions) is 30 days or more after August 20, 1996.

Modify rules for taxing foreign trusts.—This Act strengthens information reporting and penalties related to foreign trusts, and tightens tax planning rules involving foreign trusts, their beneficiaries, and grantors.

Repeal bad debt reserve deduction for thrift institutions.—Under prior law, certain thrift insitutions were allowed deductions for bad debts under rules more favorable than those granted to commercial banks. Generally effective for taxable years beginning after December 31, 1995, thrifts must account for bad debts in the same manner as banks.

ADMINISTRATION PROPOSALS

Provide Tax Relief and Extend Expiring Provisions

The President's plan targets tax relief to middle-income Americans through his Middle Class Bill of Rights. His plan also includes a targeted home-ownership tax cut, a new welfare-to-work incentive, a District of Columbia tax incentive program, estate tax relief for small businesses and family farms, initiatives for economically distressed areas, and the extension of certain expiring tax provisions.

Middle Class Bill of Rights.—The Administration is again proposing, with certain modifications and enhancements, the three features of its Middle Class Bill of Rights designed to give middle-income families the tax relief they need to help them raise their children, save for the future and pay for postsecondary education.

Provide tax credit for dependent children.—A nonrefundable credit would be allowed for each dependent child under the age of 13. The credit would equal $300 for 1997, 1998 and 1999, and would rise to $500 for 2000 and subsequent years. The credit would be phased out for taxpayers with adjusted gross income (AGI) between $60,000 and $75,000. Both the credit amount and the phase-out range would be indexed for inflation beginning in 2001. The credit would be applied before the earned income tax credit but could not be used to offset alternative minimum tax liability.

Expand Individual Retirement Accounts (IRAs).—Under present law, eligibility for deductible IRAs is phased out for single taxpayers with AGI between $25,000 and $35,000 and for couples filing a joint return with AGI between $40,000 and $50,000, if the individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan. Under the Administration's proposal, the AGI thresholds and phase-out ranges would be doubled over time. For 1997 through 1999, eligibility would be phased out for single taxpayers with AGI between $45,000 and $65,000, and for couples filing a joint return with AGI between $70,000 and $90,000. For 2000 and later years, eligibility would be phased out for single taxpayers with AGI between $50,000 and $70,000 and for couples filing a joint return with AGI between $80,000 and $100,000. These thresholds and the present law annual contribution limit of $2,000 would be indexed for inflation. Withdrawals from IRAs would not be subject to the ten percent early withdrawal tax if the proceeds were used to pay post-secondary education costs, to buy or build a first home, or to cover living expenses if unemployed for at least 12 consecutive weeks. (Prior versions of the Administration's proposal would also have permitted early withdrawal to pay catastrophic medical expenses (including nursing home or other costs associated with caring for an incapacitated parent or grandparent); this provision was enacted in the Health Insurance Portability and Accountability Act, effective for distributions after 1996.) In addition, each individual eligible for a deductible IRA would have the option of contributing an amount up to the contribution limit to a traditional deductible IRA or to a new back-loaded special IRA. Contributions to this special IRA would not be tax deductible, but distributions of the contributions would be tax-free. If the contributions remained in the account for at least five years, earnings on the contributions also would be tax-free when withdrawn. Withdrawals of account balances from special IRAs during the five-year period would be subject to ordinary

income tax and a ten-percent early withdrawal tax. However, withdrawals during the five-year period for the purposes described above (or upon death or disability of the taxpayer) would not be subject to the early withdrawal tax. Individuals whose AGI for a year fell within the eligibility thresholds would be allowed to convert an existing IRA into a special IRA, and for conversions before 1999, income inclusion would be spread over four years.

Provide tax incentive for education and training.—The Administration's proposed HOPE scholarship plan would make 14 years of education—at least two years of college—the standard for all Americans. A taxpayer could claim a $1,500 per-student nonrefundable tax credit for tuition and required fees for enrollment of the taxpayer, the taxpayer's spouse or the taxpayer's dependent in a post-secondary degree or certificate program. The credit would be available for payments made during 1997 and thereafter for education commencing on or after July 1, 1997. The amount of the credit would be reduced by any other non-taxable Federal educational grants received by the student. The credit could be claimed twice (i.e., in two different years) for a student, provided the credit was claimed in a year in which the student was enrolled at least half-time in the thirteenth or fourteenth year of post-secondary education. The credit would be available for a second year, however, only if the student had obtained a B-average for all prior post-secondary course work. No credit would be available for a student who had been convicted of a drug-related felony. A deduction would be permitted for up to $5,000 per family in annual tuition and required fees for post-secondary education and job training for the taxpayer, the taxpayer's spouse and dependents. The maximum allowable deduction would increase to $10,000 effective January 1, 1999. A taxpayer could claim either the credit or the deduction for a student's expenses, but not both in the same taxable year. In addition, both the credit and deduction would be phased out for taxpayers filing a joint return with AGI (before the proposed deduction) between $80,000 and $100,000. For taxpayers filing a head-of-household or single return, the credit and deduction would be phased out for those with AGI between $50,000 and $70,000. The phase-out ranges would be indexed for inflation beginning in 2000. Education expenses qualifying for the credit and deduction include tuition and fees paid to institutions and programs eligible to participate in Federal student aid programs. No deduction or credit would be available for expenses for meals, lodging, books or transportation. In addition, to provide assistance with education-related debt to graduates entering public service, the current exclusion from income for the discharge of certain student loans would be expanded to cover discharge of certain direct loans made by the Federal government and certain loans made by charitable and educational institutions.

Provide targeted welfare-to-work tax credit.—The Administration proposes a targeted welfare-to-work credit designed to create new job opportunities for long-term welfare recipients. The credit would enable employers to claim a 50-percent credit on the first $10,000 of annual wages paid to long-term welfare recipients. The credit could be claimed for up to two years and employers would be able to treat education and training assistance, health care, and dependent care expenses as eligible wages. The credit would be available for wages paid or incurred effective the date of enactment through September 30, 2000. The Administration also proposes to expand the existing Work Opportunity Tax Credit to include adults age 18 to 50 who are subject to more rigorous work requirements for food stamps under the Administration's proposal to amend last year's welfare reform law.

Provide capital gains exclusion on sale of principal residence.—Under current law gains on the sale of a taxpayer's principal residence are subject to the capital gains tax; however, taxes on the gain can be deferred through the purchase of a new home of equal or greater value within a specified period of time. Taxpayers over 55 may elect to take a one-time exclusion of up to $125,000 of gain from the sale of their home. The Administration proposes to exclude up to $500,000 of gain from the sale of a taxpayer's principal residence ($250,000 for a single taxpayer) effective for sales on or after January 1, 1997. The proposal would repeal the current-law exclusion for taxpayers over age 55 and the section 1034 deferral for purchasing a more expensive home, with transition relief. Gain recognition would be required on the sale of a principal residence to the extent of any depreciation allowable after December 31, 1996. The proposal would exempt over 99 percent of home sales from the capital gains tax and would dramatically simplify taxes and record keeping for over 60 million homeowners.

Establish District of Columbia (DC) tax incentive program.—To encourage employment of disadvantaged DC residents and to revitalize those DC areas where development has been inadequate, tax incentives are proposed.

Provide estate tax relief for small business.—Estate tax attributable to certain interests in closely held businesses may be paid in installments over a period of up to 14 years. A special four percent interest rate is provided for the tax deferred on the first $1 million of value. The $1 million cap has been in effect since 1976. To address the liquidity problems that may arise upon the death of a farmer or small business owner, and to adjust for inflation, the Administration proposes to increase the amount of property eligible for the special interest rate from $1 million to $2.5 million. The proposal also simplifies current law by eliminating distinctions based on the form of ownership, providing alternatives to the estate tax lien, and reducing the interest rate by 50 percent or more in exchange for making the interest payments nondeductible. The proposal would be effective for decedents who die after December 31, 1997.

Provide tax incentives for distressed areas.—The Administration is proposing tax incentives for the cleanup of polluted urban and rural areas and is proposing an expansion of the empowerment zone and enterprise community program, as described below.

Provide tax incentives to clean up environmentally contaminated areas known as brownfields in distressed communities.—To encourage the cleanup of polluted urban and rural areas known as brownfields, the Administration proposes to allow a current deduction for certain costs incurred by businesses to remediate environmentally contaminated land in certain areas. Qualified sites generally would be limited to those properties located in or next to high-poverty areas, Federal empowerment zones and enterprise communities, and areas subject to certain Environmental Protection Agency (EPA) Brownfields Pilots. To claim this incentive, taxpayers would be required to obtain from the appropriate State or local agency, or the EPA in certain circumstances, verification that the site satisfies the geographic and contamination requirements. The proposal would be effective for qualified expenses incurred after the date of enactment.

Expand Empowerment Zone and Enterprise Community program.—Under the Omnibus Budget Reconciliation Act of 1993 (OBRA 93), certain tax incentives were provided for nine empowerment zones and 95 enterprise communities. The tax incentives were a 20-percent employer wage credit, increased Section 179 expensing, and a new category of tax-exempt financing. Qualifying businesses in empowerment zones were eligible for all three incentives, while businesses in enterprise communities were eligible for the tax-exempt financing. Over 500 communities submitted applications for these 104 designations that were announced in December 1994. The Administration proposes a three-part expansion of this program. First, the designation of two additional urban empowerment zones would be authorized, to be made within 180 days of enactment. Second, the restrictions on the tax-exempt financing would be loosened to make this incentive more accessible. Third, the designation of 20 additional empowerment zones (15 urban, 5 rural) and 80 additional enterprise communities (50 urban, 30 rural) would be authorized. Businesses in the new enterprise communities would be eligible for the current-law tax-exempt financing, as revised, as well as the brownfields tax incentive described above (including an additional 1,000 acres). Businesses in the new empowerment zones would be eligible for the OBRA 93 increased section 179 expensing, the brownfields tax incentive (including an additional 2,000 acres), and tax-exempt financing that would not be subject to the current-law State volume caps, but rather would only be subject to zone-by-zone volume caps. The current-law wage credit would not be applicable in these 100 new zones and communities. The designations of these new zones and communities would be required to occur before 1999, and the designations would generally be effective for ten years.

Provide tax credit for investment in community development financial institutions (CDFI).—The Community Devolopment Banking and Financial Institutions Act of 1994 created a Federal Community Development Financial Institution (CDFI) Fund to provide grants, loans, and technical assistance to qualifying lenders. As part of its comprehensive strategy to increase investment in distressed communities, the Administration proposes to provide $100 million in nonrefundable tax credits to the CDFI Fund to be allocated among equity investors in community development banks. The allocation of credits would be determined by the CDFI Fund using a competitive process similar to the one used to allocate grants. The maximum amount of credit allocable to a particular investment would be 25 percent of the amount invested, though a lower percentage could be negotiated. The full credit would be available the year the investment is made. In order to ensure long-term investment, the credit would be recaptured if the investment were sold or redeemed within five years.

Toll statute of limitations for incapacitated taxpayers.—The time limit within which claims for refund must be made would be extended for the period of time a taxpayer was subject to disability, in effect extending the stututory time by the period of disability. "Disability" would be defined to include judicial determinations of incompetency, commitment to mental institutions or hospitals, or other debilitating physical, mental, or psychological conditions that prevent the taxpayer from managing his or her financial affairs. The proposal would be effective for tax years ending after the date of enactment.

Allow Foreign Sales Corporation (FSC) benefits for computer software licenses.—The Administration proposes to extend FSC benefits to licenses of computer software for reproduction abroad. The FSC provisions, which provide a limited exemption from U.S. tax for income arising in certain export transactions, currently are not available for most exports of intangible property, including computer software copyrights. Because FSC benefits are currently available for copyrights to "films, tapes, records, and similar reproductions," the Administration proposes to extend benefits to a category of nearly indistinguishable property.

Extend the income exclusion for employer-provided educational assistance and provide credit for small business.—The Administration proposes to extend the exclusion for employer-provided educational assistance from its expiration in mid-1997 through December 31, 2000. The proposal would also reinstate and extend through December 31, 2000 the expired exclusion for employer-provided graduate education. In addition, for taxable years after December 31, 1997, small businesses would be allowed a ten-percent income tax credit with respect to amounts paid under an employer-provided educational assistance program. The credit would be available to employers with average annual

gross receipts of $10 million or less for the prior three years.

Extend for one year the R&E tax credit.—The tax credit provided for certain research and experimentation expenditures, which is scheduled to expire after May 31, 1997, is proposed to be extended for one year through May 31, 1998.

Extend for one year the orphan drug tax credit.—The 50-percent nonrefundable tax credit provided for qualified clinical testing expenses paid or incurred in the testing of certain drugs for rare diseases or conditions is proposed to be extended for one year through May 31, 1998.

Extend for one year the work opportunity tax credit.—The work opportunity tax credit, generally equal to 35 percent of up to $6,000 in qualified first-year wages, is proposed to be extended for one year beyond its expiration date of September 30, 1997.

Extend for one year the deduction provided for contributions of appreciated stock to private foundations.—The special rule that allows a taxpayer to deduct the full fair market value of qualified stock donated to a private foundation is proposed to be extended to apply to contributions made during the period June 1, 1997 through May 31, 1998. The current law deduction expires with respect to contributions made after May 31, 1997.

Extend and modify Puerto Rico economic-activity tax credit (Section 30A).—Although the Puerto Rico and possession tax credit generally was repealed in 1996, both the income-based option and the economic-activity option under the credit remain available for existing business operations through 2005, subject to base-period caps. To provide a more efficient and effective tax incentive for the economic development of Puerto Rico and to continue the shift from an income-based credit to an economic-activity credit that was begun in OBRA 93, the Administration proposes to modify the economic-activity credit for Puerto Rico by (1) extending it indefinitely, (2) opening it to newly established business operations, effective for taxable years beginning after December 31, 1997, and (3) removing the base-period cap.

Eliminate Unwarranted Benefits and Adopt Other Revenue Measures

The President's plan cuts unwarranted corporate tax subsidies, closes tax loopholes, improves tax compliance and adopts other revenue measures.

Deny interest deduction on certain debt instruments.—If an instrument qualifies as equity, the issuer generally does not receive a deduction for dividends paid. If an instrument qualifies as debt, the issuer may receive a deduction for accrued interest and the holder generally includes interest in income, subject to certain limitations. The line between debt and equity is uncertain and it has proven difficult to formulate general rules of classification. Taxpayers have exploited this lack of guidance by issuing instruments that have substantial equity features, but for which they claim interest deductions. Effective for instruments issued on or after the date of first committee action, the Administration proposes that no deduction be allowed for interest or original issue discount (OID) on an instrument issued by a corporation that has a maximum term of more than 40 years, or is payable in stock of the issuer or a related party. The proposal also modifies the rules for certain indebtedness that is reflected as equity on the issuer's financial statements.

Defer original issue discount deduction on convertible debt.—If a debt instrument is convertible into stock of the issuer or a related party and provides no payment of, or adjustment for, accrued interest on conversion, no deduction is allowed for accrued but unpaid stated interest. In contrast, the accrued but unpaid discount on a convertible debt instrument with OID generally is deductible, even if the instrument is converted before the issuer pays any OID. The Administration proposal would defer the deduction for all interest, including OID, on convertible debt until payment and would be effective for convertible debt issued on or after the date of first committee action.

Reduce dividends-received deduction to 50 percent and eliminate dividends-received deduction for certain preferred stock.—A corporate holder of stock generally is entitled to a deduction for dividends received on stock in the following amounts: 70 percent if the recipient owns less than 20 percent of the stock of the payor, 80 percent if the recipient owns 20 percent or more of the stock, and 100 percent if the recipient owns 80 percent or more of the stock. The Administration proposes to replace the 70- and 80-percent dividends-received deduction with a 50-percent deduction for dividends on common stock and most preferred stock, effective for dividends paid or accrued more than 30 days after the date of enactment. In addition, the Administration proposes to eliminate the 70- and 80-percent dividends-received deduction for dividends on certain limited-term preferred stock, effective for stock issued after the date of enactment.

Modify holding period for dividends-received deduction.—The dividends-received deduction is allowed to a corporate shareholder only if the shareholder satisfies a 46-day holding period for the dividend-paying stock or a 91-day period for certain dividends on preferred stock. The 46- or 91-day holding period generally does not include any time in which the shareholder is protected from the risk of loss otherwise inherent in the ownership of an equity interest. However, the holding period requirement does not have to be proximate to the time the dividend distribution is made. Effective for dividends paid or accrued more than 30 days after the date of enactment, the Administration

proposes that for a dividend to be eligible for the dividends-received deduction, the holding period requirement must be satisfied with respect to that dividend over a period immediately before or immediately after the taxpayer becomes entitled to receive the dividend.

Extend pro rata disallowance of tax-exempt interest expense to all corporations.—No income tax deduction is allowed for interest on debt used directly or indirectly to acquire or hold investments the income on which is tax-exempt. The determination of whether debt is used to acquire or hold tax-exempt investments depends on the holder of the instrument. For financial institutions and dealers in tax-exempt investments, debt generally is treated as financing all of the taxpayer's assets proportionately. For corporations, other than financial institutions and dealers, and for individuals, deductions are disallowed only when indebtedness is incurred or continued for the purpose of purchasing or carrying tax-exempt investments. These corporations are therefore able to reduce their tax liabilities inappropriately through the double Federal tax benefits of interest expense deductions and tax-exempt interest income. Effective for taxable years beginning after the date of enactment, with respect to obligations acquired on or after the date of first committee action, the Administration proposes that all corporations other than insurance companies be treated the same as financial institutions are treated under current law with regard to deductions for interest on debt used directly or indirectly to acquire or hold tax-exempt obligations. The proposal also would expressly apply these rules to related parties, by treating all members of a consolidated group (other than members that are insurance companies) as a single entity and by tracing debt and tax-exempt holdings among other related parties.

Require average-cost basis for stocks, securities, etc.—A taxpayer who sells stock or other securities is allowed to account for the transaction by specifically identifying the stock or securities or by using an accounting system such as first-in, first-out or last-in, first-out. The Administration proposes to require taxpayers to determine their basis in substantially identical securities using the average of all their holdings in the securities. Holding period would be determined on a first-in, first-out basis. The method of determining basis and holding period would apply to all securities, including stocks, notes, bonds, and derivative financial instruments. The proposal would be effective 30 days after the date of enactment.

Require recognition of gain on certain stocks, indebtedness and partnership interests.—Gain and loss are generally taken into account for tax purposes when realized. Gain or loss is usually realized with respect to a capital asset at the time the asset is sold or exchanged. Many transactions designed to reduce or eliminate risk of loss and opportunity for gain on financial assets generally do not cause realization. For example, taxpayers may lock in gain on securities by entering into a "short sale against the box," that is, the taxpayer owns securities that are the same as or substantially identical to the securities borrowed and sold short. It is inappropriate for taxpayers to be able to dispose of the economic risks and rewards of owning appreciated property without realizing income for tax purposes. Therefore, the Administration proposes to require a taxpayer to recognize gain (but not loss) upon entering into a constructive sale of any appreciated position in stock, a debt instrument, or a partnership interest. A taxpayer would be treated as making a constructive sale of an appreciated position when the taxpayer (or in certain limited circumstances, a person related to the taxpayer) substantially eliminates risk of loss and opportunity for gain by entering into one or more positions with respect to the same or substantially identical property. The proposal would generally be effective for constructive sales entered into after the date of enactment.

Change the treatment of gains and losses on extinguishment.—The tax law distinguishes between the sale of a right or obligation to a third party and the extinguishment or retirement of the right or obligation. A sale to a third party can give rise to capital treatment while an extinguishment is ordinary. Extinguishment treatment has been eliminated for all debt instruments except those issued by natural persons and for most options and other positions in actively traded property. The application of the extinguishment doctrine in other contexts is unclear. The extinguishment doctrine allows taxpayers to control whether gain or loss is capital or ordinary by deciding whether to sell or extinguish a contract. The Administration proposes to eliminate the remaining portions of the extinguishment doctrine so that gain or loss attributable to the cancellation, lapse, expiration, or other termination of any right or obligation with respect to property that is or would be a capital asset in the hands of the taxpayer would be treated as gain or loss from the sale or exchange of a capital asset. In addition, the proposal would repeal the natural person exception for debt instruments. The proposal would be effective 30 days after the date of enactment.

Require reasonable payment assumptions for interest accruals on certain debt instruments.—The original issue discount (OID) rules do not measure income appropriately for certain debt instruments that are prepayable without interest or at reduced interest rates. If the instruments are held in large pools, it can be statistically predicted that a certain portion will prepay. Prepayment assumptions are used to account for certain debt instruments with payments based on mortgages, but the OID rules otherwise ignore these probabilities. The proposal would require taxpayers that hold prepayable debt instruments in large pools to use prepayment assumptions similar to the rules that apply for debt instruments with payments based on mortgages. The proposal would be effective for taxable years beginning after the date of enactment.

Require gain recognition for certain extraordinary dividends.—A corporate shareholder is generally allowed to deduct a percentage of dividends received from another domestic corporation. Certain dividends and dividend equivalent transactions are treated as "extraordinary" dividends. If a corporate shareholder receives an extraordinary dividend, the corporate shareholder must reduce the basis of the stock to which the distribution relates by the amount of the nontaxed portion of the dividend (generally the amount of the dividend that was deducted). If the nontaxed portion of the dividend exceeds the basis of the stock, the excess is deferred and recognized on a later disposition of the stock. If a shareholder's stock is redeemed, the redemption may be treated as a dividend if the shareholder's interest in the corporation has not been meaningfully reduced. In determining if a shareholder's interest has been meaningfully reduced, the ownership of options to purchase stock may be treated as actual stock ownership. The exclusion of a substantial portion of the amount received by a corporate shareholder on the redemption of its stock is inappropriate in certain cases when options are used to create stock ownership. Also, it is inappropriate to defer gain recognition when the portion of the distribution that is excluded due to the dividends received deduction exceeds the basis of the stock with respect to which the extraordinary dividend is received. The Administration proposes that corporate shareholders will recognize gain on redemptions of stock that are treated as dividends because of options when the nontaxed portion of the dividend exceeds the basis of the shares surrendered. In addition, immediate gain recognition would be required whenever the basis of stock with respect to which any extraordinary dividend was received was reduced below zero. The proposed change generally would be effective for distributions after May 3, 1995.

Repeal percentage depletion for non-fuel minerals mined on Federal and formerly Federal lands.—Taxpayers are allowed to deduct a reasonable allowance for depletion relating to certain mineral deposits. The depletion deduction for any taxable year is calculated under either the cost depletion method or the percentage depletion method, whichever results in the greater allowance for depletion for the year. The percentage depletion method is viewed as an incentive for mineral production rather than as a normative rule for recovering the taxpayer's investment in the property. This incentive is excessive with respect to minerals mined on Federal and formerly Federal lands under the 1872 mining act, in light of the minimal costs of acquiring the mining rights ($5.00 or less per acre). Effective for taxable years beginning after the date of enactment, the Administration proposes to repeal percentage depletion for non-fuel minerals mined both on Federal lands where the mining rights were originally acquired under the 1872 law, and on private lands acquired under the 1872 law.

Modify loss carryback and carryforward rules.—Net operating losses (NOLs) generally can be used to offset taxable income from the prior three taxable years (carrybacks) and the succeeding 15 taxable years (carryforwards). Because of the increased complexity and administrative burden associated with carrybacks, the carryback period should be shortened. The carryforward period could be lengthened, however, to allow taxpayers more time to utilize their NOLs without increasing either complexity or administrative burdens. The Administration proposes to limit carrybacks of NOLs to one year and to extend carryforwards to 20 years, effective for NOLs arising in taxable years beginning after the date of enactment.

Treat certain preferred stock as "boot."—In reorganization transactions, no gain or loss is recognized except to the extent "other property" (boot) is received; that is, property other than certain stock, including preferred stock. Upon the receipt of "other property," gain but not loss can be recognized. Because preferred stock has an enhanced likelihood of recovery of principal or of maintaining a dividend or both, such tax-free treatment is inappropriate. The Administration therefore proposes to treat certain preferred stock as "other property," subject to certain exceptions. The proposal would be effective for transactions on or after the date of first committee action.

Repeal tax-free conversions of large C corporations to S corporations (Section 1374).—A corporation can avoid the existing two-tier tax by electing to be treated as an S corporation or by converting to a partnership. Converting to a partnership is a taxable event that generally requires the corporation to recognize any built-in gain on its assets and requires the shareholders to recognize any built-in gain on their stock. By contrast, the conversion to an S corporation is generally tax-free, except that the S corporation generally must recognize the built-in gain on assets held at the time of conversion if the assets are sold within ten years. Under the Administration's proposal, the conversion of a C corporation with a value of more than $5 million into an S corporation would be treated as a liquidation of the C corporation followed by a contribution of the assets to an S corporation by the recipient shareholders. Thus, the proposal would require immediate gain recognition by both the corporation (with respect to its appreciated assets) and its shareholders (with respect to their stock). This proposal makes the tax treatment of conversions to an S corporation generally consistent with conversions to a partnership. The proposal would apply to elections that are first effective for a taxable year beginning on or after January 1, 1998 and to acquisitions of a C corporation by an S corporation made after December 31, 1997.

Require gain recognition on certain distributions of controlled corporation stock.—A corporation is generally required to recognize gain on a distribution of property (including stock of a controlled

corporation) unless the distribution meets certain requirements. If various requirements are met, including restrictions relating to acquisitions and dispositions of stock of the distributing corporation or the controlled corporation, a distribution of the stock of a controlled corporation will be tax-free to the distributing corporation. Certain distributions may effectively be dispositions of a business, in which case tax-free treatment for the distributing corporation is inappropriate. Accordingly, the Administration proposes to adopt additional restrictions on acquisitions and dispositions of the stock of a distributing corporation or controlled corporation that are related to the distribution. Under this proposal, the distributing corporation would recognize gain on the distribution of the stock of the controlled corporation if the shareholders of the distributing corporation do not retain a sufficient stock interest (generally 50 percent) in the distributing and controlled corporations during the four-year period commencing two years prior to the distribution. For this purpose, unrelated transactions (such as public trading on the stock market) would be disregarded. This proposal would be effective for distributions occurring on or after the date of first committee action.

Reform the treatment of certain stock transfers.—Certain sales of stock to a related corporation are treated as the payment of a dividend by the purchaser. In cases where the seller is a corporation that does not actually own stock in the purchaser, taxpayers may take the position that the transaction produces tax benefits that would be unavailable if the purchaser distributed a dividend to its actual shareholders. For example, if a foreign-controlled domestic corporation sells the stock of a subsidiary to a foreign sister corporation, the domestic corporation may take the position that it is entitled to credit foreign taxes that were paid by the foreign sister corporation. In such cases, the Administration proposes to limit the amount treated as a dividend (and the associated foreign tax credits) from the purchaser to the amount of the purchaser's earnings and profits attributable to stock owned by U.S. persons related to the seller. If the purchaser is a domestic corporation, taxpayers may take the position that stock basis need not be reduced by the nontaxed portion of the dividend. The proposal would also clarify that a deemed dividend from a purchaser that is a domestic corporation should generally be treated as an extraordinary dividend requiring a basis reduction. The proposal would further require gain recognition to the extent that the nontaxed portion exceeds the basis of the shares transferred. The proposal would be effective for transactions on or after the date of first committee action.

Expand Subpart F provisions regarding income from notional principal contracts and stock lending transactions.—Subpart F income includes income from notional principal contracts referenced to foreign currency, commodities, or interest rates, or to indices based thereon. It also includes income with respect to the lending of debt securities. Subpart F income does not include income from equity swaps or other types of notional principal contracts or income from transfers of equities. Subpart F income should include income from all types of notional principal contracts and from stock-lending transactions, because such income is indistinguishable on policy grounds from other types of highly mobile income already targeted by Subpart F. The Administration is proposing to include in Subpart F income the net income from equity swaps and certain categories of notional principal contracts that are not reached by current law, as well as income from stock lending transactions. An ordinary-course-of-business exception would be provided for regular dealers in property, forwards, options, notional principal contracts, and similar financial instruments. The proposal would be effective for taxable years beginning after the date of enactment.

Modify taxation of captive "insurance" companies.—For tax purposes, "insurance" has been defined by the courts to require "risk shifting" or "risk distribution." In the case of a "captive" insurance company, one court has held that risk-shifting and risk-distribution requirements are satisfied even if the captive's "related person insurance income" accounts for nearly 70 percent of its total business. The Administration proposes that an insurance arrangement between a captive insurer and a large shareholder of the captive generally would not be respected as a valid insurance arrangement if more than 50 percent of the captive's net written premiums were attributable to the insurance or reinsurance of large-shareholder risks. In addition, such a captive would not be considered an insurance company for tax purposes. The proposal would be effective for taxable years beginning after the date of enactment.

Modify foreign tax credit carryback and carryforward rules.—The United States permits taxpayers to credit income taxes paid to a foreign government against U.S. tax on foreign source income. Through the foreign tax credit limitations, the Code prevents the use of foreign tax credits to reduce U.S. tax on U.S. source income. Under the foreign tax credit mechanism, current foreign income taxes in excess of the relevant current-year foreign tax credit limitation are not creditable against current U.S. tax liabilities. However, such excess foreign tax credits generally may be carried back for two years and carried forward for five years, and used as a credit to the extent there is excess foreign tax credit limitation (that is, an excess of the foreign tax credit limitation over creditable foreign taxes) in any of those years. Experience over the years has shown, however, that carrybacks are associated with increased complexity and administrative burdens as compared to carryforwards. Therefore, to reduce such complexity and burdens, the proposal would limit foreign tax credit carrybacks to one year and extend foreign tax credit carryforwards to seven years. The proposal would be effective for foreign taxes paid or

accrued or deemed paid or accrued in taxable years beginning on or after January 1, 1998.

Replace sales source rules with activity-based rules.—The foreign tax credit generally reduces U.S. tax on foreign source income, but does not reduce U.S. tax on U.S. source income. Where products are manufactured in the United States and sold abroad, Treasury regulations provide that 50 percent of such income generally is treated as earned in production activities, and sourced on the basis of the location of assets held or used to produce income from the sale. The remaining 50 percent of the income is treated as earned in sales activities and sourced based on where title to the inventory transfers. Thus, if a U.S. manufacturer sells inventory abroad, half of the income generally is treated as derived from domestic sources, and half of the income generally is treated as derived from foreign sources. However, the taxpayer may use a more favorable method if it can establish to the satisfaction of the IRS that more than half of its economic activity occurred in a foreign country. This 50/50 rule provides a benefit to U.S. exporters that operate in high-tax foreign countries. Thus, U.S. multinational exporters have a competititive advantage over U.S. exporters that conduct all their business activities in the United States. Because export benefits should be targeted equally to all exporters, the proposal reduces the amount of export sales income that such corporations may treat as derived from foreign sources by requiring that the allocation be based on actual economic activity. The proposal would be effective for taxable years beginning after the date of enactment.

Modify rules relating to foreign oil and gas extraction income.—To be eligible for the U.S. foreign tax credit, a foreign levy must be the substantial equivalent of an income tax in the U.S. sense, regardless of the label the foreign government attaches to it. Under regulations, a foreign levy is a tax if it is a compulsory payment under the authority of a foreign government to levy taxes and is not compensation for a specific economic benefit provided by the foreign country. Taxpayers that are subject to a foreign levy and that also receive (directly or indirectly) a specific economic benefit from the levying country are referred to as "dual capacity" taxpayers and may not claim a credit for that portion of the foreign levy paid as compensation for the specific economic benefit received. The proposal would treat as taxes payments by a dual-capacity taxpayer to a foreign country that would otherwise qualify as income taxes or "in lieu of" taxes, only if there is a "generally applicable income tax" in that country. For this purpose, a generally applicable income tax is an income tax (or a series of income taxes) that applies to trade or business income from sources in that country, so long as the levy has substantial application both to non-dual-capacity taxpayers and to persons who are citizens or residents of that country. Where the foreign country does generally impose an income tax, as under present law, credits would be allowed up to the level of taxation that would be imposed under that general tax, so long as the tax satisfies the new statutory definition of a "generally applicable income tax." The proposal would treat foreign oil and gas income as Subpart F income. It also would create a new foreign tax credit basket within Section 904 for foreign oil and gas income. The proposal would be effective for taxable years beginning after the date of enactment. The proposal would yield to U.S. treaty obligations that allow a credit for taxes paid or accrued on certain oil or gas income.

Phase out preferential tax deferral for certain large farm corporations required to use accrual accounting.—Under the Revenue Act of 1987, family farm corporations were required to change to the accrual method of accounting if their gross receipts exceeded $25 million in any taxable year beginning after 1985. However, in lieu of including in gross income the entire amount of the adjustment attributable to the change in accounting method, a family farm corporation could establish a suspense account. The amount of the suspense account was to be included in gross income if the corporation ceased to be a family corporation or to the extent the gross receipts of the corporation from farming declined. To eliminate the potential indefinite deferral of the adjustment, the Administration proposes to repeal the ability of family farm corporations to establish such suspense accounts. Any taxpayer subsequently required to change to the accrual method of accounting would be required to take the adjustment into account generally over a ten-year period. Any existing suspense accounts would be restored to income ratably over a ten-year period, or sooner to the extent provided under existing law. This provision would be effective for taxable years beginning after September 13, 1995.

Repeal lower of cost or market inventory accounting method.—Taxpayers required to maintain inventories are permitted to use a variety of methods to determine the cost of their ending inventories, including the last-in, first-out (LIFO) method, the first-in, first-out (FIFO) method, and the retail method. Taxpayers not using a LIFO method may determine the carrying values of their inventories by applying the lower of cost or market (LCM) method and by writing down the cost of goods that are unsalable at normal prices or unusable in the normal way because of damage, imperfection or other causes (subnormal goods method). The allowance of write-downs under the LCM and subnormal goods methods is essentially a one-way mark-to-market method that understates taxable income. The Administration proposes to repeal the LCM and subnormal goods methods, effective for taxable years beginning after the date of enactment.

Repeal components of cost inventory accounting method.—Taxpayers that use the LIFO method to determine the cost of their ending inventories may use a variety of dollar-value methods, including double extension, link-chain and other index methods, in order

to determine whether an increment has occurred and the cost of that increment. Certain taxpayers are permitted to use simplified LIFO methods based on externally developed price indexes. Some taxpayers that use a dollar-value, double-extension method make their computations with respect to the three components of cost (materials, labor and overhead) of their finished goods and work-in-process inventories (the COC method), rather than the aggregate cost of these goods (the total product cost method). The COC method, in many cases, does not adequately account for technological efficiencies in which skilled labor is substituted for less-skilled labor or where overhead costs replace direct labor costs. The Administration is proposing to repeal the COC method effective for taxable years beginning after the date of enactment.

Expand requirement that involuntarily converted property be replaced with property acquired from an unrelated party.—Gain realized by taxpayers from certain involuntary conversions is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within a specified period of time. C corporations (and partnerships with one or more corporate partners that own more than 50 percent of the capital or profits interest in the partnership) generally are not entitled to defer gain if the replacement property is purchased from a related person. The Administration proposes to extend this rule to any other taxpayer, including an individual, that acquires replacement property from a related person, unless the taxpayer has an aggregate realized gain of $100,000 or less during the year as a result of involuntary conversions. In the case of a partnership or S corporation, the $100,000 annual limitation would apply to the entity and each partner or shareholder. The proposal would generally be effective for involuntary conversions occurring after September 13, 1995.

Place further restrictions on like-kind exchanges involving personal property.—An exchange of property, like a sale, is generally a taxable transaction. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a like kind that is to be held for productive use in a trade or business or for investment. In general, any kind of real estate is treated as of a like kind with other real property; however real property located in the United States and real property located outside the United States are not of a like kind. For personal property, property of a "like class" is treated as being of a like kind; no restrictions apply with regard to location in or outside the United States. To conform the limitations on exchanges of personal property to the limitations on exchanges of real property, the Administration proposes that effective for exchanges on or after the date of first committee action, personal property located in the United States and personal property located outside the United States would not be treated as like kind.

Require registration of certain confidential corporate tax shelters.—Many corporate tax shelters are not registered with the Internal Revenue Service (IRS). Requiring registration of corporate tax shelters would allow the IRS to make better informed judgments regarding the audit of corporate tax returns and to monitor whether legislation or administrative action is necessary regarding the type of transactions being registered. The Administration is therefore proposing the registration of any investment, plan, arrangement or transaction: (1) a significant purpose of the structure of which is tax avoidance or evasion by a corporate participant, (2) that is offered to any potential participant under conditions of confidentiality, and (3) for which the tax shelter promoter may receive total fees in excess of $100,000. The proposal would be effective for any tax shelter offered to potential participants after the date the Secretary of the Treasury prescribes guidance regarding the filing requirements.

Require reporting of payments to corporations rendering services to Federal agencies.—All persons engaged in a trade or business and making payments of $600 or more to another person in remuneration for services generally must report those payments to the IRS and to the recipient. No reporting is required if the recipient is a corporation, permitting significant amounts of income to escape the tax system. To ensure that corporations that do business with the Federal Government appropriately report as income their payments from the Federal Government, the Administration proposes to require executive agencies to report payments of $600 or more made to corporations for services rendered. The proposal would be effective for returns the due date of which is more than 90 days after the date of enactment.

Increase penalties for failure to file correct information returns.—Any person who fails to file required information returns in a timely manner or incorrectly reports such information is subject to penalties. For taxpayers filing large volumes of information returns or reporting significant payments, existing penalties ($15 per return, not to exceed $75,000 if corrected within 30 days; $30 per return, not to exceed $150,000 if corrected by August 1; and $50 per return, not to exceed $250,000 if not corrected at all) may not be sufficient to encourage timely and accurate reporting. The Administration proposes to increase the general penalty amount, subject to the overall dollar limitations, to the greater of $50 per return or 5 percent of the total amount required to be reported. The increased penalty would not apply if the aggregate amount actually reported by the taxpayer on all returns filed for that calendar year was at least 97 percent of the amount required to be reported. The increased penalty would be effective for returns the due date for which is more than 90 days after the date of enactment.

Tighten the substantial understatement penalty for large corporations.—Currently taxpayers may be

penalized for erroneous, but non-negligent, return positions if the amount of the understatement is "substantial" and the taxpayer did not disclose the position in a statement with the return. "Substantial" is defined as ten percent of the taxpayer's total current tax liability, but this can be a very large amount. This has led some large corporations to take aggressive reporting positions where huge amounts of potential tax liability are at stake—in effect playng the audit lottery—without any downside risk of penalties if they are caught, because the potential tax still would not exceed ten percent of the company's total tax liability. To discourage such aggressive tax planning, the proposal considers any deficiency greater than $10 million to be "substantial" for purposes of the substantial understatement penalty, whether or not it exceeds ten percent of the taxpayer's liability. The proposal, which would be effective for taxable years beginning after the date of enactment, affects only taxpayers that have tax liabilities greater than or equal to $100 million.

Repeal exemption for withholding on gambling winnings from bingo and keno in excess of $5,000.—Proceeds of most wagers with odds of less than 300 to 1 are exempt from withholding, as are all bingo and keno winnings. The proposal would impose withholding on proceeds of bingo or keno in excess of $5,000 at a rate of 28 percent, regardless of the odds of the wager, effective for payments made after the date of enactment.

Require tax reporting for payments to attorneys.—Tax information reporting is required for persons engaged in a trade or business making payments of rent, salaries, wages, or other fixed or determinable income in the course of the trade or business. Treasury regulations require a payor to report payments of attorney's fees if the payments are made in the course of a trade or business, although generally a payor is not required to report payments made to corporations. If a payment to an attorney is a gross amount, and it cannot be determined what portion is the attorney's fee (as in the case of lump-sum judgments or settlements made jointly payable to a lawyer and a plaintiff), then no reporting is required. The Administration proposes requiring that any person making a payment in the course of a trade or business to a lawyer or a law firm, whether as sole or joint payee, report the payment to the IRS. When the portion that constitutes fees cannot be determined, the amount paid would be reported as gross proceeds. A lawyer receiving a payment would be required to provide his or her taxpayer identification number to the payor or be subject to backup withholding and applicable penalties. The exception for payments to corporations would not apply to payments of attorney's fees. The proposal would be effective for payments made after December 31, 1997.

Extend oil spill excise tax.—Before January 1, 1995, a five-cents-per-barrel excise tax was imposed on domestic crude oil and imported oil and petroleum products. The tax was dedicated to the Oil Spill Liability Trust Fund to finance the cleanup of oil spills and was not imposed for a calendar quarter if the unobligated balance in the Trust Fund exceeded $1 billion at the close of the preceding quarter. The Administration proposes to reinstate this tax for the period after the date of enactment and before October 1, 2007. The tax would be suspended for a given calendar quarter if the unobligated Trust Fund balance at the end of the preceding quarter exceeded $2.5 billion.

Impose excise taxes on kerosene as diesel fuel.—A 24.3-cents-per-gallon excise tax is imposed on diesel fuel upon removal from a registered terminal facility unless the fuel is indelibly dyed and is destined for a nontaxable use. Treasury regulations provide that kerosene is not treated as a diesel fuel for this purpose; thus, undyed kerosene is not subject to the diesel fuel excise tax when it is removed from a terminal. Undyed kerosene is subject to tax, however, when it is blended with previously taxed diesel fuel. Some producers of this blended fuel may not be paying the tax, thereby placing complying taxpayers at a competitive disadvantage and resulting in revenue losses to the Federal government. Effective July 1, 1998, the Administration proposes to tax kerosene as diesel fuel when it is removed from a terminal. Exceptions would be provided for aviation fuel and, to the extent provided in regulations, for feedstock uses. In addition, special refund rules would apply in certain cases of kerosene used for heating purposes.

Limit extension of tax credit for producing fuel from a nonconventional source.—The Small Business Job Protection Act extended the $3 per barrel synthetic fuels tax credit to apply to synthetic fuels from coal and gas from biomass sold before January 1, 2008, if produced from facilities placed in service before July 1, 1998, pursuant to a binding contract entered into before January 1, 1997. The prior law placed in service and binding contract dates had been January 1, 1997 and January 1, 1996, respectively. The Administration proposes to modify the extension of the placed-in-service date by moving it to July 1, 1997; the binding contract date would not be modified.

Extend and modify Federal Unemployment Act (FUTA) provisions.—The temporary unemployment surtax of 0.2 percent imposed on employers, which is scheduled to expire with respect to wages paid after December 31, 1998, is proposed to be extended through December 31, 2007. Beginning in 2002, the Administration proposes to require an employer to pay Federal and State unemployment taxes monthly (instead of quarterly) in a given year, if the employer's FUTA tax liability in the immediately prior year was $1,100 or more.

Other Provisions That Affect Receipts

Extend environmental tax on corporate taxable income deposited in the Hazardous Substance

Superfund Trust Fund.—A tax equal to 0.12 percent of alternative minimum taxable income (with certain modifications) in excess of $2 million is levied on all corporations and deposited in the Hazardous Substance Superfund Trust Fund. The Administration proposes to reinstate this tax, which expired on December 31, 1995, for taxable years beginning after December 31, 1996 and before January 1, 2008.

Extend excise taxes deposited in the Hazardous Substance Superfund Trust Fund.—The excise taxes that are levied on petroleum, chemicals, and imported substances and deposited in the Hazardous Substance Superfund Trust Fund, are proposed to be reinstated for the period after the date of enactment and before October 1, 2007. These taxes expired on December 31, 1995.

Extend excise taxes deposited in the Leaking Underground Storage Tank (LUST) Trust Fund.—The excise taxes that are levied on gasoline, other motor fuels, methanol and ethanol fuels, aviation fuel, and on fuels used in inland waterways and deposited in the LUST Trust Fund, expired on December 31, 1995. The Administration proposes to reinstate these taxes for the period after the date of enactment and before October 1, 2007.

Extend excise taxes deposited in the Airport and Airway Trust Fund/assess fees for Federal Aviation Administration (FAA) services.—The excise taxes that are levied on domestic air passenger tickets, international departures, domestic air cargo and non-commercial aviation fuels and deposited in the Airport and Airway Trust Fund, are proposed to be reinstated for the period April 1, 1997 through September 30, 2007. These taxes expired on December 31, 1996. The Administration will propose legislation to completely replace these taxes, effective October 1, 1998, with cost-based user fees, as part of the Administration's effort to create a more business-like Federal Aviation Administration.

Extend the Generalized System of Preferences (GSP) and modify other trade provisions.—Under GSP duty-free access is provided to over 4,000 items from eligible developing countries that meet certain worker rights, intellectual property protection, and other criteria. The Administration proposes to extend the program, which expires May 31, 1997. The Administration also proposes to provide expanded trade benefits mainly on textiles and apparel to Caribbean Basin countries that meet new eligibility criteria to prepare for a future free trade agreement with the U.S. The program is proposed to expire on September 30, 2005. The Administration also proposes to implement the OECD Shipbuilding Agreement.

Assess fees for examination of FDIC-insured banks and bank holding companies (receipt effect).—The Administration proposes to require the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve to assess fees for examination of FDIC-insured banks and bank holding companies. The Federal Reserve currently funds the costs of such examinations from earnings; therefore, deposits of earnings by the Federal Reserve, which are classified as governmental receipts, will increase by the amount of the fees.

Modify method of reimbursing Federal Reserve Banks.—Beginning in fiscal year 1998 and thereafter, the Administration proposes to appropriate such sums as may be necessary to reimburse Federal Reserve Banks in their capacity as depositaries and fiscal agents for the United States for all services required or directed by the Secretary of the Treasury to be performed by such banks on behalf of the Treasury or other fiscal agencies. These payments to the Federal Reserve Banks would be deficit neutral because they would result in corresponding increases in deposits of earnings by the Federal Reserve.

Establish IRS continuous levy.—The Administration seeks to strengthen the enforcement tools available to the IRS to recover delinquent tax debt. New authority is proposed for the IRS to effect a continuous levy on non-means tested Federal payments, such as Federal salaries and pensions, received by individuals who owe delinquent tax debt.

Assess fees for National Transportation Safety Board (NTSB) aviation accident investigation activities.—Beginning in 1998, the Administration proposes to charge a fee on commercial air carrier operations to offset a portion of the NTSB's growing cost of commercial aviation accident investigations.

Establish alien labor certification fee.—To protect U.S. workers, the Employment and Training Administration of the Department of Labor administers the Alien Labor Certification program. This program determines the admissibility of aliens to work in the United States. Consistent with a recommendation by the National Performance Review, the Administration proposes to charge employers who benefit from the program a fee for alien labor certification services.

Exempt Federal vaccine purchases from the payment of the vaccine excise tax.—The Administration proposes to exempt vaccine purchases paid through grants from the Centers for Disease Control and Prevention and the Health Care Financing Administration from payment of the vaccine excise tax. The proposal is effective for purchases after September 30, 1997 and before September 30, 1998.

Extend and increase Food and Drug Administration (FDA) user fees.—To finance FDA activities, the Administration proposes to reauthorize the Prescription Drug User Fee Act (PDUFA) of 1992 and the Mammography Quality Standards Act (MQSA), which are currently authorized through fiscal year 1997. PDUFA au-

thorizes the collection of fees paid by the pharmaceutical industry to expedite FDA's review of human drug applications and MQSA authorizes the collection of fees for the inspection of mammography facilities. Along with the continued collection of these fees, the Administration proposes new fees effective October 1, 1997 for medical device reviews, animal drug approvals, import inspections, food additive petition reviews, generic/over-the-counter drug applications, and the postmarket surveillance of products.

Initiate Health Care Financing Administration (HCFA) Medicare survey and certification fee.—In order to participate in the Medicare program (or the Medicaid program for dually-participating providers), providers must demonstrate that they comply with Federal health and safety standards. Program certification allows them to provide services to Medicare and Medicaid beneficiaries. Beginning in fiscal year 1998, the Administration would require State survey agencies to impose fees on health care providers for initial surveys required as a condition of participation in the Medicare program. The proposal would allow State survey agencies to collect and retain fees from health care providers to cover the cost of conducting initial surveys.

Increase employee contributions to the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS).—The Administration proposes to increase employee contributions to CSRS and FERS by 0.5 percent of base pay in three steps. Contributions would increase by 0.25 percent of base pay on January 1, 1999, another 0.15 percent on January 1, 2000 and a final 0.10 percent on January 1, 2001. These higher contribution rates would be effective through 2002; on January 1, 2003, contribution rates would return to the levels in effect on December 31, 1998.

Modify Federal pay raise (receipt effect).—The Administration is proposing a pay raise of 2.8 percent for 1998, less than the raise that would take effect under normal operation of the law. This raise would cover both the national schedule and the locality pay adjustments. The lower proposed pay raise affects Federal employees' contributions to CSRS and FERS.

Tax Simplification and Taxpayers' Rights

The Administration continues to support revenue-neutral initiatives designed to promote sensible and equitable administration of the tax laws. These include simplification, technical corrections, and taxpayer compliance measures. The Administration will propose to Congress in the near future a package of measures to simplify the tax laws and enhance taxpayers' rights. In addition to legislative initiatives, the Administration is committed to taking appropriate administrative action to simplify tax laws and enhance procedural safeguards for taxpayers.

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS

(In billions of dollars)

	Estimate						
	1997	1998	1999	2000	2001	2002	1998–2002
Provide tax relief and extend expiring provisions:							
Middle Class Bill of Rights:							
Provide tax credit for dependent children	–0.7	–9.9	–6.8	–8.6	–10.4	–10.4	–46.0
Expand Individual Retirement Accounts (IRAs)	.....	–1.5	–0.5	–0.8	–1.2	–1.7	–5.5
Provide tax incentive for education and training	–0.1	–4.0	–6.2	–7.8	–8.6	–9.4	–36.1
Subtotal, Middle Class Bill of Rights	–0.8	–15.4	–13.5	–17.2	–20.2	–21.4	–87.6
Provide targeted welfare-to-work tax credit	.....	–0.1	–0.1	–0.2	–0.1	–0.1	–0.6
Provide capital gains exclusion on sale of principal residence	–0.1	–0.3	–0.3	–0.3	–0.3	–0.2	–1.4
Establish DC tax incentive program	.....	–*	–*	–0.1	–0.1	–0.1	–0.3
Provide estate tax relief for small business	.....	–*	–0.2	–0.2	–0.2	–0.2	–0.7
Provide tax incentives for distressed areas	–*	–0.4	–0.5	–0.5	–0.5	–0.4	–2.3
Provide tax credit for investment in community development financial institutions (CDFI)	.....	–*	–*	–*	–*	–*	–*
Toll statute of limitations for incapacitated taxpayers	.....	.....	.....	.....	–*	–*	–0.1
Allow Foreign Sales Corporation (FSC) benefits for computer software licenses	–*	–0.1	–0.1	–0.1	–0.1	–0.1	–0.6
Extend exclusion for employer-provided educational assistance	–0.1	–0.6	–0.7	–0.8	–0.2	.....	–2.3
Extend R&E tax credit	–0.4	–0.8	–0.5	–0.2	–0.1	–*	–1.7
Extend orphan drug tax credit	–*	–*	–*	–*	–*	–*	–*
Extend work opportunity tax credit	.....	–0.1	–0.2	–0.1	–*	–*	–0.4
Extend deduction for contributions of appreciated stock	.....	–*	–*	.....	.....	.....	–0.1
Extend and modify Puerto Rico economic-activity tax credit	.....	–*	–0.1	–0.1	–0.1	–0.1	–0.4
Subtotal, Provide tax relief and extend expiring provisions	–1.4	–17.9	–16.2	–19.6	–21.9	–22.8	–98.4
Eliminate unwarranted benefits and adopt other revenue measures:							
Deny interest deduction on certain debt instruments	*	0.1	0.1	0.2	0.2	0.3	0.8
Defer original issue discount deduction on convertible debt	.....	*	*	*	*	0.1	0.2

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

(In billions of dollars)

	Estimate						
	1997	1998	1999	2000	2001	2002	1998–2002
Limit dividends-received deduction (DRD):							
Reduce DRD to 50 percent	.....	0.3	0.3	0.4	0.4	0.4	1.7
Eliminate DRD for certain stock	.....	*	*	*	*	0.1	0.2
Modify holding period for DRD	.....	*	*	*	*	*	0.1
Interaction	.....	–*	–*	–*	–*	–*	–*
Extend pro-rata disallowance of tax-exempt interest expense to all corporations	.....	*	*	*	0.1	0.1	0.2
Require average-cost basis for stocks, securities, etc.	.....	0.6	0.6	0.6	0.6	0.6	3.0
Require recognition of gain on certain stocks, indebtedness and partnership interests	.....	*	0.1	0.1	0.1	0.1	0.3
Change the treatment of gains and losses on extinguishment	.....	*	*	*	*	*	*
Require reasonable payment assumptions for interest accruals on certain debt instruments	.....	0.1	0.2	0.3	0.3	0.2	1.1
Require gain recognition for certain extraordinary dividends	0.4	0.6	*	*	*	*	0.6
Repeal percentage depletion for non-fuel minerals mined on Federal and formerly Federal lands	*	0.1	0.1	0.1	0.1	0.1	0.5
Modify loss carryback and carryforward rules	*	0.1	0.6	0.8	0.7	0.6	2.9
Treat certain preferred stock as ''boot''	*	0.1	0.2	0.2	0.2	0.1	0.8
Repeal tax-free conversions of large C corporations to S corporations	.....	*	*	*	*	*	0.1
Require gain recognition in certain distributions of controlled corporation stock	*	0.1	0.1	0.1	0.1	0.1	0.3
Reform treatment of certain stock transfers	*	0.1	0.1	0.1	0.1	0.2	0.7
Expand Subpart F provisions regarding certain income	.....	*	*	*	*	*	0.2
Modify taxation of captive ''insurance'' companies	.....	*	*	*	*	*	0.1
Modify foreign tax credit carryback and carryforward rules	.....	*	0.3	0.3	0.3	0.3	1.2
Replace sales source rules with activity-based rules	.....	0.9	1.5	1.6	1.8	1.9	7.5
Modify rules relating to foreign oil and gas extraction income	.....	*	0.1	0.1	0.1	0.1	0.4
Phase out preferential tax deferral for certain large farm corporations required to use accrual accounting	*	0.1	0.1	0.1	0.1	0.1	0.6
Initiate inventory reform:							
Repeal lower of cost or market method	*	0.2	0.4	0.4	0.4	0.2	1.5
Repeal components of cost method	*	0.1	0.2	0.2	0.2	0.2	0.9
Expand requirement that involuntarily converted property be replaced with property acquired from an unrelated party	.....	*	*	*	*	*	*
Place further restrictions on like-kind exchanges involving personal property	*	*	*	*	*	*	0.1
Require registration of certain corporate tax shelters	.....	*	*	*	*	*	*
Require reporting of payments to corporations rendering services to Federal agencies	.....	*	*	*	*	0.1	0.2
Increase penalties for failure to file correct information returns	.....	*	*	*	*	*	0.1
Tighten substantial understatement penalty for large corporations	.....	*	*	*	*	*	0.2
Repeal exemption for withholding on gambling winnings from bingo and keno in excess of $5,000	*	*	*	*	*	*	*
Require tax reporting for payments to attorneys	.....	.....	*	*	*	*	*
Extend oil spill excise tax [1]	*	0.2	0.2	0.2	0.2	0.2	1.1
Impose excise taxes on kerosene as diesel fuel [1]	*	*	*	*	*	*	0.2
Limit extension of tax credit for producing fuel from a nonconventional source	*	0.1	0.1	0.1	0.1	0.1	0.5
Extend and modify FUTA provisions:							
Extend FUTA surtax [1]	.....	.....	0.9	1.2	1.3	1.3	4.7
Accelerate deposit of unemployment insurance taxes	.....	.....	.....	.....	.....	1.3	1.3
Subtotal, Eliminate unwarranted benefits	0.6	4.1	6.3	7.3	7.6	8.9	34.3
Other provisions that affect receipts:							
Extend corporate environmental tax [2]	.....	1.1	0.7	0.8	0.8	0.8	4.2
Extend Superfund excise taxes [1]	0.1	0.7	0.7	0.7	0.7	0.7	3.4
Extend LUST excise taxes [1]	*	0.1	0.1	0.1	0.1	0.1	0.6
Extend aviation excise taxes/new user fees [1, 3]	2.3	5.0	6.7	6.6	6.8	7.0	32.2
Extend GSP and modify other trade provisions [1]	.....	–0.7	–0.5	–0.6	–0.7	–0.8	–3.3
Assess fees for examination of FDIC-insured banks and bank holding companies (receipt effect) [1]	.....	0.1	0.1	0.1	0.1	0.1	0.4
Modify method of reimbursing Federal Reserve Banks (receipt effect)	.....	0.1	0.1	0.1	0.1	0.1	0.6
Establish IRS continuous levy	.....	0.4	0.4	0.4	0.3	0.2	1.6
Assess fees for NTSB aviation accident investigation activities [1]	.....	*	*	*	*	*	*
Establish alien labor certification fee [1]	.....	*	*	*	*	*	0.2
Exempt Federal vaccine purchases from the payment of vaccine excise taxes [1]	.....	–0.1	.....	.....	.....	.....	–0.1
Extend and increase FDA user fees [1]	.....	0.2	0.2	0.2	0.2	0.2	1.0
Initiate HCFA Medicare survey and certification fee [1]	.....	*	*	*	*	*	*
Increase employee contributions to CSRS and FERS	.....	.....	0.2	0.4	0.6	0.6	1.8
Modify Federal pay raise (receipt effect)	.....	–0.2	–0.2	–0.2	–0.2	–0.2	–1.0
Subtotal, Other	2.4	6.8	8.5	8.6	8.8	9.0	41.7
Subtotal, Eliminate unwarranted benefits and other provisions that affect receipts	3.0	10.9	14.9	15.9	16.4	17.9	76.0

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

(In billions of dollars)

	Estimate						
	1997	1998	1999	2000	2001	2002	1998–2002
Total effect of proposals [1]	**1.6**	**–7.0**	**–1.4**	**–3.7**	**–5.5**	**–4.9**	**–22.4**

* $50 million or less.
[1] Net of income offsets.
[2] Net of deductibility for income tax purposes.
[3] The aviation excise taxes are proposed to be reinstated effective April 1, 1997. In addition, the Administration proposes that aviation excise taxes be repealed effective October 1, 1998 and replaced with cost-based user fees.

Table 3–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	1996 actual	1997 estimate	1998 estimate
Individual income taxes (federal funds):			
Existing law	656,417	674,342	708,356
Proposal (PAYGO)	.....	-1,659	-17,178
Proposal (non-PAYGO)	.....	.....	21
Total individual income taxes	**656,417**	**672,683**	**691,199**
Corporation income taxes:			
Federal funds:			
Existing law	171,501	176,196	187,009
Proposal (PAYGO)	.....	-1	1,280
Proposal (non-PAYGO)	.....	.....	4
Total Federal funds corporation income taxes	171,501	176,195	188,293
Trust funds:			
Hazardous substance superfund	323	4	.....
Proposal (PAYGO)	.....	.....	1,369
Total corporation income taxes	**171,824**	**176,199**	**189,662**
Social insurance taxes and contributions (trust funds):			
Employment taxes and contributions:			
Old-age and survivors insurance (Off-budget)	311,869	334,139	349,435
Disability insurance (Off-budget)	55,623	54,764	55,509
Hospital insurance	104,997	109,180	114,167
Railroad retirement:			
Social Security equivalent account	1,510	1,496	1,486
Rail pension and supplemental annuity	2,362	2,384	2,375
Total employment taxes and contributions	476,361	501,963	522,972
On-budget	108,869	113,060	118,028
Off-budget	367,492	388,903	404,944
Unemployment insurance:			
State taxes deposited in Treasury [1]	22,706	23,517	24,496
Federal unemployment tax receipts [1]	5,854	5,920	5,976
Railroad unemployment tax receipts [1]	24	28	67
Total unemployment insurance	28,584	29,465	30,539
Other retirement contributions:			
Federal employees' retirement—employee contributions	4,389	4,266	4,370
Proposal (non-PAYGO)	.....	.....	-164
Contributions for non-Federal employees [2]	80	72	66
Total other retirement contributions	4,469	4,338	4,272
Total social insurance taxes and contributions	**509,414**	**535,766**	**557,783**
On-budget	141,922	146,863	152,839
Off-budget	367,492	388,903	404,944
Excise taxes:			
Federal funds:			
Alcohol taxes	7,220	7,171	7,119
Tobacco taxes	5,795	5,694	5,661
Transportation fuels tax	7,468	7,669	7,835
Telephone and teletype services	4,234	4,485	4,746
Ozone depleting chemicals and products	320	113	47
Other Federal fund excise taxes	410	1,363	1,341
Proposal (PAYGO)	.....	-327	952
Proposal (non-PAYGO)	.....	.....	-24
Total Federal fund excise taxes	25,447	26,168	27,677
Trust funds:			
Highway	24,651	24,880	25,332
Proposal (PAYGO)	.....	2	-617
Airport and airway	2,369	1,439	.....
Proposal (PAYGO)	.....	3,384	6,391
Aquatic resources	315	324	331
Black lung disability insurance	614	604	613
Inland waterway	108	117	121
Hazardous substance superfund	313	.....	.....
Proposal (PAYGO)	.....	147	881
Oil spill liability	34	.....	.....
Proposal (PAYGO)	.....	34	296
Vaccine injury compensation	115	125	125
Proposal (non-PAYGO)	.....	.....	-73
Leaking underground storage tank	48	.....	.....
Proposal (PAYGO)	.....	23	162
Total trust funds excise taxes	28,567	31,079	33,562
Total excise taxes	**54,014**	**57,247**	**61,239**
Estate and gift taxes:			
Existing law	17,189	17,588	18,818
Proposal (PAYGO)	.....	.....	-1
Total estate and gift taxes	**17,189**	**17,588**	**18,817**
Customs duties:			
Federal funds	17,910	16,545	18,271
Proposal (PAYGO)	.....	.....	-799
Trust funds	760	783	835
Total customs duties	**18,670**	**17,328**	**18,307**
MISCELLANEOUS RECEIPTS: [3]			
Miscellaneous taxes	110	123	127
United Mine Workers of America combined benefit fund	304	311	280
Deposit of earnings, Federal Reserve System	20,477	23,184	22,788
Proposal (PAYGO)	.....	.....	96
Proposal (non-PAYGO)	.....	.....	122
Fees for permits and regulatory and judicial services	2,896	3,456	4,533
Proposal (PAYGO)	.....	.....	278
Fines, penalties, and forfeitures	1,744	1,412	1,435
Gifts and contributions	122	139	187
Refunds and recoveries	-119	-11	-11
Total miscellaneous receipts	**25,534**	**28,614**	**29,835**
Total budget receipts	**1,453,062**	**1,505,425**	**1,566,842**
On-budget	1,085,570	1,116,522	1,161,898
Off-budget	367,492	388,903	404,944
MEMORANDUM			
Federal funds	916,802	938,126	973,677
Trust funds	353,105	366,155	396,764
Interfund transactions	-184,337	-187,759	-208,543
Total on-budget	**1,085,570**	**1,116,522**	**1,161,898**
Off-budget (trust funds)	**367,492**	**388,903**	**404,944**

Table 3–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	1996 actual	1997 estimate	1998 estimate
Total	**1,453,062**	**1,505,425**	**1,566,842**

[1] Deposits by States are State payroll taxes that cover benefit part of the program. Federal unemployment tax receipts cover administrative costs at both the Federal and State level. Railroad unemployment tax receipts cover both the benefits and adminstrative costs of the program for the railroads.

[2] Represents employer and employee contributions to the civil service retirement and disability fund for covered employees of Government-sponsored, privately owned enterprises and the District of Columbia municipal government.

[3] Includes both Federal and trust funds. Trust fund amounts in miscellaneous receipts are 1996: $557 million; 1997: $663 million; and 1998: $687 million.

4. USER FEES AND OTHER COLLECTIONS

In addition to collecting taxes and other governmental receipts by the exercise of its sovereign powers, the Federal Government earns income from its various business-type activities. Examples of this income include the sale of postage stamps and electricity, the collection of fees for admittance to national parks, premiums for deposit insurance, and rents and royalties for the right to extract oil from the Outer Continental shelf. Because these collections stem from business-type activities, as opposed to exercise of sovereign powers, they are subtracted from gross outlays rather than added to the taxes and other governmental receipts discussed in the previous chapter. Because these collections reduce outlays, they are called "offsetting collections." The purpose of this treatment is to produce budget totals for receipts, outlays, and budget authority in terms of the amount of resources allocated governmentally, through collective political choice rather than through the market.

Offsetting collections are classified into two major categories: offsetting receipts, which are deposited in receipt accounts; and offsetting collections credited to appropriations (expenditure) accounts, which are deposited directly in these accounts and usually can be spent without further action by the Congress. Both categories include collections from other accounts within the Government as well as the public. Chapter 24, "Budget System and Concepts," explains the budgetary treatment of these collections more fully.

The term "user fee" is not a separate budget category for collections. It is a general term referring to fees charged to users directly availing themselves of, or subject to, a government service, program, or activity, in order to cover the government's costs. Depending primarily on whether the user charge is based on the Government's sovereign power or business-type activity, it may be classified as a governmental receipt or an offsetting collection.

As shown in Table 4–1, total offsetting collections from the public (including those proposed in this budget) are estimated to be $209.1 billion 1998. This is only 13 percent as large as the governmental receipts discussed in the previous chapter. Table 4–1 divides this total between offsetting receipts and offsetting collections credited to appropriations accounts and shows major subcategories of each. Table 4–3 provides more detail for offsetting receipts collected from the public and offsetting receipts collected from other accounts within the Government.

