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 2000 are estimated to be $1,883.0 billion, an increase of $76.7 billion or 4.2 percent relative to 1999. 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 3.6 percent between 2000 and 2004, rising to $2,165.5 billion.

As a share of GDP, receipts are projected to decline from 20.6 percent in 1999 to 20.0 percent in 2004.

Table 3–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	1998 actual	Estimate					
		1999	2000	2001	2002	2003	2004
Individual income taxes	828.6	868.9	899.7	912.5	942.8	970.7	1,017.7
Corporation income taxes	188.7	182.2	189.4	196.6	203.4	212.3	221.5
Social insurance and retirement receipts	571.8	608.8	636.5	660.3	686.3	712.0	739.2
(On-budget)	(156.0)	(164.8)	(171.2)	(177.7)	(184.6)	(189.8)	(196.3)
(Off-budget)	(415.8)	(444.0)	(465.3)	(482.6)	(501.8)	(522.2)	(542.9)
Excise taxes	57.7	68.1	69.9	70.8	72.3	73.8	75.4
Estate and gift taxes	24.1	25.9	27.0	28.4	30.5	31.6	33.9
Customs duties	18.3	17.7	18.4	20.0	21.4	23.0	24.9
Miscellaneous receipts	32.7	34.7	42.1	44.9	50.3	51.7	53.0
Total receipts	**1,721.8**	**1,806.3**	**1,883.0**	**1,933.3**	**2,007.1**	**2,075.0**	**2,165.5**
(On-budget)	*(1,306.0)*	*(1,362.3)*	*(1,417.7)*	*(1,450.7)*	*(1,505.3)*	*(1,552.8)*	*(1,622.6)*
(Off-budget)	*(415.8)*	*(444.0)*	*(465.3)*	*(482.6)*	*(501.8)*	*(522.2)*	*(542.9)*

Table 3–2. CHANGES IN RECEIPTS

(In billions of dollars)

	Estimate					
	1999	2000	2001	2002	2003	2004
Receipts under tax rates and structure in effect January 1, 1999 [1]	1,806.6	1,870.1	1,918.8	1,988.3	2,052.8	2,139.5
Social security (OASDI) taxable earnings base increases:.						
$72,600 to $76,200 on Jan. 1, 2000	.....	1.7	4.4	4.8	5.2	5.7
$76,200 to $79,200 on Jan. 1, 2001	.....	.....	1.4	3.6	3.9	4.3
$79,200 to $81,900 on Jan. 1, 2002	.....	.....	.....	1.3	3.2	3.5
$81,900 to $84,600 on Jan. 1, 2003	.....	.....	.....	.....	1.3	3.2
$84,600 to $87,000 on Jan. 1, 2004	.....	.....	.....	.....	.....	1.1
Proposals [2]	–0.3	11.2	8.7	9.1	8.7	8.2
Total, receipts under existing and proposed legislation	1,806.3	1,883.0	1,933.3	2,007.1	2,075.0	2,165.5

[1] These estimates assume a social security taxable earnings base of $72,600 through 2004.
[2] Net of income offsets.

ENACTED LEGISLATION

Several laws were enacted in 1998 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

Transportation Equity Act for the 21st Century.—This Act, which was signed by President Clinton on June 9, 1998, represents a significant achievement in the Administration's efforts to meet our country's transportation needs in the next century. By building on the initiatives established in the Intermodal Surface Transportation Efficiency Act of 1991, this Act combines the continuation and improvement of current programs with new initiatives to meet the challenges of improving safety as traffic continues to increase, protecting and enhancing communities and the natural environment as we provide transportation, and advancing America's economic growth and competitiveness domestically and internationally through efficient and flexible transportation. The major provisions of the Act affecting receipts are described below:

Extend highway-related taxes.—The excise taxes levied on gasoline (other than aviation gasoline), diesel fuel, and special motor fuels, which were scheduled to fall to 4.4 cents per gallon (or comparable rates in the case of special motor fuels) after September 30, 1999, are extended at their prior law rates (with a 0.1-cent-per-gallon reduction, reflecting the expiration of the LUST Trust Fund tax, on April 1, 2005) through September 30, 2005. Highway Trust Fund excise taxes on heavy truck tires and the sale and the use of heavy trucks, which were scheduled to expire on September 30, 1999, are extended at their prior law rates through September 30, 2005.