The budget contains a variety of user fee and other collections proposals that would yield $1.6 billion in 1998 and $47.3 billion from 1998 through 2002. In addition, the Administration proposes dedicating $1.1 billion of existing collections in 1998, and $5.0 billion from 1998 through 2002 to discretionary spending. These proposals establish, increase, or extend fees in order to recover more of the costs of providing government services. Table 4–2 splits the proposals between discretionary and mandatory categories for the appropriate

Table 4–1. OFFSETTING COLLECTIONS FROM THE PUBLIC

(In millions of dollars)

Type	1996 actual	Estimate	
		1997	1998
Collections deposited in receipt accounts:			
Medicare premiums	20,038	20,293	21,772
Military assistance trust fund property sales	14,747	13,760	13,400
Outer Continental Shelf payments, naval petroleum reserve lease and other undistributed offsetting receipts	3,742	4,152	9,817
Spectrum auction proceeds, undistributed	342	7,961	11,459
Sale of property and services, interest income and all other collections deposited in receipt accounts	20,139	23,401	26,194
Subtotal, collections from the public deposited in receipt accounts	59,008	69,567	82,642
Collections credited to appropriations accounts:			
Postal Service Stamp sales and other collections	55,477	56,801	58,533
Deposit insurance funds	10,320	12,363	4,524
Tennessee Valley Authority and Power Administration collections	9,440	8,096	9,284
Commodity Credit Corporation loan repayments and other collections	7,360	7,056	8,154
Other loan repayments	7,867	7,195	6,296
Loan guaranty and other insurance premiums, interest income and all other collections credited to appropriations accounts	46,927	43,529	39,661
Subtotal, collections from the public credited to appropriation accounts	137,391	135,040	126,452
Offsetting collections from the public	196,399	204,607	209,094
Offsetting collections from the public excluding off-budget Postal Service collections	140,922	147,806	150,561

scoring under the Budget Enforcement Act of 1990 (BEA). It includes user fees classified as offsetting collections and governmental receipts. The budget includes several specific proposals to fund discretionary spending with existing or new user fees that are governmental or offsetting receipts. Legislation will be proposed to authorize the fees and, upon enactment of the authorization, a budget amendment to the current appropriations language will be proposed to make the fees available for expenditure. Because the current requirements of the Budget Enforcement Act of 1990 make it difficult to fund discretionary programs with receipts not authorized in appropriations acts, the Administration is proposing a change in the requirements to facilitate enactment of such proposals.

Table 4–2. PROPOSED USER FEES AND OTHER COLLECTIONS

(In millions of dollars)

	1998	1999	2000	2001	2002	1998–2002
User fees:						
Discretionary fee proposals:						
New and increased fees:						
Department of Agriculture:						
Food Safety and Inspection Service—New meat, poultry, and eggs inspection fees	390	390	390	390	390	1,950
Animal and Plant Health Inspection Service—Establish new fees	10	10	10	10	10	50
Grain Inspection, Packers and Stockyards Administration— New standardization and licensing fees	16	19	19	19	19	92
Department of Transportation:						
Federal Railroad Administration—Extend railroad safety inspection fees	60	60	60	60	60	300
Surface Transportation Board—New fees to offset expenses	13	14	14	14	14	69
Department of Veterans Affairs—Veterans Health Administration:						
Medical care collections—extend expiring provisions	123	362	394	421	451	1,751
Social Security Administration:						
Increase user fees for SSA to administer State supplementation of SSI benefits to $7.25	40	70	80	80	90	360
Army Corps of Engineers:						
Increase wetlands dredging permit application fees	7	14	14	14	14	63
Federal Emergency Management Agency:						
Extend fee to cover 100% of radiological emergency preparedness program	12	12	12	12	12	60
National Capital Planning Commission:						
Establish Geographic Information System fees	*	*	*	*	*	*
Nuclear Regulatory Commission:						
Extend nuclear facility fees	—	310	310	310	310	1,240
Subtotal, new and increased discretionary user fees	671	1,261	1,303	1,330	1,370	5,935
Existing mandatory fees reclassified as discretionary:						
Department of Veterans Affairs—Veterans Health Administration:.						
Medical care current law collections	468	308	355	404	452	1,987
Governmental receipts dedicated to discretionary spending:						
New and increased fees:						
Department of Health and Human Services—Food and Drug Administration:						
Extend prescription drug user fees; establish new fees for medical device reviews, import inspections, and other FDA activities	237	252	267	282	297	1,335
Department of Labor—Employment and Training Administration:						
New alien labor certification user fee charged to employers	25	50	50	50	50	225
Department of Transportation:						
Federal Aviation Administration—establish cost-based fee system	300	8,734	8,862	9,099	9,342	36,337
National Transportation Safety Board:						
New accident investigation user fees	6	6	6	6	6	30
Subtotal, new and increased governmental receipts dedicated to discretionary spending	568	9,042	9,185	9,437	9,695	37,927
Existing governmental receipts dedicated to discretionary spending:						
Department of State:						
Immigration, passport and other fees	455	455	455	455	455	2,275
Machine readable visa fee	140	140	140	140	140	700
Subtotal, current law amounts dedicated to discretionary	595	595	595	595	595	2,975
Mandatory fee proposals:						
New and increased fees:						
Department of Agriculture—Agricultural Marketing Service:						
Recover costs for oversight of marketing agreements and orders	10	11	11	11	11	54
Department of Commerce:						
Patent and Trademark Office—Extend patent surcharge	—	119	119	119	119	476
Department of Health and Human Services:						
Health Care Financing Administration—New Medicare initial survey and certification fees (governmental receipt)	10	10	10	10	10	50

Table 4–2. PROPOSED USER FEES AND OTHER COLLECTIONS—Continued

(In millions of dollars)

	1998	1999	2000	2001	2002	1998–2002
Department of the Interior:						
Bureau of Land Management:						
Extend and index hardrock mining holding fees on public lands	1	32	33	34	35	135
Establish hardrock mining royalties on public lands (5% on net-smelter return)	—	42	63	35	35	175
National Park Service:						
Increase Hetch Hetchy Dam rental payments	1	1	1	1	1	5
Extend demonstration authority to collect recreation and related fees—(also affects Fish and Wildlife Service, Bureau of Land Management and Forest Service)	—	—	77	79	87	243
Establish Everglades sugar assessment	35	35	35	35	35	175
Department of Justice/Federal Trade Commission:						
Increase Hart-Scott-Rodino merger filing fees	70	70	70	70	70	350
Department of Transportation—Coast Guard:						
Extend vessel tonnage fees	—	62	62	62	62	248
Department of the Treasury—Financial Management Service:						
Establish fee on vendors for cost of payments by paper check	15	10	5	5	5	40
Department of Veterans Affairs—Veterans Benefits Administration:						
Conform fees for non-veterans in the home loan program to match Federal Housing Administration fees	26	26	26	26	27	131
Extend provisions that maintain higher loan fees and reduce resale losses on foreclosed properties	—	204	198	197	192	791
Federal Deposit Insurance Corporation/Federal Reserve:						
New examination fees for FDIC-insured banks and bank holding companies:						
Bank Insurance Fund—Collections net of premium reduction	79	82	-161	—	—	—
Federal Reserve—Collections (governmental receipt)	96	100	104	109	114	523
Subtotal, new and increased mandatory user fees	343	804	653	793	803	3,396
Total, existing user fees reclassified as, or dedicated to, discretionary spending	**1,063**	**903**	**950**	**999**	**1,047**	**4,962**
New and increased user fees:						
Federal Aviation Administration fees	300	8,734	8,862	9,099	9,342	36,337
All other new and increased user fees	1,282	2,373	2,279	2,461	2,526	10,921
Total, new and increased user fees	**1,582**	**11,107**	**11,141**	**11,560**	**11,868**	**47,258**

*$500,000 or less

Discretionary: The following proposed fees are classified as discretionary because the Appropriations Committees are being requested to authorize the fees and make them available for expenditure. In two cases—VA medical care third party collections and SSA State Administrative fees—the fees would be included in authorizing legislation but classified as discretionary under the Administration's proposed new rule.

Department of Agriculture

Food Safety and Inspection Service.—The 1998 Budget proposes a new user fee for USDA's Food Safety and Inspection Service (FSIS). Under the proposed fee, the meat, poultry and egg industries would be required to reimburse the Federal government for the cost of the salaries and benefits and other direct costs for all in-plant inspection. This new fee is estimated to generate approximately $390 million in new, annual revenues or approximately 70 percent of the current cost of the inspection system. Although presented in the budget as discretionary offsetting collections requiring Appropriations Committee action, the Administration will propose authorizing legislation to authorize the fees and, upon enactment, a budget amendment to the current appropriations language to make the fees available for expenditure. The treatment will be consistent with that proposed for FDA user fees.

Animal and Plant Health Inspection Service (APHIS).—The budget proposes to establish five APHIS fees for certain activities:

- Fees to cover cost of providing animal welfare inspections would be charged to recipients of APHIS services such as animal research centers, humane societies, and kennels.
- Fees to cover cost of issuance of biotechnology certificates would be charged to firms that manufacture biotechnologically-derived products.
- Fees to cover cost of veterinary biologics licensing, inspection, and testing activities of medications would be paid by veterinary biologic companies.
- Fees to cover inspections to ensure that garbage fed to swine is properly cooked to avoid contamination would be charged to establishments regulated under the Swine Health Protection Act.
- Fees would be charged to users to cover the costs of the pink bollworm eradication program.

Grain Inspection, Packers and Stockyards Administration (GIPSA) licensing fees.—GIPSA will pass on to the grain industry the costs to develop, review and maintain standards used by the grain industry. In addition, an annual licensing fee would be proposed to cover costs associated with administration of the Packers and Stockyards Act. In 1998 only, annual collections would be offset by $3 million in start-up costs.

Department of Transportation

Federal Railroad Administration railroad safety inspection fee.—Legislation will be proposed to permanently extend the railroad safety inspection fees that were enacted in the Omnibus Budget Reconciliation Act of 1990. The fee would be expanded to cover hours of service and hazardous materials inspections. This fee offsets the costs incurred by the Federal Railroad Administration for inspection, enforcement, and related activities to ensure the safe operation of passenger and freight railroads. The fee expired at the end of 1995.

Surface Transportation Board fees.—The Administration proposes to create a fee mechanism to completely offset the expenses of the Surface Transportation Board (STB), the successor to the Interstate Commerce Commission (ICC). The fees would be collected from those who benefit from the continuation of the ICC functions transferred to the STB, i.e. railroads and shippers.

Department of Veterans Affairs (VA)—Veterans Health Administration

Extend medical care collections.—The Administration proposes to extend three provisions in current law that expire on September 30, 1998. VA will have the authority to: 1) charge third party insurers for service-connected veterans who are treated for their non-service connected conditions, 2) charge copayments and per diems for lower-priority veterans, and 3) extend income verification for first and third party payments. These fees are in conjunction with the Administration's proposal to allow all medical care collections to be used for medical care to improve the health care of veterans. Currently, the mandatory collections are deposited in the Treasury's general fund. Under the Administration's proposal, these offsetting collections would be classified as discretionary and would be available to the extent appropriated.

Social Security Administration (SSA)

State administrative fees.—As part of the Supplemental Security Income Program (SSI), SSA administers State supplemental payments at the State's option. For those states that choose to have SSA administer these payments, the Omnibus Budget Reconciliation Act of 1993 put in place a per payment fee for SSA's services. These offsetting receipts are deposited in the general fund of the Treasury. The current fee is $5.00 per month per payment. The Administration proposes to increase the $5.00 charge to $6.12 in 1998 and to $7.25 in 1999. The fee would be indexed to the CPI thereafter. The additional revenue would be subject to appropriation and will be used to help cover SSA's administrative costs. Under the Administration's proposed new rule, these offsetting collections would be classified as discretionary.

Army Corps of Engineers

Wetlands permit fees.—Legislation will be proposed to increase fees for the issuance of wetlands regulatory permits for commercial activities. The fees would be deposited in a special Treasury account and would be available to be used for the regulatory program to the extent provided in appropriations acts.

Federal Emergency Management Agency (FEMA)

Radiological emergency preparedness fee.—The budget includes a proposal to reauthorize FEMA's assessments on Nuclear Regulatory Commission (NRC) licensees to cover 100 percent of the cost of providing site-specific services that directly contribute to the fulfillment of emergency preparedness requirements needed for NRC licensing. The proposal would extend the authority for 1998.

National Capital Planning Commission (NCPC)

Washington Geographic Information System fees.—Legislation will be proposed to allow the National Capital Planning Commission to charge fees to cover the full costs of providing Washington Geographic Information System (WGIS) products and services to all interested public and private parties beginning in 1998. The WGIS project is a cooperative effort in the National Capital Region to capture, display and analyze geographically-based data. The fees will be credited as offsetting collections to the NCPC discretionary Salaries and Expenses account, and remain available until expended.

Nuclear Regulatory Commission (NRC)

Nuclear Regulatory Commission fees.—Under current law, the NRC must recover 100 percent of its costs from licensing, inspection and annual fees charged to its applicants and licensees through 1998. Unless the law is extended, the fee coverage requirement will revert to 33 percent of NRC costs. The Administration proposes to extend the fees at 100 percent of NRC's cost of operations through 2002. The fees are credited to the NRC expenditure accounts, and spending of the collections is subject to appropriations.

Governmental receipts dedicated to discretionary spending: The following are new or increased fees.

Department of Health and Human Services

Food and Drug Administration (FDA) activities.—The proposal seeks $237 million in reauthorized/new fees including continued collection of Prescription Drug User Fee Act fees and Mammography Quality Standards Act fees, as well as new fees for medical device reviews, animal drug approvals, import inspections, food additive petition reviews, generic/over-the-counter drug applications, and fees for postmarket surveillance of products. These fees will be governmental receipts made available in appropriations acts to fund discretionary spending under the Administration's proposed new rule.

Department of Labor—Employment and Training Administration

Alien labor certification fees.—The proposal would establish a new fee, charged to businesses, for processing of alien labor certification and attestation applications by the Labor Department. The fee proceeds would be used to offset the costs of administering the alien labor program. However, in both 1998 and 1999, regular appropriations of $41 million are required in addition to user fees to work off a large backlog of applications already in the pipeline and created primarily by appropriations cuts in 1996. These fees will be governmental receipts made available in appropriations acts to fund discretionary spending under the Administration's proposed new rule.

Department of Transportation

Coast Guard icebreaking fee.—Legislation will be proposed to establish a user fee, effective in fiscal year 1999, to recover the Coast Guard's costs of providing icebreaking services to commercial maritime carriers in the Great Lakes and the Northeast. Fishing and recreational vessels would be exempt. The fees are estimated to result in collections of approximately $25 million annually. These fees will be governmental receipts made available in appropriations acts to fund discretionary spending under the Administration's proposed new rule.

Federal Aviation Administration (FAA) fees.—In 1998, the budget proposes to collect $300 million in new aviation user fees that will recover from users of FAA's services costs that they do not currently pay under the existing system of aviation excise taxes. This proposal is an interim measure until comprehensive financial reform, based on the work of the White House Commission on Aviation Safety and Security and the National Civil Aviation Review Commission, can be achieved over the next 18 months. Beginning in 1999, the Budget assumes that the existing system of aviation excise taxes will be replaced by cost-based user fees which will be available to meet the FAA's needs. Such user fees are an important element of the Administration's effort to create a more business-like FAA. These fees will be governmental receipts made available in appropriations acts to fund discretionary spending under the Administration's proposed new rule.

National Transportation Safety Board (NTSB)

Accident investigation fees.—To offset a portion of the NTSB's growing cost of commercial aviation accident investigations, a new aviation accident recovery and investigation fee is proposed. This fee, which would be paid by commercial air carriers based on revenue flight hours of operation, would collect an estimated $6 million in 1998. These fees will be governmental receipts made available in appropriations acts to fund discretionary spending under the Administration's proposed new rule.

Existing governmental receipts proposed to fund discretionary spending:

Department of State

Immigration, passport, and other fees.—The Budget proposes to dedicate existing governmental receipts generated by consular activities toward support and improvement of State Department operations.

Machine readable visa fees.—The Budget proposes to correct the classification of existing receipts used to support the State Department's border security program. These fees were previously classified as offsetting collections; they will now be classified as governmental receipts.

Both of these fees will be governmental receipts made available in appropriations acts to fund discretionary spending under the Administration's proposed new rule.

Mandatory: The following new and increased fees are classified as mandatory because they will be included in authorizing legislation.

Department of Agriculture—Agricultural Marketing Service (AMS)

Marketing order fees.—The Administration proposes to authorize local marketing administrators to collect fees to recover AMS' cost of administering commodity marketing orders and agreements. Marketing orders help stabilize market prices for milk, fruit, and other specialty crops by prescribing certain sale, quality, and quantity guidelines. Currently, costs at the local level are financed by assessments on commodity producers and handlers, while costs of these orders at the national level are funded through appropriations. The proposal would increase the existing assessments.

Department of Commerce—Patent and Trademark Office

Extend surcharge on patent fees.—The budget proposes to extend the Patent and Trademark Office's authority to collect the patent surcharge fee through 2002. The current authority expires in 1998. The surcharge fee is paid entirely by patent applicants and holders.

Department of Health and Human Services—Health Care Financing Administration

Medicare survey and certification fee.—Legislation will be proposed to require state survey agencies to impose fees on health care providers for initial surveys required as a condition of participation in the Medicare program. The proposal will authorize states to collect and retain fees from health care providers to cover the cost of the initial surveys. The proceeds are automatically available.

Department of the Interior

Bureau of Land Management

Hardrock mining holding fees.— The proposal would extend beyond 1998, the $100 claim maintenance fee and the $25 location fee established in the 1993 Omnibus Budget Reconciliation Act. As under current law, the fees would also be adjusted annually based on the Consumer Price Index.

Hardrock mining royalty and Abandoned Hardrock Mine Reclamation Fund.— Legislation will be proposed to charge a 5 percent royalty on the net-smelter return from the production of hardrock minerals produced on Federal lands. The royalties collected will be deposited into a new reclamation fund for the environmental restoration of abandoned mine sites on Federal lands.

National Park Service

Hetch Hetchy Dam rental payments.—Legislation will be proposed to raise the annual rental payment for the use of land within Yosemite National Park by the City of San Francisco for a dam and reservoir that supplies drinking water to the City. Receipts (estimated at $600 thousand for 1998) would be available, subject to appropriation, for the annual operations of Yosemite and other national parks in California.

Parks and recreation fees.—Legislation will be proposed to authorize the National Park Service, Fish and Wildlife Service, Bureau of Land Management, and Forest Service to collect additional admission, recreation, and commercial user fees. New receipts will remain available for improvements to facilities and services. This authority would take effect when the existing demonstration fee authority expires at the end of 1999.

Everglades sugar assessment.—Legislation will be proposed to establish a marketing assessment of one cent per pound on processed cane sugar produced in Florida's Everglades Agricultural Area. Receipts will remain available for land acquisition and other activities contributing to Everglades restoration.

Department of Justice/Federal Trade Commission (FTC)

Merger filing fees.—The Administration proposes authorizing legislation to restructure the Hart-Scott-Rodino fee, which is charged to acquiring firms in mergers. The fee partially funds both the Federal Trade Commission and the Justice Department's Antitrust Division, subject to appropriation.

Department of Transportation—Coast Guard

Vessel tonnage fees.—The budget proposes to extend fees collected by the Customs Service based on the cargo-carrying capacity of a vessel entering a U.S. port. These fees were set to expire at the end of 1998. The collections are credited to the Department of Transportation to offset costs incurred by the Coast Guard for services provided to the Merchant Marine industry.

Department of the Treasury—Financial Management Service

Charge to vendors for payment by paper check.—The Administration proposes to authorize the Department of the Treasury to charge for the cost of payments to vendors by paper check. Paper checks are costly to print, mail and replace when lost or stolen. The Federal Government makes over 25 million check payments to vendors annually, or over 80 percent of all payments made for goods and services. The Debt Collection Improvement Act of 1996 mandates phase-in of electronic payments for all Federal payments by 1999, with the exception of tax refunds. This proposal institutes a fee of $1.00 for the cost of providing the service to vendors as determined in regulation by the Secretary of the Treasury. Electronic payment through commercial electronic funds transfer/direct deposit or through the use of payment cards is cheaper, faster, and more secure than payments by paper checks and will involve no charge to the vendor.

Department of Veterans Affairs—Veterans Benefits Administration

Fees for non-veterans in the home loan program.—When VA takes possession of properties resulting from defaulted loans, the homes are ultimately sold to the general public. VA finances these properties through its vendee loan program. The Administration proposes to raise the up-front fees charged on these loans to 2.25 percent—the same level that is charged on Federal Housing Administration loans.

Extend expiring home loan provisions.—The Administration proposes to permanently extend three provisions in current law that expire September 30, 1998. VA charges borrowers using VA's home loan guaranty program a two percent fee instead of 1.25 percent, 2) charges veterans who use the loan guaranty benefit more than once a funding fee of 3 percent to reduce losses, and 3) include expected resale losses when determining whether to acquire a foreclosed property or pay the guaranty.

Federal Deposit Insurance Corporation (FDIC) and Federal Reserve (Fed)

State bank examination fee.—The Administration proposes to require the FDIC and the Federal Reserve to assess fees for examinations of FDIC-insured banks and bank holding companies. The costs of such examinations are currently funded from deposit insurance premiums and Fed earnings from monetary policy activities. The FDIC fee proceeds would be used to finance the examination operation. The Fed proceeds would be transferred to Treasury annually in the form of surplus earnings.

OFFSETTING RECEIPTS

Table 4–3 itemizes all offsetting collections deposited in receipt accounts. These include payments from one part of the Government to another, called intra governmental transactions, and collections from the public.

These receipts are offset (deducted) from outlays in the Federal budget. In total, offsetting receipts are estimated at $368.6 billion in 1998.

Table 4–3. OFFSETTING RECEIPTS BY TYPE

(In millions of dollars)

Source	1996 actual	1997 estimate	1998 estimate
INTRAGOVERNMENTAL TRANSACTIONS			
On-budget receipts:			
Federal intrafund transactions:			
Distributed by agency:			
Interest from the Federal Financing Bank	6,458	4,351	3,958
Interest on Government capital in enterprises	1,815	1,442	1,581
Proposed Legislation (non-PAYGO)	.....	157	.....
Other	1,257	1,351	1,430
Total Federal intrafunds	9,530	7,301	6,969
Trust intrafund transactions:			
Distributed by agency:			
Payments to railroad retirement	3,556	3,817	3,887
Other	1	1	1
Total trust intrafunds	3,557	3,818	3,888
Total intrafund transactions	13,087	11,119	10,857
Interfund transactions:			
Distributed by agency:			
Federal fund payments to trust funds:			
Contributions to insurance programs:			
Military retirement fund	10,699	15,151	15,833
Supplementary medical insurance	61,702	59,354	63,416
Proposed Legislation (non-PAYGO)	.....	.....	14,668
Hospital insurance	4,623	4,833	4,572
Railroad social security equivalent fund	46	60	61
Rail industry pension fund	181	186	195
Civilian supplementary retirement contributions	20,382	21,215	21,587
Proposed Legislation (non-PAYGO)	.....	.....	–23
Unemployment insurance	438	612	604
Other contributions	528	440	377
Miscellaneous payments	464	725	712
Subtotal	99,063	102,576	122,002
Trust fund payments to Federal funds:			
Quinquennial adjustment for military service credits	332	.....	.....
Other	3,380	1,013	1,035
Proposed Legislation (non-PAYGO)	.....	.....	53
Subtotal	3,712	1,013	1,088
Total interfunds distributed by agency	102,775	103,589	123,090
Undistributed by agency:			
Employer share, employee retirement (on-budget) [1]:			
Civil service retirement and disability insurance	7,880	8,187	8,413
Proposed Legislation (non-PAYGO)	.....	.....	621
CSRDI from Postal Service	5,712	5,916	6,103
Hospital insurance (contribution as employer) [2]	1,860	1,875	2,007
Postal employer contributions to FHI	522	595	618
Military retirement fund	11,174	11,180	10,544
Other Federal employees retirement	111	116	122
Total employer share, employee retirement (on-budget)	27,259	27,869	28,428
Interest received by on-budget trust funds	60,869	62,812	63,002
Proposed Legislation (non-PAYGO)	.....	.....	744

Table 4–3. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	1996 actual	1997 estimate	1998 estimate
Total interfund transactions undistributed by agency	88,128	90,681	92,174
Total interfund transactions	190,903	194,270	215,264
Total on-budget intragovernmental receipts	203,990	205,389	226,121
Off-budget receipts:			
Interfund transactions:			
Distributed by agency:			
Federal fund payments to trust funds:			
Old-age, survivors, and disability insurance	6,133	6,927	7,616
Undistributed by agency:			
Employer share, employee retirement (off-budget)	6,278	6,505	7,028
Interest received by off-budget trust funds	36,507	41,238	45,199
Total off-budget intragovernmental receipts:	48,918	54,670	59,843
Total intragovernmental transactions	**252,908**	**260,059**	**285,964**
PROPRIETARY RECEIPTS FROM THE PUBLIC			
Distributed by agency:			
Interest:			
Interest on foreign loans and deferred foreign collections	747	711	647
Interest on deposits in tax and loan accounts	757	736	750
Other interest (domestic—civil) [3]	3,430	4,795	6,153
Total interest	4,934	6,242	7,550
Royalties and rents	1,062	1,231	1,299
Proposed Legislation (PAYGO)	.....	.....	1
Sale of products:			
Sale of timber and other natural land products	567	573	517
Proposed Legislation (PAYGO)	.....	.....	–67
Sale of minerals and mineral products	530	706	289
Sale of power and other utilities	832	840	840
Other	48	39	40
Total sale of products	1,977	2,158	1,619
Fees and other charges for services and special benefits:			
Medicare premiums and other charges (trust funds)	20,038	20,293	21,983
Proposed Legislation (PAYGO)	.....	.....	–211
Nuclear waste disposal revenues	634	649	655
Veterans life insurance (trust funds)	236	256	216
Other [3]	2,004	2,162	2,072
Proposed Legislation (non-PAYGO)	.....	.....	455
Proposed Legislation (PAYGO)	.....	.....	–365
Total fees and other charges	22,912	23,360	24,805
Sale of Government property:			
Sale of land and other real property	106	92	104
Military assistance program sales (trust funds)	14,747	13,760	13,400
Other	6	26	16
Total sale of Government property	14,859	13,878	13,520
Realization upon loans and investments:			
Foreign military credit sales	661	637	535
Negative subsidies and downward reestimates	1,756	2,166	1,881
Proposed Legislation (non-PAYGO)	.....	.....	52
Proposed Legislation (PAYGO)	.....	.....	1,035
Repayment of loans to United Kingdom	106	108	110
Other	158	137	142
Total realization upon loans and investments	2,681	3,048	3,755
Recoveries and refunds [3]	2,059	2,958	3,261
Proposed Legislation (non-PAYGO)	.....	.....	176

Table 4–3. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	1996 actual	1997 estimate	1998 estimate
Proposed Legislation (PAYGO)	.....	.....	555
Miscellaneous receipt accounts [3]	1,633	1,688	1,682
Proposed Legislation (PAYGO)	.....	.....	67
Total proprietary receipts from the public distributed by agency	52,117	54,563	58,290
Undistributed by agency:			
Other interest: Interest received from Outer Continental Shelf escrow account	1	.....	1,142
Rents and royalties on the Outer Continental Shelf:			
Rents and bonuses	691	778	1,095
Royalties	3,050	3,374	3,280
Sale of major assets	.....	.....	4,300
Total proprietary receipts from the public undistributed by agency	3,742	4,152	9,817
Total proprietary receipts from the public [4]	**55,859**	**58,715**	**68,107**
OFFSETTING GOVERNMENTAL RECEIPTS			
Distributed by agency:			
Regulatory fees	2,730	2,821	2,872
Proposed Legislation (non-PAYGO)	.....	.....	67
Proposed Legislation (PAYGO)	.....	.....	70
Other	77	70	67
Undistributed by agency:			
Spectrum auction proceeds	342	7,961	9,359
Proposed Legislation (PAYGO)	.....	.....	2,100
Total offsetting governmental receipts	3,149	10,852	14,535
Total offsetting receipts	**311,916**	**329,626**	**368,606**

[1] Includes provision for covered Federal civilian employees and military personnel.
[2] Interchange receipts between the social security and railroad retirement funds place the social security funds in the same position they would have been if there were no separate railroad retirement system.
[3] Includes both Federal funds and trust funds.
[4] Consists of:

	1996 actual	*1997 estimate*	*1998 estimate*
On-budget:			
Federal funds	19,678	23,325	31,698
Trust funds	36,164	35,371	36,390
Off-budget:			
Trust funds	17	19	19

1998

5. TAX EXPENDITURES

Tax expenditures are revenue losses due to preferential provisions of the Federal tax laws, such as special exclusions, exemptions, deductions, credits, deferrals, or tax rates. They are alternatives to other policy instruments, such as spending or regulatory programs, as means of achieving Federal policy goals. Tax expenditures are created for a variety of reasons, including to encourage certain activities, to improve fairness, to ease compliance with and administration of the tax system, and to reduce certain tax-induced distortions. The Congressional Budget Act of 1974 (Public Law 93–344) requires that a list of tax expenditures be included in the budget.

The largest tax expenditures tend to be associated with the individual income tax. For example, tax preferences are provided for employer contributions for medical insurance, pension contributions and earnings, mortgage interest payments on owner-occupied homes, capital gains transferred at death, and payments of State and local individual income taxes. Tax expenditures under the corporate income tax tend to be related to the rate of cost recovery for various investments; as is discussed below, the extent to which these provisions are classified as tax expenditures varies according to the conceptual baseline used. Charitable contributions and credits for State death taxes are the largest tax expenditures under the unified transfer (i.e., estate and gift) tax.

Because of potential interactions among provisions, this chapter does not present a grand total revenue loss estimate for tax expenditures. Moreover, past tax changes entailing broad elimination of tax expenditures were generally accompanied by changes in tax rates or other basic provisions, so that the net effects on Federal revenues were considerably (if not totally) offset. Nevertheless, in aggregate, tax expenditures have revenue impacts of hundreds of billions of dollars, and are some of the most important ways in which the Federal Government affects economic decisions and social welfare.

While the significant economic impact is self-evident for large provisions, smaller tax expenditures can be important for certain sectors or types of taxpayers. As is discussed later in this chapter, the Administration is developing a framework for analyzing and reporting the economic and other effects of tax expenditures, so that they can be better compared with policy alternatives. Tax expenditures are also discussed in Section VI of the *Budget*, which considers the Federal Government's spending, regulatory, and tax policies across functional areas.

Tax expenditures relating to the individual and corporate income taxes are considered first in this chapter. They are estimated for fiscal years 1996–2002 using three methods of accounting: revenue loss, outlay equivalent, and present value. The present value approach provides estimates of the revenue losses for tax expenditures that involve deferrals of tax payments into the future or have similar long-term effects. Tax expenditures relating to the unified transfer tax are considered in a section at the end of the chapter.

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

The Treasury Department prepared all tax expenditure estimates presented here based upon tax law enacted as of December 31, 1996. The analysis includes new tax expenditures which were enacted this year in the Health Insurance Protection and Accountability Act and the Small Business Job Protection Act of 1996. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 1996.

The total revenue loss estimates for tax expenditures for fiscal years 1996–2002 are displayed by the budget's functional categories in table 5–1. Descriptions of the specific tax expenditure provisions follow the tables of estimates and discussion of general features of the tax expenditure concept.

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

Table 5–2 reports the respective portions of the total revenue losses that arise under the individual and corporate income taxes. Listing revenue loss estimates under the individual and corporate headings does not imply that these categories of filers benefit from the special tax provisions in proportion to the respective tax expenditure amounts shown. Rather, these breakdowns show the specific tax accounts through which the various provisions are cleared. The ultimate beneficiaries of corporate tax expenditures, for example, could be stockholders, employees, customers, or others, depending on the circumstances.

Table 5–3 ranks the major tax expenditures by fiscal year 1998 revenue loss. This table merges several individual entries provided in table 5–1; for example, table 5–3 contains one merged entry for charitable contributions instead of the three separate entries found in table 5–1.

Interpreting Tax Expenditure Estimates

Tax expenditure revenue loss estimates do not necessarily equal the increase in Federal revenues (or the reduction in budget deficits) that would result from repealing the special provisions, for the following reasons:

- *Eliminating a tax expenditure may have incentive effects that alter economic behavior.* These incentives can affect the resulting magnitudes of the formerly subsidized activity or of other tax preferences or Government programs. For example, if deductibility of mortgage interest were limited, some taxpayers would hold smaller mortgages, with a concomitantly smaller effect on the budget than if no such limits were in force.
- *Tax expenditures are interdependent even without incentive effects.* Repeal of a tax expenditure provision can increase or decrease the revenue losses associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the revenue losses from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the revenue loss from other deductions if taxpayers are led to claim the standard deduction instead of itemizing. Similarly, if two provisions were repealed simultaneously, the increase in tax liability could be greater or less than the sum of the two separate tax expenditures, since each is estimated assuming that the other remains in force. In addition, the estimates reported in Table 5–1 are the totals of individual and corporate income tax revenue losses reported in Table 5–2 and do not reflect any possible interactions between the individual and corporate income tax receipts. For this reason, the figures in Table 5–1 (as well as those in Table 5–5, which are also based on summing individual and corporate estimates) should be regarded as approximations.
- *Revenues raised by changes to tax expenditures are sensitive to timing effects and effective dates.* Changes in some provisions would yield their full potential revenue gains relatively quickly, whereas changes to other provisions would only gradually yield their full revenue potential, as certain deductions or exemptions would likely be grandfathered.
- *The annual value of tax expenditures for tax deferrals is reported on a cash basis in all tables except table 5–4.* Cash-based estimates reflect the difference between taxes deferred in the current year and incoming revenues that are received due to deferrals of taxes from prior years. While such estimates are useful as a measure of cash flows into the Government, they do not always accurately reflect the true economic cost of these provisions. For example, for a provision where activity levels have changed, so that incoming tax receipts from past deferrals are greater than deferred receipts from new activity, the cash-basis tax expenditure estimate can be negative, despite the fact that in present-value terms current deferrals do have a real cost to the Government. Alternatively, in the case of a newly enacted deferral provision, a cash-based estimate can overstate the real cost to the Government because the newly deferred taxes will ultimately be received. Present-value estimates, which are a useful supplement to the cash-basis estimates for provisions involving deferrals, are discussed below.
- *Repeal of some provisions could affect overall levels of income and rates of economic growth.* In principle, repeal of major tax provisions may have some impact on the budget economic assumptions. In general, however, most changes in particular provisions are unlikely to have significant macroeconomic effects.

Present-Value Estimates

Discounted present-value estimates of revenue losses are presented in table 5–4 for certain provisions that involve tax deferrals or other long-term revenue effects. These estimates complement the cash-based tax expenditure estimates presented in the other tables.

The present-value estimates represent the revenue losses, net of future tax payments, that follow from activities undertaken during calendar year 1997 which cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 1997 would cause a deferral of tax payments on wages in 1997 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 1997 pension contribution and accrued earnings will be paid out and taxes will be due; these receipts are included in the present-value estimate. In general, this conceptual approach is similar to the one used for reporting the budgetary effects of credit programs, where direct loans and guarantees in a given year affect future cash flows.

TABLE 5–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX

(In millions of dollars)

Provision	Total Revenue Loss							
	1996	1997	1998	1999	2000	2001	2002	1998–2002
National defense:								
Exclusion of benefits and allowances to armed forces personnel	2,060	2,080	2,095	2,120	2,140	2,160	2,180	10,695
International affairs:								
Exclusion of income earned abroad by United States citizens	1,520	1,680	1,865	2,065	2,290	2,545	2,825	11,590
Exclusion of income of foreign sales corporations	1,500	1,600	1,700	1,800	1,900	2,000	2,100	9,500
Inventory property sales source rules exception	1,400	1,500	1,600	1,700	1,800	1,900	2,000	9,000
Deferral of income from controlled foreign corporations (normal tax method)	2,100	2,200	2,400	2,600	2,800	3,000	3,200	14,000
General science, space, and technology:								
Expensing of research and experimentation expenditures (normal tax method)	40	195	430	580	685	740	765	3,200
Credit for increasing research activities	805	685	1,045	250	105	40	5	1,445
Energy:								
Expensing of exploration and development costs, fuels	–210	–130	–40	20	100	75	80	235
Excess of percentage over cost depletion, fuels	1,125	1,145	1,170	1,190	1,205	1,225	1,255	6,045
Alternative fuel production credit	570	600	485	565	535	505	485	2,575
Exception from passive loss limitation for working interests in oil and gas properties	50	50	55	55	60	60	65	295
Capital gains treatment of royalties on coal	15	15	15	20	20	20	20	95
Exclusion of interest on State and local IDBs for energy facilities	315	315	315	315	310	310	310	1,560
Enhanced oil recovery credit	80	85	90	100	105	105	110	510
New technology credit	30	35	40	40	40	45	45	210
Alcohol fuel credit [1]	10	10	10	10	10	10	10	50
Tax credit and deduction for clean-fuel burning vehicles and properties	65	65	75	80	85	90	95	425
Exclusion from income of conservation subsidies provided by public utilities	150	65	15	30	35	45	45	170
Natural resources and environment:								
Expensing of exploration and development costs, nonfuel minerals	35	35	35	35	35	35	35	175
Excess of percentage over cost depletion, nonfuel minerals	285	295	300	305	315	320	325	1,565
Capital gains treatment of iron ore	.....	.....	.....	.....	.....	.....	.....	.....
Special rules for mining reclamation reserves	50	50	50	50	50	50	50	250
Exclusion of interest on State and local IDBs for pollution control and sewage and waste disposal facilities	700	690	675	655	640	600	545	3,115
Capital gains treatment of certain timber income	15	15	15	20	20	20	20	95
Expensing of multiperiod timber growing costs	395	415	440	460	485	505	525	2,415
Investment credit and seven-year amortization for reforestation expenditures	45	50	50	50	50	50	50	250
Tax incentives for preservation of historic structures	125	120	115	115	110	105	105	550
Agriculture:								
Expensing of certain capital outlays	65	65	65	70	70	70	70	345
Expensing of certain multiperiod production costs	80	80	80	85	85	85	85	420
Treatment of loans forgiven solvent farmers as if insolvent	10	10	10	10	10	10	10	50
Capital gains treatment of certain income	165	170	175	180	185	190	195	925
Commerce and housing:								
Financial institutions and insurance:								
Exemption of credit union income	660	700	745	790	835	885	940	4,195
Excess bad debt reserves of financial institutions	90	70	40	15	5	.....	.....	60
Deferral on income on life insurance and annuity contracts	10,525	11,210	11,940	12,715	13,540	14,420	15,360	67,975
Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25
Tax exemption of certain insurance companies	240	245	255	260	280	295	310	1,400
Small life insurance company deduction	110	115	120	130	135	140	145	670
Housing:								
Exclusion of interest on owner-occupied mortgage subsidy bonds	1,765	1,755	1,735	1,715	1,690	1,665	1,640	8,445
Exclusion of interest on State and local debt for rental housing	755	760	755	760	765	760	750	3,790
Deductibility of mortgage interest on owner-occupied homes	47,525	49,820	52,115	54,440	56,830	59,345	62,060	284,790
Deductibility of State and local property tax on owner-occupied homes	15,900	16,670	17,435	18,215	19,015	19,855	20,765	95,285
Deferral of income from post 1987 installment sales	955	975	995	1,015	1,035	1,055	1,075	5,175
Deferral of capital gains on home sales	14,410	14,845	15,290	15,745	16,220	16,705	17,205	81,165
Exclusion of capital gains on home sales for persons age 55 and over	5,225	5,230	5,095	5,515	5,295	5,810	5,495	27,210
Exception from passive loss rules for $25,000 of rental loss	3,950	3,700	3,470	3,260	3,065	2,885	2,715	15,395
Credit for low-income housing investments	2,600	2,840	3,270	3,500	3,595	3,445	3,325	17,135
Accelerated depreciation on rental housing (normal tax method)	1,190	1,350	1,555	1,955	2,335	2,240	2,310	10,395
Commerce:								
Cancellation of indebtedness	70	40	15	.....	–10	–5	–5	–5
Permanent exceptions from imputed interest rules	150	155	155	160	160	160	165	800
Capital gains (other than agriculture, timber, iron ore, and coal) (normal tax method)	7,990	8,230	8,480	8,730	8,995	9,265	9,540	45,010
Capital gains exclusion of small corporation stock	.....	.....	5	20	40	70	95	230
Step-up basis of capital gains at death	29,530	30,715	31,945	33,225	34,555	35,940	37,375	173,040
Carryover basis of capital gains on gifts	140	150	160	170	180	190	200	900
Ordinary income treatment of loss from small business corporation stock sale	35	35	35	35	40	40	40	190

TABLE 5–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

Provision	Total Revenue Loss							
	1996	1997	1998	1999	2000	2001	2002	1998–2002
Accelerated depreciation of buildings other than rental housing (normal tax method)	6,800	5,800	4,660	3,420	2,385	1,640	1,085	13,190
Accelerated depreciation of machinery and equipment (normal tax method)	25,430	27,280	29,285	32,500	35,730	38,325	40,125	175,965
Expensing of certain small investments (normal tax method)	1,440	1,065	900	890	850	700	560	3,900
Amortization of start-up costs (normal tax method)	195	200	205	210	215	220	225	1,075
Graduated corporation income tax rate (normal tax method)	4,435	4,695	4,940	5,125	5,455	5,720	5,925	27,165
Exclusion of interest on small issue IDBs	275	265	260	255	250	250	240	1,255
Treatment of Alaska Native Corporations	20	15	10	5	5	5	.....	25
Transportation:								
Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
Exclusion of reimbursed employee parking expenses	1,250	1,285	1,315	1,350	1,385	1,425	1,470	6,945
Exclusion for employer-provided transit passes	50	60	70	85	100	115	130	500
Community and regional development:								
Investment credit for rehabilitation of structures (other than historic)	80	80	70	70	70	65	65	340
Exclusion of interest on IDBs for airports, docks, and sports and convention facilities	1,980	1,975	1,970	1,915	1,865	1,810	1,760	9,320
Exemption of certain mutuals' and cooperatives' income	60	60	60	65	65	65	70	325
Empowerment zones	530	585	640	670	700	700	530	3,240
Education, training, employment, and social services:								
Education:								
Exclusion of scholarship and fellowship income (normal tax method)	835	845	850	860	870	875	885	4,340
Exclusion of interest on State and local student loan bonds	305	290	280	265	260	250	250	1,305
Exclusion of interest on State and local debt for private nonprofit educational facilities	955	930	895	860	830	800	775	4,160
Exclusion of interest on savings bonds transferred to educational institutions	5	10	10	15	15	15	20	75
Parental personal exemption for students age 19 or over	820	845	885	930	985	1,045	1,090	4,935
Deductibility of charitable contributions (education)	1,865	1,960	2,060	2,165	2,270	2,385	2,500	11,380
Exclusion of employer provided educational assistance	20	575	20	.....	.....	.....	.....	20
Training, employment, and social services:								
Work opportunity tax credit	.....	120	150	85	30	10	.....	275
Exclusion of employer provided child care	775	830	890	955	1,025	1,100	1,180	5,150
Adoption assistance	.....	10	200	320	355	370	365	1,610
Exclusion of employee meals and lodging (other than military)	570	600	630	665	700	735	775	3,505
Credit for child and dependent care expenses	2,580	2,705	2,840	2,985	3,130	3,290	3,455	15,700
Credit for disabled access expenditures	80	85	85	85	90	90	90	440
Expensing of costs of removing certain architectural barriers to the handicapped	20	20	20	20	20	20	20	100
Deductibility of charitable contributions, other than education and health	16,045	16,845	17,680	18,560	19,480	20,445	21,455	97,620
Exclusion of certain foster care payments	30	35	35	35	40	40	45	195
Exclusion of parsonage allowances	295	315	335	360	380	410	435	1,920
Health:								
Exclusion of employer contributions for medical insurance premiums and medical care	64,450	70,460	75,750	81,285	86,900	92,815	98,995	435,745
Medical savings accounts	.....	10	100	190	195	195	200	880
Deductibility of medical expenses	3,675	4,060	4,535	4,895	5,270	5,670	6,100	26,470
Exclusion of interest on State and local debt for private nonprofit health facilities	2,135	2,080	2,005	1,930	1,855	1,790	1,745	9,325
Deductibility of charitable contributions (health)	2,360	2,480	2,600	2,735	2,870	3,005	3,155	14,365
Tax credit for orphan drug research	5	20	10	.....	.....	.....	.....	10
Special Blue Cross/Blue Shield deduction	120	135	95	150	165	200	250	860
Income security:								
Exclusion of railroad retirement system benefits	440	440	450	450	455	455	465	2,275
Exclusion of workmen's compensation benefits	4,695	4,970	5,305	5,550	5,855	6,220	6,660	29,590
Exclusion of public assistance benefits (normal tax method)	500	515	550	575	600	625	655	3,005
Exclusion of special benefits for disabled coal miners	90	90	85	80	75	75	70	385
Exclusion of military disability pensions	130	130	130	130	130	130	130	650
Net exclusion of pension contributions and earnings:								
Employer plans	55,410	55,810	56,245	56,665	57,085	57,510	57,940	285,445
Individual Retirement Accounts	8,025	8,345	8,600	8,880	9,125	9,340	9,520	45,465
Keogh plans	3,030	3,200	3,325	3,500	3,680	3,875	4,080	18,460
Exclusion of employer provided death benefits	35	35	35	40	40	45	45	205
Exclusion of other employee benefits:								
Premiums on group term life insurance	2,495	2,615	2,745	2,880	3,020	3,170	3,325	15,140
Premiums on accident and disability insurance	155	165	175	185	195	205	215	975
Income of trusts to finance supplementary unemployment benefits	20	20	20	20	20	20	20	100
Special ESOP rules	905	735	720	740	760	790	820	3,830
Additional deduction for the blind	25	25	25	30	30	30	30	145
Additional deduction for the elderly	1,470	1,485	1,495	1,500	1,510	1,515	1,515	7,535
Tax credit for the elderly and disabled	45	50	50	50	50	50	50	250
Deductibility of casualty losses	460	485	510	535	560	590	620	2,815
Earned income credit [2]	5,097	5,653	5,814	6,112	6,319	6,621	6,859	31,725

TABLE 5–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

Provision	Total Revenue Loss							
	1996	1997	1998	1999	2000	2001	2002	1998–2002
Social Security:								
Exclusion of social security benefits:								
OASI benefits for retired workers	17,005	17,810	18,495	19,290	20,190	20,875	21,495	100,345
Disability insurance benefits	2,090	2,375	2,615	2,820	3,045	3,290	3,545	15,315
Benefits for dependents and survivors	3,795	3,985	4,175	4,355	4,530	4,710	4,895	22,665
Veterans benefits and services:								
Exclusion of veterans disability compensation	2,615	2,770	2,930	3,100	3,280	3,470	3,675	16,455
Exclusion of veterans pensions	70	70	70	70	75	80	85	380
Exclusion of GI bill benefits	50	60	70	80	90	95	100	435
Exclusion of interest on State and local debt for veterans housing	40	40	35	35	35	35	35	175
General purpose fiscal assistance:								
Exclusion of interest on public purpose State and local debt	15,720	15,800	15,735	15,595	15,445	15,300	15,170	77,245
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	28,265	29,630	30,995	32,375	33,800	35,290	36,910	169,370
Tax credit for corporations receiving income from doing business in U.S. possessions	2,760	2,700	2,770	2,800	2,885	2,970	3,060	14,485
Interest:								
Deferral of interest on savings bonds	1,300	1,290	1,285	1,270	1,215	1,170	1,155	6,095
Addendum—Aid to State and local governments:								
Deductibility of:								
Property taxes on owner-occupied homes	15,900	16,670	17,435	18,215	19,015	19,855	20,765	95,285
Nonbusiness State and local taxes other than on owner-occupied homes	28,265	29,630	30,995	32,375	33,800	35,290	36,910	169,370
Exclusion of interest on:								
Public purpose State and local debt	15,720	15,800	15,735	15,595	15,445	15,300	15,170	77,245
IDBs for certain energy facilities	315	315	315	315	310	310	310	1,560
IDBs for pollution control and sewage and waste disposal facilities	700	690	675	655	640	600	545	3,115
Small-issue IDBs	275	265	260	255	250	250	240	1,255
Owner-occupied mortgage revenue bonds	1,765	1,755	1,735	1,715	1,690	1,665	1,640	8,445
State and local debt for rental housing	755	760	755	760	765	760	750	3,790
IDBs for airports, docks, and sports and convention facilities	1,980	1,975	1,970	1,915	1,865	1,810	1,760	9,320
State and local student loan bonds	305	290	280	265	260	250	250	1,305
State and local debt for private nonprofit educational facilities	955	930	895	860	830	800	775	4,160
State and local debt for private nonprofit health facilities	2,135	2,080	2,005	1,930	1,855	1,790	1,745	9,325
State and local debt for veterans housing	40	40	35	35	35	35	35	175

[1] In addition alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 1996 $670; 1997 $670; 1998 $700; 1999 $740; 2000 $770; 2001 $800; and 2002 $840.

[2] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1996 $19,159; 1997 $21,163; 1998 $21,983; 1999 $22,864; 2000 $23,818; 2001 $24,634; and 2002 $25,518.

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

All estimates have been rounded to the nearest $5 million.

Figures in table 5–1 are the arithmetic sums of corporate and individual income tax revenue loss estimates from table 5–2, and do not reflect possible interactions across these two taxes.

TABLE 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES

(In millions of dollars)

Provision	Revenue Loss													
	Corporations							Individuals						
	1996	1997	1998	1999	2000	2001	2002	1996	1997	1998	1999	2000	2001	2002
National defense:														
Exclusion of benefits and allowances to armed forces personnel	—	—	—	—	—	—	—	2,060	2,080	2,095	2,120	2,140	2,160	2,180
International affairs:														
Exclusion of income earned abroad by United States citizens	—	—	—	—	—	—	—	1,520	1,680	1,865	2,065	2,290	2,545	2,825
Exclusion of income of foreign sales corporations	1,500	1,600	1,700	1,800	1,900	2,000	2,100	—	—	—	—	—	—	—
Inventory property sales source rules exception	1,400	1,500	1,600	1,700	1,800	1,900	2,000	—	—	—	—	—	—	—
Deferral of income from controlled foreign corporations (normal tax method)	2,100	2,200	2,400	2,600	2,800	3,000	3,200	—	—	—	—	—	—	—
General science, space, and technology:														
Expensing of research and experimentation expenditures (normal tax method)	40	190	420	570	670	725	750	.....	5	10	10	15	15	15
Credit for increasing research activities	790	670	1,035	250	105	40	5	15	15	10	.....	.....	.....	.....
Energy:														
Expensing of exploration and development costs, fuels	–155	–95	–30	15	80	55	60	–55	–35	–10	5	20	20	20
Excess of percentage over cost depletion, fuels	845	860	875	890	905	920	940	280	285	295	300	300	305	315
Alternative fuel production credit	535	565	450	535	505	475	455	35	35	35	30	30	30	30
Exception from passive loss limitation for working interests in oil and gas properties	—	—	—	—	—	—	—	50	50	55	55	60	60	65
Capital gains treatment of royalties on coal	—	—	—	—	—	—	—	15	15	15	20	20	20	20
Exclusion of interest on State and local IDBs for energy facilities	125	125	125	125	125	125	125	190	190	190	190	185	185	185
Enhanced oil recovery credit	75	80	85	90	95	95	100	5	5	5	10	10	10	10
New technology credit	30	35	40	40	40	45	45	.....	.....	.....	.....	.....	.....	.....
Alcohol fuel credit [1]	5	5	5	5	5	5	5	5	5	5	5	5	5	5
Tax credit and deduction for clean-fuel burning vehicles and properties	55	55	60	60	60	65	70	10	10	15	20	25	25	25
Exclusion from income of conservation subsidies provided by public utilities	100	10	–45	–35	–30	–25	–25	50	55	60	65	65	70	70
Natural resources and environment:														
Expensing of exploration and development costs, nonfuel minerals	25	25	25	25	25	25	25	10	10	10	10	10	10	10
Excess of percentage over cost depletion, nonfuel minerals	215	220	225	230	235	240	245	70	75	75	75	80	80	80
Capital gains treatment of iron ore	—	—	—	—	—	—	—	.....	.....	.....	.....	.....	.....	.....
Special rules for mining reclamation reserves	45	45	45	45	45	45	45	5	5	5	5	5	5	5
Exclusion of interest on State and local IDBs for pollution control and sewage and waste disposal facilities	280	275	270	260	255	235	215	420	415	405	395	385	365	330
Capital gains treatment of certain timber income	—	—	—	—	—	—	—	15	15	15	20	20	20	20
Expensing of multiperiod timber growing costs	225	235	250	260	275	285	295	170	180	190	200	210	220	230
Investment credit and seven-year amortization for reforestation expenditures	20	20	20	20	20	20	20	25	30	30	30	30	30	30
Tax incentives for preservation of historic structures	25	25	25	25	20	20	20	100	95	90	90	90	85	85
Agriculture:														
Expensing of certain capital outlays	10	10	10	10	10	10	10	55	55	55	60	60	60	60
Expensing of certain multiperiod production costs	10	10	10	10	10	10	10	70	70	70	75	75	75	75
Treatment of loans forgiven solvent farmers as if insolvent	—	—	—	—	—	—	—	10	10	10	10	10	10	10
Capital gains treatment of certain income	—	—	—	—	—	—	—	165	170	175	180	185	190	195
Commerce and housing:														
Financial institutions and insurance:														
Exemption of credit union income	660	700	745	790	835	885	940	—	—	—	—	—	—	—
Excess bad debt reserves of financial institutions	90	70	40	15	5	.....	.....	—	—	—	—	—	—	—
Deferral on income on life insurance and annuity contracts	325	345	370	395	420	445	475	10,200	10,865	11,570	12,320	13,120	13,975	14,885
Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	—	—	—	—	—	—	—
Tax exemption of certain insurance companies	240	245	255	260	280	295	310	—	—	—	—	—	—	—
Small life insurance company deduction	110	115	120	130	135	140	145	—	—	—	—	—	—	—
Housing:														
Exclusion of interest on owner-occupied mortgage subsidy bonds	705	700	690	685	675	665	655	1,060	1,055	1,045	1,030	1,015	1,000	985
Exclusion of interest on State and local debt for rental housing	300	305	300	305	305	305	300	455	455	455	455	460	455	450
Deductibility of mortgage interest on owner-occupied homes	—	—	—	—	—	—	—	47,525	49,820	52,115	54,440	56,830	59,345	62,060
Deductibility of State and local property tax on owner-occupied homes	—	—	—	—	—	—	—	15,900	16,670	17,435	18,215	19,015	19,855	20,765
Deferral of income from post 1987 installment sales	245	250	255	260	265	270	275	710	725	740	755	770	785	800
Deferral of capital gains on home sales	—	—	—	—	—	—	—	14,410	14,845	15,290	15,745	16,220	16,705	17,205
Exclusion of capital gains on home sales for persons age 55 and over	—	—	—	—	—	—	—	5,225	5,230	5,095	5,515	5,295	5,810	5,495
Exception from passive loss rules for $25,000 of rental loss	—	—	—	—	—	—	—	3,950	3,700	3,470	3,260	3,065	2,885	2,715
Credit for low-income housing investments	520	570	655	700	720	690	665	2,080	2,270	2,615	2,800	2,875	2,755	2,660
Accelerated depreciation on rental housing (normal tax method)	750	855	1,005	1,340	1,650	1,500	1,515	440	495	550	615	685	740	795
Commerce:														
Cancellation of indebtedness	—	—	—	—	—	—	—	70	40	15	.....	–10	–5	–5

TABLE 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

Provision	Revenue Loss													
	Corporations							Individuals						
	1996	1997	1998	1999	2000	2001	2002	1996	1997	1998	1999	2000	2001	2002
Permanent exceptions from imputed interest rules	—	—	—	—	—	—	—	150	155	155	160	160	160	165
Capital gains (other than agriculture, timber, iron ore, and coal) (normal tax method)	—	—	—	—	—	—	—	7,990	8,230	8,480	8,730	8,995	9,265	9,540
Capital gains exclusion of small corporation stock	—	—	—	—	—	—	—	.....	.....	5	20	40	70	95
Step-up basis of capital gains at death	—	—	—	—	—	—	—	29,530	30,715	31,945	33,225	34,555	35,940	37,375
Carryover basis of capital gains on gifts	—	—	—	—	—	—	—	140	150	160	170	180	190	200
Ordinary income treatment of loss from small business corporation stock sale	—	—	—	—	—	—	—	35	35	35	35	40	40	40
Accelerated depreciation of buildings other than rental housing (normal tax method)	4,780	4,070	3,260	2,385	1,695	1,185	800	2,020	1,730	1,400	1,035	690	455	285
Accelerated depreciation of machinery and equipment (normal tax method)	20,195	21,510	23,055	25,510	27,980	29,625	31,080	5,235	5,770	6,230	6,990	7,750	8,700	9,045
Expensing of certain small investments (normal tax method)	875	655	575	580	560	470	385	565	410	325	310	290	230	175
Amortization of start-up costs (normal tax method)	90	95	95	100	100	105	105	105	105	110	110	115	115	120
Graduated corporation income tax rate (normal tax method)	4,435	4,695	4,940	5,125	5,455	5,720	5,925	—	—	—	—	—	—	—
Exclusion of interest on small issue IDBs	110	105	105	100	100	100	95	165	160	155	155	150	150	145
Treatment of Alaska Native Corporations	20	15	10	5	5	5	.....	—	—	—	—	—	—	—
Transportation:														
Deferral of tax on shipping companies	20	20	20	20	20	20	20	—	—	—	—	—	—	—
Exclusion of reimbursed employee parking expenses	—	—	—	—	—	—	—	1,250	1,285	1,315	1,350	1,385	1,425	1,470
Exclusion for employer-provided transit passes	—	—	—	—	—	—	—	50	60	70	85	100	115	130
Community and regional development:														
Investment credit for rehabilitation of structures (other than historic)	15	15	15	15	15	15	15	65	65	55	55	55	50	50
Exclusion of interest on IDBs for airports, docks, and sports and convention facilities	790	790	785	760	740	720	700	1,190	1,185	1,185	1,155	1,125	1,090	1,060
Exemption of certain mutuals' and cooperatives' income	60	60	60	65	65	65	70	—	—	—	—	—	—	—
Empowerment zones	500	550	600	625	650	650	490	30	35	40	45	50	50	40
Education, training, employment, and social services:														
Education:														
Exclusion of scholarship and fellowship income (normal tax method)	—	—	—	—	—	—	—	835	845	850	860	870	875	885
Exclusion of interest on State and local student loan bonds	120	115	110	105	105	100	100	185	175	170	160	155	150	150
Exclusion of interest on State and local debt for private nonprofit educational facilities	380	370	355	340	330	320	310	575	560	540	520	500	480	465
Exclusion of interest on savings bonds transferred to educational institutions	—	—	—	—	—	—	—	5	10	10	15	15	15	20
Parental personal exemption for students age 19 or over	—	—	—	—	—	—	—	820	845	885	930	985	1,045	1,090
Deductibility of charitable contributions (education)	180	190	200	210	220	230	240	1,685	1,770	1,860	1,955	2,050	2,155	2,260
Exclusion of employer provided educational assistance	—	—	—	—	—	—	—	20	575	20	.....	.....	.....	.....
Training, employment, and social services:														
Work opportunity tax credit	.....	100	130	70	25	10	.....	.....	20	20	15	5	.....	.....
Exclusion of employer provided child care	—	—	—	—	—	—	—	775	830	890	955	1,025	1,100	1,180
Adoption assistance	—	—	—	—	—	—	—	.....	10	200	320	355	370	365
Exclusion of employee meals and lodging (other than military)	—	—	—	—	—	—	—	570	600	630	665	700	735	775
Credit for child and dependent care expenses	—	—	—	—	—	—	—	2,580	2,705	2,840	2,985	3,130	3,290	3,455
Credit for disabled access expenditures	50	50	50	50	55	55	55	30	35	35	35	35	35	35
Expensing of costs of removing certain architectural barriers to the handicapped	15	15	15	15	15	15	15	5	5	5	5	5	5	5
Deductibility of charitable contributions, other than education and health	670	700	730	760	790	820	850	15,375	16,145	16,950	17,800	18,690	19,625	20,605
Exclusion of certain foster care payments	—	—	—	—	—	—	—	30	35	35	35	40	40	45
Exclusion of parsonage allowances	—	—	—	—	—	—	—	295	315	335	360	380	410	435
Health:														
Exclusion of employer contributions for medical insurance premiums and medical care	—	—	—	—	—	—	—	64,450	70,460	75,750	81,285	86,900	92,815	98,995
Medical savings accounts	—	—	—	—	—	—	—	.....	10	100	190	195	195	200
Deductibility of medical expenses	—	—	—	—	—	—	—	3,675	4,060	4,535	4,895	5,270	5,670	6,100
Exclusion of interest on State and local debt for private nonprofit health facilities	850	825	795	765	735	710	695	1,285	1,255	1,210	1,165	1,120	1,080	1,050
Deductibility of charitable contributions (health)	640	675	705	745	780	810	850	1,720	1,805	1,895	1,990	2,090	2,195	2,305
Tax credit for orphan drug research	5	20	10	.....	.....	.....	.....	—	—	—	—	—	—	—
Special Blue Cross/Blue Shield deduction	120	135	95	150	165	200	250	—	—	—	—	—	—	—
Income security:														
Exclusion of railroad retirement system benefits	—	—	—	—	—	—	—	440	440	450	450	455	455	465
Exclusion of workmen's compensation benefits	—	—	—	—	—	—	—	4,695	4,970	5,305	5,550	5,855	6,220	6,660
Exclusion of public assistance benefits (normal tax method)	—	—	—	—	—	—	—	500	515	550	575	600	625	655

TABLE 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

Provision	Revenue Loss													
	Corporations							Individuals						
	1996	1997	1998	1999	2000	2001	2002	1996	1997	1998	1999	2000	2001	2002
Exclusion of special benefits for disabled coal miners	—	—	—	—	—	—	—	90	90	85	80	75	75	70
Exclusion of military disability pensions	—	—	—	—	—	—	—	130	130	130	130	130	130	130
Net exclusion of pension contributions and earnings:														
Employer plans	—	—	—	—	—	—	—	55,410	55,810	56,245	56,665	57,085	57,510	57,940
Individual Retirement Accounts	—	—	—	—	—	—	—	8,025	8,345	8,600	8,880	9,125	9,340	9,520
Keogh plans	—	—	—	—	—	—	—	3,030	3,200	3,325	3,500	3,680	3,875	4,080
Exclusion of employer provided death benefits	—	—	—	—	—	—	—	35	35	35	40	40	45	45
Exclusion of other employee benefits:														
Premiums on group term life insurance	—	—	—	—	—	—	—	2,495	2,615	2,745	2,880	3,020	3,170	3,325
Premiums on accident and disability insurance	—	—	—	—	—	—	—	155	165	175	185	195	205	215
Income of trusts to finance supplementary unemployment benefits	—	—	—	—	—	—	—	20	20	20	20	20	20	20
Special ESOP rules	845	675	660	680	700	730	760	60	60	60	60	60	60	60
Additional deduction for the blind	—	—	—	—	—	—	—	25	25	25	30	30	30	30
Additional deduction for the elderly	—	—	—	—	—	—	—	1,470	1,485	1,495	1,500	1,510	1,515	1,515
Tax credit for the elderly and disabled	—	—	—	—	—	—	—	45	50	50	50	50	50	50
Deductibility of casualty losses	—	—	—	—	—	—	—	460	485	510	535	560	590	620
Earned income credit [2]	—	—	—	—	—	—	—	5,097	5,653	5,814	6,112	6,319	6,621	6,859
Social Security:														
Exclusion of social security benefits:														
OASI benefits for retired workers	—	—	—	—	—	—	—	17,005	17,810	18,495	19,290	20,190	20,875	21,495
Disability insurance benefits	—	—	—	—	—	—	—	2,090	2,375	2,615	2,820	3,045	3,290	3,545
Benefits for dependents and survivors	—	—	—	—	—	—	—	3,795	3,985	4,175	4,355	4,530	4,710	4,895
Veterans benefits and services:														
Exclusion of veterans disability compensation	—	—	—	—	—	—	—	2,615	2,770	2,930	3,100	3,280	3,470	3,675
Exclusion of veterans pensions	—	—	—	—	—	—	—	70	70	70	70	75	80	85
Exclusion of GI bill benefits	—	—	—	—	—	—	—	50	60	70	80	90	95	100
Exclusion of interest on State and local debt for veterans housing	15	15	15	15	15	15	15	25	25	20	20	20	20	20
General purpose fiscal assistance:														
Exclusion of interest on public purpose State and local debt	6,290	6,310	6,280	6,220	6,160	6,105	6,055	9,430	9,490	9,455	9,375	9,285	9,195	9,115
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	—	—	—	—	—	—	—	28,265	29,630	30,995	32,375	33,800	35,290	36,910
Tax credit for corporations receiving income from doing business in U.S. possessions	2,760	2,700	2,770	2,800	2,885	2,970	3,060	—	—	—	—	—	—	—
Interest:														
Deferral of interest on savings bonds	—	—	—	—	—	—	—	1,300	1,290	1,285	1,270	1,215	1,170	1,155
Addendum—Aid to State and local governments:														
Deductibility of:														
Property taxes on owner-occupied homes	—	—	—	—	—	—	—	15,900	16,670	17,435	18,215	19,015	19,855	20,765
Nonbusiness State and local taxes other than on owner-occupied homes	—	—	—	—	—	—	—	28,265	29,630	30,995	32,375	33,800	35,290	36,910
Exclusion of interest on:														
Public purpose State and local debt	6,290	6,310	6,280	6,220	6,160	6,105	6,055	9,430	9,490	9,455	9,375	9,285	9,195	9,115
IDBs for certain energy facilities	125	125	125	125	125	125	125	190	190	190	190	185	185	185
IDBs for pollution control and sewage and waste disposal facilities	280	275	270	260	255	235	215	420	415	405	395	385	365	330
Small-issue IDBs	110	105	105	100	100	100	95	165	160	155	155	150	150	145
Owner-occupied mortgage revenue bonds	705	700	690	685	675	665	655	1,060	1,055	1,045	1,030	1,015	1,000	985
State and local debt for rental housing	300	305	300	305	305	305	300	455	455	455	455	460	455	450
IDBs for airports, docks, and sports and convention facilities	790	790	785	760	740	720	700	1,190	1,185	1,185	1,155	1,125	1,090	1,060
State and local student loan bonds	120	115	110	105	105	100	100	185	175	170	160	155	150	150
State and local debt for private nonprofit educational facilities	380	370	355	340	330	320	310	575	560	540	520	500	480	465
State and local debt for private nonprofit health facilities	850	825	795	765	735	710	695	1,285	1,255	1,210	1,165	1,120	1,080	1,050
State and local debt for veterans housing	15	15	15	15	15	15	15	25	25	20	20	20	20	20

[1] In addition alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 1996 $670; 1997 $670; 1998 $700; 1999 $740; 2000 $770; 2001 $800; and 2002 $840.

[2] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1996 $19,159; 1997 $21,163; 1998 $21,983; 1999 $22,864; 2000 $23,818; 2001 $24,634; and 2002 $25,518.

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

All estimates have been rounded to the nearest $5 million.

TABLE 5–3. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 1998 REVENUE LOSS

(In millions of dollars)

Provision	1998	1998–2002
Exclusion of employer contributions for medical insurance premiums and medical care	75,750	435,745
Net exclusion of employer pension-plan contributions and earnings	56,245	285,445
Deductibility of mortgage interest on owner-occupied homes	52,115	284,790
Step-up basis of capital gains at death	31,945	173,040
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	30,995	169,370
Accelerated depreciation of machinery and equipment (normal tax method)	29,285	175,965
Deductibility of charitable contributions	22,340	123,365
Exclusion of OASI benefits for retired workers	18,495	100,345
Deductibility of State and local property tax on owner-occupied homes	17,435	95,285
Exclusion of interest on public purpose State and local debt	15,735	77,245
Deferral of capital gains on home sales	15,290	81,165
Deferral on income on life insurance and annuity contracts	11,940	67,975
Exclusion of interest on State and local debt for various non-public purposes	8,925	42,450
Net exclusion of Individual Retirement Account contributions and earnings	8,600	45,465
Capital gains (other than agriculture, timber, iron ore, and coal) (normal tax method)	8,480	45,010
Earned income credit [1]	5,814	31,725
Exclusion of workmen's compensation benefits	5,305	29,590
Exclusion of capital gains on home sales for persons age 55 and over	5,095	27,210
Graduated corporation income tax rate (normal tax method)	4,940	27,165
Accelerated depreciation of buildings other than rental housing (normal tax method)	4,660	13,190
Deductibility of medical expenses	4,535	26,470
Exclusion of Social Security benefits for dependents and survivors	4,175	22,665
Exception from passive loss rules for $25,000 of rental loss	3,470	15,395
Net exclusion of Keogh plan contributions and earnings	3,325	18,460
Credit for low-income housing investments	3,270	17,135
Exclusion of veterans disability compensation	2,930	16,455
Credit for child and dependent care expenses	2,840	15,700
Tax credit for corporations receiving income from doing business in U.S. possessions	2,770	14,485
Exclusion of employer-provided premiums on group term life insurance	2,745	15,140
Exclusion of Social Security disability insurance benefits	2,615	15,315
Deferral of income from controlled foreign corporations (normal tax method)	2,400	14,000
Exclusion of benefits and allowances to armed forces personnel	2,095	10,695
Exclusion of interest on State and local debt for private nonprofit health facilities	2,005	9,325
Exclusion of income earned abroad by United States citizens	1,865	11,590
Exclusion of income of foreign sales corporations	1,700	9,500
Inventory property sales source rules exception	1,600	9,000
Accelerated depreciation on rental housing (normal tax method)	1,555	10,395
Additional deduction for the elderly	1,495	7,535
Exclusion of reimbursed employee parking expenses	1,315	6,945
Deferral of interest on savings bonds	1,285	6,095
Excess of percentage over cost depletion (fuels)	1,170	6,045
Credit for increasing research activities	1,045	1,445
Deferral of income from post 1987 installment sales	995	5,175
Expensing of certain small investments (normal tax method)	900	3,900
Exclusion of employer provided child care	890	5,150
Parental personal exemption for students age 19 or over	885	4,935
Exclusion of scholarship and fellowship income (normal tax method)	850	4,340
Exemption of credit union income	745	4,195
Special ESOP rules	720	3,830
Empowerment zones	640	3,240
Exclusion of employee meals and lodging (other than military)	630	3,505
Exclusion of public assistance benefits (normal tax method)	550	3,005
Deductibility of casualty losses	510	2,815
Alternative fuel production credit	485	2,575
Exclusion of railroad retirement system benefits	450	2,275
Expensing of multiperiod timber growing costs	440	2,415
Expensing of research and experimentation expenditures (normal tax method)	430	3,200
Exclusion of parsonage allowances	335	1,920
Excess of percentage over cost depletion, nonfuel minerals	300	1,565
Exclusion of interest on small issue IDBs	260	1,255
Tax exemption of certain insurance companies	255	1,400
Amortization of start-up costs (normal tax method)	205	1,075
Adoption assistance	200	1,610
Capital gains treatment of certain income	175	925
Exclusion of employer-provided premiums on accident and disability insurance	175	975
Carryover basis of capital gains on gifts	160	900
Permanent exceptions from imputed interest rules	155	800
Work opportunity tax credit	150	275
Exclusion of military disability pensions	130	650

TABLE 5–3. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 1998 REVENUE LOSS—Continued

(In millions of dollars)

Provision	1998	1998–2002
Small life insurance company deduction	120	670
Tax incentives for preservation of historic structures	115	550
Medical savings accounts	100	880
Special Blue Cross/Blue Shield deduction	95	860
Enhanced oil recovery credit	90	510
Credit for disabled access expenditures	85	440
Exclusion of special benefits for disabled coal miners	85	385
Expensing of certain multiperiod production costs	80	420
Tax credit and deduction for clean-fuel burning vehicles and properties	75	425
Exclusion for employer-provided transit passes	70	500
Investment credit for rehabilitation of structures (other than historic)	70	340
Exclusion of veterans pensions	70	380
Exclusion of GI bill benefits	70	435
Expensing of certain capital outlays	65	345
Exemption of certain mutuals' and cooperatives' income	60	325
Exception from passive loss limitation for working interests in oil and gas properties	55	295
Tax credit for the elderly and disabled	50	250
Special rules for mining reclamation reserves	50	250
Investment credit and seven-year amortization for reforestation expenditures	50	250
Excess bad debt reserves of financial institutions	40	60
New technology credit	40	210
Exclusion of employer provided death benefits	35	205
Ordinary income treatment of loss from small business corporation stock sale	35	190
Exclusion of certain foster care payments	35	195
Expensing of exploration and development costs, nonfuel minerals	35	175
Additional deduction for the blind	25	145
Exclusion of employer provided educational assistance	20	20
Deferral of tax on shipping companies	20	100
Exclusion of income of trusts to finance supplementary unemployment benefits	20	100
Expensing of costs of removing certain architectural barriers to the handicapped	20	100
Exclusion from income of conservation subsidies provided by public utilities	15	170
Cancellation of indebtedness	15	–5
Capital gains treatment of royalties on coal	15	95
Capital gains treatment of certain timber income	15	95
Treatment of Alaska Native Corporations	10	25
Treatment of loans forgiven solvent farmers as if insolvent	10	50
Tax credit for orphan drug research	10	10
Exclusion of interest on savings bonds transferred to educational institutions	10	75
Alcohol fuel credit [2]	10	50
Capital gains exclusion of small corporation stock	5	230
Special alternative tax on small property and casualty insurance companies	5	25
Capital gains treatment of iron ore	.....	.....
Expensing of exploration and development costs (fuels)	–40	235

[1] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1996 $19,159; 1997 $21,163; 1998 $21,983; 1999 $22,864; 2000 $23,818; 2001 $24,634; and 2002 $25,518.

[2] In addition alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 1996 $670; 1997 $670; 1998 $700; 1999 $740; 2000 $770; 2001 $800; and 2002 $840.

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

All estimates have been rounded to the nearest $5 million.

Figures in table 5–3 are the arithmetic sums of corporate and individual income tax revenue loss estimates from table 5-2, and do not reflect possible interactions across these two taxes.

TABLE 5–4. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 1997

(In millions of dollars)

Provision	Present Value of Revenue Loss
Deferral of income from controlled foreign corporations (normal tax method)	2,150
Expensing of research and experimentation expenditures (normal tax method)	1,610
Expensing of exploration and development costs—fuels	205
Expensing of exploration and development costs—nonfuels	60
Expensing of multiperiod timber growing costs	140
Expensing of certain multiperiod production costs—agriculture	85
Expensing of certain capital outlays—agriculture	70
Deferral of income on life insurance and annuity contracts	18,700
Deferral of capital gains on home sales	14,630
Credit for low-income housing investments	3,150
Accelerated depreciation of rental housing (normal tax method)	2,025
Accelerated depreciation of buildings other than rental housing (normal tax method)	420
Accelerated depreciation of machinery and equipment (normal tax method)	29,830
Expensing of certain small investments (normal tax method)	1,050
Amortization of start-up costs (normal tax method)	170
Deferral of tax on shipping companies	10
Exclusion of pension contributions and earnings—employer plans	54,060
Exclusion of IRA contributions and earnings	2,175
Exclusions of contribution and earnings for Keogh plans	3,220
Exclusion of interest on State and local public-purpose bonds	17,535
Exclusion of interest on State and local non-public purpose bonds	8,925
Deferral of interest on U.S. savings bonds	210

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

Outlay Equivalents

The concept of "outlay equivalents" complements "revenue losses" as a measure of the budget effect of tax expenditures. It is the amount of outlay that would be required to provide the taxpayer the same after-tax income as would be received through the tax preference. The outlay equivalent measure allows a comparison of the cost of the tax expenditure with that of a direct Federal outlay. Outlay equivalents are reported in table 5–5.

The measure is larger than the revenue loss estimate when the tax expenditure is judged to function as a Government payment for service. This occurs because an outlay program would increase the taxpayer's pre-tax income. For some tax expenditures, however, the revenue loss equals the outlay equivalent measure. This occurs when the tax expenditure is judged to function like a price reduction or tax deferral that does not directly enter the taxpayer's pre-tax income.[1]

[1] Budget outlay figures generally reflect the pre-tax price of the resources. In some instances, however, Government purchases or subsidies are exempted from tax by a special tax provision. When this occurs, the outlay figure understates the resource cost of the program and is, therefore, not comparable with other outlay amounts. For example, the outlays for certain military personnel allowances are not taxed. If this form of compensation were treated as part of the employee's taxable income, the Defense Department would have to make larger cash payments to its military personnel to leave them as well off after tax as they are now. The tax subsidy must be added to the tax-exempt budget outlay to make this element of national defense expenditures comparable with other outlays.

TABLE 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX

(In millions of dollars)

Provision	Outlay Equivalents							
	1996	1997	1998	1999	2000	2001	2002	1998–2002
National defense:								
Exclusion of benefits and allowances to armed forces personnel	2,405	2,425	2,445	2,470	2,495	2,520	2,545	12,475
International affairs:								
Exclusion of income earned abroad by United States citizens	2,025	2,240	2,485	2,755	3,055	3,390	3,770	15,455
Exclusion of income of foreign sales corporations	2,310	2,460	2,615	2,770	2,925	3,075	3,230	14,615
Inventory property sales source rules exception	2,155	2,310	2,460	2,615	2,770	2,925	3,075	13,845
Deferral of income from controlled foreign corporations (normal tax method)	2,100	2,200	2,400	2,600	2,800	3,000	3,200	14,000
General science, space, and technology:								
Expensing of research and experimentation expenditures (normal tax method)	40	195	430	580	685	740	765	3,200
Credit for increasing research activities	1,245	1,055	1,610	380	160	60	10	2,220
Energy:								
Expensing of exploration and development costs, fuels	–210	–130	–40	20	100	75	80	235
Excess of percentage over cost depletion, fuels	1,580	1,620	1,640	1,675	2,705	1,730	1,765	8,515
Alternative fuel production credit	800	795	845	795	755	715	685	3,795
Exception from passive loss limitation for working interests in oil and gas properties	50	50	55	55	60	60	65	295
Capital gains treatment of royalties on coal	20	20	20	25	25	25	25	120
Exclusion of interest on State and local IDBs for energy facilities	420	420	415	415	410	405	400	2,045
New technology credit	40	50	55	60	60	60	65	300
Alcohol fuel credit [1]	10	10	10	10	10	10	10	50
Tax credit and deduction for clean-fuel burning vehicles and properties	90	95	105	110	120	125	130	590
Exclusion from income of conservation subsidies provided by public utilities	210	95	25	40	55	60	65	245
Natural resources and environment:								
Expensing of exploration and development costs, nonfuel minerals	35	35	35	35	35	35	35	175
Excess of percentage over cost depletion, nonfuel minerals	405	415	425	435	440	455	460	2,215
Capital gains treatment of iron ore	.....	.....	.....	.....	.....	.....	.....	.....
Special rules for mining reclamation reserves	50	50	50	50	50	50	50	250
Exclusion of interest on State and local IDBs for pollution control and sewage and waste disposal facilities	925	900	870	845	815	755	675	3,960
Capital gains treatment of certain timber income	20	20	20	25	25	25	25	120
Expensing of multiperiod timber growing costs	395	415	440	460	485	505	525	2,415
Investment credit and seven-year amortization for reforestation expenditures	65	65	75	75	75	75	75	375
Tax incentives for preservation of historic structures	125	120	115	115	110	105	105	550
Agriculture:								
Expensing of certain capital outlays	65	65	65	70	70	70	70	345
Expensing of certain multiperiod production costs	80	80	80	85	85	85	85	420
Treatment of loans forgiven solvent farmers as if insolvent	10	10	10	10	10	10	10	50
Capital gains treatment of certain income	220	225	235	240	245	255	260	1,235
Commerce and housing:								
Financial institutions and insurance:								
Exemption of credit union income	840	895	945	1,005	1,065	1,130	1,200	5,345
Excess bad debt reserves of financial institutions	90	70	40	15	5	.....	.....	60
Deferral on income on life insurance and annuity contracts	10,525	11,210	11,940	12,715	13,540	14,420	15,360	67,975
Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25
Tax exemption of certain insurance companies	315	320	335	340	370	390	405	1,840
Small life insurance company deduction	145	150	160	170	175	185	190	880
Housing:								
Exclusion of interest on owner-occupied mortgage subsidy bonds	2,305	2,265	2,230	2,190	2,150	2,110	2,070	10,750
Exclusion of interest on State and local debt for rental housing	990	985	980	985	990	980	970	4,905
Deductibility of mortgage interest on owner-occupied homes	47,525	49,820	52,115	54,440	56,830	59,345	62,060	284,790
Deductibility of State and local property tax on owner-occupied homes	15,900	16,670	17,435	18,215	19,015	19,855	20,765	95,285
Deferral of income from post 1987 installment sales	955	975	995	1,015	1,035	1,055	1,075	5,175
Deferral of capital gains on home sales	14,410	14,845	15,290	15,745	16,220	16,705	17,205	81,165
Exclusion of capital gains on home sales for persons age 55 and over	6,965	6,975	6,795	7,355	7,060	7,745	7,325	36,280
Exception from passive loss rules for $25,000 of rental loss	3,950	3,700	3,470	3,260	3,065	2,885	2,715	15,395
Credit for low-income housing investments	2,660	2,945	3,270	3,500	3,595	3,445	3,325	17,135
Accelerated depreciation on rental housing (normal tax method)	1,190	1,350	1,560	1,955	2,340	2,240	2,310	10,405
Commerce:								
Cancellation of indebtedness	70	40	15	.....	–10	–5	–5	–5
Permanent exceptions from imputed interest rules	150	155	155	160	160	160	165	800
Capital gains (other than agriculture, timber, iron ore, and coal)	10,655	10,975	11,295	11,640	11,995	12,355	12,720	60,005
Capital gains exclusion of small corporation stock	.....	.....	5	25	55	95	125	305
Step-up basis of capital gains at death	39,375	40,955	42,595	44,300	46,075	47,920	49,835	230,725
Carryover basis of capital gains on gifts	140	150	160	170	180	190	200	900
Ordinary income treatment of loss from small business corporation stock sale	45	45	50	50	55	55	55	265
Accelerated depreciation of buildings other than rental housing (normal tax method)	6,800	5,795	4,655	3,420	2,380	1,640	1,085	13,180
Accelerated depreciation of machinery and equipment (normal tax method)	25,430	27,280	29,285	32,500	35,730	38,320	40,125	175,960

TABLE 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

Provision	Outlay Equivalents							
	1996	1997	1998	1999	2000	2001	2002	1998–2002
Expensing of certain small investments (normal tax method)	1,435	1,065	900	890	845	700	560	3,895
Amortization of start-up costs (normal tax method)	195	200	205	210	215	220	225	1,075
Graduated corporation income tax rate (normal tax method)	5,995	6,345	6,675	6,925	7,370	7,730	8,005	36,705
Exclusion of interest on small issue IDBs	335	310	300	290	285	275	270	1,420
Treatment of Alaska Native Corporations	20	15	10	5	5	5	.....	25
Transportation:								
Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
Exclusion of reimbursed employee parking expenses	1,625	1,670	1,715	1,755	1,805	1,855	1,910	9,040
Exclusion for employer-provided transit passes	65	80	100	115	135	155	180	685
Community and regional development:								
Investment credit for rehabilitation of structures (other than historic)	80	80	70	70	70	65	65	340
Exclusion of interest on IDBs for airports, docks, and sports and convention facilities	2,570	2,550	2,525	2,445	2,360	2,280	2,200	11,810
Exemption of certain mutuals' and cooperatives' income	60	60	60	65	65	65	70	325
Empowerment zones	530	585	640	670	700	700	530	3,240
Education, training, employment, and social services:								
Education:								
Exclusion of scholarship and fellowship income (normal tax method)	915	925	935	945	955	965	980	4,780
Exclusion of interest on State and local student loan bonds	380	360	335	320	305	295	290	1,545
Exclusion of interest on State and local debt for private nonprofit educational facilities	1,225	1,175	1,120	1,065	1,015	970	935	5,105
Exclusion of interest on savings bonds transferred to educational institutions	5	10	10	15	15	15	20	75
Parental personal exemption for students age 19 or over	910	935	980	1,030	1,090	1,155	1,205	5,460
Deductibility of charitable contributions (education)	2,480	2,605	2,730	2,870	3,000	3,155	3,295	15,050
Exclusion of employer provided educational assistance	25	710	25	.....	.....	.....	.....	25
Training, employment, and social services:								
Work opportunity tax credit	.....	120	150	85	30	10	.....	275
Exclusion of employer provided child care	1,035	1,105	1,185	1,275	1,365	1,465	1,575	6,865
Adoption assistance	.....	10	240	385	430	450	435	1,940
Exclusion of employee meals and lodging (other than military)	695	730	770	810	855	900	950	4,285
Credit for child and dependent care expenses	3,440	3,605	3,785	3,980	4,175	4,385	4,605	20,930
Credit for disabled access expenditures	105	115	115	115	120	120	120	590
Expensing of costs of removing certain architectural barriers to the handicapped	20	20	20	20	20	20	20	100
Deductibility of charitable contributions, other than education and health	27,365	28,740	30,185	31,735	33,305	34,965	36,365	166,555
Exclusion of certain foster care payments	40	40	45	45	50	50	55	245
Exclusion of parsonage allowances	365	390	415	440	470	505	540	2,370
Health:								
Exclusion of employer contributions for medical insurance premiums and medical care	82,200	90,035	96,950	104,220	111,490	119,100	127,045	558,805
Medical savings accounts	.....	10	110	205	210	210	220	955
Deductibility of medical expenses	3,675	4,060	4,535	4,895	5,270	5,670	6,100	26,470
Exclusion of interest on State and local debt for private nonprofit health facilities	2,740	2,630	2,510	2,390	2,275	2,175	2,095	11,445
Deductibility of charitable contributions (health)	3,175	3,325	3,585	3,655	3,825	4,005	4,195	19,265
Tax credit for orphan drug research	5	30	15	.....	.....	.....	.....	15
Special Blue Cross/Blue Shield deduction	155	175	125	200	220	260	330	1,135
Income security:								
Exclusion of railroad retirement system benefits	440	440	450	450	455	455	465	2,275
Exclusion of workmen's compensation benefits	4,695	4,970	5,305	5,550	5,855	6,220	6,660	29,590
Exclusion of public assistance benefits (normal tax method)	500	515	550	575	600	625	655	3,005
Exclusion of special benefits for disabled coal miners	90	90	85	80	75	75	70	385
Exclusion of military disability pensions	130	130	130	130	130	130	130	650
Net exclusion of pension contributions and earnings:								
Employer plans	72,195	77,045	77,625	78,175	78,760	79,350	79,950	314,510
Individual Retirement Accounts	11,110	11,615	12,045	12,515	12,950	13,370	13,755	64,635
Keogh plans	3,990	4,215	4,380	4,610	4,850	5,105	5,375	24,320
Exclusion of employer provided death benefits	45	50	50	55	55	60	65	285
Exclusion of other employee benefits:								
Premiums on group term life insurance	3,280	3,440	3,610	3,790	3,975	4,170	4,375	19,920
Premiums on accident and disability insurance	200	210	225	235	250	260	275	1,245
Income of trusts to finance supplementary unemployment benefits	20	20	20	20	20	20	20	100
Special ESOP rules	1,255	1,020	1,000	1,030	1,055	1,095	1,140	5,320
Additional deduction for the blind	30	30	35	35	35	35	40	180
Additional deduction for the elderly	1,780	1,795	1,805	1,815	1,825	1,830	1,830	9,105
Tax credit for the elderly and disabled	60	60	60	60	60	60	60	300
Deductibility of casualty losses	600	630	660	695	730	765	805	3,655
Earned income credit [2]	5,663	6,281	6,460	6,792	7,021	7,357	7,621	35,251

TABLE 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

Provision	Outlay Equivalents							
	1996	1997	1998	1999	2000	2001	2002	1998–2002
Social Security:								
Exclusion of social security benefits:								
OASI benefits for retired workers	17,005	17,810	18,495	19,290	20,190	20,875	21,495	100,345
Disability insurance benefits	2,090	2,375	2,615	2,820	3,045	3,290	3,545	15,315
Benefits for dependents and survivors	3,795	3,985	4,175	4,355	4,530	4,710	4,895	22,665
Veterans benefits and services:								
Exclusion of veterans disability compensation	2,615	2,770	2,930	3,100	3,280	3,470	3,675	16,455
Exclusion of veterans pensions	70	70	70	70	75	80	85	380
Exclusion of GI bill benefits	50	60	70	80	90	95	100	435
Exclusion of interest on State and local debt for veterans housing	50	45	45	45	40	40	40	210
General purpose fiscal assistance:								
Exclusion of interest on public purpose State and local debt	19,840	19,700	19,490	19,225	18,950	18,675	18,420	94,760
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	28,265	29,630	30,995	32,375	33,800	35,290	36,910	169,370
Tax credit for corporations receiving income from doing business in U.S. possessions	3,940	3,860	3,960	4,000	4,120	4,245	4,370	20,695
Interest:								
Deferral of interest on savings bonds	1,300	1,290	1,285	1,270	1,215	1,170	1,155	6,095
Addendum—Aid to State and local governments:								
Deductibility of:								
Property taxes on owner-occupied homes	15,900	16,670	17,435	18,215	19,015	19,855	20,765	95,285
Nonbusiness State and local taxes other than on owner-occupied homes	28,265	29,630	30,995	32,375	33,800	35,290	36,910	169,370
Exclusion of interest on:								
Public purpose State and local debt	19,840	19,700	19,490	19,225	18,950	18,675	18,420	94,760
IDBs for certain energy facilities	420	420	415	415	410	405	400	2,045
IDBs for pollution control and sewage and waste disposal facilities	925	900	870	845	815	755	675	3,960
Small-issue IDBs	335	310	300	290	285	275	270	1,420
Owner-occupied mortgage revenue bonds	2,305	2,265	2,230	2,190	2,150	2,110	2,070	10,750
State and local debt for rental housing	990	985	980	985	990	980	970	4,905
IDBs for airports, docks, and sports and convention facilities	2,570	2,550	2,525	2,445	2,360	2,280	2,200	11,810
State and local student loan bonds	380	360	335	320	305	295	290	1,545
State and local debt for private nonprofit educational facilities	1,225	1,175	1,120	1,065	1,015	970	935	5,105
State and local debt for private nonprofit health facilities	2,740	2,630	2,510	2,390	2,275	2,175	2,095	11,445
State and local debt for veterans housing	50	45	45	45	40	40	40	210

[1] In addition, alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 1996 $670; 1997 $670; 1998 $700; 1999 $740; 2000 $770; 2001 $800; and 2002 $840.

[2] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1996 $19,159; 1997 $21,163; 1998 $21,983; 1999 $22,864; 2000 $23,818; 2001 $24,634; and 2002 $25,518.

Note: Provisions with estimates denoted "normal tax method" have outlay equivalents of zero under the reference tax law method.

All estimates have been rounded to the nearest $5 million.

Tax Expenditure Baselines

A tax expenditure is a preferential exception to the baseline provisions of the tax structure. The 1974 Congressional Budget Act does not, however, specify the baseline provisions of the tax law. Deciding whether provisions are preferential exceptions, therefore, is a matter of judgement. As in prior years, this year's tax expenditure estimates are presented using two baselines: the normal tax baseline, which is used by the Joint Committee on Taxation, and the reference tax law baseline, which has been used by the Administration since 1983.

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

The reference tax law baseline is also patterned on a comprehensive income tax, but in practice is closer to existing law. Reference law tax expenditures are limited to special exceptions in the tax code that serve programmatic functions. These functions correspond to specific budget categories such as national defense, agriculture, or health care. While tax expenditures under the reference law baseline are generally tax expenditures under the normal tax baseline, the reverse is not always true.

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

- *Income is taxable when realized in exchange.* Thus, neither the deferral of tax on unrealized capital gains nor the tax exclusion of imputed income (such as the rental value of owner-occupied housing or farmers' consumption of their own produce) is regarded as a tax expenditure. Both accrued and imputed income would be taxed under a comprehensive income tax.
- *There is a separate corporation income tax.* Under a comprehensive income tax corporate income would be taxed only once—at the shareholder

level, whether or not distributed in the form of dividends.

- *Values of assets and debt are not adjusted for inflation.* A comprehensive income tax would adjust the cost basis of capital assets and debt for changes in the price level during the time the assets or debt are held. Thus, under a comprehensive income tax baseline the failure to take account of inflation in measuring depreciation, capital gains, and interest income would be regarded as a negative tax expenditure (i.e., a tax penalty), and failure to take account of inflation in measuring interest costs would be regarded as a positive tax expenditure (i.e., a tax subsidy).

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

- *Tax rates.* The separate schedules applying to the various taxpaying units are included in the reference law baseline. Thus, corporate tax rates below the maximum statutory rate do not give rise to a tax expenditure. The normal tax baseline is similar, except that it specifies the current maximum rate as the baseline for the corporate income tax. The lower tax rates applied to the first $10 million of corporate income are thus regarded as a tax expenditure. Similarly, under the reference law baseline, preferential tax rates for capital gains generally do not yield a tax expenditure; only capital gains treatment of otherwise "ordinary income," such as that from coal and iron ore royalties and the sale of timber and certain agricultural products, is considered a tax expenditure. The alternative minimum tax is treated as part of the baseline rate structure under both the reference and normal tax methods.
- *Income subject to the tax.* Income subject to tax is defined as gross income less the costs of earning that income. The Federal income tax defines gross income to include: (1) consideration received in the exchange of goods and services, including labor services or property; and (2) the taxpayer's share of gross or net income earned and/or reported by another entity (such as a partnership). Under the reference tax rules, therefore, gross income does not include gifts—defined as receipts of money or property that are not consideration in an exchange—or most transfer payments, which can be thought of as gifts from the Government.[2] The normal tax baseline also excludes gifts between individuals from gross income. Under the normal tax baseline, however, all cash transfer payments from the Government to private individuals are counted in gross income, and exemptions of such transfers from tax are identified as tax expenditures. The costs of earning income are generally deductible in determining taxable income under both the reference and normal tax baselines.[3]
- *Capital recovery.* Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. Under the normal tax baseline, the depreciation allowance for machinery and equipment is determined using straight-line depreciation over tax lives equal to mid-values of the asset depreciation range (a depreciation system in effect from 1971 through 1980). The normal tax baseline for real property is computed using 40-year straight-line depreciation.
- *Treatment of foreign income.* Both the normal and reference tax baselines allow a tax credit for foreign income taxes paid (up to the amount of U.S. income taxes that would otherwise be due), which prevents double taxation of income earned abroad. Under the normal tax method, however, controlled foreign corporations (CFCs) are not regarded as entities separate from their controlling U.S. shareholders. Thus, the deferral of tax on income received by CFCs is regarded as a tax expenditure under this method. In contrast, except for tax haven activities, the reference law baseline follows current law in treating CFCs as separate taxable entities whose income is not subject to U.S. tax until distributed to U.S. taxpayers. Under this baseline, deferral of tax on CFC income is not a tax expenditure because U.S. taxpayers generally are not taxed on accrued, but unrealized, income.

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

Performance Measures and the Economic Effects of Tax Expenditures

Under the Government Performance and Results Act of 1993 (GPRA), Federal agencies, in conjunction with the Office of Management and Budget, are directed to develop strategic plans for their functions and programs, with specific performance measures and performance goals. Consistent with this effort, OMB and the Department of the Treasury have started to develop a framework for evaluating the performance and economic effects of tax expenditures. This framework is expected to evolve based on additional work within the Executive branch and consultation with Congressional units, including the Joint Committee on Taxation and the General Accounting Office. Initial work is summarized below and will be updated in the Administration's May 1997 report on GPRA implementation.

Tax expenditures have a variety of objectives and effects. These include encouraging certain types of activities (e.g., saving for retirement or investing in certain sectors); increasing certain types of after-tax income (e.g., favorable tax treatment of social security

[2] Gross income does, however, include transfer payments associated with past employment, such as social security benefits.

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

income); reducing private compliance costs and government administrative costs (e.g., favorable treatment of certain employer-provided fringe benefits); and promoting tax neutrality (e.g., accelerated depreciation in the presence of inflation). Some of these objectives are well suited to quantitative measurement, while others are less suited. Also, many tax expenditures, including those cited above, may have more than one objective. As just one example, favorable treatment of employer-provided pensions might be argued to have aspects of most, or even all, of the goals mentioned above. In addition, the economic effects of particular provisions can extend beyond their intended objectives (e.g., a provision intended to promote an activity or raise certain incomes may have positive or negative effects on tax neutrality).

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

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

Estimation of these performance indicators and economic effects may be pursued via economic modeling and use of tax data. It is anticipated that OMB, Treasury, and other agencies will work together, as appropriate, on determining a set of useful measures and in developing quantitative and other estimates of provisions' impacts.

The discussion below considers the types of measures that might be useful for some major programmatic groups of tax expenditures. The discussion is intended to be illustrative, and not all encompassing.

One major set of tax expenditures benefits retirement savings, through employer-provided pensions, individual retirement accounts, Keogh plans and other instruments, such as annuities. These provisions might be evaluated in terms of their effects on boosting retirement incomes and private savings. In considering the provisions' distributional effects, it may be of interest to consider beneficiaries' incomes while retired and over their entire lifetimes.

Individuals also benefit from favorable treatment of employer-provided health insurance. Measures of these benefits could include increased coverage and the distribution of this coverage across different income groups. In principle, the effects of insurance coverage on final outcome measures of actual health (e.g., infant mortality, days of work lost due to illness, or life expectancy) or intermediate outcomes (e.g., use of preventative health care) could also be investigated.

Other provisions principally have income distribution, rather than incentive, effects. For example, tax-favored treatment of social security benefits provides increased incomes to eligible groups; the distribution of these increased incomes may be a useful performance measure. The earned-income tax credit, in contrast, should probably be evaluated both for its effects on labor force participation and its distributional properties.

Housing investment also benefits from tax expenditures, including the mortgage interest deduction and preferential treatment of capital gains on housing. Measures of the effectiveness of these provisions could include consideration of their effects on increasing the extent of home ownership and the quality of housing. The effects of the capital gains provisions in terms of offsetting inflationary gains are also likely to be relevant. Deductibility of State and local property taxes assists with making housing more affordable as well as easing the cost of providing community services through these taxes. Provisions that are intended to promote investment in rental housing could be evaluated for their effects on making rental housing more available and affordable.

A series of tax expenditures reduces the cost of investment, both in specific activities—such as research and experimentation, extractive industries, and certain financial activities—and more generally, through accelerated depreciation for plant and equipment. These provisions can be evaluated along a number of dimensions. For example, in addition to considering revenue effects, it is can be useful to consider the extent of the incentive delivered by measuring the provisions' effects on the cost of capital (the interest rate which investments must yield to cover their pretax tax costs) and effective tax rates. Another set of measures would reflect the impact of these provisions on the amounts of corresponding forms of investment—such as research spending, exploration activity, or equipment. A third group of measures would, in turn, consider the provisions' effects on production from these investments—such as numbers or value of patents, energy production and reserves, and industrial production. Other measures could consider objectives which are less directly attributable but still are ultimate goals, such as assisting the U.S. technological base, energy security, or economic growth.

The above illustrative discussion, while broad, is nevertheless incomplete, both for the provisions mentioned and the many that are not explicitly cited. Developing a framework which is appropriately comprehensive, accurate, and flexible to reflect the objectives and effects

of the wide range of tax expenditures will be a significant challenge. It is expected that this framework will evolve and improve over the next several years and that quantitative estimates will be made to the extent possible. Such estimates could then be compared with the costs of the provisions and with the costs and benefits of other means of achieving the same performance goals.

Other Considerations

The tax expenditure analysis could be extended beyond the income and transfer taxes to include payroll and excise taxes. The exclusion of certain forms of compensation from the wage base, for instance, reduces payroll taxes, as well as income taxes. Payroll tax exclusions are complex to analyze, however, because they also affect social insurance benefits. Certain targeted excise tax provisions might also be considered tax expenditures. In this case challenges include determining an appropriate baseline.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported upon in this chapter follow.

NATIONAL DEFENSE

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

INTERNATIONAL AFFAIRS

Income earned abroad.—A U.S. citizen or resident alien who resides in a foreign country or who stays in one or more foreign countries for a minimum of 11 out of the past 12 months may exclude $70,000 per year of foreign-earned income. Eligible taxpayers also may exclude or deduct reasonable housing costs in excess of one-sixth of the salary of a civil servant at grade GS –14, step 1. These provisions do not apply to Federal employees working abroad; however, the tax expenditure estimate does reflect certain allowances that are excluded from their taxable income.

Income of Foreign Sales Corporations.—The Foreign Sales Corporation (FSC) provisions exempt from tax a portion of U.S. exporters' foreign trading income to reflect the FSC's sales functions as foreign corporations. These provisions conform to the General Agreement on Tariffs and Trade.

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

Income of U.S.-controlled foreign corporations.—The income of foreign corporations controlled by U.S. shareholders is not subject to U.S. taxation. The income becomes taxable only when the controlling U.S. shareholders receive dividends or other distributions from their foreign stockholding. Under the normal tax method, the currently attributable foreign source pre-tax income from such a controlling interest is subject to U.S. taxation, whether or not distributed. Thus, under the normal tax baseline the excess of controlled foreign corporation income over the amount distributed to a U.S. shareholder gives rise to a tax expenditure in the form of a tax deferral.

GENERAL SCIENCE, SPACE, AND TECHNOLOGY

Expensing R&E expenditures.—Research and experimentation (R&E) projects can be viewed as investments because their benefits accrue for several years when they are successful. It is difficult, however, to identify whether a specific R&E project is completed and successful and, if it is successful, what its expected life will be. For these reasons, the statutory provision that these expenditures may be expensed is considered part of the reference law. Under the normal tax method, however, the expensing of R&E expenditures is viewed as a tax expenditure. The baseline assumed for the normal tax method is that all R&E expenditures are successful and have an expected life of five years.

R&E credit.—The R&E credit, which had expired on July 1, 1995, was reinstated under the Small Business Job Protection Act of 1996 for 11 months (July 1, 1996 through May 31, 1997). The 1996 Act also provided a special rule for taxpayers that elect an alternative credit regime. The tax credit is 20 percent of qualified research expenditures in excess of a base amount. The base amount is generally determined by multiplying a "fixed-base percentage" (limited to a maximum of .16) by the average amount of the company's gross receipts for the 1984 to 1988 period. Certain start-up companies are assigned a fixed-base percentage of .03 for the first five taxable years, which is gradually phased out in years 6 through 10 and replaced by the firm's actual fixed- base percentage. Under the alternative credit regime, the credit rate is reduced and the taxpayer is assigned a three-tiered fixed-base percentage that is lower than the fixed-base percentage that would otherwise apply. A credit with a separate threshold is provided for a taxpayer's payments to universities for basic research.

ENERGY

Exploration and development costs.—In the case of successful investments in domestic oil and gas wells,

intangible drilling costs, such as wages, the costs of using machinery for grading and drilling, and the cost of unsalvageable materials used in constructing wells, may be expensed rather than amortized over the productive life of the property.

Integrated oil companies may currently deduct only 70 percent of such costs and amortize the remaining 30 percent over five years. The same rule applies to the exploration and development costs of surface stripping and the construction of shafts and tunnels for other fuel minerals.

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

Alternative fuel production credit.—A nontaxable credit of $3 per barrel (in 1979 dollars) of oil-equivalent production is provided for several forms of alternative fuels. It is generally available as long as the price of oil stays below $29.50 (in 1979 dollars). The credit generally expires on December 31, 2002.

Oil and gas exception to passive loss limitation.—Although owners of working interests in oil and gas properties are subject to the alternative minimum tax, they are exempted from the "passive income" limitations. This means that the working interest-holder, who manages on behalf of himself and all other owners the development of wells and incurs all the costs of their operation, may aggregate negative taxable income from such interests with his income from all other sources. Thus, he will be relieved of the minimum tax rules limit on tax deferrals.

Capital gains treatment of royalties on coal.—Sales of certain coal under royalty contracts can be treated as capital gains. While the top statutory rate on ordinary income is 39.6 percent, the rates on capital gains are limited to 28 percent.

Tax-exempt bonds for energy facilities.—Certain energy facilities, such as municipal electric and gas utilities, may benefit from tax-exempt financing.

Enhanced oil recovery credit.—A credit is provided equal to 15 percent of the taxpayer's costs for tertiary oil recovery on projects in the United States. Qualifying costs include tertiary injectant expenses, intangible drilling and development costs on a qualified enhanced oil recovery project, and amounts incurred for tangible depreciable property.

New technology credits.—A credit of 10 percent is available for investment in solar and geothermal energy facilities. In addition, a credit of 1.5 cents is provided per kilowatt hour of electricity produced from renewable resources such as wind and biomass. The renewable resources credit applies only to electricity produced by a facility placed in service before July 1, 1999.

Alcohol fuel credit.—Gasohol, a motor fuel composed of at least 10 percent alcohol, is exempt from 5.4 of the 18.4 cents per gallon Federal excise tax on gasoline. Smaller exemptions are allowed for motor fuel with lower alcohol content. There is a corresponding income tax credit for alcohol used as a fuel in applications where the excise tax is not assessed. This credit, equal to a subsidy of 54 cents per gallon for alcohol used as a motor fuel, is intended to encourage substitution of alcohol for petroleum-based gasoline. In addition, small producers of ethanol are eligible for a 10 cent per gallon credit.

Credit and deduction for clean-fuel vehicles and property.—A tax credit of 10 percent is provided for electric vehicles. In addition, a deduction is provided for other clean-fuel burning vehicles as well as refueling property.

Exclusion of utility conservation subsidies.—Subsidies by public utilities for customer expenditures on energy conservation measures are excluded from the gross income of the customer. After December 31, 1996, the exclusion does not apply to subsidies provided to businesses.

NATURAL RESOURCES AND ENVIRONMENT

Exploration and development costs.—As is true for fuel minerals, certain capital outlays associated with exploration and development of nonfuel minerals may be expensed rather than depreciated over the life of the asset.

Percentage depletion.—Most nonfuel mineral extractors also make use of percentage depletion rather than cost depletion, with percentage depletion rates ranging from 22 percent for sulphur down to 5 percent for sand and gravel.

Capital gains treatment of iron ore and of certain timber income.—Iron ore and certain timber sold under a royalty contract can be treated as capital gains.

Mining reclamation reserves.—Taxpayers are allowed to establish reserves to cover certain costs of

mine reclamation and of closing solid waste disposal properties. Net increases in reserves may be taken as a deduction against taxable income.

Tax-exempt bonds for pollution control and waste disposal.—Interest on State and local government debt issued to finance private pollution control and waste disposal facilities was excludable from income subject to tax. This authorization was repealed for most pollution control equipment and limits placed on the amount of debt that can be issued for private waste disposal facilities by the Tax Reform Act of 1986.

Expensing multiperiod timber growing costs.—Generally, costs must be capitalized when goods are produced for inventory used in one's own trade or business, or under contract to another party. Timber production, however, was specifically exempted from these multiperiod cost capitalization rules, creating a special benefit derived from this deferral of taxable income.

Credit and seven-year amortization for reforestation.—A special 10 percent investment tax credit is allowed for up to $10,000 invested annually in clearing land and planting trees for the ultimate production of timber. The same amount of forestation investment may also be amortized over a seven-year period. Without this preference, the amount would have to be capitalized and could be recovered (deducted) only when the trees were sold or harvested 20 or more years later. Moreover, the amount of forestation investment that is amortizable is not reduced by any of the investment credit that is allowed.

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

AGRICULTURE

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

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

Loans forgiven solvent farmers.—Farmers are granted special tax treatment by being forgiven the tax liability on certain forgiven debt. Normally, the amount of loan forgiveness is accounted for as a gain (income) of the debtor and he must either report the gain, or reduce his recoverable basis in the property to which the loan relates. If the debtor elects to reduce basis and the amount of forgiveness exceeds his basis in the property, the excess forgiveness is taxable. However, in the case of insolvent (bankrupt) debtors, the amount of loan forgiveness never results in an income tax liability.[4] Farmers with forgiven debt are considered insolvent for tax purposes, and thus qualify for income tax forgiveness.

Capital gains treatment of certain income.—Certain agricultural income, such as unharvested crops, can be treated as capital gains.

COMMERCE AND HOUSING

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

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

Bad debt reserves.—Small (less than $500 million in assets) commercial banks, mutual savings banks, and savings and loan associations may deduct additions to bad debt reserves in excess of actually experienced losses. Before January 1, 1996, all thrifts could use either the "experience" method or the "percentage of taxable income" method for determining deductible additions to bad debt reserves.

Deferral of income on life insurance and annuity contracts.—Favorable tax treatment is provided for investment income ("inside buildup") within qualified life insurance and annuity contracts. Investment income earned on qualified life insurance contracts held until death is permanently exempted from Federal income tax. Investment income distributed prior to the death of the insured is tax-deferred, if not tax-exempt. Investment income earned on annuities is treated less favorably than income earned on life insurance contracts, but it benefits from tax deferral without annual contribution or income limits generally applicable to other tax-favored retirement income plans.

Small property and casualty insurance companies.— Insurance companies that have annual net premium incomes of less than $350,000 are exempted from

[4] The insolvent taxpayer's carryover losses and unused credits are extinguished first, and then his basis in assets reduced to no less than amounts still owed creditors. Finally, the remainder of the forgiven debt is excluded from tax.

tax; those with $350,000 to $2,100,000 of net premium incomes may elect to pay tax only on the income earned by their investment portfolio.

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

Mortgage housing bonds.—Interest on all mortgage revenue bonds issued by State and local governments is exempt from taxation. Proceeds are used to finance homes purchased by first-time buyers—with low to moderate incomes—of dwellings with prices under 90 percent of the average area purchase price.

There are limits imposed on the amount of tax-exempt State and local government bonds that could be issued to fund private activity. The volume cap for single-family mortgage revenue bonds and multifamily rental housing bonds is combined with the cap for student loans and industrial development bonds (IDBs). The cap is set at $50 per capita or a minimum of $150 million for each State.

States are authorized to issue mortgage credit certificates (MCCs) in lieu of qualified mortgage revenue bonds because the bonds are relatively inefficient subsidies to first-time home buyers. MCCs entitle home buyers to income tax credits for a specified percentage of interest on qualified mortgage loans. In this way, the entire amount of the subsidy flows directly to the home buyer without being partly diverted to financial middlemen or bondholders. A State cannot issue an aggregate annual amount of MCCs greater than 25 percent of its annual ceiling for qualified mortgage bonds. Because of the relationship between MCCs and qualified mortgage bonds, their estimates are presented as one line item in the tables.

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

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

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

Capital gains on home sales.—When a primary residence is sold, the homeowner can defer paying a capital gains tax on the proceeds by purchasing or constructing a home of value at least equal to that of the prior home (net of sales and qualified fix-up expenses) within two years. This deferral is a tax expenditure.

Capital gains on sales by owners aged 55 or older.—A taxpayer who is 55 years of age or older at the time of the sale of his residence may elect to exclude from tax up to $125,000 of the gain from its sale. This is a once-in-a-lifetime election. In effect, this provision converts some prior deferrals of tax into forgiveness of tax.

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

Low-income housing investment.—Through 1989, a tax credit for investment in new, substantially rehabilitated, and certain unrehabilitated low-income housing was structured to have a present value of 70 percent of construction or rehabilitation costs incurred and was allowed over 10 years. For Federally subsidized projects and those involving unrehabilitated existing low income housing, the credit was structured to have a present value of 30 percent. Beginning on January 1, 1990, the credit was extended at a present value of 70 percent, including projects financed with other Federal subsidies, but only if substantial rehabilitation was done. Notwithstanding the capital grant character of this subsidy, the investor's recoverable basis is not reduced by the substantial credit allowed.

Accelerated depreciation of real property, machinery and equipment.—As previously noted, the tax depreciation allowance provisions are part of the reference law rules, and thus do not cause tax expenditures under the reference method. Under the normal tax method, however, a 40-year tax life for depreciable real property is the norm. So, the statutory depreciation period in effect from 1987 to 1993 for nonresidential properties of 31.5 years, and the 39-year period for property placed in service after February 25, 1993, give rise to tax expenditures. The statutory depreciation period for residential property is 27.5 years, which also results in tax expenditures. Statutory depreciation of machinery, equipment, and some other property also is somewhat accelerated relative to the normal tax baseline. In addition, tax expenditures arise from pre-1987 tax allowances for real and personal property.

Cancellation of indebtedness.—Individuals are not required to report the cancellation of certain indebtedness as current income. However, if they do not, it would be included as an adjustment in the basis of the underlying property.

Imputed interest rules.—Under reference law rules commonly referred to as original issue discount (OID), both the holder and seller of a financial contract are generally required to report interest earned in the period it accrues, not when the contract payments are made. Moreover, the amount of interest accruable is determined by the actual price paid for the contract, not by the stated or nominal principal and interest stipulated in the contract.[5]

Exceptions to the general rules for accounting for interest expense or income include the following: (a) permission for the mortgagor of his personal residence to treat the discount from the nominal principal of his mortgage loan, commonly called "points," as prepaid interest which is deductible in the year paid, not the year accrued; and (b) sellers of farms and small businesses worth less than $1 million, in exchange for the purchaser's debt obligation, are exempted from the OID rules. This is $750,000 more than the $250,000 exemption that the reference tax law generally allows for such transactions.

Capital gains (other than agriculture, timber, iron ore and coal).—While the top statutory rate on ordinary income is 39.6 percent, the rates on capital gains are limited to 28 percent. This treatment is considered a tax expenditure under the normal tax method but not under the reference law method.

Capital gains exclusion for small business stock.—An exclusion of 50 percent is provided for capital gains from qualified small business stock held by individuals for more than 5 years. A qualified small business is a corporation whose gross assets do not exceed $50 million as of the date of issuance of the stock. Certain activities such as personal services and banking are ineligible for the exclusion.

Step-up in basis of capital gains at death.—Capital gains on assets held at the owner's death are not subject to capital gains taxes. The cost basis of the appreciated assets is adjusted upward to the market value at the owner's date of death. The step-up in the heir's cost basis means that, in effect, the capital gain is forgiven.

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

Ordinary income treatment of losses from sale of small business corporate stock shares.—Up to $100,000 in losses from the sale of such stock may be treated as ordinary losses, and therefore not be subject to the $3,000 annual capital loss write-off limit if the corporation's capitalization is less than $1 million.

Expensing of certain small investments.—In 1996, qualifying investments in tangible property up to $18,500 can be expensed rather than depreciated over time. (The expensing limit increases annually until 2003, when it reaches $25,000). To the extent that qualifying investment during the year exceeds $200,000, the amount eligible for expensing is decreased. In 1996, the amount expensed is completely phased out when qualifying investments exceed $218,500.

Business start-up costs.—When an individual or corporation acquires or otherwise enters into a new business, certain start-up expenses, such as the costs of investigating opportunities and legal services, are normally incurred. The taxpayer may elect to amortize these outlays over 60 months although they are similar to other payments he makes for nondepreciable intangible assets that are not recoverable until the business is sold. Under the normal tax method this gives rise to a tax expenditure, while under the reference method it does not.

Graduated corporation income tax rate schedule.—The schedule is graduated, with rates of 15 percent on the first $50,000 of taxable income, 25 percent on the next $25,000, 34 percent on the next $9.925 million, and a rate of 35 percent on income over $10 million. As compared with a flat 35 percent tax rate, the lower rates provide a $111,000 reduction in tax liability for corporations with taxable incomes of $10 million. This benefit is recaptured in the cases of corporations with taxable incomes exceeding $100,000.

[5] Thus, when a borrower on December 31, 1996, issues a promise to pay $1,000 plus interest at 10 percent on December 30, 1997, for a total repayment of $1,100, and accepts $900 from a lender in exchange for the contract, the rules require that both parties: (a) recognize that $900 is the amount lent, so that the effective loan interest rate is not the nominal 10 percent rate but is 22.2 percent; and (b) both report $200 as interest paid or received in 1996, as the case may be.

This is accomplished by (1) a 5 percent additional tax on corporate incomes in excess of $100,000, but less than $335,000 and (2) a 3 percent additional tax on income over $15 million but less than $18.33 million. At this point the $111,000 is fully recaptured. Since this rate schedule is part of the reference tax law, it does not give rise to a tax expenditure under the reference method. A flat corporation income tax rate is taken as the baseline under the normal tax method; therefore the lower rates do yield a tax expenditure under this concept.

Small issue industrial development bonds.—The interest on small issue industrial development bonds (IDBs) issued by State and local governments to finance private business property is excluded from income subject to tax. Depreciable property financed with small issue IDBs must be depreciated, however, using the straight-line method. The tax exemption of small issue bonds expired in 1986, except for small issue IDBs exclusively issued to finance manufacturing facilities for which the tax exemption is permanent. The annual volume of small issue IDBs is subject to the unified volume cap discussed in the mortgage housing bond section above.

Treatment of Alaskan Native Corporations losses.—Tax law restricts the ability of profitable corporations to reduce their tax liabilities by merging or buying corporations with accumulated net operating losses (NOLs) and as yet unrefunded claims to investment credits. Alaska Native Corporations have a limited exemption (fifteen years after the NOL or credit claim was first experienced) from these restrictions that includes NOLs and credits claimable prior to April 26, 1988.

TRANSPORTATION

Shipping companies that are U.S. flag carriers.—Certain companies that operate U.S. flag vessels receive a deferral of income taxes on that portion of their income used for shipping purposes, primarily construction, modernization and major repairs to ships, and repayment of loans to finance these qualified investments. Once indefinite, the deferral has been limited to 25 years since January 1, 1987.

Exclusion of reimbursed employee parking expenses.—Parking at or near an employer's business premises that is paid for by the employer is excludable from the income of the employee as a working condition fringe benefit. The maximum amount of the parking exclusion is $155 month (in 1993 dollars), indexed in $5 increments. The tax expenditure estimate does not include parking at facilities owned by the employer.

Exclusion of employer-provided transit passes.—Transit passes, tokens, and fare cards provided by an employer to defray an employee's commuting costs are excludable from the employee's income as a de minimis fringe benefit, if the total value of the benefit does not exceed $60 per month (in 1993 dollars), indexed in $5 increments.

COMMUNITY AND REGIONAL DEVELOPMENT

Rehabilitation of structures.—A 10 percent investment tax credit is available for the rehabilitation of buildings that are used for business or productive activities and that were erected before 1936 for other than residential purposes. A full reduction by the amount of the credit is required in the taxpayer's recoverable basis.

Tax-exempt bonds for airports and similar facilities.—Government-owned airports, docks and wharves, as well as high-speed rail facilities that need not be government-owned, may be financed with tax-exempt bonds. These bonds are not covered by a volume cap.

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

Empowerment zones.—Qualifying businesses in designated economically depressed areas can receive tax benefits such as an employer wage credit, increasing expensing of investment in equipment, tax-exempt financing, and accelerated depreciation. In addition, a tax credit for contributions to certain community development corporations can be available.

EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES

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

Tax-exempt bonds for educational purposes.—Interest on State and local government debt issued to finance student loans or the construction of facilities used by private nonprofit educational institutions is excluded from income subject to tax. The aggregate vol-

ume of such private activity bonds that each State may issue during any calendar year is limited.

U.S. savings bonds for education.—Interest on U.S. savings bonds, issued after December 31, 1989, may be excluded from tax if the bonds, plus accrued interest, are transferred to an educational institution as payment for educational expenses. The exclusion from tax is phased out for joint returns with adjusted gross incomes of $74,200 to $104,200 and $49,250 to $64,250 for single and head of household returns in 1996.

Dependent students age 19 or older.—Taxpayers can claim personal exemptions for dependent children age 19 or over who receive parental support payments of $1,000 or more per year, are full-time students, and do not claim a personal exemption on their own tax returns. This preferential arrangement usually generates tax savings because the students' marginal tax rates are more often than not lower than their parents' marginal tax rates.

Charitable contributions.—Contributions to charitable, religious, and certain other nonprofit organizations are allowed as an itemized deduction for individuals, generally up to 50 percent of adjusted gross income. Taxpayers who donate capital assets to charitable or educational organizations can deduct the assets' current value without the taxation of any appreciation in value. Corporations can also deduct charitable contributions up to 10 percent of their pre-tax income. Tax expenditures resulting from the deductibility of contributions are shown separately for educational and other institutions. Contributions to health institutions are reported under the health function.

Employer provided benefits.—Many employers provide employee benefits that are not counted in employee income. The employers' costs for these benefits are deductible business expenses. The exclusion from an employee's income of the value of educational assistance, child care, meals and lodging, as well as ministers' housing allowances and the rental value of parsonages are tax expenditures. The exclusion for educational assistance expires in mid-1997. After June 30, 1996, the exclusion does not apply to graduate courses. Health and other insurance benefits are reported under the health and income security functions. Certain parking and transit benefits are reported under the transportation function.

Work opportunity tax credit.—Employers can claim a tax credit for qualified wages paid to individuals who begin work after September 30, 1996 and before October 1, 1997 and who are certified as members of various targeted groups. The amount of the credit that can be claimed is 35 percent of the first $6,000 paid during the first year of employment. Employers must reduce their deduction for wages paid by the amount of the credit claimed. The work opportunity tax credit is similar to the targeted jobs tax credit, which applied to employees hired before January 1, 1995.

Child and dependent care expenses.—A tax credit may be claimed by married couples for child and dependent care expenses incurred when one spouse works full time and the other works at least part time or goes to school. The credit may also be claimed by divorced or separated parents who have custody of children, and by single parents. Expenditures up to a maximum $2,400 for one dependent and $4,800 for two or more dependents are eligible for the credit. The credit is equal to 30 percent of qualified expenditures for taxpayers with incomes of $10,000 or less. The credit is reduced to a minimum of 20 percent by one percentage point for each $2,000 of income between $10,000 and $28,000.

Adoption assistance.—Beginning January 1, 1997, taxpayers can receive a nonrefundable tax credit for qualified adoption expenses. The maximum credit is $5,000 per child ($6,000 for special needs adoptions, except foreign adoptions). The credit is phased-out ratably for taxpayers with modified AGI between $75,000 and $115,000. Unused credits may be carried forward. In lieu of the tax credit, taxpayers may exclude qualified adoption expenses from income, subject to the same maximum amounts and phase-out as the credit. The non-special needs adoption assistance and foreign special needs assistance expire on December 31, 2001.

Disabled access expenditures.—A credit is provided of 50 percent of eligible disabled access expenditures in excess of $250. The credit is limited to $5,000.

Costs of removing architectural barriers to the handicapped.—The investment cost of making any business accessible to persons suffering physical or mental disabilities may be deducted, rather than capitalized as part of the taxpayer's basis in such property and recovered by subsequent depreciation allowances, as is generally required.

Foster care payments.—Foster parents provide a home and care for children who are wards of the State, under contract with the State. Compensation received for this service is explicitly excluded from the gross incomes of foster parents, making the expenses they incur nondeductible. This activity is, in effect, tax-exempt.

HEALTH

Employer paid medical insurance and expenses.—Employee compensation, in the form of payments by employers for health insurance premiums and other medical expenses (including long-term care), is deducted as a business expense by employers, but it is not included in employee gross income. The self-employed also may deduct part of their family health insurance premiums.

Medical savings accounts.—Beginning January 1, 1997, some employees may deduct annual contributions to a medical savings account (MSA); employer contributions to MSAs (except those made through cafeteria plans) for qualified employees are also excluded from income. An employee may contribute to an MSA in a given year only if the employer does not contribute to the MSA in that year. MSAs are only available to self-employed individuals or employees covered under an employer-sponsored high deductible health plan of a small employer. The maximum annual MSA contribution is 75 percent of the deductible under the high deductible plan for family coverage (65 percent for individual coverage). Earnings from MSAs are excluded from taxable income. Distributions from an MSA for medical expenses are not taxable. The number of taxpayers who may benefit annually from MSAs is generally limited to 750,000. No new MSAs may be established after December 31, 2000.

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

Tax-exempt bonds for hospital construction.—Interest earned on State and local government debt issued to finance hospital construction is excluded from income subject to tax.

Charitable contributions to health institutions.—Contributions to nonprofit health institutions are allowed as a deduction for individuals and corporations. Tax expenditures resulting from the deductibility of contributions to other charitable institutions are listed under the education, training, employment, and social services function.

Orphan drugs.—To encourage the development of drugs for the treatment of rare diseases or physical conditions, a tax credit was granted equal to 50 percent of the costs for clinical testing that must be completed before manufacture and distribution are approved by the Food and Drug Administration. Because the drug firm was not required to reduce its deduction for testing expenses (an R&D expenditure) by the amount of this credit, the private cost of clinically testing orphan drugs was reduced substantially. This tax expenditure expires on May 31, 1997.

Blue Cross and Blue Shield.—Although these organizations are not qualified as exempt, they are provided exceptions from otherwise applicable insurance company income tax accounting rules that effectively eliminate their tax liabilities.

INCOME SECURITY

Railroad retirement benefits.—These benefits are not generally subject to the income tax unless the recipient's gross income reaches a certain threshold discussed more fully under the social security function.

Workmen's compensation benefits.—Workmen's compensation provides payments to disabled workers. These benefits, although income to the recipients, are a tax preference because they are not subject to the income tax.

Public assistance benefits.—The exclusion from taxable income of public assistance benefits received by individuals is listed as a tax expenditure under the normal tax method because, under this method, cash transfers from government are included in gross income. In contrast, gifts not conditioned on the performance of services, including transfers from government, are not taxable under the reference law. Therefore, under the reference tax method, the tax exclusion for public assistance benefits is not shown as a tax expenditure.

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

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

Pension contributions and earnings.—Certain employer contributions to pension plans, along with individual contributions to individual retirement accounts (IRAs) and amounts set aside by the self-employed, are excluded from adjusted gross income in the year of contribution. The investment income earned by pension funds and other qualifying retirement plans is not taxable when earned, and this deferral is, therefore, also a tax expenditure.

In 1997, $9,500 (indexed) can be excluded from an employee's adjusted gross income under a qualified cash or deferred arrangement with the employer (401(k) plan). An employee's own contribution of no more than $9,500 or the 401(k) limitation (whichever is greater) may be excluded annually from an employee's adjusted gross income when placed in a tax-sheltered annuity (403(b) plan).

In 1996, employees could deduct annual contributions to an IRA of $2,000 (or 100 percent of compensation, if less), or $2,250 on a joint return with only one spouse earning income (beginning January 1, 1997, each spouse may contribute $2,000 to a deductible IRA), if: (a) neither the individual or spouse is an active participant in an employer-provided retirement plan; or (b) their adjusted gross income falls below $40,000 ($25,000 for a single taxpayer). The allowable IRA deduction is phased out between $40,000 and $50,000 for a joint return and $25,000 and $35,000 for a single return. Beyond these income limits, nondeductible contributions to IRAs are available to taxpayers who are active participants in employer-provided retirement plans. Self-employed persons can make deductible contributions to their own retirement (Keogh) plans equal to

25 percent of their income, up to a maximum of $30,000 per year.

Employer provided insurance benefits.—Many employers cover part or all the cost of premiums or payments for: (a) employees' life insurance benefits; (b) accident and disability benefits; (c) death benefits; and (d) supplementary unemployment benefits. The amounts are deductible by the employers and are excluded as well from employees' gross incomes for tax purposes.

Employer Stock Ownership Plan (ESOP) provisions.—A special type of employee benefit plan, organized as a trust, is tax-exempt. Employer-paid contributions (the value of stock issued to the ESOP) are deductible by the employer as part of employee compensation costs. They are not included in the employees' gross income for tax purposes, however, until they are paid out as benefits. The following special income tax provisions for ESOPs are intended to increase ownership of corporations by their employees: (1) annual employer contributions are subject to less restrictive limitations (percentages of employees' cash compensation); (2) ESOPs may borrow to purchase employer stock, guaranteed by their agreement with the employer that the debt will be serviced by his payment (deductible by him) of a portion of wages (excludable by the employees) to service the loan; (3) ESOPs' lenders may exclude half the interest from their gross income (the ESOP interest exclusion expired on June 10, 1996); (4) employees who sell appreciated company stock to the ESOP may defer any taxes due until they withdraw benefits; and (5) dividends paid to ESOP-held stock are deductible by the employer.

Support of the aged and the blind.—Taxpayers who are blind or 65 years of age or older may take an additional $1,000 standard deduction if single, or $800 if married. In addition, individuals who are 65 years of age or older, or who are permanently disabled, can take a tax credit equal to 15 percent of the sum of their earned and retirement income. Qualified income is limited to no more than $2,500 for single individuals or married couples filing a joint return where only one spouse is 65 years of age or older, and up to $3,750 for joint returns where both spouses are 65 years of age or older. These limits are reduced by one-half of the taxpayer's adjusted gross income over $7,500 for single individuals and $10,000 for married couples filing a joint return.

Casualty losses.—Neither the purchase of property nor insurance premiums to protect its value are deductible as costs of earning income; therefore, reimbursement for insured loss of such property is not reportable as a part of gross income. However, a special provision permits relief for taxpayers suffering an uninsured loss. They may deduct casualty and theft losses of more than $100 each, but only to the extent that total losses during the year exceed 10 percent of adjusted gross income.

Earned income credit.—This credit may be claimed by low income workers. For a family with one qualifying child, the credit is 34 percent of the first $6,500 of earned income in 1997. The credit is 40 percent of the first $9,140 of income for a family with two or more qualifying children. When the taxpayer's income exceeds $11,930, the credit is phased out at the rate of 15.98 percent (21.06 percent if two or more qualifying children are present). It is completely phased out at $25,760 of adjusted gross income ($29,290 if two or more qualifying children are present).

The credit may also be claimed by workers who do not have children living with them. Qualifying workers must be at least age 25 and may not be claimed as a dependent on another taxpayer's return. The credit is not available to workers age 65 or older. In 1996, the credit is 7.65 percent of the first $4,340 of earned income. When the taxpayer's income exceeds $5,430, the credit is phased out at the rate of 7.65 percent. It is completely phased out at $9,770 of adjusted gross income.

For workers with or without children, the income level at which the credit's phase-outs begin and the maximum amounts of income on which the credit can be taken are adjusted for inflation. Earned income tax credits in excess of tax liabilities are refundable to individuals, and as such are paid by the Federal Government. This portion of the credit is included in outlays, while the amount that offsets tax liabilities is shown as a tax expenditure.