Extend and modify ethanol tax benefit.—Under prior law, ethanol fuels were eligible for a tax benefit equal to 54 cents per gallon, which could be claimed through reduced excise taxes paid on motor fuels, as well as through income tax credits. The authority to claim the credit against income taxes was scheduled to expire after December 31, 2000 and the authority to claim the benefit through reduced excise taxes was scheduled to expire after September 30, 2000. This Act extends the authority to claim the credit against income taxes through December 31, 2007; the authority to claim the benefit through reduced excise taxes is extended through September 30, 2007. In addition, the tax benefit is reduced to 53 cents per gallon effective January 1, 2001, 52 cents per gallon effective January 1, 2003, and 51 cents per gallon effective January 1, 2005.

Repeal excise tax on railroad diesel fuel.—The 1.25 cents-per-gallon tax on railroad diesel fuel, which was scheduled to expire after September 30, 1999, is repealed effective November 1, 1998.

Extend and increase transfers of motorboat and small engine fuels taxes to the Aquatic Resources Trust Fund.—Under prior law, 11.5 cents per gallon of the 18.4-cents-per-gallon tax on gasoline and special motor fuels used in motorboats and small engines was transferred to the Aquatic Resources Trust Fund. This Act extends the transfer, which was scheduled to expire after September 30, 1998, through September 30, 2005. In addition, the amount transferred is increased to 13.0 cents per gallon effective October 1, 2001 and to 13.5 cents per gallon effective October 1, 2003.

Modify tax treatment of transportation benefits.—Under prior law, up to $175 per month (for 1998) of employer-provided parking benefits were excludable from an employee's gross income, regardless of whether the benefits were offered in addition to, or in lieu of, any compensation otherwise payable to the employee. In contrast, up to $65 per month (for 1998) of employer-provided transit and vanpool benefits were excludable from an employee's gross income, but only if the benefits were provided in addition to, and not in lieu of, any compensation otherwise payable to the employee. The dollar limits for both benefits were indexed annually for inflation. Under this Act, effective for taxable years beginning after December 31, 1997, employers are allowed to offer employees the option of electing cash compensation in lieu of any qualified transportation benefit, or a combination of any of these benefits. In addition, effective for taxable years beginning after December 31, 2001, the exclusion for transit and vanpool benefits is increased to $100 per month, with annual indexing thereafter. The Act also eliminates the 1999 inflation adjustment to the dollar limit on transportation benefits.

Simplify motor fuels tax refund procedures.—Under prior law, gasoline and diesel fuel excise tax refunds were administered separately, subject to separate quarterly minimum filing thresholds. Effective for claims filed after September 30, 1998, refunds of gasoline and diesel fuel excise taxes may be aggregated, and a claim may be filed once a single $750 minimum is reached (determined on a year-to-date basis).

Internal Revenue Service Restructuring and Reform Act of 1998.—This Act, which was signed by President Clinton on July 22, 1998, sets in motion the most comprehensive overhaul of IRS's internal operations in more than four decades, puts new emphasis on electronic filing, and puts in place new rights and protections for taxpayers when dealing with the IRS. The major provisions of the Act are described below.

Reorganization of Structure and Management of the IRS

Reorganize and revise the mission of the IRS.—The IRS Commissioner is required to replace the existing three-tier geographic structure of the IRS (national, regional, district) with organizational units serving particular groups of taxpayers. The IRS is also required to review and restate its mission to place greater emphasis on serving the public and meeting taxpayer's needs. An independent Appeals function must also be established within the IRS.

Establish IRS Oversight Board.—A nine-member IRS Oversight Board is established within the Treasury Department. The responsibilities of the Board include the following: (1) Review and approval of IRS strategic plans. (2) Review operational functions of the IRS. (3) Recommend candidates for IRS Commissioner and review the selection, evaluation, and compensation of senior managers. (4) Review and approve plans for any major future reorganization of the IRS. (5) Review and approve the Commissioner's IRS budget request to be submitted to the Department of the Treasury. This budget request also will be submitted to Congress concurrent with the President's annual budget request for the IRS. (6) Ensure the proper treatment of taxpayers by IRS employees.

Modify appointment and duties of IRS Commissioner.—The IRS Commissioner is nominated by the President and confirmed by the Senate, as under prior law. However, under this Act the Commissioner is appointed to a five-year term and is required to have a demonstrated ability in management.