SOCIAL SECURITY

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

Social Security benefits for the disabled, dependents and survivors.—Benefit payments from the Social Security Trust Fund, for disability and for dependents and survivors, are excluded from the beneficiaries' gross incomes, and thus give rise to tax expenditures.

VETERANS BENEFITS AND SERVICES

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

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

GENERAL GOVERNMENT

Public purpose State and local debt.—Interest on State and local government debt, issued to finance government activities, is excluded from Federal taxation. State and local governments, therefore, can sell debt obligations at a lower interest cost than would be possible if such interest were subject to tax. Only the excluded interest on bonds for public purposes, such as schools, roads, and sewers, is included here.

Nonbusiness State and local taxes excluding home-owner property taxes.—The deductibility of nonbusiness State and local income and personal property taxes gives indirect assistance to these governments by reducing the costs of the services they provide.

Business income earned in U.S. possessions.—Under certain conditions, U.S. corporations receiving income from an active trade or business, or from investments located in a U.S. possession, can claim a special credit against U.S. tax otherwise due.

INTEREST

U.S. savings bonds.—The interest on U.S. savings bonds is not taxable until the bonds are redeemed, thereby deferring tax liability. The deferral is equivalent to an interest-free loan and, therefore, it is a tax expenditure.

TAX EXPENDITURES IN THE UNIFIED TRANSFER TAX

Exceptions to the general terms of the Federal unified transfer tax favor particular transferees or dispositions of transferors, similar to Federal direct expenditure or loan programs. The transfer tax provisions identified as tax expenditures satisfy the reference law criteria for inclusion in the tax expenditure budget that were described above. There is no generally accepted normal tax baseline for transfer taxes.

Unified Transfer Tax Reference Rules

The reference tax rules for the unified transfer tax from which departures represent tax expenditures include:

- *Definition of the taxpaying unit.* The payment of the tax is the liability of the transferor whether the transfer of cash or property was made by gift or bequest.
- *Definition of the tax base.* The base for the tax is the transferor's cumulative, taxable lifetime gifts made plus the net estate at death. Gifts in the tax base are all annual transfers in excess of $10,000 to any donee except the donor's spouse. Excluded are, however, payments on behalf of family members' educational and medical expenses, as well as the cost of ceremonial gatherings and celebrations that are not in honor of the donor.
- *Property valuation.* In general, property is valued at its fair market value at the time it is transferred. This is not necessarily the case in the valuation of property for transfer tax purposes. Executors of estates are provided the option to value assets at the time of the testator's death or up to six months later.
- *Tax rate schedule.* A single graduated tax rate schedule applies to all taxable transfers. This is reflected in the name of the "unified transfer tax" that has replaced the former separate gift and estate taxes. The tax rates vary from 18 percent on the first $10,000 of aggregate taxable transfers, to 55 percent on amounts exceeding $3 million. A $192,800 lifetime credit is provided against the tax in determining the final amount of transfer taxes that are due and payable. This allows each taxpayer to make a $600,000 tax-free transfer of assets that otherwise would be liable to the unified transfer tax.[6]
- *Time when tax is due and payable.* Donors are required to pay the tax annually as gifts are made. The generation-skipping transfer tax is payable by the donees whenever they accede to the gift. The net estate tax liability is due and payable within nine months after the decedent's death. The Internal Revenue Service may grant an extension of up to 10 years for a reasonable cause. Interest is charged on the unpaid tax liability at a rate equal to the cost of Federal short-term borrowing, plus three percentage points.

[6] An additional tax, at a flat rate of 55 percent, is imposed on lifetime, generation-skipping transfers in excess of $1 million. It is considered a generation-skipping transfer whenever the transferee is at least two generations younger than the transferor, as it would be in the case of transfers to grandchildren or great-grandchildren. The liability of this tax is on the recipients of the transfer.

Tax Expenditures by Function

The estimates of tax expenditures in the Federal unified transfer tax for fiscal years 1996–2002 are displayed by functional category in table 5–6. Outlay equivalent estimates are similar to revenue loss estimates for transfer tax expenditures and, therefore, are not shown separately. A description of the provisions follows.

Natural Resources and Environment

Donations of conservation easements.—Bequests for conservation are excluded from taxable estates. A conservation bequest is the value of property and easements (in perpetuity) to such property the use of which is restricted to any one or more of the following: the public for outdoor recreation; protection of the natural habitats of fish, wildlife, plants, etc.; scenic enjoyment of the public; and preservation of historic land areas and structures. Similar conservation gifts are excluded from the gift tax base and are also deductible from the donor's otherwise taxable income in the year of the gift.

Agriculture

Special use valuation of farms.—Farmland owned and operated by a decedent and/or a member of the family may be valued for estate tax purposes on the basis of its "continued use" as a farm if: the farmland is at least 25 percent of the decedent's gross estate; the entire value of all farm property is at least 50 percent of the gross estate; and family heirs to the farm agree to continue to operate the property as a farm for at least 10 years. Since continued use valuation of farmland is frequently substantially less than the fair market value, the resulting reduction in tax liability serves as a subsidy to the continued operation of family farms.

Tax deferral of closely held farms.—Decedents' estates may use a preferential, extended installment payment period of five to 15 years to discharge estate tax liabilities if the value of the farm properties exceeds 35 percent of the net estates. The interest charged is only 4 percent for the first five years, rather than the standard Federal short-term borrowing rate plus three percentage points, which applies during the last 10 years of the repayment period.

Commerce and Housing Credit

Special use valuation of closely held businesses.—The two estate tax incentives to family farming are also available to the estates of owners of 1995 nonfarm family businesses. If the same three conditions previously described are met, the real property in their estates is eligible for continued use valuation.

Tax deferral of closely held businesses.—Nonfarm family businesses that satisfy the net estate requirements qualify for preferential 15 year deferred estate tax payment. To be eligible for this special provision, the value of stock in closely held corporations must exceed 35 percent of the decedent's gross estate, less debt and funeral expenses.

Education, Training, Employment, and Social Services

Bequests to tax-exempt organizations.—These bequests are deductible from decedent's otherwise taxable lifetime transfers.

TABLE 5–6. REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE FEDERAL UNIFIED TRANSFER TAX

(In millions of dollars)

Description	Fiscal Years							
	1996	1997	1998	1999	2000	2001	2002	1998–2002
Natural Resources and Environment:								
Deductions for donations of conservation easements	.....	.....	.....	.....	.....	.....	.....	.....
Agriculture:								
Special use valuation of farm real property	75	80	85	90	95	100	105	475
Tax deferral of closely held farms	10	10	10	15	15	15	15	70
Commerce:								
Special use valuation of real property used in closely held businesses	20	20	25	25	25	25	30	130
Tax deferral of closely held business	60	65	70	75	80	85	90	400
Education, training, employment, and social services:								
Deduction for charitable contributions (education)	940	1,005	1,080	1,155	1,240	1,330	1,430	6,235
Deduction for charitable contributions (other than education and health)	2,765	2,965	3,180	3,415	3,665	3,930	4,220	18,410
Health:								
Deduction for charitable contributions (health)	845	905	975	1,045	1,120	1,205	1,290	5,635
General government:								
Credit for State death taxes	3,235	3,465	3,720	3,990	4,285	4,600	4,935	21,530

Note: All estimates have been rounded to the nearest $5 million.

HEALTH

Bequests to health providers.—Such bequests, that are exempt from the income tax, are deductible from otherwise taxable lifetime transfers of decedents.

GENERAL GOVERNMENT

State and local death taxes.—A credit is allowed for state death taxes against any Federal estate tax that otherwise would be due. The amount of the state death tax credit is determined by a rate schedule that reaches a limit of 16 percent of the taxable estate in excess of $60,000.

3. FEDERAL RECEIPTS

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

Growth in receipts.—Total receipts in 1999 are estimated to be $1,742.7 billion, an increase of $84.9 billion or 5.1 percent relative to 1998. This increase is largely due to assumed increases in incomes resulting from both real economic growth and inflation. Receipts are projected to grow at an average annual rate of 3.9 percent between 1999 and 2003, rising to $2,028.2 billion.

As a share of GDP, receipts are projected to decline from 19.9 percent in 1998 to 19.6 percent in 2003.

Table 3–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	1997 actual	Estimate					
		1998	1999	2000	2001	2002	2003
Individual income taxes	737.5	767.8	791.5	804.6	833.4	877.1	915.5
Corporation income taxes	182.3	190.8	198.0	202.9	209.2	214.7	220.4
Social insurance and retirement receipts	539.4	571.4	595.9	623.0	649.0	677.8	706.5
(On-budget)	(147.4)	(155.4)	(161.8)	(169.1)	(176.3)	(183.5)	(189.9)
(Off-budget)	(392.0)	(416.0)	(434.1)	(453.9)	(472.7)	(494.3)	(516.6)
Excise taxes	56.9	55.5	72.0	69.6	71.6	74.0	74.6
Estate and gift taxes	19.8	20.4	20.5	21.6	22.6	24.4	25.6
Customs duties	17.9	18.4	18.2	19.5	20.4	22.4	24.0
Miscellaneous receipts	25.5	33.5	46.7	52.2	56.4	59.0	61.4
Total receipts	**1,579.3**	**1,657.9**	**1,742.7**	**1,793.6**	**1,862.6**	**1,949.3**	**2,028.2**
(On-budget)	*(1,187.3)*	*(1,241.9)*	*(1,308.6)*	*(1,339.7)*	*(1,389.9)*	*(1,455.0)*	*(1,511.5)*
(Off-budget)	*(392.0)*	*(416.0)*	*(434.1)*	*(453.9)*	*(472.7)*	*(494.3)*	*(516.6)*

Table 3–2. CHANGES IN RECEIPTS

(In billions of dollars)

	Estimate					
	1998	1999	2000	2001	2002	2003
Receipts under tax rates and structure in effect January 1, 1998 [1]	1,657.9	1,728.7	1,774.4	1,837.3	1,918.0	1,991.8
Social security (OASDI) taxable earnings base increases:.						
$68,400 to $70,800 on Jan. 1, 1999	.....	1.1	3.0	3.3	3.6	3.9
$70,800 to $74,100 on Jan. 1, 2000	.....	.....	1.6	4.1	4.5	4.9
$74,100 to $76,800 on Jan. 1, 2001	.....	.....	.....	1.3	3.3	3.7
$76,800 to $79,800 on Jan. 1, 2002	.....	.....	.....	.....	1.4	3.7
$79,800 to $82,800 on Jan. 1, 2003	.....	.....	.....	.....	.....	1.4
Proposals [2]	–0.1	12.9	14.7	16.7	18.5	18.7
Total, receipts under existing and proposed legislation	**1,657.9**	**1,742.7**	**1,793.6**	**1,862.6**	**1,949.3**	**2,028.2**

[1] These estimates assume a social security taxable earnings base of $68,400 through 2003.
[2] Net of income offsets.

ENACTED LEGISLATION

Several laws were enacted in 1997 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

Airport and Airway Trust Fund Tax Reinstatement Act of 1997.—This Act reinstated, through September 30, 1997, aviation excise taxes that expired on December 31, 1996. The reinstated taxes on commercial air transportation included a 10-percent excise tax on domestic passenger tickets, a $6-per-person international departure tax, and a 6.5-percent domestic air freight excise tax. The reinstated taxes also included an excise tax on fuels used in general aviation of 17.5 cents per gallon for jet fuel and 15 cents per gallon for aviation gasoline. In addition, the Act authorized the Treasury Department to transfer to the Airport and Airway Trust Fund any aviation excise taxes collected during the fourth quarter of calendar year 1996 but not remitted to the Federal government during that period.

Taxpayer Relief Act of 1997. —This Act, together with the Balanced Budget Act of 1997, implements the bipartisan budget agreement announced on May 2, 1997. The legislation includes, with certain modifications, the key features of the Administration's proposals to give middle-income families the tax relief they need to help raise their children, save for the future, and pay for postsecondary education. In addition, the provisions of the Act promote a fairer tax system and encourage economic growth, while being fiscally responsible. The major provisions of the Act are described below.

Family Tax Relief

Provide tax credit for dependent children.—A credit is allowed for each dependent child under the age of 17. The credit equals $400 for 1998 and rises to $500 for 1999 and subsequent years. The credit is phased out for taxpayers with adjusted gross income (AGI) in excess of the following thresholds: $110,000 for married taxpayers filing a joint return, $75,000 for a single taxpayer or head of household, and $55,000 for married taxpayers filing a separate return. The amount of the credit and the thresholds are not indexed for inflation. The phase-out rate is $50 for each $1,000 of modified AGI (or fraction thereof) in excess of the threshold. For low-income families with three or more children, a refundable child credit is available to the extent that their income and employee payroll taxes exceed their earned income tax credit.

Education Tax Incentives

Provide tax credits for higher education tuition expenses.—Taxpayers are allowed to claim a per-student nonrefundable tax credit (Hope Credit) for qualified tuition and fees for enrollment of the taxpayer, the taxpayer's spouse or the taxpayer's dependent in a post-secondary degree or certificate program. To be eligible for the credit, a student must be enrolled on at least a half-time basis. The Hope Credit is equal to 100 percent of the first $1,000 of qualified expenses and 50 percent of the next $1,000 of qualified expenses, for a maximum credit of $1,500 per student. The maximum credit is indexed for inflation. The Hope Credit is available for expenses paid after December 31, 1997, for education furnished in academic periods beginning after that date, and is available for only the first two years of a student's post-secondary education. Alternatively, taxpayers are allowed a nonrefundable Lifetime Learning Credit for all postsecondary education, including graduate education. The credit is equal to 20 percent of qualified tuition and fees paid during the taxable year on behalf of the taxpayer, the taxpayer's spouse, or the taxpayer's dependent. A maximum credit of $1,000 per family is provided for expenses paid after June 30, 1998 and before January 1, 2003; the maximum credit increases to $2,000 per family effective for expenses paid after December 31, 2002. There is no limit on the number of years for which the Lifetime Learning Credit may be claimed. With respect to an eligible student, a taxpayer may elect either the Hope Credit, the Lifetime Learning Credit, or the exclusion from gross income for withdrawals from an education savings account (discussed below), but only one of these preferences may be used in a taxable year. Both credits are phased out for married taxpayers filing a joint return with modified AGI between $80,000 and $100,000 and for single taxpayers and heads of households with modified AGI between $40,000 and $50,000. The phase-out ranges will be indexed for inflation beginning in 2002.

Provide deduction for student loan interest.—Interest paid on a qualified education loan during the first 60 months that payment is required is deductible for income tax purposes, effective for payments due and paid after December 31, 1997. The maximum allowable deduction is $1,000 in 1998, $1,500 in 1999, $2,000 in 2000 and $2,500 in 2001 and subsequent years. The maximum amount is not indexed for inflation. In addition, the deduction is phased out ratably for single taxpayers with AGI between $40,000 and $55,000 and for married taxpayers filing a joint return with AGI between $60,000 and $75,000. The phase-out ranges are indexed for inflation beginning after 2002.

Expand tax preferences provided qualified State tuition programs.—Qualified State tuition programs (programs eligible for tax-exempt status and deferral of tax on earnings) are expanded to include State programs where individuals prepay for room and board, in addition to tuition, fees, books and supplies. This Act also expands the definition of eligible institution, expands the definition of "member of the family" with regard to tax-free rollovers of credits or account balances, and clarifies the estate and gift tax treatment of contributions to such programs. These modifications generally are effective after December 31, 1997.

Provide penalty-free withdrawals from Individual Retirement Accounts (IRAs) for education expenses.—Penalty-free withdrawals are permitted from IRAs for qualified higher education expenses of the taxpayer, the taxpayer's spouse, and the children and grandchildren of the taxpayer and the taxpayer's spouse. The provision applies to distributions made after December 31, 1997 with respect to expenses paid after that date for education furnished in academic periods beginning after that date.

Establish education savings accounts for children under 18.—Effective for taxable years beginning after December 31, 1997, taxpayers may contribute up to $500 per year, per beneficiary under age 18, to an education savings account. Earnings on contributions accumulate tax-free and distributions are excludable from gross income to the extent that the distribution does not exceed qualified higher education expenses incurred during the year the distribution is made. The earnings portion of a distribution not used to cover qualified education expenses is includable in the gross income of the beneficiary and is generally subject to an additional 10-percent tax. However, prior to the beneficiary reaching age 30, tax-free (and penalty-free) rollovers of account balances may be made to an education IRA benefitting another family member. The contribution limit is phased out ratably for married couples filing a joint return with AGI between $150,000 and $160,000 and for single taxpayers and heads of households with AGI between $95,000 and $110,000. If a taxpayer uses tax-free education savings account withdrawals for a student's qualified education expenses in a taxable year, neither the Hope Credit nor the Lifetime Learning Credit may be claimed in that year for the same student's education expenses.

Extend exclusion for employer-provided educational assistance.—Certain amounts paid by an employer for undergraduate educational assistance expenses are excluded from the employee's gross income for income and payroll tax purposes. This exclusion, which was scheduled to expire with respect to undergraduate education beginning after June 30, 1997, is extended to apply to undergraduate education courses beginning before June 1, 2000. The exclusion is limited to $5,250 of undergraduate educational assistance with respect to an individual during a calendar year.

Modify limit on qualified section 501(c)(3) private activity bonds.—Interest on State and local government bonds generally is excluded from income if the bonds are issued to finance activities carried out and paid for with revenues of these governments. Interest on bonds issued by these governments to finance activities of other persons, e.g., private activity bonds, is taxable unless a specific exception is provided in law. One such exception is for private activity bonds issued by certain tax-exempt organizations (section 501(c)(3) organizations) to finance activities that do not constitute an unrelated trade or business. The $150 million limit on the amount of outstanding bonds issued by an organization for other than hospital purposes is repealed, effective for section 501(c)(3) bonds isued after August 5, 1997 that are used to finance capital expenditures incurred after that date.

Enhance deduction for corporate contributions of computer technology and equipment.—Under current law augmented deductions are provided for certain corporate contributions of inventory property and scientific equipment. The amount of augmented deduction available to a corporation making these contributions is equal to its basis in the donated property plus one-half of the amount of ordinary income that would have been realized if the property had been sold. However, the amount of augmented deduction cannot exceed twice the basis of the donated property. Effective for contributions made in taxable years beginning after 1997 and before January 1, 2000, the list of contributions that qualify for the augmented deduction is expanded to include gifts of computer technology and equipment to be used within the United States for educational purposes in any of grades K-12.

Provide tax credit for holders of qualified zone academy bonds.—Certain financial institutions that hold qualified zone academy bonds are provided a nonrefundable tax credit in an amount equal to a credit rate (set by the Department of Treasury) multiplied by the face amount of the bond. The tax credit is includable in the gross income of the holder as interest. A qualified zone academy bond is any bond issued by a State or local government, provided that (1) 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a qualified zone academy and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds. A total of $400 million of qualified zone academy bonds may be issued in each of 1998 and 1999. The bond cap is allocated each year to the States according to their respective populations of individuals below the poverty line; any unused allocation may be carried into subsequent years.

Savings and Investment Incentives

Expand Individual Retirement Accounts (IRAs).—Under prior law, eligibility for a deductible IRA was phased out for a single taxpayer with AGI between $25,000 and $35,000 and a married taxpayer filing a joint return with AGI between $40,000 and $50,000, if the individual (or the individual's spouse) was an active participant in an employer-sponsored retirement plan. Under this Act, the AGI thresholds and phase-out ranges are doubled over time. For 1998, eligibility is phased out for single taxpayers with AGI between $30,000 and $40,000, and for couples filing a joint return with AGI between $50,000 and $60,000. For 1999 through 2002, the phase-out ranges are increased by $1,000 per year. For 2003, eligibility is phased out for single taxpayers with AGI between $40,000 and

$50,000, and for couples filing a joint return with AGI between $60,000 and $70,000. For 2004 and later years, the phase-out ranges are increased by $5,000 per year until the phase-out range is $50,000 to $60,000 for single taxpayers (2005 and subsequent years) and $80,000 to $100,000 for couples filing a joint return (2007 and subsequent years). Spouses of individuals who are active participants in an employer-sponsored retirement plan, but who are not themselves active participants, are permitted to make deductible contributions to an IRA. This spousal deduction is phased out for taxpayers with AGI between $150,000 and $160,000.

A new, tax-free nondeductible IRA called the "Roth IRA" is created. Eligibility for participation in these IRAs is phased out for single taxpayers with AGI between $95,000 and $110,000 and for married couples filing a joint return with AGI between $150,000 and $160,000. Taxpayers with AGI of less than $100,000 are eligible to roll over or convert an existing IRA to a Roth IRA. Distributions from the Roth IRA generally are tax free if (i) made more than 5 years after an account has been established, and (ii) made after age 59½, upon death or disability, or for first-time homebuyer expenses (up to a $10,000 lifetime cap). The same exceptions to the 10-percent early withdrawal tax apply to Roth IRAs and deductible IRAs, and these prior law exceptions have been expanded to include withdrawals for qualified first-time homebuyer expenses and qualified education expenses. Annual contributions to all IRAs for an individual may not exceed $2,000.

Reduce tax rate on capital gains.—The maximum capital gains tax rate for individuals is reduced from 28 percent to 20 percent (10 percent for individuals in the 15-percent tax bracket) effective May 7, 1997. The prior law maximum tax rate of 28 percent is retained for collectibles and, effective July 29, 1997, for assets held between 1 year and 18 months. Real estate depreciation recapture generally is taxed at a maximum rate of 25 percent. Beginning in 2001, assets acquired after December 31, 2000 and held for 5 years will be taxed at favorable rates of 8 percent (those in the 15-percent bracket) and 18 percent (those in other tax brackets). A taxpayer holding a capital asset or an asset used in his/her trade or business on January 1, 2001, may elect to treat the asset as having been sold on that date for its fair market value and as having been reacquired at the market price. Taxes must be paid on any gain realized as a result of the election; losses are disallowed.

Provide capital gains exclusion on sale of principal residence.—Under prior law gains on the sale of a taxpayer's principal residence were subject to the capital gains tax; however, taxes on the gain could be deferred through the purchase of a new home of equal or greater value within a specified period of time. Taxpayers over 55 could elect to take a one-time exclusion of up to $125,000 of gain from the sale of their home. Effective for sales on or after May 7, 1997, up to $500,000 of gain from the sale of a taxpayer's principal residence ($250,000 for a single taxpayer) is excluded from tax. The exclusion is allowed each time a taxpayer selling or exchanging a principal residence meets the eligibility requirements, but generally no more frequently than once every two years. To be eligible for the exclusion, a taxpayer generally must have owned the residence and occupied it as a principal residence for at least two of the five years prior to the sale or exchange.

Alternative Minimum Tax (AMT) Provisions

Exempt small corporations from the AMT and conform AMT depreciation lives to the regular tax.—For taxable years beginning after December 31, 1997, the corporate AMT is repealed for small businesses. A corporation with average gross receipts of less than $5 million for three taxable years, the last of which begins after December 31, 1996, is a small business corporation for any taxable year beginning after December 31, 1997. The exemption continues to apply as long as the business has three-year average gross receipts of less than $7.5 million. In addition, for property placed in service after December 31, 1998, the recovery periods used for purposes of the AMT depreciation adjustment are equal to the recovery periods used for purposes of the regular tax under present law.

Estate, Gift, and Generation-Skipping Tax Provisions

Increase estate and gift tax unified credit.—Under prior law, a unified estate and gift tax credit of $192,800 was provided, which effectively exempted the first $600,000 of cumulative taxable transfers from tax. Under this Act, a phased-in increase in the unified credit increases the effective exemption to $1,000,000 in 2006. The effective exemption is $625,000 for decedents dying and gifts made in 1998, $650,000 in 1999, $675,000 in 2000 and 2001, $700,000 in 2002 and 2003, $850,000 in 2004, $950,000 in 2005, and $1,000,000 in 2006 and subsequent years.

Provide estate tax exclusion for qualified family-owned businesses, including farms.—If "family-owned business interests" comprise more than 50 percent of a decedent's estate and certain other requirements are met, the first $1 million in qualified family-owned business interests may be excluded from a decedent's taxable estate. This exclusion, which is effective with respect to decedents dying after December 31, 1997, is in addition to the unified credit; however, the total amount excluded from tax is capped at $1.3 million.

Reduce estate tax for certain land subject to permanent conservation easement.—A 40-percent estate tax exclusion is provided for the value of any land subject to a qualified conservation easement that meets specified requirements. The maximum allowable exclusion is $100,000 in 1998, $200,000 in 1999, $300,000 in 2000, $400,000 in 2001 and $500,000 in 2002 and subsequent years. The exclusion may be taken in addition to the maximum exclusion for qualified family-owned business interests and applies to decedents dying after December 31, 1997.

Prohibit the revaluation of gifts for estate tax purposes after expiration of 3-year statute of limitations.—Estate and gift taxes generally must be assessed within 3 years after the filing of the return. In the past, in order to determine the appropriate tax rate bracket and unified credit for the estate tax, the Courts generally permitted the revaluation of a gift for which the statute of limitation period had expired. Effective for gifts made after August 5, 1997, revaluation of a gift for which the limitations period has expired is no longer permitted.

Expiring Provisions

Extend research and experimentation tax credit.—The 20-percent tax credit for certain incremental research and experimentation expenditures is extended to apply to expenditures paid or incurred during the period June 1, 1997 through June 30, 1998.

Extend orphan drug tax credit.—The 50-percent nonrefundable tax credit provided for qualified clinical testing expenses paid or incurred in the testing of certain drugs for rare diseases or conditions (generally known as "orphan drugs") is permanently extended, effective for expenses paid or incurred after May 31, 1997.

Extend deduction for contributions of stock to private foundations.—The deduction for a contribution of property to a private foundation is limited to the adjusted basis of the contributed property. However, prior law allowed a taxpayer who contributed qualified appreciated stock to a private foundation before June 1, 1997 to deduct the full fair market value of the stock, rather than the adjusted basis of the contributed stock. This Act extends the rule for private foundations through June 30, 1998.

Extend work opportunity tax credit, with modifications.—Under prior law, an employer hiring individuals from one or more of seven targeted groups was allowed a work opportunity tax credit equal to 35 percent of the first $6,000 in qualified first-year wages paid to a qualified individual beginning work after September 30, 1996 and before October 1, 1997. For wages paid to be eligible for the credit, the qualified individual had to be employed by the employer for at least 180 days (20 days in the case of a qualified summer youth employee) or 400 hours (120 hours in the case of a qualified summer youth employee). This Act extends the credit to apply to wages paid to qualified individuals beginning work after September 30, 1997 and before July 1, 1998. In addition, a credit of 25 percent is provided for wages paid to a qualified individual employed at least 120 and fewer than 400 hours, and the credit is increased to 40 percent for wages paid to a qualified individual employed for at least 400 hours. Eligibility is extended to members of families receiving AFDC benefits (or its successor programs) and to SSI beneficiaries.

Extend Generalized System of Preferences (GSP).—Under GSP, duty-free access is provided to over 4,000 items from eligible developing countries that meet certain worker rights, intellectual property protection, and other criteria. This program, which had expired after May 31, 1997, is temporarily extended through June 30, 1998. Refunds of any duty paid between May 31, 1997 and August 5, 1997 are provided upon request of the importer.

Extend unemployment surtax and increase the statutory limit on Federal Unemployment Act (FUTA) trust fund balances.—The temporary unemployment surtax of 0.2 percent imposed on employers, which was scheduled to expire with respect to wages paid after December 31, 1998, is extended through December 31, 2007. In addition, the statutory limit on balances in the Federal Unemployment Account (FUA) of the FUTA trust fund is increased from .25 percent to .50 percent of covered wages.

District of Columbia (D.C.) Tax Incentives

Designate D.C. Enterprise Zone.—Certain economically depressed census tracts within D.C. are designated as the "D.C. Enterprise Zone." The following tax incentives are available to businesses and individual residents within the zone: (1) a 20-percent wage credit for the first $15,000 of wages paid to D.C. residents who work in the zone; (2) an additional $20,000 of expensing under section 179 for qualified zone property; and (3) special tax-exempt financing for certain zone facilities. The D.C. Enterprise Zone designation will remain in effect for the period from January 1, 1998 through December 31, 2002.

Provide zero-percent capital gains rate on certain Enterprise Zone property.—A zero-percent capital gains rate is provided for capital gains from the sale of certain qualified assets held for more than five years. To qualify for the zero-percent rate, the asset must be within a census tract within the D.C. Enterprise Zone where the poverty rate is not less than 10 percent.

Provide tax credit to first-time homebuyers.—A tax credit of up to $5,000 of the purchase price is provided first-time homebuyers of a principal residence in the District of Columbia. The credit phases out for single taxpayers with AGI between $70,000 and $90,000 and for married couples filing a joint return with AGI between $110,000 and $130,000. The credit is available with respect to property purchased after August 4, 1997 and before January 1, 2001.

Welfare-to-Work Tax Credit

Provide welfare-to-work tax credit.—Employers are provided a tax credit on the first $20,000 of eligible wages paid to qualified recipients of long-term family assistance (AFDC or its successor program) during the first two years of employment. The credit is 35 percent of the first $10,000 of eligible wages in the first year of employment and 50 percent of the first $10,000 of eligible wages in the second year of employment. The credit is effective for wages paid or incurred by the employer for a qualified employee who begins work on or after January 1, 1998 and before May 1, 1999.

Excise Tax Provisions

Repeal excise tax on diesel fuel used in recreational motorboats.—The 24.3-cents-per-gallon excise tax on diesel fuel used in recreational motorboats is repealed. Under prior law, imposition of this tax had been suspended through December 31, 1997.

Transfer 4.3-cents-per-gallon General Fund highway fuels tax to the Highway Trust Fund.—Under prior law 4.3-cents-per-gallon of the excise tax on gasoline, diesel fuel, and special motor fuels used in highway vehicles was transferred to the General Fund of the Treasury. Under this Act, collections from these taxes are deposited in the Highway Trust Fund, with 3.45-cents-per-gallon allocated to the Highway Account and .85-cents-per-gallon allocated to the Mass Transit Account. Conforming amendments ensure that no direct spending increases will occur as a result of this transfer of funds.

Modify deposit rules for excise taxes on highway motor fuels.—The excise taxes imposed on highway motor fuels that would otherwise be required to be deposited with the Treasury after July 31, 1998 and before September 30, 1998 are not required to be deposited until October 5, 1998, resulting in a shift of collections from 1998 to 1999.

Modify and expand excise tax on vaccines.—Under prior law an excise tax was imposed on the following vaccines: DPT (diphtheria, pertussis, tetanus) at $4.56 per dose; DT (diphtheria, tetanus) at $0.06 per dose; MMR (measles, mumps, or rubella) at $4.44 per dose; and polio at $0.29 per dose. Effective for sales after August 5, 1997, a uniform rate of $0.75 per dose on any listed vaccine component is imposed on all previously taxed vaccines. In addition, the tax is expanded to apply to HIB (haemophilus influenza type B), Hepatitis B, and varicella (chickenpox) vaccines

Extend and modify excise taxes deposited in the Airport and Airway Trust Fund.—Under prior law, the excise taxes deposited in the Airport and Airway Trust Fund were scheduled to expire after September 30, 1997. These taxes included a 10-percent excise tax on domestic passenger tickets, a $6-per-person international departure tax, a 6.5-percent domestic air freight excise tax, and an excise tax on fuels used in general aviation of 17.5 cents per gallon for jet fuel and 15 cents per gallon for aviation gasoline. This Act extends these taxes for 10 years, through September 30, 2007, with the following modifications:

- *Tax on domestic passenger tickets.*—The 10-percent ad valorem tax on domestic passenger tickets is replaced with a combination ad valorem and per-domestic-flight-segment tax. Effective October 1, 1997 the tax is 9 percent of fare plus $1 per domestic flight segment. The tax changes to 8 percent of fare and $2 per domestic flight segment effective October 1, 1998; and to 7.5 percent of fare and $2.25 per domestic flight segment effective October 1, 1999. The ad valorem tax remains at 7.5 percent, but the per-domestic-flight-segment tax increases to $2.50 effective January 1, 2000, $2.75 effective January 1, 2001 and $3 effective January 1, 2002. The $3 rate is indexed annually for inflation effective January 1, 2003. The per-domestic-flight-segment tax is not imposed on flight segments to and from qualified rural airports; the ad valorem tax on such flights is 7.5 percent of fare. The 7.5 percent ad valorem tax also applies to payments to air carriers (and related parties) for the right to award air travel benefits.
- *Tax on international departures and arrivals.*—The $6-per-passenger international departure tax is increased to $12 per passenger and extended to apply to international arrivals effective October 1, 1997. A $6-per-passenger rate is applicable to the international airspace component of flights between the 48 contiguous States and Alaska or Hawaii (or flights between Alaska and Hawaii). Both the $6 and $12 taxes are indexed annually for inflation effective January 1, 1999.
- *Deposit schedule for certain aviation taxes.*—Deposits of air passenger taxes otherwise due after August 14, 1997 and before October 1, 1997 are due on October 10, 1997. In addition, deposits of air passenger taxes otherwise required after August 14, 1998 and before October 1, 1998 are due on October 5, 1998. Deposits of commercial air cargo and aviation fuels taxes otherwise required to be made after July 31, 1998 and before October 1, 1998 are due on October 5, 1998.
- *Transfer of General Fund taxes.*—The 4.3-cents-per-gallon excise tax on aviation fuels that was deposited in the General Fund of the Treasury under prior law is deposited in the Airport and Airway Trust Fund effective October 1, 1997.

Impose excise taxes on kerosene as diesel fuel.—A 24.3-cents-per-gallon excise tax is imposed on diesel fuel upon removal from a registered terminal storage facility unless the fuel is indelibly dyed and is destined for a nontaxable use. Under prior law, undyed kerosene was not subject to the diesel fuel excise tax when it was removed from a terminal. Undyed kerosene was subject to tax, however, when it was blended with previously taxed diesel fuel. Effective July 1, 1998, kerosene is taxed as diesel fuel when it is removed from a terminal. Exceptions are provided for aviation fuel and, to the extent provided in regulations, for feedstock uses. In addition, special refund rules apply in certain cases of kerosene used for heating purposes.

Reinstate excise taxes deposited in the Leaking Underground Storage Tank (LUST) Trust Fund.—Before January 1, 1996, a 0.1-cent-per-gallon excise tax was levied on gasoline, other motor fuels, methanol and ethanol fuels, aviation fuels, and on fuels used in inland waterways and deposited in the LUST Trust Fund. This Act reinstates those taxes effective October 1, 1997 through March 31, 2005.

Apply communications excise tax to prepaid telephone cards.—A 3-percent excise tax is imposed on amounts paid for local and toll telephone service and teletypewriter exchange service. This Act extends this tax to

apply to amounts paid to communications service providers (in cash or in kind) for the right to award or otherwise distribute free or reduced-rate telephone service. The tax is effective for cards sold after October 31, 1997.

Modify treatment of tires under the heavy highway vehicle retail excise tax.—A 12-percent retail excise tax is imposed on certain heavy highway trucks and trailers, and on highway tractors. A separate manufacturer's excise tax is imposed on tires weighing more than 40 pounds. Under prior law, because tires were taxed separately, the value of tires installed on highway vehicles was excluded from the 12-percent retail excise tax on heavy highway vehicles. This Act repeals this exclusion; instead, a credit for the amount of manufacturers' excise tax paid on the tires is allowed. This change is effective after December 31, 1997.

Small Business Provisions

Clarify definition of principal place of business for home office deduction.—The definition of "principal place of business" is expanded to include a home office that is used by the taxpayer to conduct administrative or management activities of the business, provided that there is no other fixed location where the taxpayer conducts substantial administrative or management activities of the business, regardless of whether such activities are performed by others at other locations. As under prior law, deductions are allowed only if the office is exclusively used on a regular basis as a place of business and, in the case of an employee, only if such exclusive use is for the convenience of the employer. The expanded definition applies to taxable years beginning after December 31, 1998.

Increase deduction of health insurance costs for self-employed individuals.—Under prior law self-employed individuals were allowed a deduction for the cost of health insurance for themselves and their spouse and dependents as follows: 40 percent for 1997; 45 percent for 1998 through 2002; 50 percent for 2003; 60 percent for 2004; 70 percent for 2005; and 80 percent for 2006 and subsequent years. This Act increases the allowable deduction to 100 percent as follows: 45 percent for 1998 and 1999; 50 percent for 2000 and 2001; 60 percent for 2002; 80 percent for 2003 through 2005; 90 percent for 2006; and 100 percent for 2007 and subsequent years.

Increase deduction for business meals for certain individuals.—Generally the amount allowable as a deduction for food and beverage is limited to 50 percent of the otherwise deductible amount. Exceptions to this 50-percent rule are provided for food and beverages provided to crew members of certain vessels and offshore oil or gas platforms or drilling rigs. This Act increases the deduction for food and beverages consumed while away from home by an individual during or incident to a period of duty subject to the hours of service limitations of the Department of Transportation. Such individuals include certain air transportation employees, interstate truck operators and bus drivers, certain railroad employees and certain merchant mariners. The increase in the deductible percentage is phased in as follows: 55 percent for 1998 and 1999, 60 percent for 2000 and 2001, 65 percent for 2002 and 2003, 70 percent for 2004 and 2005, 75 percent for 2006 and 2007, and 80 percent for 2008 and subsequent years.

Increase standard mileage rate for purposes of computing the charitable deduction.—Effective for taxable years beginning after December 31, 1997, for purposes of computing the charitable deduction, the standard mileage rate for the use of a passenger vehicle is increased from 12 cents per mile to 14 cents per mile.

Incentives for Distressed Areas

Provide tax incentive to clean up environmentally contaminated areas known as brownfields.—A current deduction is allowed for certain costs incurred by businesses to remediate environmentally contaminated land in certain areas. Qualified sites generally are limited to those properties located in or next to census tracts with a poverty rate of 20 percent or more, Federal empowerment zones and enterprise communities, and areas subject to certain Environmental Protection Agency (EPA) Brownfields Pilots. To claim this incentive, taxpayers are required to obtain from the appropriate State or local agency verification that the site satisfies geographic and contamination requirements. The deduction is available for qualified expenses incurred after August 5, 1997 and before January 1, 2001.

Expand and modify Empowerment Zone and Enterprise Community program.—Under the Omnibus Budget Reconciliation Act of 1993 (OBRA 93), certain tax incentives were provided for nine empowerment zones (6 urban and 3 rural) and 95 enterprise communities. The tax incentives were a 20-percent employer wage credit, an additional $20,000 of section 179 expensing, and a new category of tax-exempt financing. Qualifying businesses in empowerment zones were eligible for all three incentives, while businesses in enterprise communities were eligible only for the tax-exempt financing. This Act authorizes the designation of two additional urban empowerment zones within 180 days of enactment; however, the designations, which generally will remain in effect for 10 years, will not take effect before January 1, 2000. These two additional zones are subject to the same eligibility criteria as the original 6 urban empowerment zones, and, except for a modification of the wage credit, generally enjoy the same tax incentives as the original zones. For these two additional zones the wage credit is modified slightly to provide that the percentage of wages taken into account for purposes of determining the wage credit is 20 percent for 2000 through 2004, 15 percent for 2005, 10 percent for 2006, and 5 percent for 2007; the credit is not available for subsequent years. The Act also authorizes the designation of an additional 20 empowerment zones before 1999. Businesses in these 20 additional zones are not eligible for the wage credit, but are eligible to receive up to $20,000 of additional section 179 expensing, and special tax-exempt financing benefits. The "brownfields

tax incentive" provided in this Act (see discussion above) is available within all designated empowerment zones.

Financial Product Provisions

Require recognition of gain on certain appreciated positions in personal property.—Gains and losses generally are taken into account for tax purposes when realized. Gains or losses are usually realized with respect to a capital asset at the time the asset is sold or exchanged. However, because of special rules under prior law, many transactions designed to reduce or eliminate risk of loss and opportunity for gain on financial assets generally did not cause realization. For example, taxpayers could lock in gain on securities without recognizing gain for tax purposes by entering into a "short sale against the box," that is, the taxpayer could own securities the same as or substantially identical to the securities borrowed and sold short. This Act requires in some circumstances recognition of gain (but not loss) upon entering into a constructive sale of any appreciated financial position in stock, a debt instrument, or a partnership interest. A constructive sale occurs when the taxpayer enters into one of the following transactions with respect to the same or substantially identical property: (1) a short sale, (2) an offsetting notional principal contract, (3) a futures or forward contract, or (4) to the extent provided in regulations, one or more transactions that have substantially the same effect as one of the described transactions. This provision generally is effective for constructive sales entered into after June 8, 1997.

Permit dealers in commodities and traders in securities and commodities to elect mark-to-market.—This Act permits securities traders and commodities traders and dealers to elect mark-to-market accounting similar to that currently required for securities dealers. All securities held by an electing taxpayer in connection with a trade or business as a securities trader, and all commodities held by an electing taxpayer in connection with a trade or business as a commodities dealer or trader, are subject to mark-to-market treatment. Property not held in connection with an electing taxpayer's trading activity is not subject to the election provided that it is identified by the taxpayer, under rules similar to the present law rules for securities dealers, and the electing taxpayer can demonstrate by clear and convincing evidence that the property bears no relation to its activities as a trader. Gain or loss recognized by an electing taxpayer under the provision is ordinary gain or loss. This provision applies to taxable years ending after August 5, 1997.

Change the treatment of gains and losses on extinguishment.—The tax law distinguishes between the sale of a right or obligation to a third party and the extinguishment or retirement of the right or obligation. A sale to a third party can give rise to capital treatment while an extinguishment produces ordinary income. Under prior law extinguishment treatment was eliminated for all debt instruments except those issued by natural persons and for most options and other positions in actively traded property. This Act eliminates the remaining portions of the extinguishment doctrine so that gain or loss attributable to the cancellation, lapse, expiration, or other termination of any right or obligation which is (or on acquisition would be) a capital asset in the hands of the taxpayer is treated as gain or loss from the sale or exchange of a capital asset. This change applies to property acquired or positions established 30 days after the date of enactment. In addition, redemptions of debt issued by natural persons and debt issued before July 2, 1982 are treated as an exchange and, accordingly, any gain or loss on that redemption is capital gain or loss effective for debt issued or purchased after June 8, 1997.

Deny interest deduction on certain debt instruments.—If an instrument qualifies as equity, the issuer generally does not receive a deduction for dividends paid. If an instrument qualifies as debt, the issuer may deduct accrued interest, including original issue discount (OID). The Act eliminates the deduction for interest and OID on a debt instrument that is issued by a corporation and that is payable in stock of the issuer or a related party. The Act applies to debt instruments that are mandatorily convertible or convertible at the issuer's option into stock of the issuer or of a related party. The Act does not apply to debt instruments that are convertible at the holder's option unless, at the time the instrument is issued, it is substantially certain that the holder's option will be exercised. This provision generally is effective for instruments issued after June 8, 1997.

Require reasonable payment assumptions for interest accruals on certain debt instruments.— A taxpayer that holds a debt instrument generally accrues interest income over the life of the instrument. Certain debt instruments, such as credit card receivables, do not require the debtors to pay interest if they pay their balances in full by a specified date. The operation of the interest accrual rules of prior law provided that, in such instances, the holder could assume that each debtor would pay its balance by the specified date and, thereby, avoid accruing interest over the life of the debt instrument. In these cases, the holder would not accrue any interest income until the specified date had passed. In the case of a large pool of such debt instruments, the assumption that each debtor will prepay (and thereby avoid a finance charge) is unrealistic and results in the mismeasurement of income. Under the Act, taxpayers that hold large pools of prepayable debt instruments must accrue interest on the pool by making a reasonable assumption regarding the timing of payments on the instruments that make up the pool. The provision is effective for taxable years beginning after August 5, 1997.

Corporate Organizations and Reorganizations

Require gain recognition for certain extraordinary dividends.—A corporate shareholder generally is allowed to deduct a percentage of dividends received from

another domestic corporation. A distribution in redemption of stock may be treated as a dividend if the shareholder's proportionate interest in the distributing corporation has not been meaningfully reduced. In determining if a shareholder's interest has been meaningfully reduced, the ownership of options to purchase stock may be treated as actual stock ownership, rather than as a sale of the stock, if it is essentially equivalent to a dividend. Certain dividends and dividend equivalent transactions are treated as "extraordinary" dividends. Whether a dividend is "extraordinary" is determined, among other things, by reference to the size of the dividend in relation to the adjusted basis of the shareholder's stock. If a corporate shareholder receives an extraordinary dividend, the corporate shareholder must reduce the basis of the stock to which the distribution relates by the amount of the nontaxed portion of the dividend (generally the amount of the dividend that was deducted). Under prior law, if the nontaxed portion of the dividend exceeded the basis of the stock, the excess was deferred and not taxed as gain until the sale or disposition of the stock. Under this Act a corporate shareholder generally is required to recognize gain immediately with respect to any redemption treated as a dividend when the nontaxed portion of the dividend exceeds the basis of the shares surrendered, if the redemption is treated as a dividend due to options being counted as stock ownership. In addition, immediate gain recognition is required whenever the basis of stock with respect to which any extraordinary dividend is received is reduced below zero. These changes generally are effective for distributions after May 3, 1995, unless made pursuant to the terms of a written binding contract in effect on May 3, 1995 or a tender offer outstanding on May 3, 1995.

Require gain recognition on certain distributions of controlled corporation stock.—A corporation generally is required to recognize gain on a distribution of property (including stock of a controlled corporation) unless the distribution meets certain requirements. Under prior law, if various requirements were met, including restrictions relating to acquisitions and dispositions of stock of the distributing corporation or the controlled corporation, a distribution of the stock of a controlled corporation generally was tax-free to the distributing corporation. This Act adopts additional restrictions on acquisitions and dispositions of the stock of a distributing corporation or controlled corporation. Under this Act, the distributing corporation is required to recognize gain on the distribution of the stock of the controlled corporation if the shareholders of the distributing corporation do not retain 50-percent or more of the stock interest in either the distributing or controlled corporation during the four-year period commencing two years prior to the distribution. In addition, distributions within an affiliated group of corporations, in connection with such a distribution or acquisition transaction, are no longer tax free. These changes generally are effective for distributions after April 16, 1997.

Reform the tax treatment of certain stock transfers.—Certain sales of stock to a related corporation are treated as the payment of a dividend by the purchaser. Such dividends may qualify for the dividends received deduction; in addition, such dividends may bring with them foreign tax credits. For example, if a foreign-controlled domestic corporation sells the stock of a subsidiary to a foreign sister corporation, the domestic corporation may take the position that it is entitled to credit foreign taxes that were paid by the foreign sister corporation. This Act limits the amount treated as a dividend (and the associated foreign tax credits) from the purchaser to the amount of the purchaser's earnings and profits attributable to stock owned by U.S. persons related to the seller. The Act also clarifies that a deemed dividend from a purchaser that is a domestic corporation generally should be treated as an extraordinary dividend requiring a basis reduction and gain recognition to the extent that the nontaxed portion exceeds the basis of the shares transferred. These changes generally are effective for distributions or acquisitions after June 8, 1997, but do not apply to such distributions or acquisitions made pursuant to a written agreement that was binding on that date.

Modify holding period for dividends-received deduction.—The dividends-received deduction is allowed to a corporate shareholder only if the shareholder satisfies a 46-day holding period for the dividend-paying stock or a 91-day period for certain dividends on preferred stock. The 46- or 91-day holding period generally does not include any time in which the shareholder is protected from the risk of loss otherwise inherent in the ownership of an equity interest. However, under prior law, the holding period requirement did not have to be proximate to the time the dividend distribution was made. This Act requires that in order to qualify for the dividends-received deduction, the holding period requirement must be satisfied with respect to that dividend over a period immediately before or immediately after the taxpayer becomes entitled to receive the dividend. This change generally is effective for dividends paid or accrued more than 30 days after August 5, 1997.

Pension and Employee Benefit Provisions

The Act makes a number of changes affecting pension plans and other employee benefits, including the following:

Change rule relating to involuntary distributions from retirement plans.—In the case of a participant who separates from service with the employer, a qualified retirement plan may cash out the participant's benefits without the participant's consent if the present value of the benefits does not exceed a dollar limit. The Act increases this limit from $3,500 to $5,000 effective for plan years beginning after August 5, 1997.

Repeal excess distribution and excess retirement accumulation taxes.—Under prior law, an individual's distributions from qualified retirement plans, tax-sheltered annuities and IRAs, that, in the aggregate, exceeded

$160,000 in a calendar year (or, if made as a lump sum distribution, five times that amount) were subject to a 15-percent excise tax on "excess" distributions. This excise tax was suspended for distributions received in 1997, 1998, or 1999. An individual's balance in retirement plans was subject to an additional 15-percent estate tax on excess distributions to the extent that the balance exceeded the present value of a benefit that would not be subject to the 15-percent excise tax on excess distributions. The Act repeals both the excise tax on excess distributions (effective for distributions received after 1996) and the estate tax on excess retirement accumulations (effective for decedents dying after 1996).

Treat matching contributions of self-employed individuals as not constituting elective deferrals.—Employees may elect to make tax-deferred elective contributions ("elective deferrals") to a 401(k) plan up to an indexed dollar limit ($10,000 for 1998). Employers may make matching contributions based on the employees' elective deferrals. Similarly, under a SIMPLE retirement plan, employees may make elective deferrals (of up to $6,000 per year), and employers may make matching contributions. Under prior law, matching contributions that were made for a self-employed individual generally were treated as elective deferrals and were counted against the dollar limit on elective deferrals, as well as in the nondiscrimination test applicable to elective deferrals under a 401(k) plan (the ADP test). The Act changes this treatment of matching contributions for self-employed individuals. Instead of subjecting those contributions to the limits on elective deferrals and to the ADP test, the Act generally treats them like matching contributions made for employees. This change is effective for years beginning after 1997 in the case of 401(k) plans and for years beginning after 1996 in the case of SIMPLE plans.

Change rules affecting State and local government and church plans.—The Act makes a number of changes affecting retirement plans maintained by State and local governments and churches, including permanently exempting governmental plans from the nondiscrimination and minimum participation rules that otherwise apply to qualified plans. Those rules generally prohibit plans from discriminating in favor of highly compensated employees with respect to contributions or benefits, participation, coverage and compensation counted under the plan. The exemption generally is effective for taxable years beginning on or after August 5, 1997.

Increase pension plan full funding limit.—Contributions to a defined benefit pension plan are subject to a maximum "full funding" limit. Under prior law, the full funding limit generally was the lesser of the plan's accrued liability (based on projected benefits) or 150 percent of its current liability (based on benefits accrued to date). The Act increases the 150-percent-of-current-liability component of the full funding limit to 155 percent for plan years beginning in 1999 or 2000, 160 percent for plan years beginning in 2001 or 2002, 165 percent for plan years beginning in 2003 or 2004, and 170 percent for plan years beginning thereafter. The Act also extends the amortization period, from ten to twenty years, for amounts that could not be contributed because of the 150-percent-of-current-liability limit. This change is effective for plan years beginning after December 31, 1998.

Require increased diversification of 401(k) investments.—The Employee Retirement Income Security Act of 1974, as amended (ERISA), generally permits only up to 10 percent of the fair market value of the assets of a retirement plan to be invested in employer securities or real property leased to the employer that sponsors the plan. Prior law contained an exception to this rule permitting defined contribution plans, including section 401(k) plans, to invest more than 10 percent of their assets in employer securities or employer real property if the plan authorized such investments. The Act generally provides that a plan is not permitted to require that an employee's elective deferrals be invested in employer securities or employer real property if the employee's elective deferrals are in excess of one percent of the employee's eligible compensation and if employer securities and employer real property exceed 10 percent of the plan's assets. The provision does not apply to employee stock ownership plans or if the value of assets of all defined contribution plans of the employer does not exceed 10 percent of the value of assets of all pension plans maintained by the employer. The provision is effective for elective deferrals for plan years beginning after December 31, 1998.

Tax Exempt Organization Provisions

Repeal grandfather rule with respect to pension business of certain insurers.—Under prior law, that portion of the business of the Teachers Insurance Annuity Association-College Retirement Equities Fund (TIAA-CREF) or of Mutual of America that was attributable to pension business was exempt from tax. Effective for taxable years beginning after December 31, 1997, TIAA-CREF and Mutual of America are treated for Federal tax purposes as life insurance companies; that portion of their business attributable to pension business is no longer exempt from tax.

Foreign Provisions

Place further restrictions on like-kind exchanges involving personal property.—An exchange of property, like a sale, is generally a taxable transaction. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a like kind that is to be held for productive use in a trade or business or for investment. In general, any kind of real estate is treated as of a like kind with other real property; however, real property located in the United States and real property located outside the United States are not of a like kind. Under prior law, for personal property, property of a "like class" was treated as being of a like kind; no restrictions applied with regard to location

in or outside the United States. To conform the limitations on exchanges of personal property to the limitations on exchanges of real property, this Act provides that personal property predominantly used within the United States and personal property predominantly used outside the United States are not "like-kind" properties. This change generally is effective for exchanges after June 8, 1997, unless the exchange is pursuant to a binding contract in effect on such date.

Impose holding period requirement for claiming foreign tax credits with respect to dividends.—Under prior law, U.S. persons that received dividends from a regulated investment company (RIC), generally were entitled to an indirect credit for foreign taxes paid by the RIC, regardless of the shareholder's holding period for the RIC stock. A U.S. corporation that received a dividend from a foreign corporation in which it had a 10-percent or greater voting interest generally was entitled to an indirect credit for foreign taxes paid by the foreign corporation, also regardless of the shareholder's holding period. This Act generally disallows the foreign tax credits available with respect to a dividend from a corporation or RIC if the shareholder holds the stock for less than 16 days in the case of common stock and 46 days in the case of preferred stock. This provision is effective for dividends paid or accrued more than 30 days after August 5, 1997.

Allow Foreign Sales Corporation (FSC) benefits for computer software licenses.—The FSC provisions provide a limited exemption from U.S. tax for income arising in certain export transactions; under prior law, the exemption was not available for most exports of intangible property, including computer software copyrights. This Act extends FSC benefits to licenses of computer software for reproduction abroad. The provision applies to gross receipts from computer software licenses attributable to periods after December 31, 1997. In the case of a multi-year license, the provision applies to gross receipts attributable to the period of such license that is after December 31, 1997.

Increase dollar limitation on exclusion for foreign earned income.—U.S. citizens generally are subject to U.S. income tax on all their income, whether derived in the United States or elsewhere. U.S. citizens living abroad may be eligible to exclude from their income for U.S. tax purposes certain foreign earned income. In order to qualify for this exclusion, a U.S. citizen must be either (1) a bona fide resident of a foreign country for an uninterrupted period that includes an entire taxable year, or (2) present overseas for 330 days out of any 12 consecutive month period. In addition, the taxpayer must have his or her tax home in a foreign country. Under prior law, the maximum exclusion for foreign earned income for a taxable year was $70,000. This Act increases the maximum exclusion to $80,000 in increments of $2,000 each year beginning in 1998. The limitation on the exclusion is indexed for inflation beginning in 2008.

Other Corporate Provisions

Require registration of certain corporate tax shelters.—Under prior law promoters of a corporate tax shelter were required to register such shelters with the Internal Revenue Service (IRS). This Act generally requires a promoter of a corporate tax shelter to register the shelter with the Secretary of the Treasury no later than the next business day after the day when the shelter is first offered to potential users. This Act also increases the penalty for failing to register in a timely manner a corporate tax shelter and modifies the substantial understatement penalty. The tax shelter registration provision applies to any tax shelter offered to potential participants after the date the Treasury Department issues guidance with respect to the filing requirements. The modifications to the substantial understatement penalty apply to items with respect to transactions entered into after August 5, 1997.

Treat certain preferred stock as "boot."—Under prior law, in reorganization transactions, no gain or loss was recognized except to the extent "other property" (boot) was received; that is, property other than certain stock, including preferred stock. Upon the receipt of "other property," gain but not loss was recognized. This Act requires certain preferred stock that is received in otherwise tax-free transactions to be treated as "other property." This change generally is effective for transactions after June 8, 1997 but does not apply to such transactions made pursuant to a written agreement that was binding on that date.

Administrative Provisions

Require tax reporting for payments to attorneys.—Treasury regulations require a payor to report payments of attorney's fees if the payments are made in the course of a trade or business. However, under prior law a payor generally was not required to report payments made to corporations. In addition, if a payment to an attorney was a gross amount and it could not be determined what portion was the attorney's fee (as in the case of lump-sum judgments or settlements made jointly payable to a lawyer and a plaintiff), then no reporting was required. This Act requires the reporting of gross proceeds on all payments made to attorneys by a trade or business in the course of the trade or business. In addition, the prior law exception for reporting payments to corporations no longer applies to payments made to attorneys. The provision is effective for payments made after December 31, 1997.

Require reporting of payments to corporations rendering services to Federal agencies.—All persons engaged in a trade or business and making payments of $600 or more to another person in remuneration for services generally must report those payments to the IRS and to the recipient. No reporting is required if the recipient is a corporation, unless the payment is made to an attorney (see previous provision). To ensure that corporations that do business with the Federal Government appropriately report as income their payments from the Federal Government, this Act requires execu-

tive agencies to report payments of $600 or more made to corporations for services rendered. An exception is provided for certain classified or confidential contracts. The provision is effective for returns the due date of which is more than 90 days after August 5, 1997.

Establish IRS continuous levy and improve debt collection.—Under this Act a continuous levy is applicable to non-means-tested recurring Federal payments, such as Federal salaries and pensions, received by individuals who owe delinquent tax debt. In addition, this Act provides that the levy attach up to 15 percent of any specified payment due the taxpayer. A continuous levy of up to 15 percent also applies to unemployment benefits and means-tested public assistance. The Act also permits the disclosure of otherwise confidential tax return information to the Treasury Department's Financial Management Service only for the purpose of, and to the extent necessary, in implementing these levies. The provision is effective for levies issued after August 5, 1997.

Earned Income Tax Credit (EITC) Compliance Provisions

Deny EITC eligibility for prior acts of recklessness or fraud.—A taxpayer who fraudulently claims the EITC is denied eligibility for the subsequent 10 years. A taxpayer who erroneously claims the EITC due to reckless or intentional disregard of rules or regulations is denied eligibility for the subsequent 2 years. These sanctions are in additional to any other penalties imposed by current law and are effective for taxable years beginning after December 31, 1996.

Require recertification for eligibility if past eligibility was denied as a result of deficiency procedures.—A taxpayer who has been denied the EITC as a result of deficiency procedures is denied eligibility in subsequent years unless evidence of eligibility for the credit is provided. To demonstrate current eligibility the taxpayer is required to meet evidentiary requirements established by the Secretary of the Treasury. Failure to provide this information is treated as a mathematical or clerical error. A taxpayer who has been recertified as eligible for the EITC does not have to resubmit this information in the future unless the IRS again denies the EITC as a result of a deficiency procedure. The provision is effective for taxable years beginning after December 31, 1996.

Require tax preparers to fulfill certain due diligence requirements.—Effective for taxable years beginning after December 31, 1996, tax return preparers are required to fulfill certain due diligence requirements with respect to returns they prepare claiming the EITC. The penalty for failure to meet these requirements, which is in addition to any other penalties assessed under current law, is $100 for each failure.

Modify the definition of AGI used to phaseout the EITC.—The EITC is phased out for individuals with earned income (or AGI, if greater) in excess of certain amounts. Under prior law, the definition of AGI used for the phase out of the earned income credit disregarded the following losses: (1) net capital losses (if greater than zero); (2) net losses from trusts or estates; (3) net losses from nonbusiness rents and royalties; and (4) 50 percent of the net losses from business, computed separately with respect to sole proprietorships (other than in farming), sole proprietorships in farming, and other businesses. This Act modifies the definition of AGI used for phasing out the credit by adding two sources of nontaxable income: (1) tax-exempt interest and (2) nontaxable distributions from pensions, annuities, and individual retirement arrangements. The Act also increases to 75 percent the percentage of net losses from business disregarded from the definition of AGI used for the phase out of the EITC. These changes are effective for taxable years beginning after December 31, 1997.

Use Federal case registry of child support orders for tax enforcement purposes.—The Personal Responsibility and Work Opportunity Reconciliation Act of 1997 mandated the creation of a Federal Case Registry of Child Support Orders (the FCR) by October 1, 1998. The FCR is required to include the names, and the State case identification numbers of individuals who are owed or who owe child support or for whom paternity is being established. It may also include the social security numbers (SSNs) of these individuals. Under the Taxpayer Relief Act, the Secretary of the Treasury is provided access to the FCR not later than October 1, 1998. Also, by October 1, 1999, the data elements on the State Case Registry will include the SSNs of children covered by cases in the Registry, and the States will provide the SSNs of these children to the FCR.

Expand Social Security Administration (SSA) records for tax enforcement.—Effective February 1, 1998, SSA is required to obtain SSNs of both parents on minor children's applications for SSNs. The SSA will provide this information to the IRS as part of the Data Master File. This information will enable the IRS to identify questionable claims for the earned income credit, the dependent exemption, and other tax benefits before tax refunds are paid.

Other Revenue-Increase Provisions

Phase out preferential tax deferral for certain large farm corporations required to use accrual accounting.—Under the Revenue Act of 1987, family farm corporations were required to change to the accrual method of accounting if their gross receipts exceeded $25 million in any taxable year beginning after 1985. However, in lieu of including in gross income the entire amount of the adjustment attributable to the change in accounting method, a family farm corporation could establish a suspense account. The amount of the suspense account was to be included in gross income if the corporation ceased to be a family corporation or to the extent the gross receipts of the corporation from farming declined. This Act repeals the ability of family farm corporations to establish such a suspense account and also repeals the requirement to include a portion of a suspense account in income based on a decrease in the

gross receipts of the corporation. Any taxpayer required to change to the accrual method of accounting may take the adjustment attributable to the change in accounting method into account ratably over a ten-year period, beginning with the year of change. Any existing suspense accounts are to be restored to income ratably over a twenty-year period, subject to the existing law requirement to restore such accounts more rapidly. This provision is effective for taxable years ending after June 8, 1997, except that the first year in the twenty-year period for restoring existing suspense accounts to income is the first taxable year beginning after June 8, 1997.

Modify loss carryback and carryforward rules.—Under prior law, net operating losses (NOLs) generally could be used to offset taxable income from the prior three taxable years (carrybacks) and the succeeding 15 taxable years (carryforwards). This Act generally limits carrybacks of NOLs to 2 years and extends carryforwards to 20 years, effective for NOLs arising in taxable years beginning after the date of enactment. The 3-year carryback for NOLs of farmers and small businesses attributable to losses incurred in Presidentially declared disaster areas is preserved.

Modify general business credit carryback and carryforward rules.—A qualified taxpayer is allowed to claim a number of tax credits (collectively, known as general business credits) provided under current law (rehabilitation credit, energy credit, alcohol fuels credit, orphan drug credit, etc.), subject to certain limitations based on tax liability for the year. Under prior law, unused general business credits generally could be carried back three years and carried forward 15 years to offset tax liability of such years. This Act limits the carryback period for general business credits to one year and extends the carryforward period to 20 years. The change is effective for taxable years beginning after December 31, 1997.

Expand the limitations on deductibility of premiums and interest with respect to life insurance, endowment and annuity contracts.—The prior law premium deduction limitation is expanded to provide that no deduction is permitted for premiums paid on any life insurance, endowment or annuity contract, if the taxpayer is directly or indirectly a beneficiary under the contract. In addition, generally no deduction is allowed for interest paid or accrued on any indebtedness with respect to a life insurance policy or endowment or annuity contract covering the life of any individual. In the case of a taxpayer other than a natural person, no deduction is allowed for the portion of the taxpayer's interest expense that is allocable to unborrowed policy cash surrender values with respect to any life insurance policy or annuity or endowment contract issued after June 8, 1997. These limitations apply to contracts issued after June 8, 1997. For this purpose, a material increase in the death benefit or other material change in the contract generally causes the contract to be treated as a new contract.

Expand requirement that involuntarily converted property be replaced with property acquired from an unrelated party.—Gain realized by taxpayers from certain involuntary conversions is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within a specified period of time. C corporations (and partnerships with one or more corporate partners that own more than 50 percent of the capital or profits interest in the partnership) generally are not entitled to defer gain if the replacement property is purchased from a related person. This Act extends the denial of deferral to any other taxpayer, including an individual, that acquires replacement property from a related person, unless the taxpayer has an aggregate realized gain of $100,000 or less during the year as a result of involuntary conversions. In the case of a partnership or S corporation, the $100,000 annual limitation applies to the entity and each partner or shareholder. The provision applies to involuntary conversions occurring after June 8, 1997.

Miscellaneous Tax Provisions

Provide income-averaging for farmers.—Effective for taxable years beginning after December 31, 1997 and before January 1, 2001, an individual taxpayer generally is allowed to elect to compute his or her current year regular tax liability by averaging, over the three-year period, all or a portion of his or her taxable income from farming.

Allow carryback of existing net operating losses of the National Railroad Passenger Corporation (Amtrak).—Amtrak is allowed to carryback its net operating losses against the aggregate of the net tax liability of Amtrak's railroad predecessors. The maximum allowable refund payable to Amtrak, which is to be divided equally between the first two taxable years ending after the date of enactment, is $2.323 billion. The availability of the refund was conditioned on enactment of Federal legislation authorizing reform; such legislation has been enacted.

Modify estimated tax requirements of individuals.—An individual taxpayer generally is subject to an addition to tax for any underpayment of estimated tax. An individual generally does not have an underpayment of estimated tax if timely estimated tax payments are made at least equal to: (1) 100 percent of the tax shown on the return of the individual for the preceding tax year (the "100 percent of last year's liability safe harbor") or (2) 90 percent of the tax shown on the return for the current year. Under prior law the 100 percent of last year's safe harbor was modified to be a 110 percent of last year's liability safe harbor for any individual with an AGI of more than $150,000 as shown on the return for the preceding taxable year. This Act modifies the safe harbor for individuals with AGI of more than $150,000 as follows: for taxable years beginning in 1998, the safe harbor is 100 percent; for taxable years beginning in 1999, 2000, and 2001 the safe harbor is 105 percent; for taxable years beginning in 2002, the safe harbor is 112 percent. In addition, for any

period before January 1, 1998, for any estimated payment due before January 16, 1998, no estimated tax penalties will be imposed on an underpayment created or increased by a provision of the Taxpayer Relief Act of 1997.

Balanced Budget Act of 1997. —This Act, together with the Taxpayer Relief Act of 1997, implements the historic bipartisan budget agreement that will benefit generations of Americans. While this Act is primarily a balanced package of spending provisions that includes targeted program cuts while it invests in America's future, it also includes several revenue provisions. The major provisions of the Act affecting receipts are described below.

Increase excise taxes on tobacco products.—The excise tax on small cigarettes is increased from 24 cents per pack to 34 cents per pack effective January 1, 2000 and to 39 cents per pack effective January 1, 2002. The taxes on other tobacco products (large cigarettes, cigars, cigarette papers, cigarette tubes, chewing tobacco, snuff, and pipe tobacco) are increased proportionately. In addition, the tax on roll-your-own tobacco is imposed at the same rate as pipe tobacco.

Increase employee contributions to the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS).—Employee contributions to CSRS and FERS are increased by 0.5 percent of base pay in three steps. Contributions increase by 0.25 percent of base pay on January 1, 1999, another 0.15 percent on January 1, 2000 and a final 0.10 percent on January 1, 2001. These higher contribution rates are effective through 2002; on January 1, 2003, contribution rates return to the levels in effect on December 31, 1998.

Authorize appropriation of funds for enforcement initiatives related to the EITC—In addition to any other funds available for this purpose, the following amounts are authorized to be appropriated to the Secretary of the Treasury for improved application of the earned income tax credit: not more than $138 million for 1998, $143 million for 1999, $144 million for 2000, $145 million for 2001 and $146 million for 2002.

Adjust payments to the Universal Service Fund—Payments to the Universal Service Fund by telecommunications carriers and other providers of interstate telecommunications are adjusted so that $3 million in payments otherwise due in fiscal year 2001 are deferred until October 1, 2001. This shift in payments was subsequently repealed during the FY 1998 appropriations process.

ADMINISTRATION PROPOSALS

PROVIDE TAX RELIEF AND EXTEND EXPIRING PROVISIONS

The President's plan targets tax relief to provide child-care assistance to working families. It also includes new initiatives to promote energy efficiency and environmental objectives and new incentives to promote retirement savings, as well as education incentives and extensions of certain expiring tax provisions. In addition, the President's plan contains provisions to simplify the tax laws and to enhance taxpayers' rights.

Make Child Care More Affordable

Increase and simplify child and dependent care tax credit.—Under current law, taxpayers may receive a nonrefundable tax credit for a percentage of certain child care expenses they pay in order to work. The credit rate is phased down from 30 percent of expenses (for taxpayers with adjusted gross incomes of $10,000 or less) to 20 percent (for taxpayers with adjusted gross incomes above $28,000). The Administration proposes to increase the maximum credit rate from 30 percent to 50 percent and to extend eligibility for the maximum credit rate to taxpayers with adjusted gross incomes of $30,000 or less. The credit rate would be phased down gradually for taxpayers with adjusted gross incomes between $30,000 and $59,000. The credit rate would be 20 percent for taxpayers with adjusted gross incomes over $59,000. Eligibility for the credit would be simplified by elimination of a complicated household maintenance test. Certain credit parameters would be indexed. The proposal would be effective for taxable years beginning after December 31, 1998.

Establish tax credit for employer-provided child care.—The Administration proposes to provide taxpayers a credit equal to 25 percent of expenses incurred to build or acquire a child care facility for employee use, or to provide child care services to children of employees directly or through a third party. Taxpayers also would be entitled to a credit equal to 10 percent of expenses incurred to provide employees with child care resource and referral services. A taxpayer's credit could not exceed $150,000 in a single year. Any deduction the taxpayer would otherwise be entitled to take for the expenses would be reduced by the amount of the credit. Similarly, the taxpayer's basis in a facility would be reduced to the extent that a credit is claimed for expenses of constructing or acquiring the facility. The credit would be effective for taxable years beginning after December 31, 1998.

Promote Energy Efficiency and Improve the Environment

Buildings

Provide tax credit for energy-efficient building equipment.—No income tax credit is provided currently for investment in energy-efficient building equipment. The Administration proposes to provide a new tax credit for the purchase of certain highly efficient building equipment technologies, including fuel cells, electric heat pump water heaters, natural gas heat

pumps, residential size electric heat pumps, natural gas water heaters, and advanced central air conditioners. The credit would equal 20 percent of the amount of qualified investment, subject to a cap. The credit generally would be available for equipment purchased over the five-year period beginning January 1, 1999 and ending December 31, 2003.

Provide tax credit for the purchase of new energy-efficient homes.— No income tax credit is provided currently for investment in energy-efficient homes. The Administration proposes to provide a tax credit to taxpayers who purchase, as a principal residence, certain newly constructed homes that are highly energy efficient. The credit would equal one percent of the purchase price of the home, up to a maximum of $2,000. The full credit would be available for homes purchased between January 1, 1999 and December 31, 2003. A credit of up to $1,000 would be available for homes purchased between January 1, 2004 and December 31, 2005.

Transportation

Provide tax credit for high-fuel-economy vehicles.—No income tax credit is provided currently for purchases of highly fuel-efficient vehicles. The Administration proposes to provide a credit of $4,000 for each vehicle that gets three times the base fuel economy for its class. The $4,000 credit would be available for purchases of qualifying vehicles after December 31, 2002. This credit would phase down beginning in 2007 and phase out in 2010. A $3,000 credit would also be provided for purchases of vehicles achieving two times the base fuel economy for their class. The $3,000 credit would be available for purchases of qualifying vehicles after December 31, 1999. This credit would phase down beginning in 2004 and phase out in 2006.

Equalize treatment of parking and transit benefits.—Under current law, employer-provided transit and vanpool benefits are only excluded from income if such benefits are in addition to, not in lieu of, other compensation. Under the Taxpayer Relief Act of 1997, however, parking benefits are excluded from income even if offered in lieu of other compensation. The Administration proposes to allow employers to offer their employees transit and vanpool benefits in lieu of compensation, beginning January 1, 1999, thus granting transit and vanpool benefits the same treatment as parking benefits. Also under current law, up to $155 per month (in 1993 dollars) in employer-provided parking benefits and $60 per month (in 1993 dollars) in employer-provided transit and vanpool benefits are excludable from income. The Administration proposes to raise the monthly limit on employer-provided transit and vanpool benefits excludable from income to be the same as the limit on parking.

Industry

Provide investment tax credit for combined heat and power (CHP) systems.— Combined heat and power (CHP) assets are used in the production of electricity and process heat and/or mechanical power from the same primary energy source. No tax credits are currently available for investment in CHP property. The Administration proposes to establish a 10-percent investment credit for CHP systems in order to encourage and accelerate investment in such equipment. The credit would apply to property placed in service in the United States after December 31, 1998, and before January 1, 2004.

Provide tax credit for replacement of certain circuitbreaker equipment.—The chlorofluorocarbon substitute sulfur hexafluoride (SF6), an extremely harmful greenhouse gas, is used in some large power circuit breakers used in the transmission and distribution of electric power. The Administration proposes to make a tax credit available for the installation of new power circuit breaker equipment to replace certain circuit breakers that are prone to leak SF6. The credit would be equal to 10 percent of qualified investment. To be eligible for the credit, the replaced power circuit breakers must be dual pressure circuit breakers with a capacity of at least 115kV, contain SF6, and have been installed prior to December 31, 1985. The replaced equipment must be destroyed so as to prevent further use. The credit would apply only to new equipment placed in service in the five-year period beginning January 1, 1999 and ending December 31, 2003.

Provide tax credit for certain perfluorocompound (PFC) and hydrofluorocompound (HFC) recycling equipment.—Under current law, semiconductor manufacturers who install equipment to recover or recycle PFC and HFC gases used in the production of semiconductors may depreciate the cost of that equipment, but no tax credit is provided for the purchase of such equipment. PFCs and certain HFCs are among the most potent greenhouse gases because of their extreme stability in the atmosphere and strong absorption of radiation, and they are used extensively in the semiconductor manufacturing industry. The Administration proposes to provide a 10 percent tax credit for the installation of qualified PFC/HFC recovery or recycling equipment to recover gases used in the production of semiconductors. Equipment would qualify for the credit only if it recovers at least 99 percent of the PFCs and HFCs and the equipment is placed in service in the five-year period beginning January 1, 1999 and ending December 31, 2003.

Renewables

Provide tax credit for rooftop solar equipment.— Current law provides a 10 percent business energy investment tax credit for qualifying equipment that uses

solar energy to generate electricity, to heat or cool, to provide hot water for use in a structure, or to provide solar process heat. The Administration proposes to make a new tax credit available for purchasers of rooftop photovoltaic systems and solar water heating systems located on or adjacent to the building for uses other than heating swimming pools. (Taxpayers would have to choose between the proposed credit and the current-law tax credit for each investment.) The proposed credit would be equal to 15 percent of qualified investment up to a maximum of $1,000 for solar water heating systems and $2,000 for rooftop photovoltaic systems. It would apply only to equipment placed in service after December 31, 1998 and before January 1, 2004 for solar water heating systems and after December 31, 1998 and before January 1, 2006 for rooftop photovoltaic systems.

Extend wind and biomass tax credit.—Current law provides taxpayers a 1.5-cent-per-kilowatt-hour tax credit, adjusted for inflation after 1992, for electricity produced from wind or "closed-loop" biomass. The electricity must be sold to an unrelated third party and the credit applies to the first 10 years of production. The current credit applies only to facilities placed in service before July 1, 1999, after which it expires. The Administration proposes to extend the current credit for five years, to facilities placed in service before July 1, 2004.

Promote Expanded Retirement Savings

Building on recent legislation, the Administration proposes further expansions of retirement savings incentives, including three new initiatives that would expand the availability of retirement plans and other workplace-based savings opportunities, particularly for moderate- and lower-income workers not currently covered by employer-sponsored plans. Two of the proposals are designed to expand pension coverage for employees of small businesses, a group that currently has low pension coverage. The Administration also seeks to improve existing retirement plans for employers of all sizes by promoting portability, expanding workers' and spouses' rights to know about their retirement benefits, and simplifying the pension rules. These provisions generally are effective beginning in 1999.

Promote Individual Retirement Account (IRA) contributions through payroll deduction.—Employers could offer employees the opportunity to make IRA contributions on a pre-tax basis through payroll deduction. Providing employees an exclusion from income (in lieu of a deduction) is designed to increase savings among workers in businesses that do not offer a retirement plan. Signing up for payroll deduction is easy for an employee. In addition, saving is facilitated because it becomes automatic as salary reduction contributions continue each paycheck after an employee's initial election. Peer-group participation may also encourage employees to save more. Finally, the favorable tax treatment of payroll deductions would encourage participation.

Provide tax credit for new plans.—Effective in the year of enactment, the Administration proposes a new three-year tax credit for the administrative and retirement-education expenses of any small business that sets up a new qualified defined benefit or defined contribution plan (including a 401(k) plan), savings incentive match plan for employees (SIMPLE), simplified employee pension (SEP), or payroll deduction IRA arrangement. The credit would cover 50 percent of the first $2,000 in administrative and retirement-education expenses for the plan or arrangement for the first year of the plan and 50 percent of the first $1,000 of such expenses for each of the second and third years. The tax credit would help promote new plan sponsorship by targeting a tax benefit to employers adopting new plans or payroll deduction IRA arrangements, providing a marketing tool to financial institutions and advisors promoting new plan adoption, and increasing awareness of retirement savings options.

Establish new small business pension plan.—The Administration is proposing a new small business defined benefit-type plan that combines certain key features of defined benefit plans and defined contribution plans: guaranteed minimum retirement benefits, an option for payments over the course of an employee's retirement years, and Pension Benefit Guaranty Corporation insurance, together with individual account balances that can benefit from favorable investment returns and have enhanced portability.

Enhance portability and disclosure; simplify pensions.—The Administration is also proposing accelerated vesting of employer matching contributions under 401(k) plans (and other qualified plans). This would increase pension portability, which is important given the mobility of today's workforce, particularly of working women. Matching contributions would be required to be fully vested after an employee has completed three years of service (or would vest in annual 20 percent increments beginning after two years of service). The Administration's proposal also would enhance workers' and spouses' rights to know about their pension benefits—among other things, requiring that the same explanation of a pension plan's survivor benefits that is provided to a participant be provided to the participant's spouse, and that participants in 401(k) safe harbor plans receive timely notification of plan rules governing contributions and employer matching. Improved benefits for nonhighly compensated employees under the 401(k) safe harbors, a simplified definition of highly compensated employee, and simplification of rules for multiemployer plans are also being proposed.

Expand Education Incentives

Provide incentives for public school construction.—The Taxpayer Relief Act of 1997 enacted a provi-

sion that allows certain public schools to issue "qualified zone academy bonds," the interest on which is effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of the bonds can be used for a number of purposes, including teacher training, purchases of equipment, curricular development, and rehabilitation and repair of the school facilities. The Administration proposes to institute a new program of Federal tax assistance for public school construction. Under the proposal, State and local governments would be able to issue up to $9.7 billion of "qualified school construction bonds" in each of 1999 and 2000. Holders of these bonds would receive annual federal income tax credits, set according to market interest rates by the Treasury Department, in lieu of interest. At least 95 percent of the bond proceeds of a qualified school construction bond must be used to finance public school construction or rehabilitation. The Administration also proposes to expand the amount of qualified zone academy bonds that can be issued in 1999 from $400 million to $1.4 billion and to authorize an additional $1.4 billion of qualified zone academy bonds in 2000, and to allow the proceeds of these bonds to be used for school construction.

Extend and expand exclusion for employer-provided educational assistance.—Certain amounts paid by an employer for educational assistance provided to an employee currently are excluded from the employee's gross income for income and payroll tax purposes. The exclusion is limited to $5,250 of educational assistance with respect to an individual during a calendar year and applies whether or not the education is job-related. The exclusion currently is limited to undergraduate courses beginning before June 1, 2000. The Administration proposes to extend the current law exclusion by one year to apply to undergraduate courses beginning before June 1, 2001. In addition, the exclusion would be expanded to cover graduate courses beginning after June 30, 1998 and before June 1, 2001.

Eliminate tax when forgiving student loans subject to income contingent repayment.—Students who borrow money to pay for postsecondary education through the Federal government's Direct Loan program may elect income contingent repayment of the loan. If they elect this option, their loan repayments are adjusted in accordance with their income. If after the borrower makes repayments for a twenty-five year period any loan balance remains, it is forgiven. The Administration proposes to eliminate any Federal income tax the borrower may otherwise owe as a result of the forgiveness of the loan balance. The proposal would be effective for loan cancellations after December 31, 1998.

Increase Low-Income Housing Tax Credit

Increase low-income housing tax credit per capita cap.—Low-income housing tax credits provide an incentive to build and make available rental housing units to households with incomes significantly below area medians. The amount of first-year credits that can be awarded in each State is currently limited by annual allocations of $1.25 per capita. The $1.25 per capita limitation was established in 1986. The Administration proposes to increase the annual State housing credit limitation to $1.75 per capita effective for calendar years beginning after 1998. The proposed increase in this cap will permit additional new and rehabilitated low-income housing to be provided while still encouraging State housing agencies to award the credits to projects that meet specific needs.

Extend Expiring Provisions

Extend the work opportunity tax credit.—The work opportunity tax credit provides an incentive for employers to hire individuals from certain targeted groups. The credit equals a percentage of qualified wages paid during the first year of the individual's employment with the employer. The credit percentage is 25 percent for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. The credit expires with respect to employees who begin work after June 30, 1998. The Administration proposes to extend the work opportunity tax credit so that the credit would be effective for individuals who begin work before May 1, 2000.

Extend the welfare-to-work tax credit.—The welfare-to-work tax credit enables employers to claim a tax credit on the first $20,000 of eligible wages paid to certain long-term family assistance recipients. The credit is 35 percent of the first $10,000 of eligible wages in the first year of employment and 50 percent of the first $10,000 of eligible wages in the second year of employment. The credit is effective for individuals who begin work before May 1, 1999. The Administration proposes to extend the welfare-to-work tax credit for one year, so that the credit would be effective for individuals who begin work before May 1, 2000.

Extend the R&E tax credit.—The Administration proposes to extend the tax credit provided for certain research and experimentation expenditures, which is scheduled to expire after June 30, 1998, for one year through June 30, 1999.

Extend the deduction provided for contributions of appreciated stock to private foundations.—The special rule that allows a taxpayer to deduct the full fair market value of qualified stock donated to a private foundation expires with respect to contributions made after June 30, 1998. The Administration proposes to extend the provision to apply to contributions made during the period July 1, 1998 through June 30, 1999.

Make permanent the expensing of brownfields remediation costs.—Under the Taxpayer Relief Act of 1997, taxpayers can elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year

paid or incurred. The provision does not apply to expenditures paid or incurred after December 31, 2000. The Administration proposes that the provision be made permanent.

Modify International Trade Provisions

Extend the Generalized System of Preferences (GSP) and modify other trade provisions.—Under GSP, duty-free access is provided to over 4,000 items from eligible developing countries that meet certain worker rights, intellectual property protection, and other criteria. The Administration proposes to extend the program, which expires after June 30, 1998, through September 30, 2001. The Administration is proposing new enhanced trade benefits for Subsaharan African countries undertaking strong economic reforms. The Administration also proposes to provide, through September 30, 2001, expanded trade benefits mainly on textiles and apparel to Caribbean Basin countries that meet new eligibility criteria to prepare for a future free trade agreement with the United States. The Administration also proposes to implement the OECD Shipbuilding Agreement.

Extend and modify Puerto Rico economic-activity tax credit (section 30A).—Although the Puerto Rico and possessions tax credit generally was repealed in 1996, both the income-based option and the economic-activity option under the credit remain available for existing business operations through 2005, subject to base-period caps. To provide a more efficient and effective tax incentive for the economic development of Puerto Rico and to continue the shift from an income-based credit to an economic-activity credit that was begun in the Omnibus Budget Reconciliation Act of 1993 (OBRA 93), the Administration proposes to modify the economic-activity credit for Puerto Rico by (1) extending it indefinitely, (2) making newly established business operations eligible for the credit, effective for taxable years beginning after December 31, 1998, and (3) removing the base-period cap.

Levy tariff on certain textiles and apparel products produced in the Commonwealth of the Northern Mariana Islands (CNMI).—The Administration has proposed a tariff on textile and apparel products produced in the CNMI without certain percentages of workers who are U.S. citizens, nationals or permanent residents or citizens of the Pacific island nations freely associated with the U.S.

Expand Virgin Island tariff credits.—The Administration proposes the expansion of authorized but currently unused tariff credits for wages paid in the production of watches in the Virgin Islands to be available for the production of fine jewelry.

Provide Other Tax Incentives

Expand tax incentives for specialized small business investment companies (SSBICs).—Current law provides certain tax incentives for investment in SSBICs. The Administration proposes to enhance the tax incentives for SSBICs. First, the existing provision allowing a tax-free rollover of the proceeds of a sale of publicly-traded securities into an investment in a SSBIC would be modified to extend the rollover period to 180 days, to allow investment in the preferred stock of a SSBIC, to eliminate the annual caps on the SSBIC rollover gain exclusion, and to increase the lifetime caps to $750,000 per individual and $2,000,000 per corporation. Second, the proposal would allow a SSBIC to convert from a corporation to a partnership within 180 days of enactment without giving rise to tax at either the corporate or shareholder level, but the partnership would remain subject to an entity-level tax at any time that it later disposed of assets that it holds at the time of conversion on the amount of "built-in" gains inherent in such assets at the time of conversion. Finally, in the case of a direct or indirect sale of SSBIC stock that qualifies for treatment under section 1202, the proposal would raise the exclusion of gain from 50 percent to 60 percent. The tax-free rollover and section 1202 provisions would be effective for sales occurring after the date of enactment.

Accelerate and expand incentives available to two new Empowerment Zones (EZs).—OBRA 93 authorized a Federal demonstration project in which nine EZs and 95 empowerment communities would be designated in a competitive application process. Among other benefits, businesses located in the nine original EZs are eligible for three Federal tax incentives: an employment and training credit; an additional $20,000 per year of section 179 expensing; and a new category of tax-exempt private activity bonds. The Taxpayer Relief Act of 1997 authorized the designation of two additional EZs located in urban areas, which generally are eligible for the same tax incentives as are available within the EZs authorized by OBRA 93. The two additional EZs will be designated in early 1998, but the tax incentives provided for them do not take effect until January 1, 2000. The incentives generally remain in effect for 10 years. The wage credit, however, is phased down beginning in 2005 and expires after 2007. The Administration proposes to accelerate the start-up date of the incentives for the two additional EZs to January 1, 1999. In addition, the proposal would provide that the wage credit would remain in effect for 10 years from that date and would be phased down using the same percentages that apply to the original empowerment zones designated under OBRA 93.

Make first $2,000 of severance pay exempt from income tax.—Under current law, payments made to a terminated employee are taxable as compensation. The Administration proposes to allow an individual to exclude up to $2,000 of severance pay from income when certain conditions are met. First, the severance must result from a reduction in force by the employer. Second, the individual must not obtain a job within six months of separation with compensation at least

equal to 95 percent of his or her prior compensation. Third, the total severance payments received by the employee must not exceed $125,000. The exclusion would be effective for severance pay received in taxable years beginning after December 31, 1998 and before January 1, 2004.

Simplify The Tax Laws

Provide for optional Self-employment Contributions Act (SECA) computations.—Self-employed individuals currently may elect to increase their self-employment income for purposes of obtaining social security coverage. Current law provides more liberal treatment for farmers as compared to other self-employed individuals. The Administration proposes to extend the favorable treatment currently accorded to farmers to other self-employed individuals. The proposal would be effective for taxable years beginning after December 31, 1998.

Provide statutory hedging and other rules to ensure business property is treated as ordinary property.—Under current law, there is a significant issue of whether income from hedging transactions is capital or ordinary. The rules under which assets are treated as ordinary assets and under which hedging transactions are accounted for need to be modernized. In addition, the current-law rules that allow taxpayers to defer loss when a taxpayer holds a position or positions that reduce the risk of loss on certain capital assets, the so-called straddle rules, are punitive and sometimes result in a total disallowance of losses. The proposal would generally codify the hedging rules previously promulgated by Treasury Department and make some modifications to help clarify the rules. The proposal would clarify that certain assets are ordinary assets for Federal income tax purposes, provide more equitable timing of losses under the straddle rules, and eliminate an exception to the straddle rules for positions in corporate stock. The proposal generally would be effective after the date of enactment, and would give the Treasury Department authority to issue regulations similar to the hedging provisions governing hedging transactions entered into prior to the effective date.

Clarify rules relating to certain disclaimers.—Under current law, if a person refuses to accept (i.e., disclaims) a gift or bequest prior to accepting the transfer (or any of its benefits), the transfer to the disclaiming person generally is ignored for Federal transfer tax purposes. Current law is unclear as to whether certain transfer-type disclaimers benefit from rules applicable to other disclaimers under the estate and gift tax. Current law is also silent as to the income tax consequences of a disclaimer. The Administration proposes to extend to transfer-type disclaimers the rule permitting disclaimer of an undivided interest in property as well as the rule permitting a spouse to disclaim an interest that will pass to a trust for the spouse's benefit. The proposal also clarifies that disclaimers are effective for income tax purposes. The proposal would apply to disclaimers made after the date of enactment.

Simplify the foreign tax credit limitation for dividends from 10/50 companies.—The Taxpayer Relief Act of 1997 modified the regime applicable to indirect foreign tax credits generated by dividends from so-called 10/50 companies. Specifically, the Act retained the prior law "separate basket" approach with respect to pre-2003 distributions by such companies, adopted a "single basket" approach with respect to post-2002 distributions by such companies of their pre-2003 earnings, and adopted a "look-through" approach with respect to post-2002 distributions by such companies of their post-2002 earnings. The application of the three approaches results in significant additional complexity. The proposal would simplify significantly the application of the foreign tax credit limitation by applying a look-through approach immediately to dividends paid by 10/50 companies, regardless of the year in which the earnings and profits out of which the dividends are paid were accumulated (including pre-2003 years). The proposal would be effective for taxable years beginning after December 31, 1997.

Provide interest treatment for certain payments from regulated investment companies to foreign persons.—Under current law, foreign investors in U.S. bond and money-market mutual funds are effectively subject to withholding tax on interest income and short term capital gains derived through such funds. Foreign investors that hold U.S. debt obligations directly generally are not subject to U.S. taxation on such interest income and gains. This proposal would eliminate the discrepancy between these two classes of foreign investors by eliminating the U.S. withholding tax on distributions from U.S. mutual funds that hold substantially all of their assets in cash or U.S. debt securities (or foreign debt securities that are not subject to withholding tax under foreign law). The proposal is designed to enhance the ability of U.S. mutual funds to attract foreign investors and to eliminate needless complications now associated with the structuring of vehicles for foreign investment in U.S. debt securities. The proposal would be effective for mutual fund taxable years beginning after the date of enactment.

Enhance Taxpayers' Rights

Collection

Suspend collection by levy during refund suit.—Generally, full payment of the tax at issue is a prerequisite to a refund suit (*Flora v. United States*), but this rule does not apply in the case of "divisible" taxes (such as employment taxes or the "100 percent penalty" under section 6672). The Administration proposes to require the IRS to suspend collection by levy of liabilities that are the subject of a refund suit during the pendency of the litigation. This would only apply where refund suits can be brought without the full payment of the tax, i.e., divisible taxes. Collection by levy would

be suspended unless jeopardy exists or the taxpayer waives the suspension of collection in writing. This proposal would not affect the IRS's ability to collect other assessments that are not the subject of the refund suit, to offset refunds or to file a notice of federal tax lien. The statute of limitations on collection would be stayed for the period during which collection by levy is prohibited. The proposal would be effective for refund suits brought with respect to taxable years beginning after December 31, 1998.

Suspend collection by levy while offer in compromise is pending.—The Administration proposes to bar the IRS from collecting a tax liability by levy during any period that a taxpayer's offer in compromise of that liability is being processed, during the 30 days following rejection of an offer, and for any period during which an appeal of a rejected offer is being considered. Levy would not be precluded if the IRS determines that collection is in jeopardy or that the offer is submitted solely to delay collection. This proposal would not affect liabilities or assessments that are not the subject of the offer in compromise, the IRS's ability to offset refund, or its ability to file a notice of Federal tax lien. The proposal would not require the IRS to stop any levy action that was initiated, or withdraw any lien that was filed, prior to the taxpayer's making an offer in compromise. The statute of limitations on collection would be stayed for the period during which collection by levy is barred. The proposal would be effective with respect to taxes assessed 60 days after the date of enactment.

Suspend collection to permit resolution of disputes as to liability.—The Administration proposes to permit an individual taxpayer to request that collection be suspended temporarily with regard to an income tax liability that is assessed based upon a statutory notice of deficiency that the taxpayer failed to receive or to which the taxpayer failed to respond. The IRS would suspend collection for a 60-day period, during which the taxpayer may dispute the merits of the underlying assessment. The 60-day period would be extended in appropriate cases where progress is being made in resolving the liability. Collection by refund offset and jeopardy levies would be exempted. The proposal would not affect the IRS's ability to file a notice of Federal tax lien. The statutory collection period would be stayed while the taxpayer's claim is pending. The proposal would be effective for taxes assessed with respect to taxable years beginning after December 31, 1998.

Require District Counsel approval of certain third party collection activities.—The Administration proposes to require IRS District Counsel approval before a notice of Federal tax lien can be filed or levy is made in connection with property held by a nominee, transferee, or alter ego of the taxpayer. Counsel approval would also be required before the IRS seizes property encumbered by a Federal tax lien if the property is presently neither owned nor titled in the name of the taxpayer. The only exception would be in jeopardy situations. If District Counsel's approval was not obtained, the property-owner would be entitled to obtain release of the lien or levy, and, if the IRS failed to make such release, to appeal first to the Collections Appeals process and then to the U.S. District Court. The proposal would be effective with respect to taxes assessed after the date of enactment.

Require management approval of levies on certain assets.—The Administration proposes to require the personal approval of an IRS District Director or Assistant District Director of any levy made against non-Federal pensions or the cash value of life insurance policies. The proposal would thus place these assets in the same class as principal residences pursuant to section 6334(e). The only exception would be in jeopardy situations. If the District Director's approval was not obtained, the taxpayer would be entitled to obtain release of the levy, and, if the IRS failed to make such release, to appeal first to the Collections Appeals process and then to the U.S. District Court. The proposal would be effective with respect to taxes assessed after the date of enactment.

Require District Counsel review and approval of jeopardy and termination assessments and jeopardy levies.—Current law provides special procedures allowing the IRS to make jeopardy assessments or termination assessments in certain extraordinary circumstances, for instance, if the taxpayer is leaving or removing property from the United States or if assessment or collection would be jeopardized by delay. In jeopardy situations, a levy may also be made without the 30-day notice of intent to levy that is ordinarily required. Jeopardy and termination assessments and jeopardy levies often involve difficult legal issues, and the government bears the burden of proof with respect to the reasonableness of a jeopardy or termination assessment or a jeopardy levy. The Administration proposes to require IRS District Counsel review and approval before the IRS could make a jeopardy assessment, a termination assessment, or a jeopardy levy. If District Counsel's approval was not obtained, the taxpayer would be entitled to obtain abatement of the assessment or release of the levy, and, if the IRS failed to offer such relief, to appeal first to the Collections Appeals process and then to the U.S. District Court. The proposal would be effective with respect to taxes assessed after the date of enactment.

Require management approval of sales of perishable goods.—Because of the nature of the property at issue, special accelerated procedures apply to the sale of perishable property that has been seized to satisfy a tax liability. The Administration proposes to require approval by an IRS District Director or Assistant District Director before perishable goods are sold. The proposal would also clarify what a "perishable" item is for these purposes. The proposal would be effective

with respect to taxes assessed after the date of enactment.

Codify certain Fair Debt Collection procedures.—Government agencies, including the IRS, are generally exempt from the Fair Debt Collection Practices Act (FDCPA). In the past, appropriations legislation funding the IRS has required IRS officers and employees to comply with certain provisions of the FDCPA. Placing these requirements in the Internal Revenue Code would ensure that both taxpayers and employees of the IRS are fully aware of these requirements. Therefore, the Administration proposes to add to the Internal Revenue Code two provisions of the FDCPA concerning communications in connection with debt collection and the prohibition on harassment or abuse. The proposal would be effective on the date of enactment.

Modify payment of taxes.—The Secretary of the Treasury is authorized to accept payments by stamps, check, or money orders, as provided in regulations. Checks or money orders currently are made payable to the "Internal Revenue Service." The proposal would require amending the rules, regulations, and procedures to allow payment of taxes by check or money order to be made payable to the order of "United States Treasury." This would make it clearer to taxpayers that their tax payments support the entire Federal Government, not just the IRS. The proposal would be effective on the date of enactment.

Require disclosures relating to extension of statutes of limitation by agreement.—Taxpayers and the IRS may agree in writing to extend the statutory period of limitations on assessment or collection, either for a specified period or for an indefinite period. The Administration proposes to require that, on each occasion that the taxpayer is requested by the IRS to extend the statute of limitations, the IRS must notify the taxpayer of the taxpayer's right to refuse to extend the statute of limitations or to limit the extension to particular issues. The proposal would apply to requests to extend the statute of limitations made after the date of enactment.

Publish living allowance schedules relating to offers in compromise.—The IRS is authorized to compromise a taxpayer's tax liability for less than the full amount due. In general, there are two grounds on which an offer in compromise can be made: doubt as to the taxpayer's liability for the full amount, or doubt as to the taxpayer's ability to pay in full the amount owed. The proposal would require the IRS to develop and publish schedules of national and local living allowances, taking into account variations in the cost of living in different areas. The IRS would use this information in evaluating the sufficiency of offers in compromise. The schedules would be required to be published no later than 180 days after the date of enactment.

Ensure availability of installment agreements.—The IRS is authorized to enter agreements permitting taxpayers to pay taxes in installments if such an agreement will "facilitate collection" of the liability. The IRS has discretion to determine when an installment agreement is appropriate. The Administration proposes to codify the IRS's current practice of requiring an installment agreement (at the taxpayer's option) for liabilities of $10,000 or less, provided certain conditions are met. The proposal would be effective on the date of enactment.

Increase "superpriority" dollar limits.—Current law provides protection to certain property interests even though a Notice of Federal Tax Lien has been properly filed before the interests arise. Such "superpriorities" are subject to certain dollar limitations, however. The proposal would increase the current dollar limit for purchasers at a casual sale from $250 to $1,000, and it would increase the current dollar limit from $1,000 to $5,000 for mechanics lienors who provide home improvement work for residential real property. The proposal would also clarify current law to reflect current banking practices, where a "passbook"-type loan may be made even though an actual "passbook" is not used. The proposal would be effective on the date of enactment.

Permit personal delivery of 100 percent penalty notices.—The proposal would permit personal delivery, in addition to the Internal Revenue Code's current requirement of mail delivery, of a preliminary notice that the IRS intends to assess a 100 percent penalty under section 6672 against the taxpayer. The proposal would be effective on the date of enactment.

Examination

Allow taxpayers to quash all third party summonses.—Summonses issued to "third party recordkeepers" are subject to different procedures than other summonses: notice of the summons must be given to the taxpayer, and the taxpayer has an opportunity to bring a court proceeding to quash the summons, during which time collection action is stayed and the third party recordkeeper is prohibited from complying with the summons. The Administration proposes generally to expand the "third party recordkeeper" procedures to apply to all summonses issued to third parties other than the taxpayer. This would have the beneficial effect of giving taxpayers notice and an opportunity to contest any summons issued to a third party in connection with the determination of their liability. The provision would be effective for summonses served after the date of enactment.

Require disclosure of criteria for examination selection.—The IRS examines Federal tax returns to determine the correct liability of taxpayers. Returns are selected for examination in a number of ways, such as through "matching" of returns and information returns or through the use of a computerized classifica-

tion system (the discriminant function (DIF) system). Taxpayers should better understand the reasons why they may be selected for examination. Therefore, the Administration proposes to require that within 180 days the IRS add to Publication 1 (*Your Rights as a Taxpayer*) a statement setting forth, in simple and non-technical terms, the criteria and procedures for selecting taxpayers for examination. The statement would not include any information that would be detrimental to law enforcement, and drafts of the statement would be required to be submitted to the congressional tax-writing committees prior to publication.

Prohibit threat of audit to coerce tip reporting alternative commitment agreements.—Restaurants may enter into Tip Reporting Alternative Commitment (TRAC) agreements. A restaurant entering into a TRAC agreement is obligated to educate its employees on their tip reporting obligations, to institute formal tip reporting procedures, to fulfill all filing and record keeping requirements, and to pay and deposit taxes. In return, the IRS agrees to base the restaurant's liability for employment taxes solely on reported tips and any unreported tips discovered during an IRS audit of an employee. The proposal would require the IRS to instruct its employees that they may not threaten to audit any taxpayer in an attempt to coerce the taxpayer to enter into a TRAC agreement. The provision would be effective on the date of enactment.

Permit service of summonses by mail.—This proposal would permit the IRS to serve summonses by mail, in addition to the present law requirement that all summonses be personally served. Most summonses are served on financial institutions, where personal service can disrupt the working environment. Further, notice to the taxpayer that a summons has been served on a third party recordkeeper can already be given by mail, and the proposal would thus bring the service of the actual summons into line with the notice requirements. The provision would be effective for summonses served after the date of enactment.

New Remedies

Allow suits for damages if IRS violates certain bankruptcy procedures.—No remedy exists under the Internal Revenue Code if the IRS willfully violates the automatic stay or discharge provisions of the Bankruptcy Code. The Administration proposes to provide for payment of damages, plus attorneys fees' and costs, for willful violations by officers or employees of the IRS of either the automatic stay provision or the discharge injunction under the Bankruptcy Code. Jurisdiction over such cases would lie with the Bankruptcy Court, but the claimant would be required to exhaust administrative remedies to the same extent as for other damage claims. The provision would be effective with respect to violations occurring after the date of enactment.

Increase Tax Court's "small case" limit.—Taxpayers may choose to contest many tax disputes in the Tax Court. Under current law, special "small case procedures" apply to disputes involving $10,000 or less, if the taxpayer chooses to utilize these procedures (and the Tax Court concurs). The Administration proposes to increase the cap for small case treatment in the Tax Court from $10,000 to $25,000. The proposal would apply to proceedings commenced after the date of enactment.

Provide equitable tolling.—A refund claim that is not filed within certain specified time periods is rejected as untimely. The Supreme Court recently held (*United States v. Brockamp*) that these limitations periods cannot be extended, or "tolled," for equitable reasons. This may lead to harsh results for some taxpayers, particularly when they fail to seek a refund because of a well-documented disability or similar compelling circumstance that prevents them from doing so. Consequently, the Administration proposes to permit "equitable tolling" of the limitation period on claims for refund for the period of time during which an individual taxpayer is under a sufficient medically determined physical or mental disability as to be unable to manage his or her financial affairs. Tolling would not apply during periods in which the taxpayer's spouse or another person is authorized to act on the taxpayer's behalf in financial matters. The proposal would apply with respect to taxable years ending after the date of enactment.

Require notice of deficiency to specify Tax Court filing deadlines.—Under current law, taxpayers must file a petition with the Tax Court within 90 days after the notice of deficiency is mailed (150 days if the person is outside the United States). Because timely filing in Tax Court is a jurisdictional prerequisite, the IRS cannot extend the filing period, nor can the Tax Court hear the case of a taxpayer who relies on erroneous information from the IRS and files too late. The Administration proposes to require the IRS to include on each notice of deficiency the date it determines is the last day on which the taxpayer may file a Tax Court petition (including the last day for a taxpayer who is outside the United States). Any petition filed by the later of the statutory date or the date shown on the notice would be timely. The provision would apply to notices mailed after December 31, 1998.

Allow actions for refund with respect to certain estates that have elected the installment method of payment.—Under the Internal Revenue Code, a taxpayer may bring a refund suit only if full payment of the assessed tax liability has been made. However, under certain conditions, the executor of an estate may pay the estate tax attributable to certain closely-held businesses over a 14-year period. These two rules can be in conflict, preventing electing estates from obtaining full relief in a refund jurisdiction. The Administration proposes to grant courts refund jurisdiction to deter-

mine the correct liability of such an estate, so long as the estate had properly elected to pay in installments and was current on all payments. The proposal also would make a number of technical and conforming amendments to implement this change. The proposal would be effective for claims for refunds filed after the date of enactment.

Expand authority to award costs and fees.—Any person who substantially prevails in a dispute related to taxes, interest, or penalties may be awarded reasonable administrative costs incurred before the IRS and reasonable litigation costs incurred in connection with any court proceeding. Individuals can receive an award of litigation and administrative costs only if their net worth does not exceed $2 million. Awards cannot exceed amounts actually paid or incurred, and cannot exceed a statutorily limited rate ($110 per hour, indexed for inflation). Taxpayers who are represented pro bono, and thus bear no actual attorney's fees and costs, cannot recover such amounts. The Administration proposes to allow the award of attorney's fees (in amounts up to the statutory limit) to persons who represent such taxpayers for no more than a nominal fee. The proposal would be effective with respect to costs incurred and services performed after the date of enactment.

Expand authority to issue taxpayer assistance orders.—Under current law, taxpayers can request that the Taxpayer Advocate issue a taxpayer assistance order (TAO) to require the IRS to release property of the taxpayer that has been levied upon, or to cease any action, take any action as permitted by law, or refrain from taking any action with respect to the taxpayer. A TAO may be issued if the taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the laws are being administered by IRS. The Administration proposes to provide that, in determining whether to issue a TAO, the Taxpayer Advocate will also be authorized to consider, among other factors, the following: unreasonable delays in resolving the taxpayer's account problems; immediate threats of substantial adverse action (such as the seizure of a residence to pay overdue taxes); the likelihood of irreparable harm if relief is not granted; whether the taxpayer will have to pay significant professional fees if relief is not granted; and the possibility of long-term adverse impact on the taxpayer. The proposal would be effective on the date of enactment.

Provide new remedy for third parties who claim that the IRS has filed an erroneous lien.—The Supreme Court held (*Williams v. United States*) that a third party who paid another person's tax under protest to remove a lien on the third party's property could bring a refund suit, because she had no other adequate administrative or judicial remedy. However, the Court left many important questions unresolved. The Administration proposes to create administrative and judicial remedies for a third party in that situation. Under this procedure, the owner of property (other than the taxpayer) could obtain a certificate discharging property from the Federal tax lien as a matter of right, provided certain conditions were met. The certificate of discharge would enable the property owner to sell the property free and clear of the Federal tax lien in all circumstances. The proposal would also establish a judicial cause of action for persons challenging a Federal tax lien that is similar to the wrongful levy remedy already in the Internal Revenue Code. The proposal would be effective on the date of enactment.

Allow damage suits by persons other than the taxpayer.—Under current law, taxpayers have a right to sue for damages if, in connection with any collection of Federal tax, any officer or employee of the IRS recklessly or intentionally disregards any provision of the Internal Revenue Code or any regulation thereunder. Recoverable damages are the lesser of actual, direct economic damages sustained, plus attorneys' fees, or $1 million. Actions under this provision may only be brought by an injured taxpayer, however, and not by an injured third party. The Administration proposes that persons other than the taxpayer from whom collection is sought be granted a right to sue for damages. The current law limitations on awards for damages would apply to third party plaintiffs, as well. The proposal would be effective with respect to collection actions taken after the date of enactment.

Joint Returns

Suspend collection in certain joint liability cases.—When a married couple's joint return is the subject of a Tax Court proceeding, the Administration proposes to require the IRS to withhold collection by levy against a nonpetitioning spouse while a Tax Court proceeding involving the other spouse is pending. This would treat the nonpetitioning spouse the same as the petitioning spouse in most situations. Certain exceptions would be provided, including in jeopardy situations; when the taxpayer waives this protection (i.e., agrees to the collection action); other, limited but automatic kinds of collection activity, such as automatic refund offset; filing of protective notices of Federal tax lien, etc.; or certain other situations. The statute of limitations on assessment and collection would be stayed for the period during which collection by levy is barred. If there is a final decision that reduces the proposed assessment against the petitioning spouse, the assessment against the nonpetitioning spouse would likewise be reduced. The proposal would not affect the IRS's ability to collect other liabilities or assessments that are not the subject of the Tax Court proceeding. The proposal would be effective for taxes assessed with respect to taxable years beginning after December 31, 1998.

Require explanation of joint and several liability.—In general, spouses who file a joint tax return are jointly and severally liable for the tax due. Thus each is fully responsible for the accuracy of the return

and the full amount of the liability, even if only one spouse earned the wages or income that is shown on the return. Married taxpayers need to better understand the legal implications of signing a joint return. Therefore, the Administration proposes to require the IRS to establish procedures to alert married taxpayers clearly of their joint and several liability on appropriate tax publications and instructions. The proposal would require that such procedures be established no later than 180 days after the date of enactment.

Relieve innocent spouse of liability in certain cases.—Spouses who file a joint tax return are each fully responsible for the accuracy of the return and for the full tax liability, even if only one spouse earned the wages or income shown on the return. Relief from liability is available for "innocent spouses" in certain circumstances, but the conditions are frequently hard to meet and the Tax Court may not have jurisdiction to review all denials of innocent spouse relief. The Administration proposes to generally make innocent spouse status easier to obtain. It would first eliminate certain applicable dollar thresholds for understatements of tax. Second, the proposal would specifically provide the Tax Court with jurisdiction to review the IRS's denial of innocent spouse relief and to order appropriate relief. Except in limited cases, the IRS could not collect the tax until the Tax Court case is final (although the statute of limitations would be extended while the Tax Court case is pending). Finally, the proposal would require the IRS to develop a separate form with instructions for taxpayers to use in applying for innocent spouse relief within 180 days from the date of enactment. The proposal would be effective for understatements in years beginning after the date of enactment and for overpayments assessed within the previous two years.

Miscellaneous

Allow "global" interest netting of under- and over-payments.—The rate of interest charged taxpayers on their tax underpayments differs from the rate paid to taxpayers on overpayments. Although the IRS ameliorates the effect of this interest rate differential by "netting" offsetting underpayments and overpayments in some situations, there is no authority to net when either the overpayment or the underpayment has been satisfied already ("global" netting). Global interest netting for income taxes would be implemented under this proposal. The proposal would be effective for calendar quarters with periods of overlapping mutual indebtedness after the date of enactment.

Facilitate archiving of IRS records.—The IRS, like all other Federal agencies, must create, maintain, and preserve agency records, and must transfer significant and historical records to the National Archives and Records Administration (NARA) for retention or disposal. However, tax returns and return information are confidential and can be disclosed only pursuant to limited exceptions. There is no exception authorizing the disclosure of return information to NARA. The Administration proposes to provide an exception to the disclosure rules, authorizing the IRS to disclose tax returns and return information to officers or employees of NARA, upon written request from the Archivist, for purposes of the appraisal of such records for destruction or retention. The prohibitions on, and penalties for, unauthorized re-disclosure of such information would apply. The proposal would be effective for requests made by the Archivist after the date of enactment.

Clarify authority to prescribe manner of making elections.—Except as otherwise provided by statute, elections under the Internal Revenue Code must be made in such manner as the Secretary of the Treasury "shall by regulations or forms prescribe." The question has arisen whether the Secretary can prescribe the manner of required elections other than by regulations or forms, for instance in revenue rulings or revenue procedures. The proposal would clarify that, except as otherwise provided, the Secretary may prescribe the manner of making any election by any reasonable means. The proposal would be effective on the date of enactment.

Grant IRS broad authority to enter into cooperative agreements with State taxing agencies.—Taxpayers currently must file returns with both their State taxing agency and the IRS, and frequently must resolve issues with the agencies at different times. If appropriate statutory authority were enacted, taxpayers could file only one return for both State and Federal taxes. Then, pursuant to a cooperative agreement between the IRS and the State, the information could be processed by one tax administrator and shared between the two, substantially simplifying filing requirements and reducing taxpayer burden. The Administration proposes to allow the IRS to enter such agreements with the States to provide for joint filing and processing of returns, joint collection of taxes (other than Federal income taxes), and such other provisions as may enhance joint tax administration. It would further amend the Internal Revenue Code's confidentiality provisions to permit sharing of common tax data, would address the effect of joint agreements in a number of situations, and would include a thorough list of conforming amendments. The provision would be effective on the date of enactment.

Provide clinics for low-income taxpayers.—Low-income individuals frequently have difficulty complying with their tax obligations or resolving disputes over their tax liabilities. Providing tax services to such individuals through clinics that offer such services for a nominal fee would improve compliance with the tax laws and should be encouraged. The Administration proposes that the Legal Services Corporation be authorized to make up to $3,000,000 in grants for the development, expansion, or continuation of certain low-income

taxpayer clinics. The provision would be effective on the date of enactment.

Provide procedures for release of field service memoranda.—The Administration proposes to clarify that Field Service Advice Memoranda (FSAs) are return information that is protected under the Internal Revenue Code and cannot be disclosed without authorization. It would also, however, make the non-confidential information in such documents public, subject to a redaction process in which the taxpayer whose liability is the subject of the FSA would be allowed to participate. The proposal would be effective on the date of enactment, but it would include a schedule of time over which the IRS would make past FSAs available under the redaction procedure.

ELIMINATE UNWARRANTED BENEFITS AND ADOPT OTHER REVENUE MEASURES

The President's plan curtails unwarranted corporate tax subsidies, closes tax loopholes, improves tax compliance and adopts other revenue measures.

Defer deduction for interest and original issue discount (OID) on convertible debt.— The accrued but unpaid interest and OID on a convertible debt instrument generally is deductible, even if the instrument is converted into the stock of the issuer or a related party before the issuer pays any interest or OID. The Administration proposes to defer the deduction for all interest, including OID, on convertible debt until payment. The proposal would be effective for convertible debt issued on or after the date of first committee action.

Eliminate dividends-received deduction for certain preferred stock.—A corporate holder of stock generally is entitled to a deduction for dividends received on stock in the following amounts: 70 percent if the recipient owns less than 20 percent of the stock of the payor, 80 percent if the recipient owns 20 percent or more of the stock, and 100 percent of qualifying dividends received from members of the same affiliated group. The Administration proposes to eliminate the 70- and 80-percent dividends-received deduction for dividends on certain limited-term preferred stock, effective for stock issued after the date of enactment.

Repeal percentage depletion for non-fuel minerals mined on Federal and formerly Federal lands.—Taxpayers are allowed to deduct a reasonable allowance for depletion relating to certain mineral deposits. The depletion deduction for any taxable year is calculated under either the cost depletion method or the percentage depletion method, whichever results in the greater allowance for depletion for the year. The percentage depletion method is viewed as an incentive for mineral production rather than as a normative rule for recovering the taxpayer's investment in the property. This incentive is excessive with respect to minerals mined on Federal and formerly Federal lands under the 1872 mining act, in light of the minimal costs of acquiring the mining rights ($5.00 or less per acre). The Administration proposes to repeal percentage depletion for non-fuel minerals mined on Federal lands where the mining rights were originally acquired under the 1872 law, and on private lands acquired under the 1872 law. The proposal would be effective for taxable years beginning after the date of enactment.

Repeal tax-free conversions of large C corporations to S corporations (section 1374).—A corporation can avoid the existing two-tier tax by electing to be treated as an S corporation or by converting to a partnership. Converting to a partnership is a taxable event that generally requires the corporation to recognize any built-in gain on its assets and requires the shareholders to recognize any built-in gain on their stock. By contrast, the conversion to an S corporation is generally tax-free, except that the S corporation generally must recognize the built-in gain on assets held at the time of conversion if the assets are sold within ten years. The Administration proposes that the conversion of a C corporation with a value of more than $5 million into an S corporation would be treated as a liquidation of the C corporation, followed by a contribution of the assets to an S corporation by the recipient shareholders. Thus, the proposal would require immediate gain recognition by both the corporation (with respect to its appreciated assets) and its shareholders (with respect to their stock). This proposal would make the tax treatment of conversions to an S corporation generally consistent with conversions to a partnership. The proposal would apply to elections that are first effective for a taxable year beginning after January 1, 1999 and to acquisitions of a C corporation by an S corporation made after December 31, 1998.

Replace sales-source rules with activity-based rules.—The foreign tax credit generally reduces U.S. tax on foreign source income, but does not reduce U.S. tax on U.S. source income. When products are manufactured in the United States and sold abroad, Treasury regulations provide that 50 percent of such income generally is treated as earned in production activities, and sourced on the basis of the location of assets held or used to produce income from the sale. The remaining 50 percent of the income is treated as earned in sales activities and sourced based on where title to the inventory transfers. Thus, if a U.S. manufacturer sells inventory abroad, half of the income generally is treated as derived from domestic sources, and half of the income generally is treated as derived from foreign sources. However, the taxpayer may use a more favorable method if it can establish to the satisfaction of the IRS that more than half of its economic activity occurred in a foreign country. This 50/50 rule provides a benefit to U.S. exporters that operate in high-tax foreign countries. Thus, U.S. multinational exporters have a competitive advantage over U.S. exporters that conduct all their business activities in the U.S. Because export benefits should be targeted equally to all export-

ers, the Administration proposes to reduce the amount of export sales income that such corporations may treat as derived from foreign sources by requiring that the allocation be based on actual economic activity. The proposal would be effective for taxable years beginning after the date of enactment.

Modify rules relating to foreign oil and gas extraction income.—To be eligible for the U.S. foreign tax credit, a foreign levy must be the substantial equivalent of an income tax in the U.S. sense, regardless of the label the foreign government attaches to it. Under regulations, a foreign levy is a tax if it is a compulsory payment under the authority of a foreign government to levy taxes and is not compensation for a specific economic benefit provided by the foreign country. Taxpayers that are subject to a foreign levy and that also receive (directly or indirectly) a specific economic benefit from the levying country are referred to as "dual capacity" taxpayers and may not claim a credit for that portion of the foreign levy paid as compensation for the specific economic benefit received. The Administration proposes to treat as taxes payments by a dual-capacity taxpayer to a foreign country that would otherwise qualify as income taxes or "in lieu of" taxes, only if there is a "generally applicable income tax" in that country. For this purpose, a generally applicable income tax is an income tax (or a series of income taxes) that applies to trade or business income from sources in that country, so long as the levy has substantial application both to non-dual-capacity taxpayers and to persons who are citizens or residents of that country. Where the foreign country does generally impose an income tax, as under present law, credits would be allowed up to the level of taxation that would be imposed under that general tax, so long as the tax satisfies the new statutory definition of a "generally applicable income tax." The proposal also would create a new foreign tax credit basket within section 904 for foreign oil and gas income. The proposal would be effective for taxable years beginning after the date of enactment. The proposal would yield to U.S. treaty obligations that allow a credit for taxes paid or accrued on certain oil or gas income.

Repeal lower-of-cost-or-market inventory accounting method.—Taxpayers required to maintain inventories are permitted to use a variety of methods to determine the cost of their ending inventories, including the last-in, first-out (LIFO) method, the first-in, first-out (FIFO) method, and the retail method. Taxpayers not using a LIFO method may determine the carrying values of their inventories by applying the lower-of-cost-or-market (LCM) method and by writing down the cost of goods that are unsalable at normal prices or unusable in the normal way because of damage, imperfection or other causes (subnormal goods method). The allowance of write-downs under the LCM and subnormal goods methods is essentially a one-way mark-to-market method that understates taxable income. The Administration proposes to repeal the LCM and subnormal goods methods effective for taxable years beginning after the date of enactment.

Increase penalties for failure to file correct information returns.—Any person who fails to file required information returns in a timely manner or incorrectly reports such information is subject to penalties. For taxpayers filing large volumes of information returns or reporting significant payments, existing penalties ($15 per return, not to exceed $75,000 if corrected within 30 days; $30 per return, not to exceed $150,000 if corrected by August 1; and $50 per return, not to exceed $250,000 if not corrected at all) may not be sufficient to encourage timely and accurate reporting. The Administration proposes to increase the general penalty amount, subject to the overall dollar limitations, to the greater of $50 per return or 5 percent of the total amount required to be reported. The increased penalty would not apply if the aggregate amount actually reported by the taxpayer on all returns filed for that calendar year was at least 97 percent of the amount required to be reported. The increased penalty would be effective for returns the due date for which is more than 90 days after the date of enactment.

Tighten the substantial understatement penalty for large corporations.—Currently taxpayers may be penalized for erroneous, but non-negligent, return positions if the amount of the understatement is "substantial" and the taxpayer did not disclose the position in a statement with the return. "Substantial" is defined as 10 percent of the taxpayer's total current tax liability, but this can be a very large amount. This has led some large corporations to take aggressive reporting positions where huge amounts of potential tax liability are at stake—in effect playing the audit lottery—without any downside risk of penalties if they are caught, because the potential tax still would not exceed 10 percent of the company's total tax liability. To discourage such aggressive tax planning, the Administration proposes that any deficiency greater than $10 million be considered "substantial" for purposes of the substantial understatement penalty, whether or not it exceeds 10 percent of the taxpayer's liability. The proposal, which would be effective for taxable years beginning after the date of enactment, would affect only taxpayers that have tax liabilities greater than or equal to $100 million.

Repeal exemption for withholding on gambling winnings from bingo and keno in excess of $5,000.—Proceeds of most wagers with odds of less than 300 to 1 are exempt from withholding, as are all bingo and keno winnings. The Administration proposes to impose withholding on proceeds of bingo or keno in excess of $5,000 at a rate of 28 percent, regardless of the odds of the wager, effective for payments made after the start of the first calendar quarter that is at least 30 days after the date of enactment.

Reinstate oil spill excise tax.—Before January 1, 1995, a five-cents-per-barrel excise tax was imposed on domestic crude oil and imported oil and petroleum products. The tax was dedicated to the Oil Spill Liability Trust Fund to finance the cleanup of oil spills and was not imposed for a calendar quarter if the unobligated balance in the Trust Fund exceeded $1 billion at the close of the preceding quarter. The Administration proposes to reinstate this tax for the period after the date of enactment and before October 1, 2008. The tax would be suspended for a given calendar quarter if the unobligated Trust Fund balance at the end of the preceding quarter exceeded $5 billion.

Modify Federal Unemployment Act (FUTA) provisions.—Beginning in 2004, the Administration proposes to require an employer to pay Federal and State unemployment taxes monthly (instead of quarterly) in a given year, if the employer's FUTA tax liability in the immediately preceding year was $1,100 or more.

Extend pro rata disallowance of tax-exempt interest expense that applies to banks to all financial intermediaries.—No income tax deduction is allowed for interest on debt used directly or indirectly to acquire or hold investments that produce tax-exempt income. The determination of whether debt is used to acquire or hold tax-exempt investments differs depending on the holder of the instrument. For banks and a limited class of other financial institutions, debt generally is treated as financing all of the taxpayer's assets proportionately. Securities dealers are not included in the definition of "financial institution," and under a special rule are subject to a disallowance of a much smaller portion of their interest deduction. For other financial intermediaries, such as finance companies, that are also not included in the narrow definition of "financial institutions," deductions are disallowed only when indebtedness is incurred or continued for the purpose of purchasing or carrying tax-exempt investments. These taxpayers are therefore able to reduce their tax liabilities inappropriately through the double Federal tax benefits of interest expense deductions and tax-exempt interest income, notwithstanding that they operate similarly to banks. Effective for taxable years beginning after the date of enactment, with respect to obligations acquired on or after the date of first committee action, the Administration proposes that all financial intermediaries, other than insurance companies (which are subject to a separate regime), be treated the same as banks are treated under current law with regard to deductions for interest on debt used directly or indirectly to acquire or hold tax-exempt obligations.

Increase the proration percentage for property casualty (P&C) insurance companies.—In computing their underwriting income, P&C insurance companies deduct reserves for losses and loss expenses incurred. These loss reserves are funded in part with the company's investment income. In 1986, Congress reduced the reserve deductions of P&C insurance companies by 15 percent of the tax-exempt interest or the deductible portion of certain dividends received. In 1997, Congress expanded the 15-percent proration rule to apply to the inside buildup on certain insurance contracts. The existing 15-percent proration rule still enables P&C insurance companies to fund a substantial portion of their deductible reserves with tax-exempt or tax-deferred income. Other financial intermediaries, such as life insurance companies and banks, are subject to more stringent proration rules that substantially reduce or eliminate their ability to use tax-exempt or tax-deferred investments to fund currently deductible reserves or to deduct interest expense. Effective for taxable years beginning after the date of enactment, with respect to investments acquired on or after the date of first committee action, the Administration proposes to increase the proration percentage to 30 percent.

Preclude certain taxpayers from prematurely claiming losses from receivables.—An accrual method taxpayer generally must recognize income when all events have occurred that fix the right to its receipt and its amount can be determined with reasonable accuracy. In the event that a receivable arising in the ordinary course of the taxpayer's trade or business becomes uncollectible, the accrual method taxpayer may deduct the account receivable as a business bad debt in the year in which it becomes wholly or partially worthless. Accrual method service providers, however, are provided a special exception to these general rules. Under the exception, a taxpayer using an accrual method with respect to amounts to be received for the performance of services is not required to accrue any portion of such amounts that (on the basis of experience) will not be collected. This special exception permits an accrual method service provider to reduce current taxable income by an estimate of its future bad debt losses. This method of estimation results in a mismeasurement of a taxpayer's economic income and, because this tax benefit only applies to amounts to be received for the performance of services, promotes controversy over whether a taxpayer's receivables represent amounts to be received for the performance of services or for the provision of goods. The Administration proposes to repeal the special exception for accrual method service providers effective for taxable years ending after the date of enactment.

In general, dealers in securities are required to use a mark-to-market method of accounting. Under this method, securities that are inventory in the hands of the dealer must be included in inventory at fair market value. A taxpayer that is otherwise not a dealer in securities may elect to be treated as such for this purpose if the taxpayer purchases and sells debt instruments that, at the time of purchase or sale, are customer paper with respect to either the taxpayer or a corporation that is a member of the same consolidated group as the taxpayer (the "customer paper election"). Significant numbers of taxpayers whose principal activities are selling nonfinancial goods or providing nonfinancial services are making the customer paper elec-

tion as a means of restoring bad debt reserves. The customer paper election is also being used inappropriately to mark-to-market trade receivables that bear little or no interest in order to recognize loss. Under the proposal, certain customer receivables would not be allowed to be marked to market. The proposal would be effective for taxable years ending after the date of enactment.

Restrict special net operating loss carryback rules for specified liability losses.—Under current law, the portion of a net operating loss that qualifies as a specified liability loss may be carried back 10 years rather than being limited to the general two-year carryback period. A specified liability loss includes amounts allowable as a deduction with respect to product liability, and also certain liabilities that arise under Federal or State law or out of any tort of the taxpayer. The proper interpretation of the specified liability loss provisions as they apply to liabilities arising under Federal or State law or out of any tort of the taxpayer has been the subject of manipulation and significant controversy. Accordingly, the Administration proposes to modify the specified liability loss provisions to provide that only a limited class of liabilities qualifies as a specified liability loss. Under the proposal, specified liability losses would include (in addition to product liability losses) any amount allowable as a deduction that is attributable to a liability under Federal or State law for reclamation of land, decommissioning of a nuclear power plant (or any unit thereof), dismantlement of an offshore oil drilling platform, remediation of environmental contamination, or payments under a workers' compensation statute. The proposal would be effective for taxable years beginning after the date of enactment.

Freeze grandfather status of stapled (or "paired-share") Real Estate Investment Trusts (REITs).—REITs generally are limited to owning passive investments in real estate and certain securities. Prior to 1984, certain "stapled" REITs were paired with subchapter C corporations and traded in tandem as a single unit. This effectively allowed these stapled REITs to circumvent the restrictions on operating active businesses. In the Deficit Reduction Act of 1984, Congress restricted REITs' ability to avoid these investment limitations by providing that stapled entities must be treated as one entity for purposes of determining qualification under the REIT rules. However, Congress grandfathered the existing stapled REITs indefinitely. The Administration proposes to limit the grandfather status of the existing stapled REITs. Under the proposal, for purposes of determining whether any grandfathered entity is a REIT, the stapled entities would be treated as one entity with respect to properties acquired on or after the date of the first committee action and with respect to activities or services relating to such properties (i.e., properties acquired after the effective date) that are undertaken or performed by one of the stapled entities on or after such date.

Restrict impermissible business indirectly conducted by REITs.—REITs generally are restricted to owning passive investments in real estate and certain securities. To prevent indirect ownership of impermissible businesses, current law restricts a REIT from owning more than 10 percent of the outstanding voting securities of any issuer. Nonetheless, a REIT can essentially conduct an impermissible business through a subsidiary by holding a significant amount of non-voting stock in a corporation. Through the retention of non-voting stock and debt, the REIT is able to retain most, if not all, of the income generated by the impermissible business and to circumvent the restrictions on operating active businesses. The Administration proposes to restrict this ability by prohibiting REITs from holding stock possessing more than 10 percent of the vote or value of all classes of stock of a corporation. In general, the proposal would be effective with respect to stock acquired on or after the date of first committee action.

Modify treatment of closely held REITs.—When originally enacted, the REIT legislation was intended to provide a tax-favored vehicle through which small investors could invest in a professionally managed real estate portfolio. REITs are intended to be widely held entities, and certain requirements of the REIT rules are designed to ensure this result. Among other requirements, in order for an entity to qualify for REIT status, the beneficial ownership of the entity must be held by 100 or more persons. In addition, a REIT cannot be closely held, which generally means that no more than 50 percent of the value of the REIT's stock can be owned by five or fewer individuals during the last half of the taxable year. Certain attribution rules apply in making this determination. The Administration has become aware of a number of tax avoidance transactions involving the use of closely held REITs. In order to meet the 100 or more shareholder requirement, the REIT generally issues common stock, which is held by one shareholder, and a separate class of non-voting preferred stock with a relatively nominal value, which is held by 99 "friendly" shareholders. The closely held limitation does not disqualify the REITs that are utilizing this ownership structure because the majority shareholders of these REITs are not individuals. The Administration proposes to impose as an additional requirement for REIT qualification that no person can own stock of a REIT possessing more than 50 percent of the total combined voting power of all classes of voting stock or more than 50 percent of the total value of shares of all classes of stock. For purposes of determining a person's stock ownership, rules similar to the attribution rules contained in section 856(d)(5) would apply. The proposal would be effective for entities electing REIT status for taxable years beginning on or after the date of first committee action.

Modify depreciation method for tax-exempt use property.—Current law requires tax-exempt use property (property owned by a U.S. person but leased to a foreign or tax-exempt person) to be depreciated using

the straight-line method over a period equal to the greater of (1) the property's class life; or (2) 125 percent of the lease term. This rule has led to manipulations designed to create a shortened recovery period. The Administration proposes to lengthen the recovery period for "tax-exempt use property" to 150 percent of its class life. This will prevent the U.S. tax system from providing tax benefits in the form of accelerated depreciation for the use of property that is not connected with U.S. business activities. The proposal generally would be effective for property placed in service after December 31, 1998.

Impose excise tax on purchase of structured settlements.—Current law facilitates the use of structured personal injury settlements because recipients of annuities under these settlements are less likely than recipients of lump sum awards to consume their awards too quickly and require public assistance. Consistent with that policy, this favorable treatment is conditional upon a requirement that the periodic payments cannot be accelerated, deferred, increased or decreased by the injured person. Nonetheless, certain factoring companies are able to purchase a portion of the annuities from the recipients for heavily discounted lump sums. These purchases are inconsistent with the policy underlying favorable tax treatment of structured settlements. Accordingly, the Administration proposes to impose on any person who purchases (or otherwise acquires for consideration) a structured settlement payment stream, a 20-percent excise tax on the purchase price unless such purchase is pursuant to a court order finding that the extraordinary and unanticipated needs of the original intended recipient render such a transaction desirable. The proposal would apply to purchases occurring after the date of enactment. No inference is intended as to the contractual validity of the purchase or the effect of the purchase transaction on the tax treatment of any party other than the purchaser.

Clarify and expand math error procedures.—If the IRS determines that a taxpayer has failed to provide a correct taxpayer identification number (TIN) that is required by statute, the IRS may, in certain cases, use the streamlined procedures for mathematical and clerical errors ("math error procedures") to expedite the assessment of tax. The Administration proposes the following clarifications to the math error procedures applicable to the child tax credit, the child and dependent care tax credit, the personal exemption for dependents, the Hope and Lifetime Learning tax credits, and the earned income tax credit. First, the term "correct taxpayer identification number" used on a tax return would be defined as the TIN assigned to such individual by the Social Security Administration (SSA), or in certain limited cases, the IRS. Second, the IRS would be authorized to use data obtained from SSA to verify that the TIN provided on the return corresponds to the individual for whom the TIN was assigned. Such data would include the individual's name, age or date of birth, and Social Security number. Third, the IRS would be authorized to use math error procedures to deny eligibility for those tax benefits subject to the math error procedures that impose a statutory age restriction (i.e., the child tax credit, the child and dependent care tax credit and the earned income tax credit) if the taxpayer provides a TIN for either the taxpayer or qualifying child that the IRS determines, using data from SSA, does not meet the statutory age restrictions. The proposal would be effective for taxable years ending after the date of enactment.

Clarify the meaning of "subject to" liabilities under section 357(c).—A transferor generally is required to recognize gain on a transfer of property in an otherwise tax-free section 351 exchange to the extent the sum of the liabilities assumed, plus those to which the transferred property is subject, exceeds the basis in the property. If a recourse liability is secured by multiple assets, it is unclear under present law whether a transfer of one asset where the transferor remains liable is a transfer of property "subject to the liability." Similar issues exist with respect to nonrecourse liabilities. Under the Administration's proposal, the distinction between the assumption of a liability and the acquisition of an asset subject to a liability would be eliminated. Instead, the extent to which a liability (including a nonrecourse liability) is treated as assumed for Federal income tax purposes in connection with a transfer of property would be determined on the basis of all the facts and circumstances. In general, if nonrecourse indebtedness is secured by more than one asset, and any assets securing the indebtedness are transferred subject to the indebtedness without any indemnity agreements, then for all Federal income tax purposes the transferee would be treated as assuming an allocable portion of the liability based upon the relative fair market values (determined without regard to section 7701(g)) of the assets securing the liability. The proposal would be effective for transfers after the date of first committee action. No inference regarding the tax treatment under current law is intended.

Simplify foster child definition under EITC.—In order to simplify the EITC rules, the Administration proposes to clarify the definition of foster child for purposes of claiming the EITC. Under the proposal, the foster child must be the taxpayer's sibling (or a descendant of the taxpayer's sibling), or be placed in the taxpayer's home by an agency of a State or one of its political subdivisions or a tax-exempt child placement agency licensed by a State. The proposal would be effective for taxable years beginning after December 31, 1998.

Clarify tie-breaker rule under EITC.—The earned income tax credit tie-breaker rule prevents a lower-income individual from claiming the credit with respect to a particular child who could also be a qualifying child with respect to a higher-income individual. The Administration proposes to clarify that the requirement that a taxpayer identify on his or her tax return any

child with respect to whom the taxpayer is claiming the EITC is a requirement for claiming the credit, rather than an element of the definition of "qualifying child." Thus, under the EITC tie-breaker rule, the child would be a qualifying child with respect to the higher-income individual, regardless of whether the higher-income individual actually identifies the child on his or her return. A similar change would be made to the definition of "eligible individual." The proposal is effective with respect to taxable years ending after the date of enactment. No inference is intended as to the operation of the tie-breaker rule under current law.

Eliminate non-business valuation discounts.—Under current law, taxpayers are claiming large discounts on the valuation of gifts and bequests of interests in entities holding marketable assets. Because these discounts are inappropriate, the Administration proposes to eliminate valuation discounts except as they apply to active businesses. Interests in entities generally would be required to be valued for gift and estate tax purposes at a proportional share of the net asset value of the entity to the extent that the entity holds readily marketable assets. The proposal would be effective for gifts made after, and decedents dying after, the date of enactment.

Eliminate "Crummey" rule.—Currently, gifts of present interests of up to $10,000 (in 1998) per donor per donee each year are excepted from the gift tax. The decision in *Crummey v. Commissioner* held that a transfer in trust is a transfer of a present interest if the beneficiary has a right to withdraw the property from the trust for a limited period of time. The Administration proposes to overrule this decision so that only outright gifts of present interests would be counted for purposes of the $10,000 gift exception. The proposal would be effective for gifts completed after December 31, 1998.

Eliminate gift tax exemption for personal residence trusts.— Current law excepts transfers of personal residences in trust from the special valuation rules applicable when a grantor retains an interest in a trust. The Administration proposes to repeal this personal residence exception. Thereafter, if a residence is to be used to fund a grantor retained interest trust, the trust would be required to pay out the required annuity or unitrust amount or else the grantor's retained interest would be valued at zero for gift tax purposes. This proposal would be effective for transfers in trust after the date of enactment.

Include qualified terminable interest property (QTIP) trust assets in surviving spouse's estate.—A marital deduction is allowed for qualified terminable interest property (QTIP) passing to a qualifying trust for a spouse either by gift or by bequest. The value of the recipient spouse's estate includes the value of any such property in which the decedent had a qualifying income interest for life and a deduction was allowed under the gift or estate tax. In some cases, taxpayers have attempted to whipsaw the government by claiming the deduction in the first estate and then arguing against inclusion in the second estate due to some technical flaw in the QTIP election. The Administration proposes that, if a deduction is allowed under the QTIP provisions, inclusion is required in the beneficiary spouse's estate. The proposal would be effective for decedents dying after the date of enactment.

Apply 7.7 percent capitalization rate to credit life insurance premiums.—Under current law, a company that issues group credit life insurance contracts is required to capitalize 2.05 percent of its net premiums for such contracts. However, commissions and other policy acquisition expenses on credit life insurance contracts generally are higher than policy acquisition expenses for individual life insurance contracts, to which a 7.7 percent capitalization rate applies. Thus, the statutory proxy rate for policy acquisition costs on credit life insurance contracts does not accurately reflect the level of commissions and other policy acquisition expenses for credit life insurance. Under the Administration's proposal, insurance companies would be required to capitalize 7.7 percent of their net premiums for a taxable year with respect to all credit life insurance contracts. The proposal would be effective for taxable years beginning after the date of enactment.

Modify corporate-owned life insurance (COLI) rules.—In general, interest on policy loans or other indebtedness with respect to life insurance, endowment or annuity contracts is not deductible unless the insurance contract insures the life of a "key person" of a business. In addition, the interest deductions of a business generally are reduced under a proration rule if the business owns or is a direct or indirect beneficiary with respect to certain insurance contracts. The COLI proration rules generally do not apply if the contract covers an individual who is a 20 percent owner of the business or is an officer, director, or employee of such business. These exceptions under current law still permit leveraged businesses to fund significant amounts of deductible interest and other expenses with tax-exempt or tax-deferred inside buildup. The Administration proposes to repeal the exception under the COLI proration rules for contracts insuring employees, officers or directors (other than 20 percent owners) of the business. The proposal also would conform the key person exception for disallowed interest deductions attributable to policy loans and other indebtedness with respect to insurance contracts to the 20 percent owner exception in the COLI proration rules. The proposal would be effective for taxable years beginning after date of enactment.

Modify reserve rules for annuity contracts.—Under current law, a life insurance company that issues an annuity contract claims a reserve deduction equal to the greater of the net surrender value of the contract and an amount that is based on the Commissioner's

Annuities Reserve Valuation Method (CARVM) in effect on the date that the annuity contract is issued, subject to a cap equal to the annual statement reserve for the contract. In 1997, the National Association of Insurance Commissioners adopted new actuarial guidelines interpreting CARVM. The guidelines generally require life insurance companies to compute CARVM reserves by determining the greatest possible present value of all guaranteed benefits, using a number of worst case or "conservative" assumptions. The guidelines are effective on December 31, 1998, and apply to all contracts issued on or after January 1, 1981. Because these new guidelines would be inappropriate for calculating tax reserves, the Administration proposes that tax reserves for all annuity contracts with cash surrender values would be set at the contract's net cash surrender value plus a specified percentage of the contract's net cash surrender value that would be phased out over a portion of the contract period. The proposal would be effective for taxable years ending on or after the date of enactment.

Tax certain exchanges of insurance contracts and reallocations of assets within variable insurance contracts.—Generally, investors are taxed upon the sale or exchange of assets. However, certain exchanges of life insurance, endowment and annuity contracts are not taxed. Also, the holder of a variable contract who liquidates part or all of his investment in one fund, and reallocates the proceeds to a different fund within a variable contract, is not taxed. The Adminstration proposes that all exchanges of an insurance contract for a variable contract would be taxable. Exchanges of variable contracts for any type of life insurance, endowment or annuity contract would be taxable. Each variable contract investment in a separate account mutual fund or in the insurance company's general account would be treated as a separate contract. In addition, the investment in the contract would be net of mortality and expense charges. These rules would apply to contracts issued after the date of first committee action. A material change in an existing contract would be treated as the issuance of a new contract.

Reduce "investment in the contract" for mortality and expense charges on certain insurance contracts.—For purposes of computing the amount of taxable investment income under section 72 of the Internal Revenue Code from distributions under cash value life insurance, endowment, or annuity contracts, the holder's tax basis includes premiums used to pay mortality and expense charges. These charges are used to pay for annual term life insurance coverage, other types of insurance coverage, and options to buy life annuities at specified rates guaranteed in a deferred annuity contract. As a result, these rules overstate basis and thus understate the amount of tax-deferred income under these contracts when they are surrendered for cash or the holder receives other distributions under the contract. The Administration proposes to modify the computation of basis under section 72 by subtracting mortality and expense charges. This proposal would apply to contracts issued after the date of first committee action.

Amend 80/20 company rules.—Dividends paid by a so-called "80/20 company" generally are partially or fully exempt from U.S. withholding tax. A U.S. corporation is treated as an 80/20 company if at least 80 percent of the gross income of the corporation for the three-year period preceding the year of a dividend is foreign source income attributable to the active conduct of a foreign trade or business (or the foreign business of a subsidiary). Certain foreign multinationals improperly seek to exploit the rules applicable to 80/20 companies in order to avoid U.S. withholding tax liability on earnings of U.S. subsidiaries that are distributed abroad. The proposal would prevent taxpayers from avoiding withholding tax through manipulations of these rules. The proposal would apply to interest or dividends paid or accrued after the date of enactment.

Prescribe regulatory directive to address tax avoidance involving foreign built-in losses.—Certain taxpayers are engaging in tax avoidance transactions that inappropriately use losses generated outside the United States to offset income that otherwise would be subject to U.S. tax. The provision would direct the Secretary of Treasury to prescribe regulations, as may be necessary or appropriate to prevent the avoidance of tax, to determine (1) the basis of assets held directly or indirectly by a person other than a United States person, and (2) the amount of built-in deductions of a person other than a U.S. person, or an entity held directly or indirectly by such a person. The proposal would be effective on the date of enactment.

Prescribe regulatory directive to address tax avoidance through use of hybrids.—Certain persons are entering into tax avoidance transactions that utilize hybrid entities, securities and transactions to achieve tax results that are inconsistent with the purposes of the provisions of U.S. law (including treaties) that are relied on for such results. Other transactions involving hybrids do not achieve tax results that are inconsistent with the purposes of U.S. law. The consequences of these transactions should be described in the form of promptly issued administrative guidance both to prevent inappropriate results and to provide taxpayers with greater certainty. The proposal would direct the Secretary of Treasury to prescribe regulations to prevent the avoidance of tax through the use of hybrid entities, securities and transactions that achieve results inconsistent with the purposes of U.S. law (including treaties). The proposal would be effective on the date of enactment.

Modify foreign office material participation exception applicable to inventory sales attributable to nonresident's U.S. office.—In the case of a sale of inventory property that is attributable to a non-

resident's office or other fixed place of business within the United States, the sales income is generally U.S. source. The income is foreign source, however, if the inventory is sold for use, disposition, or consumption outside the United States and the nonresident's foreign office or other fixed place of business materially participates in the sale. The proposal would provide that the foreign source exception shall apply only if an income tax equal to at least 10 percent of the income from the sale is actually paid to a foreign country with respect to such income. The proposal thereby ensures that the United States does not cede its jurisdiction to tax such sales unless the income from the sale is actually taxed by a foreign country at some minimal level. The proposal would be effective for transactions occurring on or after the date of enactment.

Stop abuse of controlled foreign corporation (CFC) exception to ownership requirements.—Under section 887 of the Internal Revenue Code, a foreign corporation is subject to a four-percent tax on its United States source gross transportation income. The tax does not apply, however, if the corporation is organized in a country (an "exemption country") that grants an equivalent tax exemption to U.S. shipping companies. The exemption from the four-percent tax is subject to an anti-abuse rule that requires at least 50 percent of the stock of the corporation be owned by individual residents of an exemption country. Thus residents of a non-exemption country cannot secure the exemption simply by forming their shipping corporation in an exemption country. The anti-abuse rule requiring exemption country ownership does not apply, however, if the corporation is a controlled foreign corporation (the "CFC exception"). The premise for the CFC exception is that the U.S. shareholders of a CFC will be subject under U.S. tax law to current income taxation on their share of the foreign corporation's shipping income and thus the four-percent tax should not apply if the corporation is organized in an exemption country. However, residents of non-exemption countries can achieve CFC status for their shipping companies simply by owning the corporations through U.S. partnerships. Non-exemption country individuals can thereby avoid the anti-abuse rule requiring exemption country ownership and illegitimately secure the exemption from the U.S. four-percent tax. The proposal would stop that abuse. It would be effective for taxable years beginning after the date of enactment.

OTHER PROVISIONS THAT AFFECT RECEIPTS

Reinstate environmental tax imposed on corporate taxable income and deposited in the Hazardous Substance Superfund Trust Fund.—Under prior law a tax equal to 0.12 percent of alternative minimum taxable income (with certain modifications) in excess of $2 million was levied on all corporations and deposited in the Hazardous Substance Superfund Trust Fund. The Administration proposes to reinstate this tax, which expired on December 31, 1995, for taxable years beginning after December 31, 1997 and before January 1, 2009.

Reinstate excise taxes deposited in the Hazardous Substance Superfund Trust Fund.—The excise taxes that were levied on petroleum, chemicals, and imported substances and deposited in the Hazardous Substance Superfund Trust Fund, are proposed to be reinstated for the period after the date of enactment and before October 1, 2008. These taxes expired on December 31, 1995.

Extend excise taxes on gasoline, diesel fuel, and special motor fuels.—Excise taxes are imposed on gasoline (other than aviation gasoline) at a rate of 18.4 cents per gallon, diesel fuel at a rate of 24.4 cents per gallon, and special motor fuels at varying rates. The tax rates are scheduled to fall to 4.4 cents per gallon (or comparable rates in the case of special motor fuels) on September 30, 1999. The Administration proposes to extend the current rates of tax on nonaviation gasoline, diesel fuel and special motor fuels (with a 0.1-cent-per-gallon reduction, reflecting the expiration of the LUST Trust Fund tax on April 1, 2005).

Convert excise taxes deposited in the Airport and Airway Trust Fund to cost-based user fees assessed for Federal Aviation Administration (FAA) services.—Beginning in 2000, the excise taxes that are levied on domestic air passenger tickets and flight segments, international departures and arrivals, domestic air cargo, and aviation fuels are proposed to be phased out over a five-year period, and replaced with more efficient, cost-based user fees charged for FAA services. As part of a continuing effort to create a more business-like FAA, the Administration will propose legislation by which the FAA would be entirely funded by cost-based user fees by 2003.

Receipts from tobacco legislation.—The Administration includes receipts from tobacco legislation in the 1999 budget. These receipts, which total approximately $65 billion for the five years 1999 through 2003, would support tobacco-related public health and other activities at the State and Federal level.

Assess fees for examination of bank holding companies and State-chartered member banks (receipt effect).—The Administration proposes to require the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) to assess fees for the examination of bank holding companies and State-chartered banks. The Federal Reserve currently funds the costs of such examinations from earnings; therefore, deposits of earnings by the Federal Reserve, which are classified as governmental receipts, will increase by the amount of the fees.

Transfer retirees and certain active employees of the FDIC and the Board of Governors of the Federal Reserve to the Federal Employee Health

Benefits Program (FEHBP) (receipt effect).—The Administration supports the transfer of health coverage for retirees and certain active employees of the FDIC and the Board of Governors of the Federal Reserve, who are now covered by in-house health care plans, to the FEHBP administered by the Office of Personnel Management (OPM). The current plans are becoming more expensive because of the small size and age of the insured group. FEHBP coverage would be more cost effective. This proposal will reduce the administrative costs of the Federal Reserve, thereby increasing deposits of earnings by the Federal Reserve, which are classified as governmental receipts.

Repeal Federal Employees Retirement System (FERS) open season (receipt effect).—The Administration proposes, in a supplemental, to repeal section 642 of the Treasury and General Government Appropriation Act, 1998. That section provides an "open season" from July 1, 1998 through December 31, 1998 during which time Federal and Postal Service employees covered by the Civil Service Retirement System (CSRS) could switch to FERS. Repealing section 642 would increase employee payments to the Civil Service Retirement and Disability Fund.

Create solvency incentive for State Unemployment Trust Fund accounts.—The Administration proposes to create an incentive for States to improve the solvency of their State accounts in the Federal Unemployment Trust Fund. This is intended to improve the ability of States to continue paying benefits in the event of a recession. The incentive consists of tying a portion of the projected distributions to the States under the Reed Act to demonstrated improvements in solvency.

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS

(In billions of dollars)

	Estimate						
	1998	1999	2000	2001	2002	2003	1999–2003
Provide tax relief and extend expiring provisions:							
Make child care more affordable:							
Increase and simplify child and dependent care tax credit	.....	–0.3	–1.3	–1.1	–1.2	–1.2	–5.1
Establish tax credit for employer-provided child care	.....	–*	–0.1	–0.1	–0.1	–0.1	–0.5
Subtotal, make child care more affordable	.....	–0.3	–1.3	–1.3	–1.3	–1.4	–5.6
Promote energy efficiency and improve the environment:							
Provide tax credit for energy-efficient building equipment	.....	–0.1	–0.2	–0.3	–0.3	–0.4	–1.4
Provide tax credit for purchase of new energy-efficient homes	.....	–*	–*	–*	–0.1	–0.1	–0.2
Provide tax credit for high-fuel-economy vehicles	.....	.....	.....	–0.1	–0.2	–0.4	–0.7
Equalize treatment of parking and transit benefits	.....	–*	–*	–*	–*	–*	–0.1
Provide investment tax credit for CHP systems	*	–0.3	–0.3	–0.1	–0.1	–0.2	–0.9
Provide tax credit for replacement of certain circuitbreaker equipment	.....	–*	–*	–*	–*	–*	–*
Provide tax credit for certain PFC and HFC recycling equipment	.....	–*	–*	–*	–*	–*	–*
Provide tax credit for rooftop solar equipment	.....	–*	–*	–*	–*	–*	–0.1
Extend wind and biomass tax credit	.....	–*	–*	–*	–0.1	–0.1	–0.2
Subtotal, promote energy efficiency and improve the environment	*	–0.4	–0.6	–0.6	–0.8	–1.2	–3.6
Promote expanded retirement savings	–*	–0.1	–0.2	–0.2	–0.2	–0.2	–0.9
Expand education incentives:							
Provide incentives for public school construction	.....	–0.2	–0.9	–1.3	–1.3	–1.3	–5.0
Extend and expand exclusion for employer-provided educational assistance	–*	–0.2	–0.3	–0.4	–0.1	.....	–1.0
Eliminate tax when forgiving student loans subject to income contingent repayment	.....	.....	.....	.....	.....	.....	.....
Subtotal, expand education incentives	–*	–0.4	–1.2	–1.7	–1.4	–1.3	–6.0
Increase low-income housing tax credit per capita cap	.....	–*	–0.2	–0.3	–0.4	–0.6	–1.6
Extend expiring provisions:							
Extend work opportunity tax credit	–*	–0.2	–0.3	–0.2	–0.1	–*	–0.8
Extend welfare-to-work tax credit	.....	–*	–0.1	–0.1	–*	–*	–0.2
Extend R&E tax credit	–0.4	–0.8	–0.6	–0.3	–0.1	–*	–1.8
Extend deduction provided for contributions of appreciated stock to private foundations	.....	–*	–*	.....	.....	.....	–0.1
Make permanent the expensing of brownfields remediation costs	.....	.....	.....	–0.1	–0.2	–0.2	–0.5
Subtotal, extend expiring provisions	–0.4	–1.1	–1.0	–0.6	–0.4	–0.3	–3.4
Modify international trade provisions:							
Extend GSP and modify other trade provisions [1]	.....	–0.5	–0.5	–0.5	–*	–*	–1.5
Extend and modify Puerto Rico economic-activity tax credit	.....	–*	–0.1	–0.1	–0.2	–0.2	–0.6
Levy tariff on certain textiles and apparel products produced in the CNMI [1]	.....	.....	0.2	0.2	0.2	0.2	0.7
Expand Virgin Island tariff credits [1]	.....	.....	–*	–*	–*	–*	–*
Subtotal, modify international trade provisions [1]	.....	–0.6	–0.4	–0.4	*	–*	–1.4

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

(In billions of dollars)

	Estimate						
	1998	1999	2000	2001	2002	2003	1999–2003
Provide other tax incentives:							
Expand tax incentives for SSBICs	–*	–*	–*	–*	–*	–*	–*
Accelerate and expand incentives available to two new empowerment zones	.....	–*	–*	.....	.....	.....	–0.1
Make first $2,000 of severance pay exempt from income tax.	.....	–*	–0.2	–0.2	–0.2	–0.2	–0.8
Subtotal, provide other tax incentives	–*	–0.1	–0.2	–0.2	–0.2	–0.2	–0.8
Simplify the tax laws	–*	–0.1	–0.1	–0.1	–0.1	–0.1	–0.6
Enhance taxpayers' rights	.....	–*	–*	–*	–0.1	–0.1	–0.2
Subtotal, provide tax relief and extend expiring provisions [1]	**–0.5**	**–3.2**	**–5.1**	**–5.5**	**–5.0**	**–5.4**	**–24.2**
Eliminate unwarranted benefits and adopt other revenue measures:							
Defer deduction for interest and OID on convertible debt	*	*	*	*	*	0.1	0.2
Eliminate dividends-received deduction for certain preferred stock	*	*	*	*	*	0.1	0.2
Repeal percentage depletion for non-fuel minerals mined on Federal and formerly Federal lands	.....	0.1	0.1	0.1	0.1	0.1	0.5
Repeal tax-free conversions of large C corporations to S corporations	.....	*	*	*	*	0.1	0.1
Replace sales-source rules with activity-based rules	.....	0.6	1.4	1.5	1.5	1.6	6.6
Modify rules relating to foreign oil and gas extraction income	.....	*	0.1	0.1	0.1	0.1	0.4
Repeal lower-of-cost-or-market inventory accounting method	*	0.4	0.5	0.4	0.2	0.1	1.6
Increase penalties for failure to file correct information returns	.....	*	*	*	*	*	0.1
Tighten the substantial understatement penalty for large corporations	.....	.....	*	*	*	*	0.1
Repeal exemption for withholding on gambling winnings from bingo and keno in excess of $5,000	.....	*	*	*	*	*	*
Reinstate oil spill excise tax [1]	*	0.2	0.2	0.2	0.2	0.3	1.2
Modify Federal Unemployment Act provisions	.....	.....	.....	.....	.....	.....	.....
Extend pro-rata disallowance of tax-exempt interest expense that applies to banks to all financial intermediaries	*	*	*	*	*	*	0.1
Increase proration percentage for P&C insurance companies	–*	*	0.1	0.1	0.1	0.1	0.4
Preclude certain taxpayers from prematurely claiming losses from receivables	.....	0.4	0.1	0.1	0.1	0.1	0.7
Restrict special net operating loss carryback rules for specified liability losses	.....	*	*	*	*	*	0.1
Freeze grandfather status of stapled (or ''paired-share'') REITs	*	*	*	*	*	*	0.1
Restrict impermissible business indirectly conducted by REITs	.....	*	*	*	*	*	*
Modify treatment of closely held REITs	.....	*	*	*	*	*	0.1
Modify depreciation method for tax-exempt use property	.....	*	*	*	*	*	0.1
Impose excise tax on purchase of structured settlements [1]	.....	*	*	*	*	*	0.1
Clarify and expand math-error procedures	.....	*	0.1	0.1	0.1	0.1	0.3
Clarify the meaning of ''subject to'' liabilities under section 357(c)	*	*	*	*	*	*	0.1
Simplify foster child definition under EITC	.....	.....	*	*	*	*	*
Clarify tie-breaker rule under EITC	.....	*	*	*	*	*	*
Eliminate non-business valuation discounts	.....	.....	0.2	0.2	0.3	0.3	1.0
Eliminate ''Crummey'' rule	.....	.....	*	*	*	*	0.1
Eliminate gift tax exemption for personal residence trusts	.....	–*	–*	*	*	*	*
Include QTIP trust assets in surviving spouse's estate	.....	.....	*	*	*	*	*
Apply 7.7% capitalization rate to credit life insurance premiums	*	*	*	*	*	*	0.1
Modify corporate-owned life insurance (COLI) rules	0.3	0.4	0.4	0.4	0.5	0.5	2.2
Modify reserve rules for annuity contracts	.....	1.8	0.7	0.8	0.6	0.7	4.6
Tax certain exchanges of insurance contracts and reallocations of assets within variable insurance contracts	*	*	0.1	0.2	0.3	0.4	0.9
Reduce ''investment in the contract'' for mortality and expense charges on certain insurance contracts	.....	*	*	*	*	0.1	0.1
Amend 80/20 company rules	*	*	*	*	0.1	0.1	0.2
Prescribe regulatory directive to address tax avoidance involving foreign built-in losses	.....	*	0.1	0.1	0.1	0.1	0.2
Prescribe regulatory directive to address tax avoidance through use of hybrids	.....	*	0.1	0.1	*	*	0.2
Modify foreign office material participation exception applicable to inventory sales attributable to nonresident's U.S. office	*	*	*	*	*	*	*
Stop abuse of CFC exception to ownership requirements	.....	*	*	*	*	*	*
Subtotal, eliminate unwarranted benefits and adopt other revenue measures [1]	**0.3**	**4.3**	**4.3**	**4.7**	**4.7**	**5.0**	**23.0**
Other provisions that affect receipts:							
Reinstate environmental tax imposed on corporate taxable income [2]	.....	1.1	0.7	0.7	0.7	0.7	3.8
Reinstate Superfund excise taxes [1]	0.1	0.7	0.7	0.7	0.7	0.7	3.6
Extend excise taxes on gasoline, diesel fuel and special motor fuels [1]	.....	.....	0.4	0.4	0.4	0.4	1.5
Convert airport and airway trust fund taxes to a cost-based user fee system [1]	.....	.....	1.7	1.7	1.7	0.8	6.0
Receipts from tobacco legislation	.....	9.8	11.8	13.3	14.5	16.1	65.5
Assess fees for examination of bank holding companies and State-chartered member banks (receipt effect) [1]	.....	0.1	0.1	0.1	0.1	0.1	0.4
Transfer retirees and certain active employees of the FDIC and Board of Governors of the Federal Reserve to FEHBP (receipt effect)	.....	*	*	*	*	*	*

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

(In billions of dollars)

	Estimate						
	1998	1999	2000	2001	2002	2003	1999–2003
Repeal FERS open season (receipt effect)	*	0.2	0.2	0.2	0.2	0.2	1.0
Create solvency incentive for State unemployment trust fund accounts [1]	.....	.....	.....	0.4	0.4	.....	0.8
Subtotal, other provisions that affect receipts [1]	**0.1**	**11.8**	**15.5**	**17.4**	**18.8**	**19.1**	**82.6**
Total effect of proposals [1]	**–0.1**	**12.9**	**14.7**	**16.7**	**18.5**	**18.7**	**81.5**

*$50 million or less.
[1] Net of income offsets.
[2] Net of deductibility for income tax purposes.

Table 3–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	1997 actual	1998 estimate	1999 estimate	2000 estimate	2001 estimate	2002 estimate	2003 estimate
Individual income taxes (Federal funds):							
Existing law	737,466	767,874	792,739	808,471	837,867	881,538	919,874
Proposed Legislation (PAYGO)	.....	–106	–1,285	–3,907	–4,503	–4,485	–4,341
Total individual income taxes	**737,466**	**767,768**	**791,454**	**804,564**	**833,364**	**877,053**	**915,533**
Corporation income taxes:							
Federal funds:							
Existing law	182,289	190,944	194,412	200,388	206,033	211,741	217,427
Proposed Legislation (PAYGO)	.....	–102	2,210	1,671	2,255	2,080	2,145
Total Federal funds corporation income taxes	182,289	190,842	196,622	202,059	208,288	213,821	219,572
Trust funds:							
Hazardous substance superfund	4	.....	.....	.....	.....	.....	.....
Proposed Legislation (PAYGO)	.....	.....	1,343	870	863	863	864
Total corporation income taxes	**182,293**	**190,842**	**197,965**	**202,929**	**209,151**	**214,684**	**220,436**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	336,729	358,949	374,612	388,988	404,101	422,586	441,648
Disability insurance (Off-budget)	55,261	57,042	59,516	64,915	68,630	71,756	74,995
Hospital insurance	110,710	118,029	122,626	128,479	134,081	140,430	146,899
Railroad retirement:							
Social Security equivalent account	1,611	1,611	1,619	1,624	1,636	1,648	1,651
Rail pension and supplemental annuity	2,440	2,493	2,495	2,507	2,521	2,536	2,548
Total employment and general retirement	506,751	538,124	560,868	586,513	610,969	638,956	667,741
On-budget	114,761	122,133	126,740	132,610	138,238	144,614	151,098
Off-budget	391,990	415,991	434,128	453,903	472,731	494,342	516,643
Unemployment insurance:							
Deposits by States [1]	22,071	22,658	24,175	25,456	26,319	27,175	28,075
Proposed Legislation (PAYGO)	.....	.....	.....	.....	450	490	.....
Federal unemployment receipts [1]	6,103	6,196	6,254	6,345	6,359	6,449	6,495
Railroad unemployment receipts [1]	28	68	104	97	78	78	95
Total unemployment insurance	28,202	28,922	30,533	31,898	33,206	34,192	34,665
Other retirement:							
Federal employees' retirement—employee share	4,344	4,245	4,247	4,361	4,601	4,382	3,838
Proposed Legislation (non-PAYGO)	.....	6	167	201	212	224	232
Non-Federal employees retirement [2]	74	77	71	65	60	54	44
Total other retirement	4,418	4,328	4,485	4,627	4,873	4,660	4,114
Total social insurance and retirement receipts	**539,371**	**571,374**	**595,886**	**623,038**	**649,048**	**677,808**	**706,520**
On-budget	147,381	155,383	161,758	169,135	176,317	183,466	189,877
Off-budget	391,990	415,991	434,128	453,903	472,731	494,342	516,643
Excise taxes:							
Federal funds:							
Alcohol taxes	7,257	7,251	7,254	7,250	7,236	7,223	7,211
Tobacco taxes	5,873	5,926	5,900	7,495	8,083	8,686	8,895
Transportation fuels tax	7,107	442	682	88	89	90	92
Telephone and teletype services	4,543	4,864	5,129	5,394	5,691	6,015	6,356
Ozone depleting chemicals and products	130	55	30	10	.....	.....	.....
Other Federal fund excise taxes	2,921	1,529	1,613	1,430	1,373	1,338	1,263
Proposed Legislation (PAYGO)	.....	.....	12	515	531	550	568
Total Federal fund excise taxes	27,831	20,067	20,620	22,182	23,003	23,902	24,385
Trust funds:							
Highway	23,867	26,063	38,614	33,201	33,812	34,448	35,107
Airport and airway	4,007	7,975	10,038	9,273	9,793	10,525	11,095

Table 3–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	1997 actual	1998 estimate	1999 estimate	2000 estimate	2001 estimate	2002 estimate	2003 estimate
Proposed Legislation (PAYGO)	.....	.....	.....	2,267	2,267	2,267	1,133
Aquatic resources	316	281	379	339	345	353	359
Black lung disability insurance	614	640	662	684	703	718	733
Inland waterway	96	116	120	123	126	131	135
Hazardous substance superfund	71	.....	.....	.....	.....	.....	.....
Proposed Legislation (PAYGO)	.....	101	934	949	960	976	990
Oil spill liability	1	.....	.....	.....	.....	.....	.....
Proposed Legislation (PAYGO)	.....	46	317	321	325	330	336
Vaccine injury compensation	123	111	111	111	111	111	111
Leaking underground storage tank	–2	140	214	182	186	189	193
Total trust funds excise taxes	29,093	35,473	51,389	47,450	48,628	50,048	50,192
Total excise taxes	**56,924**	**55,540**	**72,009**	**69,632**	**71,631**	**73,950**	**74,577**
Estate and gift taxes:							
Existing law	19,845	20,436	20,542	21,389	22,353	24,156	25,300
Proposed Legislation (PAYGO)	.....	.....	–1	253	266	291	319
Total estate and gift taxes	**19,845**	**20,436**	**20,541**	**21,642**	**22,619**	**24,447**	**25,619**
Customs duties:							
Federal funds	17,131	17,515	17,928	18,890	19,691	21,053	22,655
Proposed Legislation (PAYGO)	.....	.....	–658	–323	–333	225	224
Trust funds	797	848	905	964	1,029	1,097	1,171
Total customs duties	**17,928**	**18,363**	**18,175**	**19,531**	**20,387**	**22,375**	**24,050**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	107	113	115	118	120	123	126
Receipts from tobacco legislation (PAYGO)	.....	.....	9,795	11,787	13,283	14,544	16,085
United Mine Workers of America combined benefit fund	339	323	282	273	266	258	251
Deposit of earnings, Federal Reserve System	19,636	24,991	24,544	24,950	25,501	26,121	26,786
Proposed Legislation (PAYGO)	.....	.....	98	102	106	111	116
Defense cooperation	.....	12	6	.....	.....	.....	.....
Fees for permits and regulatory and judicial services	3,222	5,778	9,605	12,888	15,097	15,843	16,074
Fines, penalties, and forfeitures	1,994	2,140	2,100	1,991	1,899	1,877	1,877
Gifts and contributions	184	194	177	147	126	121	123
Refunds and recoveries	–17	–16	–16	–16	–16	–16	–16
Total miscellaneous receipts	**25,465**	**33,535**	**46,706**	**52,240**	**56,382**	**58,982**	**61,422**
Total budget receipts	**1,579,292**	**1,657,858**	**1,742,736**	**1,793,576**	**1,862,582**	**1,949,299**	**2,028,157**
On-budget	1,187,302	1,241,867	1,308,608	1,339,673	1,389,851	1,454,957	1,511,514
Off-budget	391,990	415,991	434,128	453,903	472,731	494,342	516,643
MEMORANDUM							
Federal funds	1,010,315	1,050,472	1,093,576	1,121,674	1,163,467	1,219,949	1,269,885
Trust funds	365,248	383,120	412,247	423,654	441,874	461,621	480,193
Interfund transactions	–188,261	–191,725	–197,215	–205,655	–215,490	–226,613	–238,564
Total on-budget	**1,187,302**	**1,241,867**	**1,308,608**	**1,339,673**	**1,389,851**	**1,454,957**	**1,511,514**
Off-budget (trust funds)	**391,990**	**415,991**	**434,128**	**453,903**	**472,731**	**494,342**	**516,643**
Total	**1,579,292**	**1,657,858**	**1,742,736**	**1,793,576**	**1,862,582**	**1,949,299**	**2,028,157**

[1] Deposits by States cover the benefit part of the program. Federal unemployment receipts cover administrative costs at both the Federal and State levels. Railroad unemployment receipts cover both the benefits and administrative costs of the program for the railroads.

[2] Represents employer and employee contributions to the civil service retirement and disability fund for covered employees of Government-sponsored, privately owned enterprises and the District of Columbia municipal government.

[3] Includes both Federal and trust funds. Trust fund amounts in miscellaneous receipts are 1997: $746 million; 1998: $740 million; 1999: $683 million; 2000: $649 million; 2001: $639 million; 2002: $647 million; and 2003: $662 million.

1999

4. USER FEES AND OTHER COLLECTIONS

In addition to collecting taxes and other governmental receipts by the exercise of its sovereign powers, the Federal Government earns income from its various business-type activities. The term "user fee" is defined as fees, charges, and assessments levied on a class directly benefiting from, or subject to regulation by, a government program or activity, to be utilized solely to support the program or activity. In addition, the payers of the fee must be limited in the authorizing legislation to those benefiting from, or subject to regulation by, the program or activity, and may not include the general public or a broad segment of the public. The user fee must be authorized for use only to fund the specified programs or activities for which they are charged, including directly associated agency functions, not for unrelated programs or activities and not for the broad purposes of the Government or an agency.

User fees include: collections from non-Federal sources for goods and services provided (such as the sale of postage stamps and electricity); voluntary payments to social insurance programs (such as Medicare Part B premiums); miscellaneous customs fees (such as United States Customs Service merchandise processing fees); and certain specific taxes and duties (such as Harbor Maintenance and Inland Waterways taxes).

The term "user fee" is not a separate budget category for collections. Depending primarily on whether the user charge is based on the Government's sovereign power or business-type activity, it may be classified as a governmental receipt, or as an offsetting collection. User fees classified as governmental receipts are included along with the taxes and other governmental receipts discussed in the previous chapter. Those fees classified as offsetting collections are subtracted from gross outlays. The purpose of this treatment is to produce budget totals for receipts, outlays, and budget authority in terms of the amount of resources allocated governmentally, through collective political choice rather than through the market.

Offsetting collections are classified into two major categories: offsetting receipts, which are deposited in receipt accounts; and offsetting collections credited to appropriations (expenditure) accounts, which are deposited directly in these accounts and usually can be spent without further action by the Congress. While most offsetting receipts and collections result from business-like activity or are collected from other Government accounts, some result from the Government's sovereign or governmental powers and would be classified as governmental receipts but are required by law to be treated as offsetting. Chapter 24, "Budget System and Concepts," explains the budgetary treatment of these collections more fully.

Not all offsetting collections are user fees. User fees do not include collections from other Federal accounts;

Why User Fees?

- The term "user fee" refers to Government charges to those who use a Government good or service or are subject to Government regulation. For example:
  —Park entrance fees charged to visitors to national parks
  —Meat, poultry, and egg inspection fees
  —Tennessee Valley Authority proceeds from power sales
  —Proceeds from the lease of Department of Energy buildings and facilities
  —Flood insurance premiums
  —Sales of commemorative coins
- User fees are dedicated to funding part or all of the cost of providing the service or regulation by crediting them to a program account instead of to the general fund of the Treasury.
- User fees are generally designated as offsetting collections or receipts so that they offset the spending they are designated to fund.
- User fees are different from general revenue, because they are not collected from the general public or broad segments of the public (like income taxes) and they are not used for the general purposes of government (like national defense).
- Users are more willing to support and pay fees when they are dedicated to maintaining or improving the quality of the programs that affect them directly.
- Government program managers may be more diligent about collecting and spending fees when funding for their programs is dependent on fees, instead of guaranteed appropriations of general taxpayer money.
- Administration policy is to shift to user fee funding wherever appropriate. However, essential government services will continue to be supported by general fund appropriations from the Treasury as necessary.
- The Administration's user fee proposals generally require authorizing legislation to authorize the fees first and appropriations action before the fees can actually be collected and spent. This is done to preserve the traditional roles of the authorizing and appropriations committees in Congress and to conform to the "scoring" conventions of the Budget Enforcement Act.

Table 4–1. USER FEE COLLECTIONS

(In millions of dollars)

	1997 actual	Estimates					
		1998	1999	2000	2001	2002	2003
Governmental receipts:							
Harbor maintenance and inland waterway fees	832	900	959	1,021	1,087	1,159	1,235
Agricultural quarantine inspection fees	115	141	144	148	153	159	163
Existing FAA user fees [1]	.....	.....	.....	5,815	7,066	7,649	11,056
Proposed FAA user fees	.....	.....	.....	1,700	1,700	1,700	850
Other governmental receipt user fees	134	215	224	224	225	229	230
Total, governmental receipts	1,081	1,256	1,327	8,908	10,231	10,896	13,534
Offsetting collections:							
Offsetting collections deposited in receipt accounts:							
Medicare premiums	20,421	20,672	21,511	23,934	26,278	28,816	31,731
Services charges on foreign military sales	15,128	13,750	12,550	11,790	11,090	10,570	9,770
Immigration fees	992	994	1,400	1,400	1,412	1,430	1,404
U.S. customs user fees	1,288	1,184	1,272	1,316	1,363	1,412	1,464
Medical care and National Serviceman's Life Insurance Premiums and other Veterans fees	234	915	889	975	1,044	1,117	1,135
Nuclear Regulatory Commission fees	459	455	467	469	480	496	510
Interior park entrance, concessionaire and other fees	349	392	420	467	454	475	469
Inspection, grading and other Agriculture fees	148	170	176	176	176	176	176
Other collections deposited in receipt accounts	396	413	428	448	441	441	465
Subtotal, offsetting collections deposited in receipt accounts	39,415	38,945	39,113	40,975	42,738	44,933	47,124
Offsetting collections deposited in appropriations accounts:							
Postal Service	57,407	59,986	63,349	64,850	67,300	69,750	72,200
Tennessee Valley Authority and other power marketing	8,135	8,829	9,121	9,389	9,557	9,623	9,750
Housing and commissary fees paid by military personnel and other defense related fees	7,909	7,378	7,428	7,402	7,402	7,402	7,402
Federal Employee and Retiree health and life insurance benefits	4,104	5,895	6,188	6,558	6,952	7,398	7,880
Pension Benefit Guaranty Corporation premiums and and other Department of Labor fees	1,576	1,708	1,740	1,615	1,610	1,652	1,681
Veterans insurance premiums and other fees	1,595	1,594	1,563	1,571	1,538	1,502	1,468
National flood insurance fund premiums	1,108	1,230	1,353	1,448	1,549	1,652	1,761
Bureau of Engraving and Printing and U.S. Mint fees	1,086	1,088	1,141	1,165	1,188	1,209	1,236
Patent and Trademark and fees	641	730	836	929	1,098	1,161	1,238
Other offsetting collections deposited in appropriations accounts	6,580	6,603	7,880	7,520	7,440	7,551	7,666
Subtotal, offsetting collections deposited in appropriations accounts	90,141	95,041	100,599	102,447	105,634	108,900	112,282
Total, offsetting collections	129,556	133,986	139,712	143,422	148,372	153,833	159,406
Total, user fee collections	**130,637**	**135,242**	**141,039**	**152,330**	**158,603**	**164,729**	**172,940**
Memorandum:							
Existing fees:							
Postal Service	57,407	59,986	63,349	64,850	67,300	69,750	72,200
Existing Medicare premiums	20,421	20,672	21,384	23,255	25,464	27,791	30,497
Service charges on foreign military sales	15,128	13,750	12,550	11,790	11,090	10,570	9,770
Other existing user fees	37,681	40,808	41,417	47,419	49,551	51,146	55,597
Subtotal, existing user fee collections	130,637	135,216	138,700	147,314	153,405	159,257	168,064
User fee proposals	.....	26	2,339	5,016	5,198	5,472	4,876

[1] Represents proceeds from current law aviation excise taxes which the FAA will convert to cost-based user fees.

collections deposited in general fund receipt accounts; collections associated with credit programs; realizations upon loans and investments; interest, dividends, and other earnings; involuntary payments to social insurance programs; excise taxes; customs duties; fines, penalties, and forfeitures; cost sharing contributions; proceeds from asset sales (property, plant, and equipment); Outer Continental Shelf receipts; spectrum auction proceeds; and Federal Reserve earnings.

As shown in Table 4–1, total user fee collections (including those proposed in this budget) are estimated to be $141.0 billion in 1999, rising to $172.9 billion in 2003. User fee collections by the United States Postal Service, Medicare premiums, and service charges on foreign military sales are estimated to be 69 percent of all user fee collections in 1999. Table 4–3 provides more detail for offsetting receipts collected from the public and includes offsetting receipts collected from other accounts within the Government.

The Budget contains a variety of user fee proposals that would yield $2.3 billion in 1999 and $22.9 billion from 1999 through 2003. User fee proposals establish, increase, or extend fees in order to recover more of the costs of providing government services. The proposals would make the affected program funding levels dependent on enactment of the user fee proposals and subsequently, the actual collections of the fees. Regular appropriations have only been requested to fund the

start-up costs associated with these fee proposals. Table 4–2 splits the proposals between discretionary and mandatory categories for the appropriate scoring under the Budget Enforcement Act of 1997 (BEA). It includes user fees classified as offsetting collections and governmental receipts.

Discretionary Proposals

The following proposed fees are classified as discretionary because the Appropriations Committees are being requested to authorize collection of the fees and make them available for expenditure. In some cases, authorizing legislation will be proposed either to establish new fees or increase existing ones. The proposed authorizing legislation will make both the fee collection and spending contingent upon appropriations action.

Collections from the following proposals are to be deposited directly in appropriations accounts as offsetting collections:

DEPARTMENT OF AGRICULTURE

Animal and Plant Health Inspection Service (APHIS): The budget proposes to establish five APHIS fees to cover the cost of:

- Providing animal welfare inspections to recipients of APHIS services such as animal research centers, humane societies, and kennels.
- Issuing biotechnology certificates to firms that manufacture biotechnologically-derived products.
- Licensing, inspecting, and testing veterinary biologics by veterinary biologic companies.
- Inspecting to ensure the garbage fed to swine is properly cooked to avoid contamination to establishments regulated under the Swine Health Protection Act.
- Eradicating the pink bollworm.

Grain Inspection, Packers and Stockyards Administration (GIPSA) licensing fees.—The budget proposes to allow GIPSA to charge the grain shippers and handlers using the official inspection system its costs to develop, review and maintain standards and methods of testing (such as for grain quality and classification) used by the grain industry. In addition, an annual licensing fee is proposed to fund GIPSA activities that ensure the integrity of the livestock, meat and poultry market and marketplace, such as fostering open competition, and protecting consumers and businesses from unfair practices.

Food Safety and Inspection Service meat, poultry and egg products inspection fee.—The 1999 Budget proposes a new user fee for USDA's Food Safety and Inspection Service (FSIS). Under the proposed fee, the meat, poultry and egg products industries would be required to reimburse the Federal government for the cost of the salaries and benefits and other direct costs for all in-plant inspection. The proposal would transfer the cost of Federal inspection services to the industries that directly benefit, and would ensure that sufficient resources are available to provide the level of in-plant inspection necessary to meet the demands of industry. The cost of the user fee would amount to less than one cent per pound of meat inspected.

Natural Resources Conservation Service (NRCS) cost-share fee.—The 1999 Budget proposes to impose fees for a number of NRCS activities, including the sale of soil survey data, maps, and snow survey data to private users, engineering designs, soil map interpretations for commercial purposes, and irrigation management activities where water supplies are not very limited. Fees would also be charged to meet requests for the NRCS to expedite soil surveys, watershed planning, and other services.

Farm services fee.—The Administration proposes to allow the Farm Services Administration (FSA) to charge fees to cover the full cost of collecting, processing, and disseminating information of interest to private individuals and companies (crop insurance companies, appraisers, and agricultural consultants, etc.), where the provision of information is not required to fulfill FSA's mission.

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration (NOAA), navigational assistance fees.—The Administration proposes a fee on U.S. and foreign commercial cargo carriers to recover the cost of navigational assistance services, such as nautical charting, provided by NOAA. The fee would be administered for NOAA by the United States Cost Guard as part of the Coast Guard's proposed navigational assistance fee program described below.

NOAA, fisheries management fees.—The Budget proposes a fee of not more than one percent of the ex-vessel value of fish harvested by commercial fisherman to provide for fisheries management and enforcement services.

Patent and Trademark fees.—The surcharge on patent fees, established in the Omnibus Budget Reconciliation Act of 1990 and extended in the Omnibus Budget Reconciliation Act of 1993, will expire at the end of 1998. The expiration of this authority will reduce Patent and Trademark Office (PTO) revenue by $182 million in 1999. The Budget proposes legislation to extend and increase statutory fees charged for patent products and services to ensure that fee revenues continue to cover the cost of patent processing and related services.

Trade promotion services fees.—The Administration proposes to charge U.S. businesses for counseling and other promotional services provided by the International Trade Administration.

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration (FDA) fees.—The proposal seeks $128 million in new fees to finance FDA activities such as medical device reviews, animal drug approvals, import inspections, food additive petition reviews, generic drug application reviews, and fees for postmarket surveillance of products.

Table 4–2. PROPOSED USER FEE COLLECTIONS

(In millions of dollars)

Discretionary fee proposals	1998	1999	2000	2001	2002	2003	1999–2003
Offsetting collections deposited in appropriations accounts:							
Department of Agriculture:							
Animal and Plant Health Inspection Service fees	.....	10	10	10	10	10	50
Grain Inspection, Packers and Stockyards Administration licensing fees	.....	17	21	21	21	21	101
Food Saftey and Inspection Service, meat, poultry, and egg products inspection fee	.....	473	573	573	573	573	2,765
Natural Resources Conservation Service (NRCS) cost-share fee	.....	10	15	15	25	25	90
Farm Services Administration, farm service fee	.....	10	15	15	25	25	90
Department of Commerce:							
National Oceanic and Atmospheric Administration proposals:							
Navigational assistance fee	.....	3	11	11	11	11	47
Fisheries management fee	.....	20	20	20	20	20	100
Patent and Trademark Office, patent fees	.....	182	189	207	219	228	1,025
International Trade Administration, trade promotion fees	.....	6	12	12	12	12	54
Department of Health and Human Services:							
Food and Drug Administration fees	26	128	128	128	128	128	640
Health Care Financing Administration Fee Proposals:							
Physician, provider, and supplier enrollment registration fees	.....	20	21	21	22	23	107
Managed care organization application and renewal fees	.....	37	38	39	41	42	196
Initial provider certification fees	.....	10	10	11	11	12	54
Provider recertification fees	.....	52	54	56	58	61	282
Paper claims submission fees	.....	110	114	118	122	126	589
Duplicate and unprocessable claims fees	.....	36	37	38	39	41	190
Department of the Interior: Bureau of Land Management, hardrock location and maintenance fees	.....	39	40	41	42	43	205
Department of Labor: Alien labor certification fee	.....	.....	40	40	40	40	160
Department of Transportation:							
Coast Guard—navigational assistance fee	.....	35	165	165	165	165	695
Surface Transportation Board fees	.....	16	16	16	16	16	80
Army Corps of Engineers, wetlands permit Fee	.....	7	14	14	14	14	63
Federal Emergency Management Administration, radiological emergency preparedness fees	.....	13	13	13	13	13	65
National Transportation Safety Board, Aviation accident investigation fee	.....	6	6	6	6	6	30
Social Security Administration, claimant representative fees	.....	7	9	9	9	9	43
Subtotal, offsetting collections deposited in appropriations accounts	26	1,246	1,571	1,599	1,642	1,663	7,721
Offsetting collections deposited in receipt accounts:							
Department of Transportation: Federal Railroad Administration—railroad safety inspection fees	.....	82	82	82	82	82	410
Department of the Treasury: Customs merchandise processing fee	.....	48	48	48	48	48	240
Environmental Protection Agency:							
Pesticide registration fees	.....	16	16	16	16	16	80
Chemical pre-manufacturing notification fees	.....	8	8	8	8	8	40
Nuclear Regulatory Commission, extend NRC fees	.....	313	314	322	332	342	1,623
Social Security Administration, claimant representative fees	.....	12	17	17	17	17	80
Subtotal, offsetting collections deposited in receipt accounts	.....	479	485	493	503	513	2,473
Total, discretionary user fee proposals	**26**	**1,725**	**2,056**	**2,092**	**2,145**	**2,176**	**10,194**
Mandatory Fee Proposals							
Offsetting collections deposited in appropriations accounts:							
Department of Health and Human Services:							
Medicare cost-based provider audit fees	.....	395	395	395	395	395	1,975
Federal Deposit Insurance Corporation state bank examination fees	.....	89	94	97	101	106	487
Subtotal, offsetting collections deposited in appropriations accounts	.....	484	489	492	496	501	2,462
Offsetting collections deposited in receipt accounts:							
Department of Health and Human Services:							
Medicare premiums	.....	127	679	814	1,025	1,234	3,879
Department of the Interior:							
Interior/USDA, entrance and recreation fees	.....	.....	86	88	88	90	352
National Park Service, park concession fees	.....	3	6	12	18	25	64
Subtotal, offsetting collections deposited in receipt accounts	.....	130	771	914	1,131	1,349	4,295
Collections deposited in governmental receipt accounts:							
Federal Aviation Administration, proposed user fees	.....	.....	1,700	1,700	1,700	850	5,950
Total, mandatory user fee proposals	.....	**614**	**2,960**	**3,106**	**3,327**	**2,700**	**12,707**
Total, User Fee Proposals	**26**	**2,339**	**5,016**	**5,198**	**5,472**	**4,876**	**22,901**

Health Care Financing Administration (HCFA).—This proposal would establish fees for a variety of activities associated with the Medicare Program, including:

Physician, provider, and supplier enrollment registration fees.—The Administration proposes to charge physicians, providers, and suppliers an initial enrollment fee and a renewal fee in order to participate in the Medicare program. Physicians would be required to re-enroll every 5 years. Durable medical equipment suppliers, hospitals, skilled nursing facilities, home health

agencies, and all other providers would be required to re-enroll every 3 years. Proceeds from the fee would be used for enrollment costs and other contracting activities.

Managed care organization application and renewal fees.—The Budget proposes to charge managed care organizations a fee to cover 100% of the cost of reviewing initial applications and renewing annual contracts with Medicare. Proceeds from this fee would be used to offset administrative costs related to managed care organization application and renewals as well as other administrative activities.

Initial provider certification fee.—The Administration proposes to levy a fee on providers (e.g., home health agencies (HHA) and skilled nursing facilities (SNF)) who wish to enter the Medicare program. The fee would vary by type of provider. Proceeds from this fee would be used to offset survey and certification costs.

Provider recertification fee.—This fee would be levied on providers who are recertified for the Medicare program. By statute, SNFs must be surveyed every year, HHAs every three years, and other providers about once every ten years. The fee would be charged every year to spread the costs of the certification program over time. Proceeds from this fee would be used to offset survey and certification costs.

Paper claims submission fee.—Providers would be charged $1.00 for every paper claim submitted for payment because of the additional cost of processing paper rather than electronic claims. Rural providers and very small providers who may not be able to purchase the necessary hardware to comply with electronic claims transmission would be exempt from the fee. Proceeds from the fee would be used for claims processing and other contracting activities.

Duplicate and unprocessable claims fees.—The budget proposes to charge Medicare providers $1.00 for each duplicate and unprocessable claim submitted for payment to the Health Care Financing Administration. Proceeds from the fee would be used for claims processing and other contracting activities.

DEPARTMENT OF THE INTERIOR

Bureau of Land Management, hardrock mining location and maintenance fees.—This proposal would raise and extend the hardrock mining location and maintenance fees established in the 1993 Omnibus Budget Reconciliation Act beyond 1998.

DEPARTMENT OF LABOR

Alien labor certification fee.—The proposal would establish a new fee, charged to businesses, for processing of alien labor certification and attestation applications by the Labor Department. Collection of the fee would begin in 2000 with the proceeds offsetting the costs of administering the alien labor program. In 2000, regular appropriations are required in addition to regular user fees to process the backlog of applications that already have been filed.

DEPARTMENT OF TRANSPORTATION

Coast Guard, navigational assistance fees.—The Administration proposes to levy a fee on U.S. and foreign commercial cargo carriers for the use of Coast Guard navigational assistance services. Navigational assistance services include the placement and maintenance of buoys and other short-range aids-to-navigation, radio navigation, and vessel traffic services. Fishing and recreational vessels would be exempt.

Surface Transportation Board fees.—The Administration proposes to create a fee mechanism to completely offset the expenses of the Surface Transportation Board (STB), the successor to the Interstate Commerce Commission (ICC). The fees would be collected from those who benefit from the continuation of the ICC functions transferred to the STB, e.g., railroads and shippers.

DEPARTMENT OF THE TREASURY

Customs merchandise processing fee.—The Budget proposes to allow the U.S. Customs Service to collect and spend an increase in the Customs Merchandise Processing Fee that will be proposed in authorizing legislation subsequent to release of the Budget. The Administration will propose to increase the ad valorem rate of the Merchandise Processing Fee paid by importers from 0.21 percent to up to 0.25 percent of the value of formal cargo entries into the United States. Collection and use of the proceeds from the fee increase would be provided for in appropriations action, and would be statutorily restricted to the modernization of Customs' automated commercial operations.

ARMY CORPS OF ENGINEERS

Wetlands permit fees.—The Budget proposes to increase fees charged to permit commercial use of wetlands. The proceeds of the fee would be used to fund wetland regulatory activities.

FEDERAL EMERGENCY MANAGEMENT AGENCY (FEMA)

Radiological emergency preparedness fee.—The budget includes a proposal to reauthorize FEMA's assessments on Nuclear Regulatory Commission (NRC) licensees to cover 100 percent of the cost of providing site-specific services that directly contribute to the fulfillment of emergency preparedness requirements needed for NRC licensing.

NATIONAL TRANSPORTATION SAFETY BOARD (NTSB)

Aviation accident investigation fees.—To offset a portion of the NTSB's growing cost of commercial aviation accident investigations, a new aviation accident recovery and investigation fee is proposed. This fee, which would be paid by commercial air carriers based on revenue flight hours of operation, would collect an estimated $6 million in 1999.

SOCIAL SECURITY ADMINISTRATION

Administration of claimant representative approval and direct payment process fees.—The Budget proposes

to impose a fee on persons who represent Supplemental Security Income claimants in administrative or judicial proceedings. This fee is designed to recover the cost of processing attorney fee agreements and determining the allowable charge under the fee petition process. This assessment would be imposed only if the claimant is awarded past due benefits and a fee for representation is approved by the Social Security Administration.

Collections from the following proposals would be deposited in receipt accounts as offsetting receipts:

DEPARTMENT OF TRANSPORTATION

Federal Railroad Administration, railroad safety inspection fee.—The rail safety fee would offset costs incurred by the Federal Railroad Administration for inspection, research and development and related activities to ensure the safe operation of passenger and freight railroads. A similar fee was enacted in the Omnibus Budget Reconciliation Act of 1990, but expired at the end of 1995.

ENVIRONMENTAL PROTECTION AGENCY

Pesticide registration fees.—The budget proposes to reinstate pesticide registration fees that are statutorily suspended through 2001. These fees would be used to offset the cost of reviewing applications for pesticide registrations, amendments to registrations, and experimental use permits.

Chemical pre-manufacturing notification (PMN) fees.—The Administration proposes to eliminate the statutory cap on PMN fees and to increase fees charged to chemical producers to recover the cost of reviewing notifications of new chemicals prior to production.

NUCLEAR REGULATORY COMMISSION (NRC)

Extend Nuclear Regulatory Commission fees.—Under current law, the NRC must recover approximately 100 percent of its costs from licensing, inspection, and annual fees charged to its applicants and licensees through 1998. Unless the law is extended, the fee coverage requirement will revert to 33 percent of NRC's cost of operations. The Administration proposes to extend fees at approximately 100 percent of NRC's cost of operations through 2003.

SOCIAL SECURITY ADMINISTRATION

Administration of claimant representative approval and direct payment process fees.—The Budget proposes to impose a fee on persons who represent Social Security claimants in administrative or judicial proceedings. This fee is designed tor ecover the cost of processing attorney fee agreements, determining the allowable charge under the fee petition process, and processing the direct payment of attorney fees. This assessment would be imposed only if the claimant is awarded past due benefits, and a fee for representation is approved by the Social Security Administration.

Mandatory Proposals

The following new and increased fees are classified as mandatory because they are proposed to be included in authorizing legislation and neither the collection or spending of the fee would be contingent upon appropriations action.

Collections from the following proposals are to be deposited directly in appropriations accounts as offsetting collections:

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Medicare cost-based provider audit fees.—The Budget proposes $395 million in 1999 in fees to charge cost-based health care providers the full cost associated with performing annual audits of these providers cost reports. The fee would allow more annual audits to be conducted and act as a deterrent to inflating reported costs.

Medicare premiums for retirees under the age of 65 and displaced workers.—The Administration proposes to charge premiums based on an actuarially fair rate to people between the ages of 62 and 65 and displaced workers between 55 and 61 who elect to participate in the Medicare buy-in premium based program. This increase in premium collections is partially offset by the reduction in premium collections due to the Medicare program integrity proposal.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)

State bank examination fee.—The Administration proposes to require the FDIC and the Federal Reserve to assess fees for examinations of bank holding companies and state-chartered FDIC-insured banks. The costs of such examinations are currently funded from deposit insurance premiums and Federal Reserve earnings from monetary policy activities. The FDIC fee proceeds would be used to finance the examination operation. The Federal Reserve collections do not meet the technical definition of user fees, but are considered governmental receipts and are discussed in the preceding chapter on governmental receipts.

Collections from the following proposals are to be deposited in receipt accounts as offsetting receipts:

DEPARTMENT OF THE INTERIOR

Interior and USDA, entrance and recreation fees.—The Administration proposes to increase entrance, recreation, and other fees charged by the National Park Service and other land management agencies, and to grant those agencies permanent authority to use all receipts for facility improvements and new repairs.

National Park Service, park concession fees.—The Administration proposes to allow parks to retain all existing and new franchise fees to use for park improvements and concessions related activities. This proposal would encourage parks to increase returns from concessions contracts, and is part of a set of legislative proposal and administrative reforms to improve management of the park concessions program and increase competition for concessions contracts.

Collections from the following proposal are to be deposited in receipt accounts, as governmental receipts.

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration (FAA), cost based user fees.—Beginning in 2000, the Budget assumes that the existing aviation excise taxes will be gradually reduced over a five year period and replaced with a more efficient system of cost-based user fees charged for FAA services. As part of a continuing effort to create a more business-like FAA, the Administration will propose legislation to fund the FAA entirely with cost-based user fees by 2003.

OFFSETTING RECEIPTS

Table 4–3 itemizes all offsetting collections deposited in receipt accounts. These include payments from one part of the Government to another, called intra-governmental transactions, and collections from the public. These receipts are offset (deducted) from outlays in the Federal budget. In total, offsetting receipts are estimated at $352.9 billion in 1999.

Table 4–3. OFFSETTING RECEIPTS BY TYPE

(In millions of dollars)

Source	1997 actual	1998 estimate	1999 estimate	2000 estimate	2001 estimate	2002 estimate	2003 estimate
INTRAGOVERNMENTAL TRANSACTIONS							
On-budget receipts:							
Federal intrafund transactions:							
Distributed by agency:							
Interest from the Federal Financing Bank	4,171	3,142	2,758	2,518	2,344	2,113	1,853
Interest on Government capital in enterprises	1,570	1,543	1,321	1,257	1,153	1,033	926
Other	1,969	1,610	1,632	1,741	1,842	1,960	2,078
Total Federal intrafunds	7,710	6,295	5,711	5,516	5,339	5,106	4,857
Trust intrafund transactions:							
Distributed by agency:							
Payments to railroad retirement	3,747	3,784	3,785	3,806	3,692	3,797	3,796
Other	1	1	1	1	1	1	1
Total trust intrafunds	3,748	3,785	3,786	3,807	3,693	3,798	3,797
Total intrafund transactions	11,458	10,080	9,497	9,323	9,032	8,904	8,654
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Contributions to insurance programs:							
Military retirement fund	15,151	15,119	15,724	16,353	17,007	17,688	18,395
Supplementary medical insurance	59,471	59,773	62,171	67,824	74,738	82,489	91,201
Proposed Legislation (PAYGO)	.....	.....	–135	–250	–295	–325	–365
Hospital insurance	4,202	5,414	6,021	5,894	6,192	6,556	6,975
Railroad social security equivalent fund	56	62	57	58	59	60	62
Rail industry pension fund	182	192	197	199	202	205	209
Civilian supplementary retirement contributions	21,558	21,502	21,813	22,041	21,918	21,770	21,718
Unemployment insurance	565	517	526	551	619	608	598
Other contributions	425	372	435	401	415	406	404
Proposed Legislation (PAYGO)	.....	.....	5	.....	.....	.....	.....
Miscellaneous payments	585	515	476	476	478	480	482
Subtotal	102,195	103,466	107,290	113,547	121,333	129,937	139,679
Trust fund payments to Federal funds:							
Quinquennial adjustment for military service credits	.....	.....	.....	.....	1,182	.....	.....
Other	1,049	1,065	1,062	1,085	1,108	1,129	1,153
Subtotal	1,049	1,065	1,062	1,085	2,290	1,129	1,153
Total interfunds distributed by agency	103,244	104,531	108,352	114,632	123,623	131,066	140,832
Undistributed by agency:							
Employer share, employee retirement (on-budget):							
Civil service retirement and disability insurance	8,168	8,676	8,776	9,032	9,400	9,819	9,774
CSRDI from Postal Service	5,927	6,068	6,014	6,237	6,452	6,715	6,863
Hospital insurance (contribution as employer) [1]	1,860	1,902	1,976	2,063	2,117	2,220	2,317
Postal employer contributions to FHI	605	597	620	645	671	698	727
Military retirement fund	11,102	10,543	10,563	10,535	10,584	10,750	11,000
Other Federal employees retirement	111	122	128	132	137	143	145
Total employer share, employee retirement (on-budget)	27,773	27,908	28,077	28,644	29,361	30,345	30,826
Interest received by on-budget trust funds	63,776	65,852	67,206	68,804	70,083	71,648	73,309
Proposed Legislation (non-PAYGO)	.....	99	214	457	728	967	1,187
Total interfund transactions undistributed by agency	91,549	93,859	95,497	97,905	100,172	102,960	105,322
Total interfund transactions	194,793	198,390	203,849	212,537	223,795	234,026	246,154
Total on-budget receipts	206,251	208,470	213,346	221,860	232,827	242,930	254,808

Table 4–3. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	1997 actual	1998 estimate	1999 estimate	2000 estimate	2001 estimate	2002 estimate	2003 estimate
Off-budget receipts:							
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Old-age, survivors, and disability insurance	6,880	9,650	8,899	9,363	9,913	10,562	11,267
Undistributed by agency:							
Employer share, employee retirement (off-budget)	6,483	7,155	7,667	8,317	8,831	9,571	10,304
Interest received by off-budget trust funds	41,214	46,730	51,623	56,966	62,889	69,318	76,337
Total off-budget receipts:	54,577	63,535	68,189	74,646	81,633	89,451	97,908
Total intragovernmental transactions	**260,828**	**272,005**	**281,535**	**296,506**	**314,460**	**332,381**	**352,716**
PROPRIETARY RECEIPTS FROM THE PUBLIC							
Distributed by agency:							
Interest:							
Interest on foreign loans and deferred foreign collections	672	633	596	561	545	602	583
Interest on deposits in tax and loan accounts	948	920	920	908	908	908	908
Other interest (domestic—civil) [2]	5,365	6,098	6,928	7,679	8,428	9,210	9,957
Total interest	6,985	7,651	8,444	9,148	9,881	10,720	11,448
Royalties and rents	1,298	1,321	1,367	1,375	1,396	1,417	1,446
Proposed Legislation (PAYGO)	.....	.....	.....	–1	–1	–1	–1
Sale of products:							
Sale of timber and other natural land products	485	499	519	500	487	473	471
Sale of minerals and mineral products	792	440	57	56	87	146	181
Sale of power and other utilities	812	739	761	761	786	791	781
Other	38	34	51	54	54	53	53
Total sale of products	2,127	1,712	1,388	1,371	1,414	1,463	1,486
Fees and other charges for services and special benefits:							
Medicare premiums and other charges (trust funds)	20,421	20,672	21,384	23,255	25,464	27,791	30,497
Proposed Legislation (PAYGO)	.....	.....	127	679	814	1,025	1,234
Nuclear waste disposal revenues	596	602	625	632	637	641	652
Veterans life insurance (trust funds)	231	224	210	192	174	158	142
Other [2]	2,095	1,806	1,621	1,598	1,581	1,596	1,602
Proposed Legislation (non-PAYGO)	.....	.....	12	17	17	17	17
Proposed Legislation (PAYGO)	.....	.....	24	119	128	135	144
Total fees and other charges	23,343	23,304	24,003	26,492	28,815	31,363	34,288
Sale of Government property:							
Sale of land and other real property	96	102	63	67	70	613	74
Military assistance program sales (trust funds)	15,128	13,750	12,550	11,790	11,090	10,570	9,770
Other	111	95	82	82	82	82	63
Total sale of Government property	15,335	13,947	12,695	11,939	11,242	11,265	9,907
Realization upon loans and investments:							
Foreign military credit sales	653	553	391	261	186	134	85
Negative subsidies and downward estimates	2,395	2,565	6,576	2,530	2,319	2,270	2,436
Proposed Legislation (non-PAYGO)	.....	.....	50	.....	.....	.....	.....
Proposed Legislation (PAYGO)	.....	.....	.....	241	234	233	237
Repayment of loans to United Kingdom	108	110	112	115	117	50	57
Other	131	73	38	40	44	29	30
Total realization upon loans and investments	3,287	3,301	7,167	3,187	2,900	2,716	2,845
Recoveries and refunds [2]	2,831	3,361	3,863	3,996	4,204	5,325	4,078
Proposed Legislation (non-PAYGO)	.....	.....	.....	.....	.....	.....	285
Proposed Legislation (PAYGO)	.....	.....	40	323	332	333	331
Miscellaneous receipt accounts [2]	1,621	2,518	2,070	2,117	2,148	2,186	2,231
Proposed Legislation (PAYGO)	.....	.....	–21	–22	–23	–24	–24
Total proprietary receipts from the public distributed by agency	56,827	57,115	61,016	59,925	62,308	66,763	68,320

Table 4–3. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	1997 actual	1998 estimate	1999 estimate	2000 estimate	2001 estimate	2002 estimate	2003 estimate
Undistributed by agency:							
Other interest: Interest received from Outer Continental Shelf escrow account	6	1,120	30	.....	.....	.....	.....
Rents and royalties on the Outer Continental Shelf:							
Rents and bonuses	1,259	1,652	983	908	877	789	725
Royalties	3,452	3,011	3,204	3,044	3,257	3,488	3,161
Sale of major assets	.....	4,424	728	.....	.....	.....	.....
Total proprietary receipts from the public undistributed by agency	4,717	10,207	4,945	3,952	4,134	4,277	3,886
Total proprietary receipts from the public [3]	**61,544**	**67,322**	**65,961**	**63,877**	**66,442**	**71,040**	**72,206**
OFFSETTING GOVERNMENTAL RECEIPTS							
Distributed by agency:							
Regulatory fees	3,057	2,927	3,127	3,184	3,237	3,311	3,365
Proposed Legislation (non-PAYGO)	.....	.....	385	386	394	404	414
Other	76	70	70	70	70	70	8
Undistributed by agency:							
Spectrum auction proceeds	11,006	2,216	1,833	4,889	4,841	11,354	3,300
Total offsetting governmental receipts	14,139	5,213	5,415	8,529	8,542	15,139	7,087
Total offsetting receipts	**336,511**	**344,540**	**352,911**	**368,912**	**389,444**	**418,560**	**432,009**

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

	1997 actual	*1998 estimate*	*1999 estimate*	*2000 estimate*	*2001 estimate*	*2002 estimate*	*2003 estimate*
On budget:							
Federal funds	24,524	31,163	30,238	26,430	27,370	29,932	28,978
Trust funds	37,002	36,139	35,691	37,410	39,035	41,071	43,191
Off-budget	18	20	32	37	37	37	37

5. TAX EXPENDITURES

Tax expenditures are revenue losses due to preferential provisions of the Federal tax laws, such as special exclusions, exemptions, deductions, credits, deferrals, or tax rates. They are alternatives to other policy instruments, such as spending or regulatory programs, as means of achieving Federal policy goals. Tax expenditures are created for a variety of reasons, including to encourage certain activities, to improve fairness, to ease compliance with and administration of the tax system, and to reduce certain tax-induced distortions. The Congressional Budget Act of 1974 (Public Law 93–344) requires that a list of tax expenditures be included in the budget.

The largest tax expenditures tend to be associated with the individual income tax. For example, tax preferences are provided for employer contributions for medical insurance, pension contributions and earnings, mortgage interest payments on owner-occupied homes, capital gains, and payments of State and local individual income taxes. Tax expenditures under the corporate income tax tend to be related to the rate of cost recovery for various investments; as is discussed below, the extent to which these provisions are classified as tax expenditures varies according to the conceptual baseline used. Charitable contributions and credits for State taxes on bequests are the largest tax expenditures under the unified transfer (i.e., estate and gift) tax.

Because of potential interactions among provisions, this chapter does not present a grand total revenue loss estimate for tax expenditures. Moreover, past tax changes entailing broad elimination of tax expenditures were generally accompanied by changes in tax rates or other basic provisions, so that the net effects on Federal revenues were considerably (if not totally) offset. Nevertheless, in aggregate, tax expenditures have revenue impacts of hundreds of billions of dollars, and are some of the most important ways in which the Federal Government affects economic decisions and social welfare.

Tax expenditures relating to the individual and corporate income taxes are considered first in this chapter. They are estimated for fiscal years 1997–2003 using three methods of accounting: revenue loss, outlay equivalent, and present value. The present value approach provides estimates of the revenue losses for tax expenditures that involve deferrals of tax payments into the future or have similar long-term effects. Tax expenditures relating to the unified transfer tax are considered in a section at the end of the chapter.

The section in this chapter on Performance Measures and the Economic Effects of Tax Expenditures presents information related to assessment of the effect of tax expenditures on the achievement of program performance goals. This section was prepared under the Government Performance and Results Act of 1993 and is a part of the government-wide performance plan required by this Act (see also Sections III, IV, and VI of the *Budget* volume). Tax expenditures are also discussed in Section VI of the *Budget,* which considers the Federal Government's spending, regulatory, and tax policies across functional areas.

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

The Treasury Department prepared all tax expenditure estimates presented here based upon tax law enacted as of December 31, 1997. The analysis includes new tax expenditures which were enacted this year in the Taxpayer Relief Act of 1997. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 1997. Due to the time required to estimate the large number of tax expenditures, the estimates are based on mid-session economic assumptions; exceptions are the earned income tax credit and child credit provisions, which involve outlay components and hence are updated to reflect the economic assumptions used elsewhere in the budget.

The total revenue loss estimates for tax expenditures for fiscal years 1997–2003 are displayed by the budget's functional categories in table 5–1. Descriptions of the specific tax expenditure provisions follow the tables of estimates and discussion of general features of the tax expenditure concept.

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

Table 5–2 reports the respective portions of the total revenue losses that arise under the individual and corporate income taxes. Listing revenue loss estimates under the individual and corporate headings does not imply that these categories of filers benefit from the special tax provisions in proportion to the respective tax expenditure amounts shown. Rather, these break-

downs show the specific tax accounts through which the various provisions are cleared. The ultimate beneficiaries of corporate tax expenditures, for example, could be stockholders, employees, customers, or others, depending on the circumstances.

Table 5–3 ranks the major tax expenditures by fiscal year 1999 revenue loss. This table merges several individual entries provided in table 5–1; for example, table 5–3 contains one merged entry for charitable contributions instead of the three separate entries found in table 5–1.

Interpreting Tax Expenditure Estimates

Tax expenditure revenue loss estimates do not necessarily equal the increase in Federal revenues (or the change in the budget balance) that would result from repealing the special provisions, for the following reasons:

- Eliminating a tax expenditure may have incentive effects that alter economic behavior. These incentives can affect the resulting magnitudes of the formerly subsidized activity or of other tax preferences or Government programs. For example, if deductibility of mortgage interest were limited, some taxpayers would hold smaller mortgages, with a concomitantly smaller effect on the budget than if no such limits were in force.
- Tax expenditures are interdependent even without incentive effects. Repeal of a tax expenditure provision can increase or decrease the revenue losses associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the revenue losses from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the revenue loss from other deductions if taxpayers are led to claim the standard deduction instead of itemizing. Similarly, if two provisions were repealed simultaneously, the increase in tax liability could be greater or less than the sum of the two separate tax expenditures, since each is estimated assuming that the other remains in force. In addition, the estimates reported in Table 5–1 are the totals of individual and corporate income tax revenue losses reported in Table 5–2 and do not reflect any possible interactions between the individual and corporate income tax receipts. For this reason, the figures in Table 5–1 (as well as those in Table 5–5, which are also based on summing individual and corporate estimates) should be regarded as approximations.
- Revenues raised by changes to tax expenditures are sensitive to timing effects and effective dates. Changes in some provisions would yield their full potential revenue gains relatively quickly, whereas changes to other provisions would only gradually yield their full revenue potential, as certain deductions or exemptions would likely be grandfathered.
- The annual value of tax expenditures for tax deferrals is reported on a cash basis in all tables except Table 5–4. Cash-based estimates reflect the difference between taxes deferred in the current year and incoming revenues that are received due to deferrals of taxes from prior years. While such estimates are useful as a measure of cash flows into the Government, they do not accurately reflect the true economic cost of these provisions. For example, for a provision where activity levels have changed, so that incoming tax receipts from past deferrals are greater than deferred receipts from new activity, the cash-basis tax expenditure estimate can be negative, despite the fact that in present-value terms current deferrals do have a real cost to the Government. Alternatively, in the case of a newly enacted deferral provision, a cash-based estimate can overstate the real cost to the Government because the newly deferred taxes will ultimately be received. Present-value estimates, which are a useful supplement to the cash-basis estimates for provisions involving deferrals, are discussed below.
- Repeal of some provisions could affect overall levels of income and rates of economic growth. In principle, repeal of major tax provisions may have some impact on the budget economic assumptions. In general, however, most changes in particular provisions are unlikely to have significant macroeconomic effects.

Present-Value Estimates

Discounted present-value estimates of revenue losses are presented in Table 5–4 for certain provisions that involve tax deferrals or other long-term revenue effects. These estimates complement the cash-based tax expenditure estimates presented in the other tables.

The present-value estimates represent the revenue losses, net of future tax payments, that follow from activities undertaken during calendar year 1998 which cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 1998 would cause a deferral of tax payments on wages in 1998 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 1998 pension contribution and accrued earnings will be paid out and taxes will be due; these receipts are included in the present-value estimate. In general, this conceptual approach is similar to the one used for reporting the budgetary effects of credit programs, where direct loans and guarantees in a given year affect future cash flows.

Table 5–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX

(In millions of dollars)

		Total revenue loss from corporate and individual Income taxes							
		1997	1998	1999	2000	2001	2002	2003	1999–2003
	National defense:								
1	Exclusion of benefits and allowances to armed forces personnel	2,080	2,095	2,120	2,140	2,160	2,180	2,200	10,800
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	1,790	1,985	2,205	2,450	2,725	3,035	3,345	13,760
3	Exclusion of income of foreign sales corporations	1,600	1,700	1,800	1,900	2,000	2,100	2,200	10,000
4	Inventory property sales source rules exception	1,500	1,600	1,700	1,800	1,900	2,000	2,100	9,500
5	Deferral of income from controlled foreign corporations (normal tax method)	2,200	2,400	2,600	2,800	3,000	3,200	3,400	15,000
	General science, space, and technology:								
6	Expensing of research and experimentation expenditures (normal tax method)	195	430	580	685	740	765	785	3,555
7	Credit for increasing research activities	880	2,125	860	370	165	55	10	1,460
	Energy:								
8	Expensing of exploration and development costs, fuels	–160	–95	–50	10	–10	.....	20	–30
9	Excess of percentage over cost depletion, fuels	830	835	840	855	865	880	890	4,330
10	Alternative fuel production credit	710	670	630	600	560	530	350	2,670
11	Exception from passive loss limitation for working interests in oil and gas properties	45	50	50	50	55	55	60	270
12	Capital gains treatment of royalties on coal	50	50	50	55	60	60	60	285
13	Exclusion of interest on energy facility bonds	175	175	170	165	155	150	140	780
14	Enhanced oil recovery credit	95	100	100	110	115	120	130	575
15	New technology credit	60	65	70	80	80	80	80	390
16	Alcohol fuel credit[1]	20	20	20	20	20	20	20	100
17	Tax credit and deduction for clean-fuel burning vehicles and properties	65	75	80	85	100	95	70	430
18	Exclusion from income of conservation subsidies provided by public utilities	70	20	30	40	45	50	60	225
	Natural resources and environment:								
19	Expensing of exploration and development costs, nonfuel minerals	45	55	55	55	55	55	55	275
20	Excess of percentage over cost depletion, nonfuel minerals	335	340	355	360	365	380	385	1,845
21	Capital gains treatment of iron ore	.....	.....	.....	.....	.....	.....	.....	.....
22	Special rules for mining reclamation reserves	20	20	20	20	20	20	20	100
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	625	605	590	565	540	500	455	2,650
24	Capital gains treatment of certain timber income	50	50	50	55	60	60	60	285
25	Expensing of multiperiod timber growing costs	460	480	505	525	540	555	575	2,700
26	Investment credit and seven-year amortization for reforestation expenditures	45	45	50	50	50	50	55	255
27	Tax incentives for preservation of historic structures	120	115	115	110	105	105	105	540
	Agriculture:								
28	Expensing of certain capital outlays	65	65	70	70	70	70	70	350
29	Expensing of certain multiperiod production costs	80	80	85	85	85	85	85	425
30	Treatment of loans for solvent farmers	10	10	10	10	10	10	10	50
31	Capital gains treatment of certain income	505	520	535	550	570	585	600	2,840
32	Income averaging for farmers	.....	5	30	35	25	.....	.....	90
	Commerce and housing:								
	Financial institutions and insurance:								
33	Exemption of credit union income	800	880	960	1,050	1,150	1,260	1,380	5,800
34	Excess bad debt reserves of financial institutions	70	45	20	10	5	5	.....	40
35	Exclusion of interest on life insurance savings	12,765	13,465	14,200	14,990	15,810	16,680	17,585	79,265
36	Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25
37	Tax exemption of insurance companies owned by tax-exempt organizations	200	215	230	245	260	280	300	1,315
38	Small life insurance company deduction	110	115	120	125	130	135	140	650
	Housing:								
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	1,750	1,670	1,595	1,520	1,440	1,365	1,290	7,210
40	Exclusion of interest on rental housing bonds	810	750	695	615	530	450	320	2,610
41	Deductibility of mortgage interest on owner-occupied homes	49,060	51,245	53,695	56,515	59,505	62,730	66,245	298,690
42	Deductibility of State and local property tax on owner-occupied homes	16,915	17,700	18,440	19,220	20,045	20,920	21,855	100,480
43	Deferral of income from post 1987 installment sales	960	975	995	1,015	1,035	1,055	1,075	5,175
44	Deferral of capital gains on home sales	12,245	5,770	.....	.....	.....	.....	.....	.....
45	Exclusion of capital gains on home sales for persons age 55 and over	3,740	1,110	.....	.....	.....	.....	.....	.....
46	Capital gains exclusion on home sales	8,750	9,100	9,465	9,845	10,235	10,645	11,070	51,260
47	Exception from passive loss rules for $25,000 of rental loss	4,175	3,910	3,680	3,465	3,270	3,080	2,900	16,395
48	Credit for low-income housing investment	2,300	2,420	2,365	2,340	2,385	2,415	2,490	11,995
49	Accelerated depreciation on rental housing (normal tax method)	1,365	1,585	1,845	2,100	2,235	2,560	2,880	11,620
	Commerce:								
50	Cancellation of indebtedness	40	15	.....	–10	–5	–5	.....	–20
51	Exceptions from imputed interest rules	155	155	160	160	160	165	165	810
52	Capital gains (other than agriculture, timber, iron ore, and coal) (normal tax method)	24,620	25,360	26,120	26,900	27,710	28,540	29,395	138,665
53	Capital gains exclusion of small corporation stock	35	35	35	35	40	40	40	190
54	Step-up basis of capital gains at death	8,750	9,100	9,465	9,845	10,235	10,645	11,070	51,260

Table 5–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

		Total revenue loss from corporate and individual Income taxes							
		1997	1998	1999	2000	2001	2002	2003	1999–2003
55	Carryover basis of capital gains on gifts	155	165	180	190	200	210	220	1,000
56	Ordinary income treatment of loss from small business corporation stock sale	.....	.....	5	20	40	70	95	230
57	Accelerated depreciation of buildings other than rental housing (normal tax method)	5,830	4,690	3,470	2,530	1,705	1,070	350	9,125
58	Accelerated depreciation of machinery and equipment (normal tax method)	24,970	26,655	28,535	29,410	30,620	31,620	31,935	152,120
59	Expensing of certain small investments (normal tax method)	1,050	970	880	815	1,360	1,285	930	5,270
60	Amortization of start-up costs (normal tax method)	200	205	210	215	220	225	230	1,100
61	Graduated corporation income tax rate (normal tax method)	4,695	4,950	5,085	5,280	5,525	5,820	6,130	27,840
62	Exclusion of interest on small-issue bonds	350	295	275	255	245	230	225	1,230
	Transportation:								
63	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
64	Exclusion of reimbursed employee parking expenses	1,280	1,315	1,340	1,370	1,405	1,440	1,475	7,030
65	Exclusion for employer-provided transit passes	60	70	80	95	110	125	145	555
	Community and regional development:								
66	Investment credit for rehabilitation of structures (other than historic)	80	70	70	70	65	65	65	335
67	Exclusion of interest for airport, dock, and similar bonds	970	1,020	1,060	1,095	1,125	1,140	1,160	5,580
68	Exemption of certain mutuals' and cooperatives' income	60	65	65	65	65	70	70	335
69	Empowerment zones and enterprise communities	255	460	555	640	670	620	465	2,950
70	Expensing of environmental remediation costs	.....	100	120	160	65	–10	–30	305
	Education, training, employment, and social services:								
	Education:								
71	Exclusion of scholarship and fellowship income (normal tax method)	875	910	955	995	1,040	1,085	1,135	5,210
72	HOPE tax credit	.....	205	4,160	4,870	5,225	5,525	5,625	25,405
73	Lifetime Learning tax credit	.....	115	2,550	2,590	2,805	2,840	3,160	13,945
74	Education Individual Retirement Accounts	.....	15	85	190	295	405	520	1,495
75	Deductibility of student-loan interest	.....	65	235	285	345	410	430	1,705
76	Deferral of state prepaid tuition plans	.....	65	110	120	130	145	155	660
77	Exclusion of interest on student loan bonds	290	275	255	240	230	215	210	1,150
78	Exclusion of interest on bonds for private nonprofit educational facilities	835	860	885	910	920	935	940	4,590
79	Credit for holders of zone academy bonds	.....	5	35	45	45	45	45	215
80	Exclusion of interest on savings bonds transferred to educational institutions	10	10	10	15	15	15	15	70
81	Parental personal exemption for students age 19 or over	845	875	925	970	1,025	1,070	1,125	5,115
82	Child credit [2]	.....	3,590	19,175	19,240	19,015	18,845	18,580	94,855
83	Deductibility of charitable contributions (education)	2,670	2,890	3,010	3,145	3,295	3,460	3,640	16,550
84	Exclusion of employer provided educational assistance	320	215	215	210	15	.....	.....	440
	Training, employment, and social services:								
85	Work opportunity tax credit	110	275	200	100	30	10	.....	340
86	Welfare-to-work tax credit	.....	10	30	30	15	10	5	90
87	Exclusion of employer provided child care	860	910	950	995	1,040	1,085	1,135	5,205
88	Adoption assistance	10	200	320	355	370	365	225	1,635
89	Exclusion of employee meals and lodging (other than military)	595	620	650	680	710	740	775	3,555
90	Credit for child and dependent care expenses	2,515	2,510	2,510	2,505	2,500	2,500	2,495	12,510
91	Credit for disabled access expenditures	65	65	65	70	70	70	70	345
92	Expensing of costs of removing certain architectural barriers to the handicapped	20	20	20	20	20	20	20	100
93	Deductibility of charitable contributions, other than education and health	17,080	18,700	19,565	20,530	21,555	22,655	23,830	108,135
94	Exclusion of certain foster care payments	35	35	40	40	45	45	50	220
95	Exclusion of parsonage allowances	295	315	340	360	385	410	440	1,935
	Health:								
96	Exclusion of employer contributions for medical insurance premiums and medical care	67,050	71,465	76,230	81,295	86,875	93,045	100,245	437,690
97	Medical savings accounts	.....	30	110	115	115	120	125	585
98	Deductibility of medical expenses	4,175	4,550	4,815	5,110	5,425	5,775	6,150	27,275
99	Exclusion of interest on hospital construction bonds	1,675	1,740	1,795	1,845	1,880	1,910	1,930	9,360
100	Deductibility of charitable contributions (health)	2,365	2,570	2,685	2,805	2,940	3,095	3,250	14,775
101	Tax credit for orphan drug research	15	40	50	55	60	70	80	315
102	Special Blue Cross/Blue Shield deduction	225	185	240	255	290	340	330	1,455
	Income security:								
103	Exclusion of railroad retirement system benefits	445	455	460	465	465	470	480	2,340
104	Exclusion of workmen's compensation benefits	4,410	4,950	5,210	5,480	5,775	6,090	6,420	28,975
105	Exclusion of public assistance benefits (normal tax method)	545	580	605	630	655	685	710	3,285
106	Exclusion of special benefits for disabled coal miners	85	85	80	75	70	70	65	360
107	Exclusion of military disability pensions	125	130	135	140	145	150	155	725
	Net exclusion of pension contributions and earnings:								
108	Employer plans	71,145	72,135	72,375	73,500	73,285	73,225	73,480	365,865
109	Individual Retirement Accounts	9,770	10,275	10,780	11,085	11,485	11,865	12,160	57,375
110	Keogh plans	3,520	3,655	3,755	3,895	4,070	4,260	4,450	20,430

Table 5–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

		Total revenue loss from corporate and individual Income taxes							
		1997	1998	1999	2000	2001	2002	2003	1999–2003
111	Exclusion of employer provided death benefits	185	190	200	210	220	230	240	1,099
	Exclusion of other employee benefits:								
112	Premiums on group term life insurance	2,065	2,110	2,150	2,200	2,240	2,290	2,340	11,220
113	Premiums on accident and disability insurance	165	175	185	195	205	215	225	1,025
114	Income of trusts to finance supplementary unemployment benefits	5	5	5	5	5	5	5	25
115	Special ESOP rules	735	720	740	760	790	820	850	3,960
116	Additional deduction for the blind	25	30	30	30	30	35	35	160
117	Additional deduction for the elderly	1,545	1,710	1,785	1,800	1,800	1,805	1,845	9,035
118	Tax credit for the elderly and disabled	50	50	50	50	50	50	50	250
119	Deductibility of casualty losses	465	485	510	535	560	590	620	2,815
120	Earned income tax credit [3]	6,065	6,210	4,635	4,515	4,625	4,790	4,965	23,530
	Social Security:								
	Exclusion of social security benefits:								
121	Social Security benefits for retired workers	17,470	18,330	19,115	20,025	20,840	21,830	22,930	104,740
122	Social Security benefits for disabled	2,270	2,495	2,685	2,875	3,090	3,325	3,590	15,565
123	Social Security benefits for dependents and survivors	3,825	4,000	4,160	4,310	4,470	4,640	4,795	22,375
	Veterans benefits and services:								
124	Exclusion of veterans death benefits and disability compensation	2,770	2,930	3,100	3,280	3,470	3,675	3,890	17,415
125	Exclusion of veterans pensions	70	70	65	70	75	80	85	376
126	Exclusion of GI bill benefits	50	60	70	80	90	95	100	435
127	Exclusion of interest on veterans housing bonds	75	75	75	75	75	80	85	390
	General purpose fiscal assistance:								
128	Exclusion of interest on public purpose bonds	13,800	14,315	14,760	15,125	15,390	15,600	15,750	76,625
129	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	30,720	32,145	33,490	34,910	36,410	37,995	39,695	182,500
130	Tax credit for corporations receiving income from doing business in U.S. possessions	2,700	2,770	2,800	2,885	2,970	3,060	3,075	14,790
	Interest:								
131	Deferral of interest on U.S. savings bonds	915	965	1,015	1,065	1,115	1,175	1,235	5,605
	Addendum—Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	16,915	17,700	18,440	19,220	20,045	20,920	21,855	100,480
	Nonbusiness State and local taxes other than on owner-occupied homes	30,720	32,145	33,490	34,910	36,410	37,995	39,695	182,500
	Exclusion of interest on:								
	Public purpose bonds	13,800	14,315	14,760	15,125	15,390	15,600	15,750	76,625
	Energy facility bonds	175	175	170	165	155	150	140	780
	Bonds for water, sewage, and hazardous waste facilities	625	605	590	565	540	500	455	2,650
	Small-issue bonds	350	295	275	255	245	230	225	1,230
	Owner-occupied mortgage revenue bonds	1,750	1,670	1,595	1,520	1,440	1,365	1,290	7,210
	Rental housing bonds	810	750	695	615	530	450	320	2,610
	Bonds for airports, docks, and sports and convention facilities	970	1,020	1,060	1,095	1,125	1,140	1,160	5,580
	Student loan bonds	290	275	255	240	230	215	210	1,150
	Bonds for private nonprofit educational facilities	835	860	885	910	920	935	940	4,590
	Hospital construction bonds	1,675	1,740	1,795	1,845	1,880	1,910	1,930	9,360
	Veterans housing bonds	75	75	75	75	75	80	85	390

Notes:
Provisions with estimates denoted ''normal tax method'' have no revenue loss under the reference tax law method.
All estimates have been rounded to the nearest $5 million.
Figures in tables 5–1 are the arithmetic sums of corporate and individual income tax revenue loss estimates from table 5–2, and do not reflect possible interactions across these two taxes.
[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 1997 $675; 1998 $720; 1999 $750; 2000 $780; 2001 $810; 2002 $845; 2003 $875.
[2] The figures in the table indicate the effect of the child credit on receipts. The effect on outlays in (in millions of dollars) is as follows: 1997 $0; 1998 $0; 1999 $538; 2000 $685; 2001 $662; 2002 $624; and 2003 $589.
[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays in (in millions of dollars) is as follows: 1997 $21,856; 1998 $22,295; 1999 $24,496; 2000 $25,334; 2001 $26,040; 2002 $26,715; and 2003 $27,414.

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES

(In millions of dollars)

		Revenue Loss													
		Corporations							Individuals						
		1997	1998	1999	2000	2001	2002	2003	1997	1998	1999	2000	2001	2002	2003
	National defense:														
1	Exclusion of benefits and allowances to armed forces personnel	.....	.....	.....	.....	.....	.....	.....	2,080	2,095	2,120	2,140	2,160	2,180	2,200
	International affairs:														
2	Exclusion of income earned abroad by U.S. citizens	.....	.....	.....	.....	.....	.....	.....	1,790	1,985	2,205	2,450	2,725	3,035	3,345
3	Exclusion of income of foreign sales corporations	1,600	1,700	1,800	1,900	2,000	2,100	2,200	.....	.....	.....	.....	.....	.....	.....
4	Inventory property sales source rules exception	1,500	1,600	1,700	1,800	1,900	2,000	2,100	.....	.....	.....	.....	.....	.....	.....
5	Deferral of income from controlled foreign corporations (normal tax method)	2,200	2,400	2,600	2,800	3,000	3,200	3,400	.....	.....	.....	.....	.....	.....	.....
	General science, space, and technology:														
6	Expensing of research and experimentation expenditures (normal tax method)	190	420	570	670	725	750	770	5	10	10	15	15	15	15
7	Credit for increasing research activities	860	2,095	845	370	165	55	10	20	30	15	.....	.....	.....	.....
	Energy:														
8	Expensing of exploration and development costs, fuels	–160	–95	–50	10	–10	.....	20	.....	.....	.....	.....	.....	.....	.....
9	Excess of percentage over cost depletion, fuels	620	625	630	640	645	660	665	210	210	210	215	220	220	225
10	Alternative fuel production credit	680	640	600	570	540	510	340	30	30	30	30	20	20	10
11	Exception from passive loss limitation for working interests in oil and gas properties	.....	.....	.....	.....	.....	.....	.....	45	50	50	50	55	55	60
12	Capital gains treatment of royalties on coal	.....	.....	.....	.....	.....	.....	.....	50	50	50	55	60	60	60
13	Exclusion of interest on energy facility bonds	70	70	70	65	60	60	55	105	105	100	100	95	90	85
14	Enhanced oil recovery credit	90	95	95	100	105	110	120	5	5	5	10	10	10	10
15	New technology credit	60	65	70	80	80	80	80	.....	.....	.....	.....	.....	.....	.....
16	Alcohol fuel credit [1]	10	10	10	10	10	10	10	10	10	10	10	10	10	10
17	Tax credit and deduction for clean-fuel burning vehicles and properties	55	60	65	70	80	75	55	10	15	15	15	20	20	15
18	Exclusion from income of conservation subsidies provided by public utilities	10	–45	–35	–30	–25	–25	–20	60	65	65	70	70	75	80
	Natural resources and environment:														
19	Expensing of exploration and development costs, nonfuel minerals	35	40	40	40	40	40	40	10	15	15	15	15	15	15
20	Excess of percentage over cost depletion, nonfuel minerals	250	255	265	270	275	285	290	85	85	90	90	90	95	95
21	Capital gains treatment of iron ore	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
22	Special rules for mining reclamation reserves	20	20	20	20	20	20	20	.....	.....	.....	.....	.....	.....	.....
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	250	240	235	225	215	195	180	375	365	355	340	325	305	275
24	Capital gains treatment of certain timber income	.....	.....	.....	.....	.....	.....	.....	50	50	50	55	60	60	60
25	Expensing of multiperiod timber growing costs	285	300	315	325	335	345	355	175	180	190	200	205	210	220
26	Investment credit and seven-year amortization for reforestation expenditures	20	20	25	25	25	25	25	25	25	25	25	25	25	30
27	Tax incentives for preservation of historic structures	25	25	25	20	20	20	20	95	90	90	90	85	85	85
	Agriculture:														
28	Expensing of certain capital outlays	10	10	10	10	10	10	10	55	55	60	60	60	60	60
29	Expensing of certain multiperiod production costs	10	10	10	10	10	10	10	70	70	75	75	75	75	75
30	Treatment of loans for solvent farmers	.....	.....	.....	.....	.....	.....	.....	10	10	10	10	10	10	10
31	Capital gains treatment of certain income	.....	.....	.....	.....	.....	.....	.....	505	520	535	550	570	585	600
32	Income averaging for farmers	.....	.....	.....	.....	.....	.....	.....	.....	5	30	35	25	.....	.....
	Commerce and housing:														
	Financial institutions and insurance:														
33	Exemption of credit union income	800	880	960	1,050	1,150	1,260	1,380	.....	.....	.....	.....	.....	.....	.....
34	Excess bad debt reserves of financial institutions	70	45	20	10	5	5	.....	.....	.....	.....	.....	.....	.....	.....
35	Exclusion of interest on life insurance savings	190	200	210	225	235	250	260	12,575	13,265	13,990	14,765	15,575	16,430	17,325
36	Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	.....	.....	.....	.....	.....	.....	.....
37	Tax exemption of insurance companies owned by tax-exempt organizations	200	215	230	245	260	280	300	.....	.....	.....	.....	.....	.....	.....
38	Small life insurance company deduction	110	115	120	125	130	135	140	.....	.....	.....	.....	.....	.....	.....
	Housing:														
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	695	660	635	600	570	540	510	1,055	1,010	960	920	870	825	780
40	Exclusion of interest on rental housing bonds	320	295	275	240	205	175	115	490	455	420	375	325	275	205
41	Deductibility of mortgage interest on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	49,060	51,245	53,695	56,515	59,505	62,730	66,245
42	Deductibility of State and local property tax on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	16,915	17,700	18,440	19,220	20,045	20,920	21,855
43	Deferral of income from post 1987 installment sales	250	255	260	265	270	275	280	710	720	735	750	765	780	795

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

		Revenue Loss													
		Corporations							Individuals						
		1997	1998	1999	2000	2001	2002	2003	1997	1998	1999	2000	2001	2002	2003
44	Deferral of capital gains on home sales	...	...	...	...	...	...	...	12,245	5,770	...	...	...	...	...
45	Exclusion of capital gains on home sales for persons age 55 and over	...	...	...	...	...	...	...	3,740	1,110	...	...	...	...	...
46	Capital gains exclusion on home sales	...	...	...	...	...	...	...	8,750	9,100	9,465	9,845	10,235	10,645	11,070
47	Exception from passive loss rules for $25,000 of rental loss	...	...	...	...	...	...	...	4,175	3,910	3,680	3,465	3,270	3,080	2,900
48	Credit for low-income housing investment	460	485	475	470	475	485	500	1,840	1,935	1,890	1,870	1,910	1,930	1,990
49	Accelerated depreciation on rental housing (normal tax method)	865	1,025	1,215	1,390	1,460	1,705	1,865	500	560	630	710	775	855	1,015
	Commerce:														
50	Cancellation of indebtedness	...	...	...	...	...	...	...	40	15	...	–10	–5	–5	...
51	Exceptions from imputed interest rules	...	...	...	...	...	...	...	155	155	160	160	160	165	165
52	Capital gains (other than agriculture, timber, iron ore, and coal) (normal tax method)	...	...	...	...	...	...	...	24,620	25,360	26,120	26,900	27,710	28,540	29,395
53	Capital gains exclusion of small corporation stock	...	...	...	...	...	...	...	35	35	35	35	40	40	40
54	Step-up basis of capital gains at death	...	...	...	...	...	...	...	8,750	9,100	9,465	9,845	10,235	10,645	11,070
55	Carryover basis of capital gains on gifts	...	...	...	...	...	...	...	155	165	180	190	200	210	220
56	Ordinary income treatment of loss from small business corporation stock sale	...	...	...	...	...	...	...	...	...	5	20	40	70	95
57	Accelerated depreciation of buildings other than rental housing (normal tax method)	4,100	3,285	2,425	1,825	1,230	765	245	1,730	1,405	1,045	705	475	305	105
58	Accelerated depreciation of machinery and equipment (normal tax method)	19,770	21,030	22,390	23,090	23,755	24,610	24,820	5,200	5,625	6,145	6,320	6,865	7,010	7,115
59	Expensing of certain small investments (normal tax method)	660	620	570	540	955	810	615	390	350	310	275	405	475	315
60	Amortization of start-up costs (normal tax method)	95	100	100	105	105	110	110	105	105	110	110	115	115	120
61	Graduated corporation income tax rate (normal tax method)	4,695	4,950	5,085	5,280	5,525	5,820	6,130	...	...	...	...	...	...	...
62	Exclusion of interest on small-issue bonds	135	115	110	100	95	90	90	215	180	165	155	150	140	135
	Transportation:														
63	Deferral of tax on shipping companies	20	20	20	20	20	20	20	...	...	...	...	...	...	...
64	Exclusion of reimbursed employee parking expenses	...	...	...	...	...	...	...	1,280	1,315	1,340	1,370	1,405	1,440	1,475
65	Exclusion for employer-provided transit passes	...	...	...	...	...	...	...	60	70	80	95	110	125	145
	Community and regional development:														
66	Investment credit for rehabilitation of structures (other than historic)	15	15	15	15	15	15	15	65	55	55	55	50	50	50
67	Exclusion of interest for airport, dock, and similar bonds	390	410	425	440	450	455	465	580	610	635	655	675	685	695
68	Exemption of certain mutuals' and cooperatives' income	60	65	65	65	65	70	70	...	...	...	...	...	...	...
69	Empowerment zones and enterprise communities	75	165	215	240	225	200	155	180	295	340	400	445	420	310
70	Expensing of environmental remediation costs	...	85	100	135	55	–10	–25	...	15	20	25	10	...	–5
	Education, training, employment, and social services:														
	Education:.														
71	Exclusion of scholarship and fellowship income (normal tax method)	...	...	...	...	...	...	...	875	910	955	995	1,040	1,085	1,135
72	HOPE tax credit	...	...	...	...	...	...	...	...	205	4,160	4,870	5,225	5,525	5,625
73	Lifetime Learning tax credit	...	...	...	...	...	...	...	...	115	2,550	2,590	2,805	2,840	3,160
74	Education Individual Retirement Accounts	...	...	...	...	...	...	...	...	15	85	190	295	405	520
75	Deductibility of student-loan interest	...	...	...	...	...	...	...	...	65	235	285	345	410	430
76	Deferral of state prepaid tuition plans	...	...	...	...	...	...	...	...	65	110	120	130	145	155
77	Exclusion of interest on student loan bonds	115	110	100	95	90	85	85	175	165	155	145	140	130	125
78	Exclusion of interest on bonds for private nonprofit educational facilities	335	345	355	365	370	375	375	500	515	530	545	550	560	565
79	Credit for holders of zone academy bonds	...	...	10	10	10	10	10	...	5	25	35	35	35	35
80	Exclusion of interest on savings bonds transferred to educational institutions	...	...	...	...	...	...	...	10	10	10	15	15	15	15
81	Parental personal exemption for students age 19 or over	...	...	...	...	...	...	...	845	875	925	970	1,025	1,070	1,125
82	Child credit [2]	...	...	...	...	...	...	...	...	3,590	19,175	19,240	19,015	18,845	18,580
83	Deductibility of charitable contributions (education)	920	970	1,000	1,025	1,065	1,120	1,180	1,750	1,920	2,010	2,120	2,230	2,340	2,460
84	Exclusion of employer provided educational assistance	...	...	...	...	...	...	...	320	215	215	210	15	...	...
	Training, employment, and social services:														
85	Work opportunity tax credit	90	235	170	80	30	10	...	20	40	30	20	...	...	...
86	Welfare-to-work tax credit	...	10	25	25	10	10	5	...	...	5	5	5	...	...
87	Exclusion of employer provided child care	...	...	...	...	...	...	...	860	910	950	995	1,040	1,085	1,135
88	Adoption assistance	...	...	...	...	...	...	...	10	200	320	355	370	365	225
89	Exclusion of employee meals and lodging (other than military)	...	...	...	...	...	...	...	595	620	650	680	710	740	775
90	Credit for child and dependent care expenses	...	...	...	...	...	...	...	2,515	2,510	2,510	2,505	2,500	2,500	2,495
91	Credit for disabled access expenditures	50	50	50	55	55	55	55	15	15	15	15	15	15	15
92	Expensing of costs of removing certain architectural barriers to the handicapped	15	15	15	15	15	15	15	5	5	5	5	5	5	5

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

		Revenue Loss													
		Corporations							Individuals						
		1997	1998	1999	2000	2001	2002	2003	1997	1998	1999	2000	2001	2002	2003
93	Deductibility of charitable contributions, other than education and health	1,130	1,190	1,225	1,260	1,305	1,375	1,450	15,950	17,510	18,340	19,270	20,250	21,280	22,380
94	Exclusion of certain foster care payments	...	...	...	...	...	...	...	35	35	40	40	45	45	50
95	Exclusion of parsonage allowances	...	...	...	...	...	...	...	295	315	340	360	385	410	440
	Health:														
96	Exclusion of employer contributions for medical insurance premiums and medical care	...	...	...	...	...	...	...	67,050	71,465	76,230	81,295	86,875	93,045	100,245
97	Medical savings accounts	...	...	...	...	...	...	...	...	30	110	115	115	120	125
98	Deductibility of medical expenses	...	...	...	...	...	...	...	4,175	4,550	4,815	5,110	5,425	5,775	6,150
99	Exclusion of interest on hospital construction bonds	675	700	720	740	755	765	770	1,000	1,040	1,075	1,105	1,125	1,145	1,160
100	Deductibility of charitable contributions (health)	575	610	625	645	670	705	740	1,790	1,960	2,060	2,160	2,270	2,390	2,510
101	Tax credit for orphan drug research	15	40	50	55	60	70	80	...	...	...	...	...	...	...
102	Special Blue Cross/Blue Shield deduction	225	185	240	255	290	340	330	...	...	...	...	...	...	...
	Income security:														
103	Exclusion of railroad retirement system benefits	...	...	...	...	...	...	...	445	455	460	465	465	470	480
104	Exclusion of workmen's compensation benefits	...	...	...	...	...	...	...	4,410	4,950	5,210	5,480	5,775	6,090	6,420
105	Exclusion of public assistance benefits (normal tax method)	...	...	...	...	...	...	...	545	580	605	630	655	685	710
106	Exclusion of special benefits for disabled coal miners	...	...	...	...	...	...	...	85	85	80	75	70	70	65
107	Exclusion of military disability pensions	...	...	...	...	...	...	...	125	130	135	140	145	150	155
	Net exclusion of pension contributions and earnings:														
108	Employer plans	...	...	...	...	...	...	...	71,145	72,135	72,375	73,500	73,285	73,225	73,480
109	Individual Retirement Accounts	...	...	...	...	...	...	...	9,770	10,275	10,780	11,085	11,485	11,865	12,160
110	Keogh plans	...	...	...	...	...	...	...	3,520	3,655	3,755	3,895	4,070	4,260	4,450
111	Exclusion of employer provided death benefits	...	...	...	...	...	...	...	185	190	200	210	220	230	240
	Exclusion of other employee benefits:														
112	Premiums on group term life insurance	...	...	...	...	...	...	...	2,065	2,110	2,150	2,200	2,240	2,290	2,340
113	Premiums on accident and disability insurance	...	...	...	...	...	...	...	165	175	185	195	205	215	225
114	Income of trusts to finance supplementary unemployment benefits	...	...	...	...	...	...	...	5	5	5	5	5	5	5
115	Special ESOP rules	675	660	680	700	730	760	790	60	60	60	60	60	60	60
116	Additional deduction for the blind	...	...	...	...	...	...	...	25	30	30	30	30	35	35
117	Additional deduction for the elderly	...	...	...	...	...	...	...	1,545	1,710	1,785	1,800	1,800	1,805	1,845
118	Tax credit for the elderly and disabled	...	...	...	...	...	...	...	50	50	50	50	50	50	50
119	Deductibility of casualty losses	...	...	...	...	...	...	...	465	485	510	535	560	590	620
120	Earned income tax credit [3]	...	...	...	...	...	...	...	6,065	6,210	4,635	4,515	4,625	4,790	4,965
	Social Security:														
	Exclusion of social security benefits:.														
121	Social Security benefits for retired workers	...	...	...	...	...	...	...	17,470	18,330	19,115	20,025	20,840	21,830	22,930
122	Social Security benefits for disabled	...	...	...	...	...	...	...	2,270	2,495	2,685	2,875	3,090	3,325	3,590
123	Social Security benefits for dependents and survivors	...	...	...	...	...	...	...	3,825	4,000	4,160	4,310	4,470	4,640	4,795
	Veterans benefits and services:														
124	Exclusion of veterans death benefits and disability compensation	...	...	...	...	...	...	...	2,770	2,930	3,100	3,280	3,470	3,675	3,890
125	Exclusion of veterans pensions	...	...	...	...	...	...	...	70	70	65	70	75	80	85
126	Exclusion of GI bill benefits	...	...	...	...	...	...	...	50	60	70	80	90	95	100
127	Exclusion of interest on veterans housing bonds	30	30	30	30	30	30	35	45	45	45	45	45	50	50
	General purpose fiscal assistance:														
128	Exclusion of interest on public purpose bonds	5,550	5,750	5,925	6,060	6,165	6,245	6,300	8,250	8,565	8,835	9,065	9,225	9,355	9,450
129	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	...	...	...	...	...	...	...	30,720	32,145	33,490	34,910	36,410	37,995	39,695
130	Tax credit for corporations receiving income from doing business in U.S. possessions	2,700	2,770	2,800	2,885	2,970	3,060	3,075	...	...	...	...	...	...	...
	Interest:														
131	Deferral of interest on U.S. savings bonds	...	...	...	...	...	...	...	915	965	1,015	1,065	1,115	1,175	1,235
	Addendum—Aid to State and local governments:														
	Deductibility of:.														
	Property taxes on owner-occupied homes	...	...	...	...	...	...	...	16,915	17,700	18,440	19,220	20,045	20,920	21,855
	Nonbusiness State and local taxes other than on owner-occupied homes	...	...	...	...	...	...	...	30,720	32,145	33,490	34,910	36,410	37,995	39,695
	Exclusion of interest on:														
	Public purpose bonds	5,550	5,750	5,925	6,060	6,165	6,245	6,300	8,250	8,565	8,835	9,065	9,225	9,355	9,450
	Energy facility bonds	70	70	70	65	60	60	55	105	105	100	100	95	90	85
	Bonds for water, sewage, and hazardous waste facilities	250	240	235	225	215	195	180	375	365	355	340	325	305	275
	Small-issue bonds	135	115	110	100	95	90	90	215	180	165	155	150	140	135

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

	Revenue Loss													
	Corporations							Individuals						
	1997	1998	1999	2000	2001	2002	2003	1997	1998	1999	2000	2001	2002	2003
Owner-occupied mortgage revenue bonds	695	660	635	600	570	540	510	1,055	1,010	960	920	870	825	780
Rental housing bonds	320	295	275	240	205	175	115	490	455	420	375	325	275	205
Bonds for airports, docks, and sports and convention facilities	390	410	425	440	450	455	465	580	610	635	655	675	685	695
Student loan bonds	115	110	100	95	90	85	85	175	165	155	145	140	130	125
Bonds for private nonprofit educational facilities	335	345	355	365	370	375	375	500	515	530	545	550	560	565
Hospital construction bonds	675	700	720	740	755	765	770	1,000	1,040	1,075	1,105	1,125	1,145	1,160
Veterans housing bonds	30	30	30	30	30	30	35	45	45	45	45	45	50	50

Notes:
Provisions with estimates denoted ''normal tax method'' have no revenue loss under the reference tax law method.
All estimates have been rounded to the nearest $5 million.
Figures in table 5–1 are the arithmetic sums of corporate and individual income tax revenue loss estimates from table 5–2, and do not reflect possible interactions across these two taxes.
[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 1997 $675; 1998 $720; 1999 $750; 2000 $780; 2001 $810; 2002 $845; 2003 $875.
[2] The figures in the table indicate the effect of the child credit on receipts. The effect on outlays in (in millions of dollars) is as follows: 1997 $0; 1998 $0; 1999 $538; 2000 $685; 2001 $662; 2002 $624; and 2003 $589.
[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays in (in millions of dollars) is as follows: 1997 $21,856; 1998 $22,295; 1999 $24,496; 2000 $25,334; 2001 $26,040; 2002 $26,715; and 2003 $27,414.

Table 5–3. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 1999 REVENUE LOSS

(In millions of dollars)

Provision	1999	1999–2003
Exclusion of employer contributions for medical insurance premiums and medical care	76,230	437,690
Net exclusion of employer pension-plan contributions and earnings	72,375	365,865
Deductibility of mortgage interest on owner-occupied homes	53,695	298,690
Deductibility of nonbusiness State and local taxes other than owner-occupied homes	33,490	182,500
Accelerated depreciation of machinery and equipment (normal tax method)	28,535	152,120
Capital gains (other than agriculture, timber, iron ore, and coal) (Normal tax method)	26,120	138,665
Deductibility of charitable contributions	25,260	139,460
Child credit [1]	19,175	94,855
Exclusion of Social Security benefits for retired workers	19,115	104,740
Deductibility of State and local property tax on owner-occupied homes	18,440	100,480
Exclusion of interest on public purpose bonds	14,760	76,625
Exclusion of interest on life insurance savings	14,200	79,265
Net Exclusion of Individual Retirement Account contributions and earnings	10,780	57,375
Capital gains exclusion on home sales	9,465	51,260
Step-up basis of capital gains at death	9,465	51,260
Exclusion of interest on State and local debt for various non-public purposs	7,395	35,550
Exclusion of workmen's compensation benefits	5,210	28,975
Graduated corporation income tax rate (normal tax method)	5,085	27,840
Deductibility of medical expenses	4,815	27,275
Earned income tax credit [2]	4,635	23,530
HOPE tax credit	4,160	25,405
Exclusion of Social Security benefits for dependents and survivors	4,160	22,375
Net exclusion of Keogh plan contributions and earnings	3,755	20,430
Exception from passive loss rules for $25,000 of rental loss	3,680	16,395
Accelerated depreciation of buildings other than rental housing (normal tax method)	3,470	9,125
Exclusion of veterans death benefits and disability compensation	3,100	17,415
Tax credit for corporations receiving income from doing business in U.S. possessions	2,800	14,790
Exclusion of Social Security benefits for disabled	2,685	15,565
Deferral of income from controlled foreign corporations (normal tax method)	2,600	15,000
Lifetime Learning tax credit	2,550	13,945
Credit for child and dependent care expenses	2,510	12,510
Credit for low-income housing investment	2,365	11,995
Exclusion of income earned abroad by U.S. citizens	2,205	13,760
Premiums on group term life insurance	2,150	11,220
Exclusion of benefits and allowances to armed forces personnel	2,120	10,800
Accelerated depreciation on rental housing (normal tax method)	1,845	11,620
Exclusion of income of foreign sales corporations	1,800	10,000
Additional deduction for the elderly	1,785	9,035
Inventory property sales source rules exception	1,700	9,500
Exclusion of reimbursed employee parking expenses	1,340	7,030
Deferral of interest on U.S. savings bonds	1,015	5,605
Deferral of income from post 1987 installment sales	995	5,175
Exemption of credit union income	960	5,800
Exclusion of scholarship and fellowship income (normal tax method)	955	5,210
Exclusion of employer provided child care	950	5,205
Parental personal exemption for students age 19 or over	925	5,115
Expensing of certain small investments (normal tax method)	880	5,270
Credit for increasing research activities	860	1,460
Excess of percentage over cost depletion, fuels	840	4,330
Special ESOP rules	740	3,960
Exclusion of employee meals and lodging (other than military)	650	3,555
Alternative fuel production credit	630	2,670
Exclusion of public assistance benefits (normal tax method)	605	3,285
Expensing of research and experimentation expenditures (normal tax method)	580	3,555
Empowerment zones and enterprise communities	555	2,950
Capital gains treatment of certain income	535	2,840
Deductibility of casualty losses	510	2,815
Expensing of multiperiod timber growing costs	505	2,700
Exclusion of railroad retirement system benefits	460	2,340
Excess of percentage over cost depletion, nonfuel minerals	355	1,845
Exclusion of parsonage allowances	340	1,935
Adoption assistance	320	1,635
Special Blue Cross/Blue Shield deduction	240	1,455
Deductibility of student-loan interest	235	1,705
Tax exemption of insurance companies owned by tax-exempt organizations	230	1,315
Exclusion of employer provided educational assistance	215	440
Amortization of start-up costs (normal tax method)	210	1,100
Work opportunity tax credit	200	340
Exclusion of employer provided death benefits	200	1,099

Table 5–3. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 1999 REVENUE LOSS—Continued

(In millions of dollars)

Provision	1999	1999–2003
Premiums on accident and disability insurance	185	1,025
Carryover basis of capital gains on gifts	180	1,000
Exceptions from imputed interest rules	160	810
Exclusion of military disability pensions	135	725
Expensing of environmental remediation costs	120	305
Small life insurance company deduction	120	650
Tax incentives for preservation of historic structures	115	540
Medical savings accounts	110	585
Deferral of state prepaid tuition plans	110	660
Enhanced oil recovery credit	100	575
Expensing of certain multiperiod production costs	85	425
Education Individual Retirement Accounts	85	1,495
Tax credit and deduction for clean-fuel burning vehicles and properties	80	430
Exclusion for employer-provided transit passes	80	555
Exclusion of special benefits for disabled coal miners	80	360
Investment credit for rehabilitation of structures (other than historic)	70	335
Expensing of certain capital outlays	70	350
New technology credit	70	390
Exclusion of GI bill benefits	70	435
Exclusion of veterans pensions	65	376
Exemption of certain mutuals' and cooperatives' income	65	335
Credit for disabled access expenditures	65	345
Expensing of exploration and development costs, nonfuel minerals	55	275
Investment credit and seven-year amortization for reforestation expenditures	50	255
Capital gains treatment of certain timber income	50	285
Tax credit for orphan drug research	50	315
Exception from passive loss limitation for working interests in oil and gas properties	50	270
Capital gains treatment of royalties on coal	50	285
Tax credit for the elderly and disabled	50	250
Exclusion of certain foster care payments	40	220
Capital gains exclusion of small corporation stock	35	190
Credit for holders of zone academy bonds	35	215
Welfare-to-work tax credit	30	90
Income averaging for farmers	30	90
Additional deduction for the blind	30	160
Exclusion from income of conservation subsidies provided by public utilities	30	225
Expensing of costs of removing certain architectural barriers to the handicapped	20	100
Special rules for mining reclamation reserves	20	100
Deferral of tax on shipping companies	20	100
Excess bad debt reserves of financial institutions	20	40
Alcohol fuel credit [3]	20	100
Treatment of loans for solvent farmers	10	50
Exclusion of interest on savings bonds transferred to educational institutions	10	70
Special alternative tax on small property and casualty insurance companies	5	25
Ordinary income treatment of loss from small business corporation stock sale	5	230
Income of trusts to finance supplementary unemployment benefits	5	25

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

All estimates have been rounded to the nearest $5 million.

Figures in table 5–3 are the arithmetic sums of corporate and individual income taxrevenue loss estimates from table 5–2, and do not reflect possible interactions across these two taxes.

[1] The figures in the table indicate the effect of the child credit on receipts. The effect on outlays in (in millions of dollars) is as follows: 1997 $0; 1998 $0; 1999 $538; 2000 $685; 2001 $662; 2002 $624; and 2003 $589.

[2] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays in (in millions of dollars) is as follows: 1997 $21,856; 1998 $22,295; 1999 $24,496; 2000 $25,334; 2001 $26,040; 2002 $26,715; and 2003 $27,414.

[3] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 1997 $675; 1998 $720; 1999 $750; 2000 $780; 2001 $810; 2002 $845; and 2003 $875.

Table 5–4. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 1998

(In millions of dollars)

Provision	Present Value of Revenue Loss
Deferral of income from controlled foreign corporation (normal tax method)	2,350
Expensing of research and experimentation expenditure (normal tax method)	1,655
Expensing of exploration and development costs—fuels	160
Expensing of exploration and development costs—nonfuels	75
Expensing of multiperiod timber growing costs	285
Expensing of certain multiperiod production costs—agriculture	70
Expensing of certain capital outlays—agriculture	85
Deferral of income on life insurance and annuity contracts	19,635
Accelerated depreciation of rental housing (normal tax method)	2,230
Accelerated depreciation of buildings other than rental housing (normal tax method)	535
Accelerated depreciation of machinery and equipment (normal tax method)	30,730
Expensing of certain small investments (normal tax method)	1,065
Amortization of start-up costs (normal tax method)	180
Deferral of tax on shipping companies	10
Credit for low-income housing investments	1,930
Exclusion of pension contributions and earnings—employer plans	77,260
Exclusion of IRA contributions and earnings	10,525
Exclusions of contribution and earnings for Keogh plans	3,185
Exclusion of interest on State and local public-purpose bonds	21,940
Exclusion of interest on State and local non-public purposes bonds	8,665
Deferral of interest on U.S. savings bonds	230

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

Outlay Equivalents

The concept of "outlay equivalents" complements "revenue losses" as a measure of the budget effect of tax expenditures. It is the amount of outlay that would be required to provide the taxpayer the same after-tax income as would be received through the tax preference. The outlay equivalent measure allows a comparison of the cost of the tax expenditure with that of a direct Federal outlay. Outlay equivalents are reported in table 5–5.

The measure is larger than the revenue loss estimate when the tax expenditure is judged to function as a Government payment for service. This occurs because an outlay program would increase the taxpayer's pre-tax income. For some tax expenditures, however, the revenue loss equals the outlay equivalent measure. This occurs when the tax expenditure is judged to function like a price reduction or tax deferral that does not directly enter the taxpayer's pre-tax income.[1]

[1]Budget outlay figures generally reflect the pre-tax price of the resources. In some instances, however, Government purchases or subsidies are exempted from tax by a special tax provision. When this occurs, the outlay figure understates the resource cost of the program and is, therefore, not comparable with other outlay amounts. For example, the outlays for certain military personnel allowances are not taxed. If this form of compensation were treated as part of the employee's taxable income, the Defense Department would have to make larger cash payments to its military personnel to leave them as well off after tax as they are now. The tax subsidy must be added to the tax-exempt budget outlay to make this element of national defense expenditures comparable with other outlays.

Table 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX

(In millions of dollars)

		Outlay Equivalents							
		1997	1998	1999	2000	2001	2002	2003	1999–2003
	National defense:								
1	Exclusion of benefits and allowances to armed forces personnel	2,425	2,445	2,470	2,495	2,520	2,545	2,570	12,600
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	2,355	2,610	2,900	3,225	3,585	3,990	4,440	18,140
3	Exclusion of income of foreign sales corporations	2,460	2,615	2,770	2,925	3,075	3,230	3,385	15,385
4	Inventory property sales source rules exception	2,310	2,460	2,615	2,770	2,925	3,075	3,230	14,615
5	Deferral of income from controlled foreign corporations (normal tax method)	2,200	2,400	2,600	2,800	3,000	3,200	3,400	15,000
	General science, space, and technology:								
6	Expensing of research and experimentation expenditures (normal tax method)	190	430	585	680	740	765	785	3,555
7	Credit for increasing research activities	1,360	3,270	1,315	565	250	85	15	2,230
	Energy:								
8	Expensing of exploration and development costs, fuels	–300	–180	–95	10	–20	.....	30	–75
9	Excess of percentage over cost depletion, fuels	1,160	1,175	1,185	1,200	1,215	1,240	1,255	6,095
10	Alternative fuel production credit	1,090	1,120	960	910	860	820	550	4,100
11	Exception from passive loss limitation for working interests in oil and gas properties	45	50	50	50	55	55	60	270
12	Capital gains treatment of royalties on coal	65	65	70	75	75	75	80	375
13	Exclusion of interest on energy facility bonds	255	245	245	240	225	210	200	1,120
14	Enhanced oil recovery credit	145	150	160	170	180	190	195	895
15	New technology credit	80	90	100	105	110	110	110	535
16	Alcohol fuel credit[1]	20	20	20	20	20	20	20	100
17	Tax credit and deduction for clean-fuel burning vehicles and properties	95	100	110	125	135	130	100	600
18	Exclusion from income of conservation subsidies provided by public utilities	95	25	40	55	60	65	80	300
	Natural resources and environment:								
19	Expensing of exploration and development costs, nonfuel minerals	65	75	75	75	75	75	75	375
20	Excess of percentage over cost depletion, nonfuel minerals	465	480	495	505	515	535	540	2,590
21	Capital gains treatment of iron ore	.....	.....	.....	.....	.....	.....	.....	.....
22	Special rules for mining reclamation reserves	25	25	25	25	25	25	25	125
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	895	870	845	810	775	720	650	3,800
24	Capital gains treatment of certain timber income	65	65	70	75	75	75	80	375
25	Expensing of multiperiod timber growing costs	460	480	505	525	540	555	575	2,700
26	Investment credit and seven-year amortization for reforestation expenditures	45	50	50	50	50	55	55	260
27	Tax incentives for preservation of historic structures	120	115	115	110	105	105	105	540
	Agriculture:								
28	Expensing of certain capital outlays	65	65	70	70	70	70	70	350
29	Expensing of certain multiperiod production costs	80	80	85	85	85	85	85	425
30	Treatment of loans for solvent farmers	10	10	10	10	10	10	10	50
31	Capital gains treatment of certain income	675	695	715	735	755	780	805	3,790
32	Income averaging for farmers	.....	5	30	35	25	.....	.....	90
	Commerce and housing:								
	Financial institutions and insurance:								
33	Exemption of credit union income	1,020	1,120	1,225	1,340	1,465	1,605	1,760	7,395
34	Excess bad debt reserves of financial institutions	70	45	20	10	5	5	.....	40
35	Exclusion of interest on life insurance savings	12,765	13,465	14,200	14,990	15,810	16,680	17,585	79,265
36	Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25
37	Tax exemption of insurance companies owned by tax-exempt organizations	280	300	320	340	360	390	415	1,825
38	Small life insurance company deduction	145	150	160	165	170	180	190	865
	Housing:								
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	2,510	2,395	2,290	2,185	2,060	1,955	1,845	10,335
40	Exclusion of interest on rental housing bonds	1,165	1,075	990	880	755	645	440	3,710
41	Deductibility of mortgage interest on owner-occupied homes	49,060	51,245	53,695	56,515	59,505	62,730	66,245	298,690
42	Deductibility of State and local property tax on owner-occupied homes	16,915	17,700	18,440	19,220	20,045	20,920	21,855	100,480
43	Deferral of income from post 1987 installment sales	960	975	995	1,015	1,035	1,055	1,075	5,175
44	Deferral of capital gains on home sales	12,245	5,770	.....	.....	.....	.....	.....	.....
45	Exclusion of capital gains on home sales for persons age 55 and over	3,740	1,110	.....	.....	.....	.....	.....	.....
46	Capital gains exclusion on home sales	11,670	12,135	12,620	13,125	13,650	14,195	14,765	68,355
47	Exception from passive loss rules for $25,000 of rental loss	4,175	3,910	3,680	3,465	3,270	3,080	2,900	16,395
48	Credit for low-income housing investment	3,490	3,670	3,590	3,550	3,615	3,665	3,775	18,195
49	Accelerated depreciation on rental housing (normal tax method)	1,365	1,585	1,840	2,100	2,235	2,560	2,885	11,620
	Commerce:								
50	Cancellation of indebtedness	40	15	.....	–10	–5	–5	.....	–20
51	Exceptions from imputed interest rules	155	155	160	160	160	165	165	810
52	Capital gains (other than agriculture, timber, iron ore, and coal) (normal tax method)	32,825	33,810	34,815	35,870	36,950	38,060	39,195	184,890
53	Capital gains exclusion of small corporation stock	.....	.....	5	25	55	95	125	305
54	Step-up basis of capital gains at death	11,670	12,135	12,620	13,125	13,650	14,195	14,765	68,355

Table 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

		Outlay Equivalents							
		1997	1998	1999	2000	2001	2002	2003	1999–2003
55	Carryover basis of capital gains on gifts	155	165	180	190	200	210	220	1,000
56	Ordinary income treatment of loss from small business corporation stock sale	45	45	50	50	55	55	55	265
57	Accelerated depreciation of buildings other than rental housing (normal tax method)	5,830	4,690	3,470	2,530	1,700	1,070	350	9,120
58	Accelerated depreciation of machinery and equipment (normal tax method)	24,970	26,655	28,535	29,410	30,620	31,620	31,935	152,120
59	Expensing of certain small investments (normal tax method)	1,055	965	880	820	1,360	1,285	930	5,275
60	Amortization of start-up costs (normal tax method)	200	205	210	215	220	225	230	1,100
61	Graduated corporation income tax rate (normal tax method)	6,345	6,690	6,870	7,135	7,465	7,865	8,280	37,615
62	Exclusion of interest on small-issue bonds	495	425	395	370	350	335	320	1,770
	Transportation:								
63	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
64	Exclusion of reimbursed employee parking expenses	1,670	1,710	1,750	1,790	1,835	1,885	1,935	9,195
65	Exclusion for employer-provided transit passes	80	100	115	135	155	175	200	780
	Community and regional development:								
66	Investment credit for rehabilitation of structures (other than historic)	80	70	70	70	65	65	65	335
67	Exclusion of interest for airport, dock, and similar bonds	1,400	1,470	1,530	1,580	1,620	1,645	1,665	8,040
68	Exemption of certain mutuals' and cooperatives' income	60	65	65	65	65	70	70	335
69	Empowerment zones and enterprise communities	255	460	555	635	670	620	465	2,945
70	Expensing of environmental remediation costs	.....	130	155	210	85	–20	–35	395
	Education, training, employment, and social services:								
	Education:								
71	Exclusion of scholarship and fellowship income (normal tax method)	970	1,015	1,060	1,105	1,155	1,210	1,265	5,795
72	HOPE tax credit	.....	265	5,335	6,245	6,700	7,085	7,210	32,575
73	Lifetime Learning tax credit	.....	145	3,270	3,320	3,595	3,640	4,050	17,875
74	Education Individual Retirement Accounts	.....	20	110	250	395	535	690	1,980
75	Deductibility of student-loan interest	.....	85	300	355	435	510	535	2,135
76	Deferral of state prepaid tuition plans	.....	80	140	155	170	185	200	850
77	Exclusion of interest on student loan bonds	415	390	365	345	325	310	300	1,645
78	Exclusion of interest on bonds for private nonprofit educational facilities	1,200	1,245	1,280	1,305	1,325	1,340	1,350	6,600
79	Credit for holders of zone academy bonds	.....	10	45	65	65	65	65	305
80	Exclusion of interest on savings bonds transferred to educational institutions	10	15	20	20	20	20	20	100
81	Parental personal exemption for students age 19 or over	935	970	1,025	1,075	1,135	1,185	1,245	5,665
82	Child credit [2]	.....	4,785	25,565	25,655	25,355	25,125	24,775	126,475
83	Deductibility of charitable contributions (education)	3,680	3,975	4,140	4,315	4,520	4,750	5,000	22,725
84	Exclusion of employer provided educational assistance	395	270	270	260	20	.....	.....	550
	Training, employment, and social services:								
85	Work opportunity tax credit	110	275	200	100	30	10	.....	340
86	Welfare-to-work tax credit	.....	10	30	30	15	10	5	90
87	Exclusion of employer provided child care	1,145	1,215	1,265	1,325	1,385	1,445	1,515	6,935
88	Adoption assistance	10	240	385	430	450	435	270	1,970
89	Exclusion of employee meals and lodging (other than military)	725	760	795	830	862	905	945	4,337
90	Credit for child and dependent care expenses	3,350	3,350	3,345	3,340	3,335	3,330	3,330	16,680
91	Credit for disabled access expenditures	115	115	115	120	120	120	120	595
92	Expensing of costs of removing certain architectural barriers to the handicapped	20	20	20	20	20	20	20	100
93	Deductibility of charitable contributions, other than education and health	22,675	24,820	25,960	27,235	28,590	30,050	31,600	143,435
94	Exclusion of certain foster care payments	40	45	45	50	50	55	55	255
95	Exclusion of parsonage allowances	365	390	415	445	475	505	540	2,380
	Health:								
96	Exclusion of employer contributions for medical insurance premiums and medical care	85,585	91,445	97,690	104,225	111,355	119,245	128,370	560,885
97	Medical savings accounts	.....	40	150	155	155	160	170	790
98	Deductibility of medical expenses	4,175	4,550	4,815	5,110	5,425	5,775	6,150	27,275
99	Exclusion of interest on hospital construction bonds	2,420	2,510	2,590	2,655	2,705	2,750	2,780	13,480
100	Deductibility of charitable contributions (health)	3,220	3,500	3,645	3,815	3,990	4,190	4,415	20,055
101	Tax credit for orphan drug research	25	65	75	80	95	105	115	470
102	Special Blue Cross/Blue Shield deduction	280	230	300	320	360	425	415	1,820
	Income security:								
103	Exclusion of railroad retirement system benefits	445	455	460	465	465	470	480	2,340
104	Exclusion of workmen's compensation benefits	4,410	4,950	5,210	5,480	5,775	6,090	6,420	28,975
105	Exclusion of public assistance benefits (normal tax method)	545	580	605	630	655	685	710	3,285
106	Exclusion of special benefits for disabled coal miners	85	85	80	75	70	70	65	360
107	Exclusion of military disability pensions	125	130	135	130	145	150	155	715
	Net exclusion of pension contributions and earnings:								
108	Employer plans	96,455	97,615	98,130	99,880	99,780	99,990	100,540	498,320
109	Individual Retirement Accounts	13,555	14,250	15,025	15,570	16,215	16,890	17,395	81,095
110	Keogh plans	4,635	4,815	4,950	5,130	5,360	5,615	5,865	26,920
111	Exclusion of employer provided death benefits	235	245	260	270	280	295	310	1,415

Table 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

		Outlay Equivalents							
		1997	1998	1999	2000	2001	2002	2003	1999–2003
	Exclusion of other employee benefits:								
112	Premiums on group term life insurance	2,730	2,790	2,845	2,905	2,965	3,030	3,090	14,835
113	Premiums on accident and disability insurance	210	225	235	250	260	275	290	1,310
114	Income of trusts to finance supplementary unemployment benefits	5	5	5	5	5	5	5	25
115	Special ESOP rules	1,020	1,000	1,030	1,055	1,095	1,140	1,190	5,510
116	Additional deduction for the blind	30	35	35	35	40	40	40	190
117	Additional deduction for the elderly	1,870	2,070	2,160	2,175	2,180	2,180	2,230	10,925
118	Tax credit for the elderly and disabled	60	60	60	60	60	60	65	305
119	Deductibility of casualty losses	600	630	665	695	730	765	805	3,660
120	Earned income tax credit [3]	5,340	5,460	3,790	3,635	3,860	4,005	4,245	19,535
	Social Security:								
	Exclusion of social security benefits:								
121	Social Security benefits for retired workers	17,470	18,330	19,115	20,025	20,840	21,830	22,930	104,740
122	Social Security benefits for disabled	2,270	2,495	2,685	2,875	3,090	3,325	3,590	15,565
123	Social Security benefits for dependents and survivors	3,825	4,000	4,160	4,310	4,470	4,640	4,795	22,375
	Veterans benefits and services:								
124	Exclusion of veterans death benefits and disability compensation	2,770	2,930	3,100	3,280	3,470	3,675	3,890	17,415
125	Exclusion of veterans pensions	70	65	70	75	80	85	90	400
126	Exclusion of GI bill benefits	60	70	80	90	95	100	105	470
127	Exclusion of interest on veterans housing bonds	110	110	105	110	110	115	120	560
	General purpose fiscal assistance:								
128	Exclusion of interest on public purpose bonds	19,915	20,650	21,285	21,795	22,170	22,475	22,680	110,405
129	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	30,720	32,145	33,490	34,910	36,410	37,995	39,695	182,500
130	Tax credit for corporations receiving income from doing business in U.S. possessions	3,860	3,960	4,000	4,120	4,245	4,370	4,390	21,125
	Interest:								
131	Deferral of interest on U.S. savings bonds	915	965	1,015	1,065	1,115	1,175	1,235	5,605
	Addendum—Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	16,915	17,700	18,440	19,220	20,045	20,920	21,855	100,480
	Nonbusiness State and local taxes other than on owner-occupied homes	30,720	32,145	33,490	34,910	36,410	37,995	39,695	182,500
	Exclusion of interest on:								
	Public purpose bonds	19,915	20,650	21,285	21,795	22,170	22,475	22,680	110,405
	Energy facility bonds	255	245	245	240	225	210	200	1,120
	Bonds for water, sewage, and hazardous waste facilities	895	870	845	810	775	720	650	3,800
	Small-issue bonds	495	425	395	370	350	335	320	1,770
	Owner-occupied mortgage revenue bonds	2,510	2,395	2,290	2,185	2,060	1,955	1,845	10,335
	Rental housing bonds	1,165	1,075	990	880	755	645	440	3,710
	Bonds for airports, docks, and sports and convention facilities	1,400	1,470	1,530	1,580	1,620	1,645	1,665	8,040
	Student loan bonds	415	390	365	345	325	310	300	1,645
	Bonds for private nonprofit educational facilities	1,200	1,245	1,280	1,305	1,325	1,340	1,350	6,600
	Hospital construction bonds	2,420	2,510	2,590	2,655	2,705	2,750	2,780	13,480
	Veterans housing bonds	110	110	105	110	110	115	120	560

Note: Provisions with estimates denoted "normal tax method" have no revenue loss under the reference tax law method.
All estimates have been rounded to the nearest $5 million.
Figures in table 5–1 are the arithmetic sums of corporate and individual income tax revenue loss estimates from table 5–2, and do not reflect possible interactions across these two taxes.
[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 1997 $675; 1998 $720; 1999 $750; 2000 $780; 2001 $810; 2002 $845; 2003 $875.
[2] The figures in the table indicate the effect of the child credit on receipts. The effect on outlays in (in millions of dollars) is as follows: 1997 $0; 1998 $0; 1999 $538; 2000 $685; 2001 $662; 2002 $624; and 2003 $589.
[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays in (in millions of dollars) is as follows: 1997 $21,856; 1998 $22,295; 1999 $24,496; 2000 $25,334; 2001 $26,040; 2002 $26,715; and 2003 $27,414.

Tax Expenditure Baselines

A tax expenditure is a preferential exception to the baseline provisions of the tax structure. The 1974 Congressional Budget Act does not, however, specify the baseline provisions of the tax law. Deciding whether provisions are preferential exceptions, therefore, is a matter of judgement. As in prior years, this year's tax expenditure estimates are presented using two baselines: the normal tax baseline, which is used by the Joint Committee on Taxation, and the reference tax law baseline, which has been reported by the Administration since 1983.

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

The reference tax law baseline is also patterned on a comprehensive income tax, but in practice is closer to existing law. Reference law tax expenditures are limited to special exceptions in the tax code that serve programmatic functions. These functions correspond to specific budget categories such as national defense, agriculture, or health care. While tax expenditures under the reference law baseline are generally tax expenditures under the normal tax baseline, the reverse is not always true.

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

- Income is taxable when realized in exchange. Thus, neither the deferral of tax on unrealized capital gains nor the tax exclusion of imputed income (such as the rental value of owner-occupied housing or farmers' consumption of their own produce) is regarded as a tax expenditure. Both accrued and imputed income would be taxed under a comprehensive income tax.
- There is a separate corporation income tax. Under a comprehensive income tax corporate income would be taxed only once—at the shareholder level, whether or not distributed in the form of dividends.
- Values of assets and debt are not adjusted for inflation. A comprehensive income tax would adjust the cost basis of capital assets and debt for changes in the price level during the time the assets or debt are held. Thus, under a comprehensive income tax baseline the failure to take account of inflation in measuring depreciation, capital gains, and interest income would be regarded as a negative tax expenditure (i.e., a tax penalty), and failure to take account of inflation in measuring interest costs would be regarded as a positive tax expenditure (i.e., a tax subsidy).

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

- Tax rates. The separate schedules applying to the various taxpaying units are included in the reference law baseline. Thus, corporate tax rates below the maximum statutory rate do not give rise to a tax expenditure. The normal tax baseline is similar, except that it specifies the current maximum rate as the baseline for the corporate income tax. The lower tax rates applied to the first $10 million of corporate income are thus regarded as a tax expenditure. Similarly, under the reference law baseline, preferential tax rates for capital gains generally do not yield a tax expenditure; only capital gains treatment of otherwise "ordinary income," such as that from coal and iron ore royalties and the sale of timber and certain agricultural products, is considered a tax expenditure. The alternative minimum tax is treated as part of the baseline rate structure under both the reference and normal tax methods.
- Income subject to the tax. Income subject to tax is defined as gross income less the costs of earning that income. The Federal income tax defines gross income to include: (1) consideration received in the exchange of goods and services, including labor services or property; and (2) the taxpayer's share of gross or net income earned and/or reported by another entity (such as a partnership). Under the reference tax rules, therefore, gross income does not include gifts—defined as receipts of money or property that are not consideration in an exchange—or most transfer payments, which can be thought of as gifts from the Government.[2] The normal tax baseline also excludes gifts between individuals from gross income. Under the normal tax baseline, however, all cash transfer payments from the Government to private individuals are counted in gross income, and exemptions of such transfers from tax are identified as tax expenditures. The costs of earning income are generally deductible in determining taxable income under both the reference and normal tax baselines.[3]
- Capital recovery. Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. Under the normal tax baseline, the depreciation allowance for machinery and equipment is determined using straight-line depreciation over tax lives equal to mid-values of the asset depreciation range (a depreciation system in effect from 1971 through 1980). The normal tax baseline for real property is computed using 40-year straight-line depreciation.
- Treatment of foreign income. Both the normal and reference tax baselines allow a tax credit for foreign income taxes paid (up to the amount of U.S. income taxes that would otherwise be due), which prevents double taxation of income earned abroad. Under the normal tax method, however, controlled foreign corporations (CFCs) are not regarded as entities separate from their controlling U.S. shareholders. Thus, the deferral of tax on income received by CFCs is regarded as a tax expenditure under this method. In contrast, except for tax haven activities, the reference law baseline follows current law in treating CFCs as separate taxable entities whose income is not subject to U.S. tax until distributed to U.S. taxpayers. Under this baseline, deferral of tax on CFC income is not a tax expenditure because U.S. taxpayers generally are not taxed on accrued, but unrealized, income.

In addition to these areas of difference, the Joint Committee on Taxation considers a somewhat broader

[2] Gross income does, however, include transfer payments associated with past employment, such as social security benefits.

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

set of tax expenditures under its normal tax baseline than is considered here.

Performance Measures and the Economic Effects of Tax Expenditures

Under the Government Performance and Results Act of 1993 (GPRA), Federal agencies are directed to develop both strategic and annual plans for their programs and activities. These plans set out performance objectives to be achieved over a specific time period. Achieving most of these objectives will largely be the result of direct expenditures of funds. However, tax expenditures may also contribute to goal achievement.

The Senate Governmental Affairs Committee report on this Act[4] called on the Executive branch to undertake a series of analyses to assess the effect of specific tax expenditures on the achievement of the goals and objectives in these strategic and annual plans. As described in OMB's May 1997 report on this Act,[5] Treasury in 1997 initiated pilot studies of three specific tax expenditures in order to explore evaluation methods and resource needs associated with evaluating the relationship between tax expenditures and performance goals. Tax expenditures were selected in each of the three main areas—individual, business, and international taxation—within the Office of Tax Analysis. The specific provisions considered were: the tax exemption for worker's compensation benefits; the tax credit for nonconventional fuels; and the tax exclusion for certain amounts of income earned by Americans living abroad. The results of these studies are summarized in the context of the three specific provisions in the section that follows, which provides provision descriptions.

For the next year, the Administration's plan is to complete additional studies that will focus on the availability of the data needed to assess the effects of selected significant tax expenditures. In addition, summarized data on the beneficiaries and other economic properties of such provisions will be developed where feasible. This effort will complement information published by the Joint Committee on Taxation and the Senate Budget Committee on the rationale, beneficiaries, and effects of tax expenditures.[6] One finding of the pilot studies is that much of the data needed for thorough analysis is not currently available. Hence, assessment of data needs and availability from Federal statistical agencies, program-agency studies, or private-sector sources, and, when feasible, publication of data on selected tax expenditures should prove valuable to broader efforts to assess the effects tax expenditures and to compare their effectiveness with outlay, regulatory and other tax polices as means of achieving objectives.

Comparisons of tax expenditure, spending, and regulatory policies. Tax expenditures by definition work through the tax system and, particularly, the income tax. Thus, they may be relatively advantageous policy approaches when the benefit or incentive is related to income and is intended to be widely available.[7] Because there is an existing public administrative and private compliance structure for the tax system, the incremental administrative and compliance costs for a tax expenditure may be low in many, though not all, cases. In addition, tax expenditures may help simplify the tax system, as where they leave certain income sources untaxed (e.g, exemptions for employer fringe benefits or exclusions for up to $500,000 of capital gains on home sales). Tax expenditures also implicitly subsidize certain activities, which benefits recipients; the beneficiaries experience reduced taxes that are offset by higher taxes (or spending reductions) elsewhere. Regulatory or tax-disincentive policies, which can also modify behavior, would have a different distributional impact. Finally, a variety of tax expenditure tools can be used—e.g., deductions, credits, exemptions and deferrals; floors and ceilings; and phase-ins and phase-outs, dependent on income, expenses, or demographic characteristics (age, number of family members, etc.). This wide range means that tax expenditures can be flexible and can have very different distributional and cost-effectiveness properties.

Tax expenditures also have limitations. In some cases they can add to the complexity of the tax system, which can raise both administrative and compliance costs; for example, various holding periods and tax rates for capital gains can complicate filing and decisionmaking. Also, the income tax system does not gather information on wealth, in contrast to certain loan programs that are based on recipients' assets and income. In addition, the tax system may have little or no contact with persons who have no or very low incomes, and incentives for such persons may need to take the form of refunds. These features may reduce the effectiveness of tax expenditures for addressing certain income-transfer objectives. Tax expenditures also generally do not enable the same degree of agency discretion as an outlay program; for example, grant or direct Federal service delivery programs can prioritize which activities are addressed with what amount of resources in a way that is difficult to emulate with tax expenditures. Finally, tax expenditures tend to escape the budget scrutiny afforded to other programs. For instance, a program funded by a tax expenditure does not increase government outlays as a share of national product and it may even decrease receipts as a share of output. However, the effective government compensation to a service provider can be identical to that of a spending program under which the outlay (and possibly the receipts) share of GDP may increase.

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

[5] Director of the Office of Management and Budget, "The Government Performance and Results Act," Report to the President and the Congress, May 1997.

[6] Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 1998–2992," JCS–22–97, December 15, 1997; and Committee on the Budget, United States Senate, "Tax Expenditures: Compendium of Background Material on Individual Provisions," prepared by the Congressional Research Service (S. Prt. 104–69, December 1996).

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

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

Regulations have a key distributional difference from outlay and tax-expenditure programs in that the immediate distributional burden of the regulation typically falls on the regulated party (i.e., the intended actor)—generally in the private sector. While the regulated parties can pass costs along through product or input prices, the initial incidence is on the regulated party. Regulations can be fine-tuned more quickly than tax expenditures, as they can generally be changed by the executive branch without legislation. Like tax expenditures, regulations often largely rely upon voluntary compliance, rather than detailed inspections and policing. As such, the public administrative costs tend to be modest, relative to the private resource costs associated with modifying activities. Historically, regulations have tended to rely on proscriptive measures, as opposed to economic incentives, which can diminish their efficiency, though this feature can also promote full compliance where (as in certain safety-related cases) policymakers believe that trade-offs with economic considerations are unnecessary. Also, regulations generally do not directly affect the Federal budget and outlays and receipts as a percentage of national output. Thus, like tax expenditures, they may escape the type of scrutiny that outlay programs receive. However, most regulations are subjected to a formal type of benefit-cost analysis that goes well beyond the analysis required for outlay and tax-expenditure programs. To some extent, the GPRA requirement for performance evaluation will address this lack of formal analysis.

Tax expenditures, like spending and regulatory programs, have a variety of objectives and effects. These include: encouraging certain types of activities (e.g., saving for retirement or investing in certain sectors); increasing certain types of after-tax income (e.g., favorable tax treatment of social security income); reducing private compliance costs and government administrative costs (e.g., favorable treatment of certain employer-provided fringe benefits); and promoting tax neutrality (e.g., accelerated depreciation in the presence of inflation). Some of these objectives are well suited to quantitative measurement, while others are less well suited. Also, many tax expenditures, including those cited above, may have more than one objective. For example, favorable treatment of employer-provided pensions might be argued to have aspects of most, or even all, of the goals mentioned above. In addition, the economic effects of particular provisions can extend beyond their intended objectives (e.g., a provision intended to promote an activity or raise certain incomes may have positive or negative effects on tax neutrality).

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

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

An overview of evaluation issues by budget function. The discussion below considers the types of measures that might be useful for some major programmatic groups of tax expenditures. The discussion is intended to be illustrative, and not all encompassing. However, it is premised on the assumption that the data needed to perform the analysis are available or can be developed. In practice, data availability is likely to be a major challenge, and data constraints may limit the assessment of the effectiveness of many of the provisions for some time. In addition, such assessments can raise significant challenges in economic modeling, which has inherent uncertainties. For these reasons, and related time, staffing, and resource constraints, the evaluation process is likely to take a number of years and to include qualitative assessments and estimated ranges of effects, in many cases, as opposed to point estimates.

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

International affairs.—Tax expenditures are also aimed at promoting U.S. exports. These include the exclusion for income earned abroad by nongovernmental employees and preferences for income from exports and U.S.-controlled foreign corporations. Measuring the effectiveness of these provisions raises challenging issues. In addition to determining their effectiveness in markets of the benefitting firms, analysis should consider the extent to which macroeconomic factors lead to offsetting effects, such as increased imports, which could moderate any net effects on employment, national output, and trade deficits. Similar issues arise in the case of export promotion programs supported by outlays.

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

Housing investment also benefits from tax expenditures, including the mortgage interest deduction and preferential treatment of capital gains on homes. Measures of the effectiveness of these provisions could include their effects on increasing the extent of home ownership and the quality of housing. In addition, the mortgage interest deduction offsets the taxable nature of investment income received by homeowners, so the relationship between the deduction and such earnings is also relevant to evaluation of this provision. Similarly, analysis of the extent of accumulated inflationary gains is likely to be relevant to evaluation of the capital gains preference for home sales. Deductibility of State and local property taxes assists with making housing more affordable as well as easing the cost of providing community services through these taxes. Provisions intended to promote investment in rental housing could be evaluated for their effects on making such housing more available and affordable. These provisions should then be compared with alternative programs that address housing supply and demand.

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

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

Education, training, employment, and social services.—Major provisions in this function are intended to promote post-secondary education, to offset costs of raising children, and to promote a variety of charitable activities. The education incentives can be compared with loans, grants, and other programs designed to promote higher education and training. The

child credits are intended to adjust the tax system for the costs of raising children; as such, they could be compared to other Federal tax and spending policies, including related features of the tax system, such as personal exemptions (which are not defined as a tax expenditure). Evaluation of charitable activities requires consideration of the beneficiaries of these activities, who are generally not the parties receiving the tax reduction.

Health.—Individuals also benefit from favorable treatment of employer-provided health insurance. Measures of these benefits could include increased coverage and the distribution of this coverage across different income groups. The effects of insurance coverage on final outcome measures of actual health (e.g., infant mortality, days of work lost due to illness, or life expectancy) or intermediate outcomes (e.g., use of preventive health care or health care costs) could also be investigated. The distribution of employer-provided health insurance is not readily evident from tax return information; thus, the distribution of benefits from this exclusion must be imputed using tax as well as other forms of information.

Income security, social security, and veterans benefits and services.—Major tax expenditures in the income security function benefit retirement savings, through employer-provided pensions, individual retirement accounts, and Keogh plans. These provisions might be evaluated in terms of their effects on boosting retirement incomes, private savings, and national savings (which would include the effect on private savings as well as public savings or deficits). In considering the provisions' distributional effects, it may be useful to consider beneficiaries' incomes while retired and over their entire lifetimes. Interactions with other programs, including social security, also may merit analysis. As in the case of employer-provided health insurance, analysis of employer-provided pension programs requires imputing the benefits of the firm-level contributions back to individuals.

Other provisions principally have income distribution, rather than incentive, effects. For example, tax-favored treatment of social security benefits, certain veterans benefits, and deductions for the blind and elderly provide increased incomes to eligible parties. The distribution of these benefits may be a useful performance measure. The earned-income tax credit, in contrast, should be evaluated both for its effects on labor force participation and its distributional properties.

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

The above illustrative discussion, while broad, is nevertheless incomplete, both for the provisions mentioned and the many that are not explicitly cited. Developing a framework that is sufficiently comprehensive, accurate, and flexible to reflect the objectives and effects of the wide range of tax expenditures will be a significant challenge. OMB, Treasury, and other agencies will work together, as appropriate, to address this challenge. Particularly over the next few years, a significant portion of this effort is likely to be devoted to data issues. Because the compilation of data is resource intensive, and must be balanced with other objectives (including minimizing information collection burdens), careful planning will be essential. Given the challenges inherent in this work, the nature of the analyses is likely to evolve and improve over the next several years.

Other Considerations

The tax expenditure analysis could be extended beyond the income and transfer taxes to include payroll and excise taxes. The exclusion of certain forms of compensation from the wage base, for instance, reduces payroll taxes, as well as income taxes. Payroll tax exclusions are complex to analyze, however, because they also affect social insurance benefits. Certain targeted excise tax provisions might also be considered tax expenditures. In this case challenges include determining an appropriate baseline.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported upon in this chapter follow.

National Defense

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

International Affairs

2. ***Income earned abroad.***—A U.S. citizen or resident alien who resides or stays overseas for at least 11 of the past 12 months may exclude $70,000 per year of foreign-earned income. Beginning in 1998, the exclusion limit is increased to $80,000 in $2,000 annual increments. Eligible taxpayers also may exclude or deduct reasonable housing costs in excess of one-sixth of the salary of a civil servant at grade GS–14, step 1 ($60,270 in 1997). Federal employees working abroad are not eligible for the foreign-earned income exclusion.

Federal employees, however, may exclude certain allowances from their taxable income.

The exclusion for certain income earned abroad was one of the tax expenditures examined by the Department of the Treasury in its pilot performance evaluations this year. This tax expenditure consists of two specific components: section 911 of the tax code, which covers private-sector employees, and section 912, which covers civilian government employees.[8]

The benefits for private-sector employees account for about 85 percent of the combined revenue loss from the two tax expenditures. The private-sector provision is intended to promote U.S. exports, help make U.S. companies competitive when doing business abroad, and to offset the costs of living abroad, which can be higher than costs in the United States. Because American workers in higher-tax nations can offset their U.S. taxes through use of the foreign tax credit, in practice the provision primarily benefits U.S. citizens who work in nations with income taxes that are lower than U.S. taxes. Using tax-return data from 1987, Treasury finds that 70 percent of the benefit of the provision goes to taxpayers with income (defined here as adjusted gross income plus the exclusion) above $50,000; over 98 percent of the housing exclusion, went to this group of taxpayers.

The provision benefiting civilian government employees is intended to help them maintain their standard of living when stationed abroad by compensating them for the higher costs of living abroad. To the extent that this compensation is carried out via the tax code, as opposed to agency appropriations, costs are shifted from outlays to revenue losses.

3. ***Income of Foreign Sales Corporations.***—The Foreign Sales Corporation (FSC) provisions exempt from tax a portion of U.S. exporters' foreign trading income to reflect the FSC's sales functions as foreign corporations. These provisions conform to the General Agreement on Tariffs and Trade.

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

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

General Science, Space, and Technology

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

7. ***R&E credit.***—The research and experimentation (R&E) credit, which expired on May 31, 1997, was reinstated under the Taxpayer Relief Act of 1997 for 13 months (through June 30, 1998). The tax credit is 20 percent of qualified research expenditures in excess of a base amount. The base amount is generally determined by multiplying a "fixed-base percentage" (limited to a maximum of .16) by the average amount of the company's gross receipts for the 1984 to 1988 period. Certain start-up companies are assigned a fixed-base percentage of .03 for the first five taxable years, which is gradually phased out in years 6 through 10 and replaced by the firm's actual fixed-base percentage. Taxpayers may also elect an alternative credit regime. Under the alternative credit regime, the credit rate is reduced and the taxpayer is assigned a three-tiered fixed-base percentage that is lower than the fixed-base percentage that would otherwise apply. A credit with a separate threshold is provided for a taxpayer's payments to universities for basic research.

Energy

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

9. ***Percentage depletion.***—Independent fuel mineral producers and royalty owners are generally allowed to take percentage depletion deductions rather than cost depletion on limited quantities of output. Under cost depletion, outlays are deducted over the productive life of the property based on the fraction of the resource extracted. Under percentage depletion, taxpayers deduct a percentage of gross income from mineral production at rates of 22 percent for uranium; 15 percent for oil, gas and oil shale; and 10 percent for coal. The deduction is limited to 50 percent of net income from

[8] Section 911 was also the subject of a January 1993 Treasury report to Congress, "Taxation of Americans Working Overseas."

the property, except for oil and gas where the deduction can be 100 percent of net property income. Production from geothermal deposits is eligible for percentage depletion at 65 percent of net income, but with no limit on output and no limitation with respect to qualified producers. Unlike depreciation or cost depletion, percentage depletion deductions can exceed the cost of the investment.

10. ***Alternative fuel production credit.***—A nontaxable credit of $3 per barrel (in 1979 dollars) of oil-equivalent production is provided for several forms of alternative fuels. The credit is generally available if the price of oil stays below $29.50 (in 1979 dollars). The credit generally expires on December 31, 2002.

Treasury reviewed the nonconventional fuel production tax credit as one of its pilot studies of tax expenditures under the Government Performance and Results Act. The provision provides a significant credit—currently about $6 per barrel of oil equivalent or $1 per thousand cubic feet of natural gas, or roughly half of the wellhead price of gas. Coalbed methane (natural gas) and gas from tight formations currently account for most of the credit. While the credit has been effective in stimulating the coalbed methane industry, increased domestic production of natural gas tends to discourage imports from stable suppliers (in particular, Canada), so there is relatively little benefit to U.S. energy security. In addition, there are indications that credit-qualified gas displaced some non-qualified domestic gas.

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

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

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

14. ***Enhanced oil recovery credit.***—A credit is provided equal to 15 percent of the taxpayer's costs for tertiary oil recovery on U.S. projects. Qualifying costs include tertiary injectant expenses, intangible drilling and development costs on a qualified enhanced oil recovery project, and amounts incurred for tangible depreciable property.

15. ***New technology credits.***—A credit of 10 percent is available for investment in solar and geothermal energy facilities. In addition, a credit of 1.5 cents is provided per kilowatt hour of electricity produced from renewable resources such as wind and biomass. The renewable resources credit applies only to electricity produced by a facility placed in service before July 1, 1999.

16. ***Alcohol fuel credits.***—Gasohol, a motor fuel composed of at least 10 percent alcohol, is exempt from 5.4 of the 18.4 cents per gallon Federal excise tax on gasoline. Smaller exemptions are allowed for motor fuel with lower alcohol content. There is a corresponding income tax credit for alcohol used as a fuel in applications where the excise tax is not assessed. This credit, equal to a subsidy of 54 cents per gallon for alcohol used as a motor fuel, is intended to encourage substitution of alcohol for petroleum-based gasoline. In addition, small producers of ethanol are eligible for a 10 cent per gallon credit.

17. ***Credit and deduction for clean-fuel vehicles and property.***—A tax credit of 10 percent (not to exceed $4,000) is provided for purchasers of electric vehicles. Purchasers of other clean-fuel burning vehicles and owners of clean-fuel refueling property may deduct part of their expenditures. The credit and deduction are phased out from 2002 through 2005.

18. ***Exclusion of utility conservation subsidies.***—Subsidies by public utilities for customer expenditures on energy conservation measures are excluded from the gross income of the customer. The exclusion does not apply to subsidies provided to businesses after December 31, 1996.

Natural Resources and Environment

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

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

21. ***Capital gains treatment of iron ore.***—Iron ore sold under a royalty contract can be treated as capital gains rather than ordinary income.

22. ***Mining reclamation reserves.***—Taxpayers are allowed to establish reserves to cover certain costs of mine reclamation and of closing solid waste disposal properties. Net increases in reserves may be taken as a deduction against taxable income.

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

24. ***Capital gains treatment of certain timber.***—Certain timber sold under a royalty contract can be treated as capital gains rather than ordinary income.

25. ***Expensing multiperiod timber growing costs.***—Most of the production costs of growing timber may be expensed rather than capitalized and deducted when the timber is sold. In most other industries, these

costs are capitalized under the uniform capitalization rules.

26. ***Credit and seven-year amortization for reforestation.***—A 10-percent investment tax credit is allowed for up to $10,000 invested annually to clear land and plant trees for the production of timber. Up to $10,000 in forestation investment may also be amortized over a seven-year period rather than capitalized and deducted when the trees are sold or harvested. The amount of forestation investment that is amortizable is not reduced by any of the allowable investment credit.

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

Agriculture

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

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

30. ***Loans forgiven solvent farmers.***—Farmers are forgiven the tax liability on certain forgiven debt. Normally, the debtor must include the amount of loan forgiveness as income or reduce his recoverable basis in the property to which the loan relates. If the debtor elects to reduce basis and the amount of forgiveness exceeds his basis in the property, the excess forgiveness is taxable. For insolvent (bankrupt) debtors, however, the amount of loan forgiveness never results in an income tax liability.[9] Farmers with forgiven debt are considered insolvent for tax purposes, and thus qualify for income tax forgiveness.

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

32. ***Income averaging for farmers.***—The Taxpayer Relief Act of 1997 allows taxpayers to lower their tax liability by averaging, over the prior three-year period, their taxable income from farming. Taxpayers may average their farm income beginning in 1998; the provision generally expires on December 31, 2000.

Commerce and Housing

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

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

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

35. ***Deferral of income on life insurance and annuity contracts.***—Favorable tax treatment is provided for investment income within qualified life insurance and annuity contracts. Investment income earned on qualified life insurance contracts held until death is permanently exempt from income tax. Investment income distributed prior to the death of the insured is tax-deferred, if not tax-exempt. Investment income earned on annuities is treated less favorably than income earned on life insurance contracts, but it benefits from tax deferral without annual contribution or income limits generally applicable to other tax-favored retirement income plans.

36. ***Small property and casualty insurance companies.***— Insurance companies that have annual net premium incomes of less than $350,000 are exempt from tax; those with $350,000 to $2,100,000 of net premium incomes may elect to pay tax only on the income earned by their investment portfolio.

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

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

39. ***Mortgage housing bonds.***—Interest earned on state and local bonds used to finance homes purchased by first-time, low-to-moderate-income buyers is tax-exempt. The amount of state and local tax-exempt bonds that can be issued to finance such private activity is limited. The combined volume cap for mortgage housing bonds, rental housing bonds, student loan bonds, and industrial development bonds is $50 per capita ($150 million minimum) per state. States may issue mortgage credit certificates (MCCs) in lieu of mortgage revenue

[9] The insolvent taxpayer's carryover losses and unused credits are extinguished first, and then his basis in assets reduced to no less than amounts still owed creditors. Finally, the remainder of the forgiven debt is excluded from tax.

bonds. MCCs entitle home buyers to income tax credits for a specified percentage of interest on qualified mortgages. The total amount of MCCs issued by a state cannot exceed 25 percent of its annual ceiling for mortgage-revenue bonds.

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

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

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

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

44. ***Capital gains deferral on home sales.***—Homeowners can defer paying capital gains tax on the sale of a principal residence by buying or constructing a home at least equal in value to that of the sold home (net of sales and qualified fix-up costs) within two years. This deferral applies to homes sold before May 7, 1997. For homes sold between May 7, 1997 and July 28, 1997, taxpayers may defer paying the capital gains tax if they elect not to use the $500,000 ($250,000 for singles) exclusion on the sale of a principal residence. The $500,000 exclusion was created by the Taxpayer Relief Act of 1997. For homes sold after July 28, 1997, no capital gains deferral is allowed.

45. ***Capital gains on sales by owners aged 55 or older.***—A taxpayer who is 55 years of age or older may elect to exclude from gross income up to $125,000 of the capital gain from the sale of a principal residence. The exclusion is a once-in-a-lifetime election. This exclusion applies to homes sold before May 7, 1997. For homes sold between May 7, 1997 and July 28, 1997, taxpayers may exclude the $125,000 from gross income if they elect not to use the $500,000 ($250,000 for singles) exclusion on the sale of a principal residence. The $500,000 exclusion was created by the Taxpayer Relief Act of 1997. For homes sold after July 28, 1997, the $125,000 exclusion is not allowed.

46. ***Capital gains exclusion on home sales.***—A homeowner can exclude from tax up to $500,000 ($250,000 for singles) of the capital gains from the sale of a principal residence. The exclusion was created by the Taxpayer Relief Act of 1997 and applies only to homes sold after May 6, 1997. The exclusion may not be used more than once every two years.

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

48. ***Low-income housing credit.***—Taxpayers who invest in certain low-income housing are eligible for a tax credit. The credit rate is set so that the present value of the credit is equal to 70 percent for new construction and 30 percent for (1) housing receiving other Federal benefits (such as tax-exempt bond financing), or (2) substantially rehabilitated existing housing. The credit is allowed in equal amounts over 10 years. States agencies determine who receives the credit; states are limited in the amount of credit they may authorize annually to $1.25 per resident.

49. ***Accelerated depreciation of rental property.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not cause tax expenditures under the reference method. Under the normal tax method, however, a 40-year tax life for depreciable real property is the norm. Thus, statutory depreciation period for rental property of 27.5 years is a tax expenditure. In addition, tax expenditures arise from pre-1987 tax allowances for rental property.

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

51. ***Imputed interest rules.***—Holders (issuers) of debt instruments are generally required to report interest earned (paid) in the period it accrues, not when paid. In addition, the amount of interest accrued is determined by the actual price paid, not by the stated

principal and interest stipulated in the instrument.[10] In general, any debt associated with the sale of property worth less than $250,000 is excepted from the general interest accounting rules. This general $250,000 exception is not a tax expenditure under reference law but is under normal law. Exceptions above $250,000 are a tax expenditure under reference law; these exceptions include the following: (1) sales of personal residences worth more than $250,000, and (2) sales of farms and small businesses worth between $250,000 and $1 million.

52. ***Capital gains (other than agriculture, timber, iron ore, and coal).***—Capital gains on assets held for more than 1 year are taxed at a lower rate than ordinary income. The lower rate on capital gains is considered a tax expenditure under the normal tax method but not under the reference law method.

For assets held for more than 1 year and sold before May 7, 1997, the top tax rate is 28 percent. For assets held for more than 1 year and sold between May 7, 1997 and July 28, 1997, the top rate is 20 percent (10 percent for taxpayers who would otherwise pay capital gains tax at the 15-percent rate). For assets held for more than 1.5 years and sold after July 28, 1997, the top rate is 20 percent (10 percent for taxpayers who would otherwise pay capital gains tax at the 15-percent rate). For assets held for more than 1 year but not more than 1.5 years and sold after July 28, 1997, the top rate is 28 percent.

In addition, for assets acquired after December 31, 2000, the maximum capital gains tax rates for assets held more than 5 years are 8 percent and 18 percent (rather than 10 percent and 20 percent). On January 1, 2001, taxpayers may mark-to-market existing assets to start the 5-year holding period.

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

54. ***Step-up in basis of capital gains at death.***—Capital gains on assets held at the owner's death are not subject to capital gains taxes. The cost basis of the appreciated assets is adjusted upward to the market value at the owner's date of death. The step-up in the heir's cost basis means that, in effect, the tax on the capital gain is forgiven.

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

[10] For example, if a borrower on December 31, 1997 issues a promise to pay $1,000 plus interest at 10 percent on December 30, 1998, for a total repayment of $1,100 and accepts $900 from a lender in exchange for the contract, the rules require that both parties (a) recognize that $900 is the amount lent, so that the effective loan interest rate is not the stated 10 percent but is 22.2 percent, and (b) report $200 as interest paid or received in 1998.

56. ***Ordinary income treatment of losses from sale of small business corporate stock shares.***—Up to $100,000 in losses from the sale of small business corporate stock (capitalization less than $1 million) may be treated as ordinary losses. Such losses would, thus, not be subject to the $3,000 annual capital loss write-off limit.

57. ***Accelerated depreciation of non-rental-housing buildings.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not cause tax expenditures under reference law. Under normal law, however, a 40-year life for non-rental-housing buildings is the norm. Thus, the 39-year depreciation period for property placed in service after February 25, 1993, the 31.5-year depreciation period for property placed in service from 1987 to February 25, 1993, and the pre-1987 depreciation periods create a tax expenditure.

58. ***Accelerated depreciation of machinery and equipment.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not cause tax expenditures under reference law. Statutory depreciation of machinery and equipment, however, is accelerated somewhat relative to the normal tax baseline, creating a tax expenditure.

59. ***Expensing of certain small investments.***—In 1997, qualifying investments in tangible property up to $18,000 can be expensed rather than depreciated over time. (The expensing limit increases annually until 2003, when it reaches $25,000). To the extent that qualifying investment during the year exceeds $200,000, the amount eligible for expensing is decreased. In 1997, the amount expensed is completely phased out when qualifying investments exceed $218,000.

60. ***Business start-up costs.***—When taxpayers enter into a new business, certain start-up expenses, such as the cost of legal services, are normally incurred. Taxpayers may elect to amortize these outlays over 60 months even though they are similar to other payments made for nondepreciable intangible assets that are not recoverable until the business is sold. The normal tax method treats this amortization as a tax expenditure; the reference tax method does not.

61. ***Graduated corporation income tax rate schedule.***—The corporate income tax schedule is graduated, with rates of 15 percent on the first $50,000 of taxable income, 25 percent on the next $25,000, and 34 percent on the next $9.925 million. Compared with a flat 34-percent rate, the lower rates provide an $11,750 reduction in tax liability for corporations with taxable income of $10 million. This benefit is recaptured for corporations with taxable incomes exceeding $100,000 by a 5-percent additional tax on corporate incomes in excess of $100,000, but less than $335,000.

The corporate tax rate is 35 percent on income over $10 million. Compared with a flat 35-percent tax rate, the 34-percent rate provides a $100,000 reduction in tax liability for corporations with taxable incomes of $10 million. This benefit is recaptured for corporations

with taxable incomes exceeding $15 million by a 3-percent additional tax on income over $15 million but less than $18.33 million. Because the corporate rate schedule is part of reference tax law, it is not considered a tax expenditure under the reference method. A flat corporation income tax rate is taken as the baseline under the normal tax method; therefore the lower rates is considered a tax expenditure under this concept.

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

Transportation

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

64. ***Exclusion of reimbursed employee parking expenses.***—Parking at or near an employer's business premises that is paid for by the employer is excludable from the income of the employee. In 1997, the maximum amount of the parking exclusion is $170 (indexed) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

65. ***Exclusion of employer-provided transit passes.***—Transit passes, tokens, and fare cards provided by an employer to defray an employee's commuting costs are excludable from the employee's income if the total value of the benefit does not exceed the transit limit. In 1997, the limit is $70 (indexed) per month.

Community and Regional Development

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

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

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

69. ***Empowerment zones and enterprise communities.***—Qualifying businesses in designated economically depressed areas can receive tax benefits such as an employer wage credit, increased expensing of investment in equipment, special tax-exempt financing, and accelerated depreciation. A tax credit for contributions to certain community development corporations can also be available. In addition, certain first-time buyers of a principal residence in the District of Columbia can receive a tax credit, and investors in certain D.C. property can receive a capital gains break.

70. ***Expensing of environmental remediation costs.***—The Taxpayer Relief Act of 1997 allows taxpayers who clean up hazardous substances at a qualified site to expense the clean-up costs, rather than capitalize the costs, even though the expenses will generally increase the value of the property significantly or appreciably prolong the life of the property. The expensing only applies to clean-up costs incurred after August 5, 1997 and before January 1, 2001.

Education, Training, Employment, and Social Services

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

72. ***HOPE tax credit.***—The Taxpayer Relief Act of 1997 created the non-refundable HOPE tax credit, which allows a credit for 100 percent of an eligible student's first $1,000 of tuition and fees and 50 percent of the next $1,000 of tuition and fees. The credit only covers tuition and fees paid during the first two years of a student's post-secondary education. The credit is phased out ratably for taxpayers with modified AGI between $80,000 and $100,000 ($40,000 and $50,000 for singles).

73. ***Lifetime Learning tax credit.***—The Taxpayer Relief Act of 1997 created the non-refundable Lifetime Learning tax credit, which allows a credit for 20 percent of an eligible student's tuition and fees. For tuition and fees paid between July 1, 1998 and December 31, 2002, the maximum credit per return is $1,000. For tuition and fees paid after December 31, 2002, the maximum credit per return is $2,000. The credit is phased

out ratably for taxpayers with modified AGI between $80,000 and $100,000 ($40,000 and $50,000 for singles). The credit applies to both undergraduate and graduate students.

74. ***Education Individual Retirement Accounts.***—The Taxpayer Relief Act of 1997 created education IRAs. Contributions to an education IRA are not tax-deductible. Investment income earned by education IRAs is not taxed when earned, and investment income from an education IRA is tax-exempt when withdrawn to pay for a student's tuition and fees. The maximum contribution to an education IRA is $500 per year per beneficiary. Contributions can be made after December 31, 1997. The maximum contribution is phased down ratably for taxpayers with modified AGI between $150,000 and $160,000 ($95,000 and $110,000 for singles). Contributions may not be made to an education IRA in any year in which a contribution has been made to a state tuition plan for the same beneficiary.

75. ***Student-loan interest.***—Taxpayers may claim an above-the-line deduction of up to $2,500 ($1,000 in 1998, $1,500 in 1999, and $2,000 in 2000) on interest paid on an education loan. Interest may only be deducted for the first five years in which interest payments are required. The maximum deduction is phased down ratably for taxpayers with modified AGI between $60,000 and $75,000 ($40,000 and $55,000 for singles). Only interest paid and due after December 31, 1997 may be deducted.

76. ***State prepaid tuition plans.***—Some states have adopted prepaid tuition plans, which allow persons to pay in advance for college tuition for designated beneficiaries. Taxes on the earnings from these plans are paid by the beneficiaries and are deferred until the tuition is actually paid. The Taxpayer Relief Act of 1997 expanded state prepaid tuition plans to include pre-payment for room and board expenses.

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

78. ***Bonds for private nonprofit educational institutions.***—Interest earned on state and local government bonds issued to finance the construction of facilities used by private nonprofit educational institutions is not taxed. The aggregate volume of all such private activity bonds that each state may issue during any calendar year is limited.

79. ***Credit for holders of zone academy bonds.***—Financial institutions that own zone academy bonds receive a non-refundable tax credit rather than interest. The credit is included in gross income. Proceeds from zone academy bonds may only be use to improve impoverished schools. The total amount of zone academy bonds that may be issued is limited to $800 million; no bonds may be issued before January 1, 1998.

80. ***U.S. savings bonds for education.***—Interest earned on U.S. savings bonds issued after December 31, 1989 is tax-exempt if the bonds are transferred to an educational institution to pay for educational expenses. The tax exemption is phased out for taxpayers with AGI between $76,250 and $106,250 ($50,850 and $65,850 for singles) in 1997.

81. ***Dependent students age 19 or older.***—Taxpayers may claim personal exemptions for dependent children age 19 or over who (1) receive parental support payments of $1,000 or more per year, (2) are full-time students, and (3) do not claim a personal exemption on their own tax returns.

82. ***Child credit.***—The Taxpayer Relief Act of 1997 provides for a $500 child credit for taxpayers with children under age 17, beginning January 1, 1999. (The Act also provides for a $400 credit in 1998.) The credit is phased out for taxpayers at the rate of $50 per $1,000 of modified AGI above $110,000 ($75,000 for singles). The child credit is refundable for taxpayers with three or more children.

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

84. ***Employer-provided educational assistance.***—Employer-provided educational assistance is excluded from an employee's gross income even though the employer's costs for this assistance are a deductible business expense. This exclusion applies only to non-graduate courses beginning before July 1, 2000.

85. ***Work opportunity tax credit.***—Employers can claim a tax credit for qualified wages paid to individuals who begin work after September 30, 1996 and before July 1, 1998 and who are certified as members of various targeted groups. For employees hired before October 1, 1997, the amount of the credit that can be claimed is 35 percent of the first $6,000 paid during the first year of employment. For employees hired after September 30, 1997, the credit is 25 percent for employment of less than 400 hours and 40 percent for employment of 400 hours or more. Employers must reduce their deduction for wages paid by the amount of the credit claimed.

86. ***Welfare-to-work tax credit.***—The Taxpayer Relief Act of 1997 provides for an employer tax credit on the first $20,000 of eligible wages paid to qualified long-term family assistance recipients during the first two years of employment. The credit is 35 percent of the first $10,000 of wages in the first year of employment and 50 percent of the first $10,000 of wages in the second year of employment. The maximum credit is $8,500 per employee. The credit applies to wages paid to employees who are hired after December 31, 1997 and before May 1, 1999.

87. ***Employer-provided child care.***—Employer-provided child care is excluded from an employee's gross

income even though the employer's costs for the child care are a deductible business expense.

88. ***Adoption assistance.***—Beginning January 1, 1997, taxpayers can receive a nonrefundable tax credit for qualified adoption expenses. The maximum credit is $5,000 per child ($6,000 for special needs adoptions, except foreign adoptions). The credit is phased-out ratably for taxpayers with modified AGI between $75,000 and $115,000. Unused credits may be carried forward. In lieu of the tax credit, taxpayers may exclude qualified adoption expenses from income, subject to the same maximum amounts and phase-out as the credit. The non-special needs adoption assistance and foreign special needs assistance expire on December 31, 2001.

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

90. ***Child and dependent care expenses.***—Married couples with child and dependent care expenses may claim a tax credit when one spouse works full time and the other works at least part time or goes to school. The credit may also be claimed by divorced or separated parents who have custody of children, and by single parents. Expenditures up to a maximum $2,400 for one dependent and $4,800 for two or more dependents are eligible for the credit. The credit is equal to 30 percent of qualified expenditures for taxpayers with incomes of $10,000 or less. The credit is reduced to a minimum of 20 percent by one percentage point for each $2,000 of income between $10,000 and $28,000.

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

92. ***Expensing costs of removing architectural barriers.***—Taxpayers can expense (up to $15,000 annually) the cost of removing architectural barriers to the handicapped rather than depreciate the cost over the useful life of the asset.

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

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

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

Health

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

97. ***Medical savings accounts.***—Beginning January 1, 1997, some employees may deduct annual contributions to a medical savings account (MSA); employer contributions to MSAs (except those made through cafeteria plans) for qualified employees are also excluded from income. An employee may contribute to an MSA in a given year only if the employer does not contribute to the MSA in that year. MSAs are only available to self-employed individuals or employees covered under an employer-sponsored high deductible health plan of a small employer. The maximum annual MSA contribution is 75 percent of the deductible under the high deductible plan for family coverage (65 percent for individual coverage). Earnings from MSAs are excluded from taxable income. Distributions from an MSA for medical expenses are not taxable. The number of taxpayers who may benefit annually from MSAs is generally limited to 750,000. No new MSAs may be established after December 31, 2000.

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

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

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

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

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

Income Security

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

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

Treasury reviewed the Federal income tax exemption for workers' compensation wage replacement benefits as one of its pilot analyses of tax expenditures. Workers' compensation programs, with the principal exception of the program covering Federal employees, are State programs that do not have to conform to any national criteria. While the legislative history does not explain the goal of the tax exemption, the exemption has the effect of reducing taxes on families with unexpected losses of earnings from work-related injuries or death. Because the tax exemption may have been considered in setting the levels of benefits mandated by State laws, the net benefit of the tax exemption to recipients is uncertain.

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

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

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

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

109. ***401(k) plans and Individual Retirement Accounts.***—Individual taxpayers can take advantage of several different tax-preferenced retirement plans: deductible IRAs, non-deductible IRAs, Roth IRAs, and 401(k) plans (and 401(k)-type plans like 403(b) plans and the government's Thrift Savings Plan).

In 1997, an employee could exclude up to $9,500 (indexed) of wages from AGI under a qualified arrangement with an employer's 401(k). Employees can annually contribute to a deductible IRA up to $2,000 (or 100 percent of compensation, if less) or $4,000 on a joint return with only one working spouse if: (a) neither the individual nor spouse is an active participant in an employer-provided retirement plan, or (b) their AGI is below $40,000 ($25,000 for singles). The IRA deduction is phased out for AGI between $40,000 and $50,000 ($25,000 and $35,000 for singles). The Taxpayer Relief Act of 1997 raises the phaseout range in 1998 to $50,000 and $60,000 ($30,000 and $40,000 for singles). Taxpayers whose AGI is above the start of the IRA phase-out range or who are active participants in an employer-provided retirement plan can contribute to a non-deductible IRA. The tax on the investment income earned by 401(k) plans, non-deductible IRAs, and deductible IRAs is deferred until the money is withdrawn.

The Taxpayer Relief Act of 1997 created Roth IRAs, effective January 1, 1998. An employed taxpayer can make a non-deductible contribution of up to $2,000 (a non-employed spouse can also contribute up to $2,000 if a joint return is filed) to a Roth IRA. Investment income of a Roth IRA is not taxed when earned. Withdrawals from a Roth IRA are tax free if (1) the Roth IRA was opened at least 5 years before the withdrawal, and (2) the taxpayer either (a) is at least 59-1/2, (b) dies, (c) is disabled, or (d) purchases a first-time house. The maximum contribution to a Roth IRA is phased out for taxpayers with AGI between $150,000 and $160,000 ($95,000 and $110,000 for singles). Total annual contributions to a taxpayer's deductible, non-deductible, and Roth IRAs cannot exceed $2,000 ($4,000 for joints).

110. ***Keogh plans.***—Self-employed individuals can make deductible contributions to their own retirement (Keogh) plans equal to 25 percent of their income, up to a maximum of $30,000 per year. In addition, the tax on the investment income earned by Keogh plans is deferred until the money is withdrawn.

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

112. ***Employer-provided life insurance benefits.***—Employer-provided life insurance benefits are excluded from an employee's gross income even though the employer's costs for the insurance are a deductible business expense.

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

114. ***Employer-provided supplementary unemployment benefits.***—Employer-provided supplementary unemployment benefits are excluded from an employee's gross income even though the employer's costs for the benefits are a deductible business expense.

115. ***Employer Stock Ownership Plan (ESOP) provisions.***—ESOPs are a special type of tax-exempt employee benefit plan. Employer-paid contributions (the value of stock issued to the ESOP) are deductible by the employer as part of employee compensation costs. They are not included in the employees' gross income for tax purposes, however, until they are paid out as benefits. The following special income tax provisions for ESOPs are intended to increase ownership of cor-

porations by their employees: (1) annual employer contributions are subject to less restrictive limitations; (2) ESOPs may borrow to purchase employer stock, guaranteed by their agreement with the employer that the debt will be serviced by his payment (deductible by him) of a portion of wages (excludable by the employees) to service the loan; (3) employees who sell appreciated company stock to the ESOP may defer any taxes due until they withdraw benefits; and (4) dividends paid to ESOP-held stock are deductible by the employer.

116. ***Additional deduction for the blind.***—Taxpayers who are blind may take an additional $1,000 standard deduction if single, or $800 if married.

117. ***Additional deduction for the elderly.***—Taxpayers who are 65 years or older may take an additional $1,000 standard deduction if single, or $800 if married.

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

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

120. ***Earned income tax credit (EITC).***—The EITC may be claimed by low income workers. For a family with one qualifying child, the credit is 34 percent of the first $6,500 of earned income in 1997. The credit is 40 percent of the first $9,140 of income for a family with two or more qualifying children. When the taxpayer's income exceeds $11,930, the credit is phased out at the rate of 15.98 percent (21.06 percent if two or more qualifying children are present). It is completely phased out at $25,760 of modified adjusted gross income ($29,290 if two or more qualifying children are present).

The credit may also be claimed by workers who do not have children living with them. Qualifying workers must be at least age 25 and may not be claimed as a dependent on another taxpayer's return. The credit is not available to workers age 65 or older. In 1997, the credit is 7.65 percent of the first $4,340 of earned income. When the taxpayer's income exceeds $5,430, the credit is phased out at the rate of 7.65 percent. It is completely phased out at $9,770 of modified adjusted gross income.

For workers with or without children, the income level at which the credit's phase-outs begin and the maximum amounts of income on which the credit can be taken are adjusted for inflation. Earned income tax credits in excess of tax liabilities owed through the individual income tax system are refundable to individuals. This portion of the credit is shown as an outlay, while the amount that offsets tax liabilities is shown as a tax expenditure.

Social Security

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

122. ***Social Security benefits for the disabled.***—Benefit payments from the Social Security Trust Fund, for disability and for dependents and survivors, are excluded from the beneficiaries' gross incomes.

123. ***Social Security benefits for dependents and survivors.***—Benefit payments from the Social Security Trust Fund for dependents and survivors are excluded from the beneficiaries' gross income.

Veterans Benefits and Services

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

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

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

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

General Government

128. ***Public purpose State and local bonds.***—Interest earned on State and local government bonds issued to finance public purpose construction (e.g., schools, roads, sewers) is tax-exempt.

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

130. ***Business income earned in U.S. possessions.***—U.S. corporations receiving income from investments or businesses located in a U.S. possession (e.g., Puerto Rico) can claim a credit against U.S. tax, which effectively excludes some of this income from tax. The credit expires December 31, 2005.

Interest

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

TAX EXPENDITURES IN THE UNIFIED TRANSFER TAX

Exceptions to the general terms of the Federal unified transfer tax favor particular transferees or dispositions of transferors, similar to Federal direct expenditure or loan programs. The transfer tax provisions identified as tax expenditures satisfy the reference law criteria for inclusion in the tax expenditure budget that were described above. There is no generally accepted normal tax baseline for transfer taxes.

Unified Transfer Tax Reference Rules

The reference tax rules for the unified transfer tax from which departures represent tax expenditures include:

- Definition of the taxpaying unit. The payment of the tax is the liability of the transferor whether the transfer of cash or property was made by gift or bequest.
- Definition of the tax base. The base for the tax is the transferor's cumulative, taxable lifetime gifts made plus the net estate at death. Gifts in the tax base are all annual transfers in excess of $10,000 to any donee except the donor's spouse. Excluded are, however, payments on behalf of family members' educational and medical expenses, as well as the cost of ceremonial gatherings and celebrations that are not in honor of the donor.
- Property valuation. In general, property is valued at its fair market value at the time it is transferred. This is not necessarily the case in the valuation of property for transfer tax purposes. Executors of estates are provided the option to value assets at the time of the testator's death or up to six months later.
- Tax rate schedule. A single graduated tax rate schedule applies to all taxable transfers. This is reflected in the name of the "unified transfer tax" that has replaced the former separate gift and estate taxes. The tax rates vary from 18 percent on the first $10,000 of aggregate taxable transfers, to 55 percent on amounts exceeding $3 million. A lifetime credit is provided against the tax in determining the final amount of transfer taxes that are due and payable. For decedents dying in 1998, this credit allows each taxpayer to make a $625,000 tax-free transfer of assets that otherwise would be liable to the unified transfer tax. This figure is scheduled to increase in steps to $1 million in 2005.[11]
- Time when tax is due and payable. Donors are required to pay the tax annually as gifts are made. The generation-skipping transfer tax is payable by the donees whenever they accede to the gift. The net estate tax liability is due and payable within nine months after the decedent's death. The Internal Revenue Service may grant an extension of up to 10 years for a reasonable cause. Interest is charged on the unpaid tax liability at a rate equal to the cost of Federal short-term borrowing, plus three percentage points.

Tax Expenditures by Function

The estimates of tax expenditures in the Federal unified transfer tax for fiscal years 1997-2003 are displayed by functional category in table 5–6. Outlay equivalent estimates are similar to revenue loss estimates for transfer tax expenditures and, therefore, are not shown separately. A description of the provisions follows.

Natural Resources and Environment

1. ***Donations of conservation easements.***—Bequests of property and easements (in perpetuity) for conservation purposes can be excluded from taxable estates. Use of the property and easements must be restricted to at least one of the following purposes: outdoor recreation or scenic enjoyment for the general public; protection of the natural habitats of fish, wildlife, plants, etc.; and preservation of historic land areas and structures. Conservation gifts are similarly excluded from the gift tax. The Taxpayer Relief Act of 1997 (TRA97) allows up to 40 percent of the value of land subject to certain conservation easements to be excluded from taxable estates; the maximum amount of the exclusion is $100,000 in 1998 and increases by $100,000 in each year through 2002. The TRA97 exclusion applies to the estates of decedents dying after December 31, 1997.

[11] An additional tax, at a flat rate of 55 percent, is imposed on lifetime, generation-skipping transfers in excess of $1 million. It is considered a generation-skipping transfer whenever the transferee is at least two generations younger than the transferor, as it would be in the case of transfers to grandchildren or great-grandchildren. The liability of this tax is on the recipients of the transfer.

Agriculture

2. ***Special-use valuation of farms.***—Up to $750,000 in farmland owned and operated by a decedent and/or a member of the family may be valued for estate tax purposes on the basis of its "continued use" as farmland if: (1) the value of the farmland is at least 25 percent of the gross estate; (2) the entire value of all farm property is at least 50 percent of the gross estate; and (3) family heirs to the farm agree to continue to operate the property as a farm for at least 10 years. The $750,000 limit is indexed at 1998 levels, beginning in 1999.

3. ***Tax deferral of closely held farms.***—The tax on a decedent's farm can be deferred for up to 14 years if the value of the farm is at least 35 percent of the net estate. For the first 4 years of deferral, no tax need be paid. During the last 10 years of deferral, the tax liability must be paid in equal annual installments. Throughout the 14 year period, interest is charged at a special, favorable rate. The Taxpayer Relief Act of 1997 (TRA97) lowered the applicable interest rates and made the interest non-deductible. The TRA97 provision applies to the estates of decedents dying after December 31, 1997.

Commerce and Housing

4. ***Special-use valuation of closely-held businesses.***—The special-use valuation rule available for family farms is also available for nonfarm family businesses. To be eligible for the special-use valuation, the same three conditions previously described must be met.

5. ***Tax deferral of closely-held businesses.***—The tax-deferral rule available for family farms is also available for nonfarm family businesses. To be eligible for the tax deferral, the value of stock in closely-held corporations must exceed 35 percent of the decedent's gross estate, less debt and funeral expenses.

6. ***Exclusion for family-owned businesses.***—The Taxpayer Relief Act of 1997 added a provision excluding from taxable estates certain family-owned businesses that are bequeathed to qualified heirs. The exclusion cannot exceed $1.3 million less the value of the unified credit. The exclusion is recaptured if certain conditions are not maintained for 10 years. The exclusion applies to the estates of decedents dying after December 31, 1997.

Education, Training, Employment, and Social Services

7. ***Charitable contributions to educational institutions.***—Bequests to educational institutions can be deducted from taxable estates.

8. ***Charitable contributions, other than education and health.***— Bequests to charitable, religious, and certain other nonprofit organizations can be deducted from taxable estates.

Health

9. ***Charitable contributions to health institutions.***—Bequests to health institutions can be deducted from taxable estates.

General Government

10. ***State and local death taxes.***—A credit against the federal estate tax is allowed for State taxes on bequests. The amount of this credit is determined by a rate schedule that reaches a maximum of 16 percent of the taxable estate in excess of $60,000.

Table 5–6. REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE FEDERAL UNIFIED TRANSFER TAX

(In millions of dollars)

	Description	1997	1998	1999	2000	2001	2002	2003	1999–2003
	Natural Resources and Environment:								
1	Donations of conservation easements	0	0	10	25	40	55	75	205
	Agriculture:								
2	Special use valuation of farm real property	80	85	90	95	100	105	110	500
3	Tax deferral of closely held farms	10	10	15	15	15	20	20	85
	Commerce:								
4	Special use valuation of real property used in closely held businesses	20	25	25	25	30	30	35	145
5	Tax deferral of closely held business	65	70	75	80	85	95	105	440
6	Exclusion for family owned businesses	0	0	390	395	400	420	435	2,040
	Education, training, employment, and social services:								
7	Deduction for charitable contributions (education)	835	905	930	975	1,025	1,100	1,160	5,190
8	Deduction for charitable contributions (other than education and health)	2,460	2,670	2,745	2,880	3,035	3,245	3,425	15,330
	Health:								
9	Deduction for charitable contributions (health)	755	820	840	880	930	995	1,050	4,695
	General government:								
10	Credit for State death taxes	3,910	4,120	4,260	4,465	4,685	4,930	5,215	23,555

Note: All estimates have been rounded to the nearest $5 million.