Rename and expand the authority of the Taxpayer Advocate.—The Taxpayer Advocate position is renamed the National Taxpayer Advocate. The individual appointed to this position cannot have been an officer or employee of the IRS during the two-year period ending with the individual's appointment, and must agree not to accept employment with the IRS (outside of the Taxpayer Advocate organization) during the five-year period beginning with the date the individual ceases to be the National Taxpayer Advocate. The person in this position is responsible for appointing at least one local taxpayer advocate for each State and has expanded authority to issue taxpayer assistance orders (orders that may be issued when a taxpayer is suffering or is about to suffer from a significant hardship as a result of the manner in which the laws are being administered by IRS). In determining whether to issue a taxpayer assistance order, the National Taxpayer Advocate is 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.

Establish position of Treasury Inspector General for Tax Administration.—The Office of the IRS Chief Inspector is to be terminated and the powers of the IRS Chief Inspector are to be transferred to the new position of Treasury Inspector General (IG) for Tax Administration. The new IG for Tax is given all the powers under the Inspector General Act for matters relating to the IRS, may conduct an audit or investigation of the IRS upon the written request of the Commissioner or the Board, and is required to establish a toll-free telephone number for taxpayers to confidentially register complaints of misconduct by IRS employees.

Prohibit Executive Branch influence over taxpayer audits.—The President, Vice President, and most Cabinet officers, other than the Attorney General, are prohibited from requesting, directly or indirectly, an officer or employee of the IRS to either conduct or terminate an audit or investigation of any particular taxpayer with respect to the tax liability of the taxpayer.

Improve personnel flexibilities.—The modification of employee personnel rules applicable to the IRS will help the IRS recruit and retain the private sector expertise it needs to fill critical technical and senior management positions and will provide important tools that will enable the IRS to accomplish its restructuring efforts.

Electronic Filing

The Act states that it is the policy of the Congress to promote paperless filing, with the long-range goal of having at least 80 percent of all tax returns filed electronically by 2007. Toward that end, the IRS is required to develop a strategic plan concerning electronic filing within 180 days after July 22, 1998, to establish an "electronic commerce advisory group," and to report periodically to Congress on progress toward meeting the 80 percent goal. The Act also requires that the IRS develop procedures to: (1) accept digital or other electronic signatures, (2) accept all forms electronically for periods beginning after December 31, 1999, to the extent practicable, (3) acknowledge electronic filing in a manner similar to certified or registered mail, (4) provide forms and other IRS documents on the Internet, (5) electronically authorize disclosure of return information to the return preparer, (6) allow taxpayers on-line access to account information, subject to suitable safeguards, and (7) implement a fully return-free tax system for certain taxpayers for taxable years beginning after 2007. In addition, the deadline for filing information returns with the IRS is extended from February 28 until March 31 of the year following the tax year to which the return relates, for returns filed electronically. The Secretary of the Treasury is required to study and report to Congress by June 30, 1999, the effect of similarly extending the deadline for providing taxpayers with copies of information returns from January 31 to February 15 of the year following the tax year to which the return relates.

Congressional Accountability for the IRS

The Act consolidates Congressional oversight of the IRS by: (1) expanding the duties of the Joint Committee on Taxation (JCT) to include review and approval of all requests for General Accounting Office (GAO) investigations of the IRS (other than those from a committee chairperson or ranking member, those required by law, and those self-initiated by GAO); (2) requiring one annual joint review of the annual filing season and the progress of the IRS in meeting its objectives under the strategic and business plans, in improving taxpayer service and compliance, and on technology modernization; (3) stating that it is the sense of the Congress that IRS should place a high priority on resolving the

century date change; (4) stating that it is the sense of the Congress that the IRS provide the Congress with an independent view of tax administration and that the tax-writing committees should hear from front-line technical experts at the IRS during the legislative process with respect to the administrability of pending amendments to the Internal Revenue Code; and (4) requiring that the IRS report to the House Committee on Ways and Means and the Senate Committee on Finance by March 1 of each year regarding sources of complexity in the administration of the Federal tax laws.

Taxpayer Protection and Rights

Burden of Proof

Shift the burden of proof to the IRS in certain circumstances.—In any court proceeding with respect to a factual issue (applicable to income, estate, gift and generation-skipping transfer taxes), the burden of proof is shifted to the IRS if the taxpayer introduces credible evidence relevant to ascertaining his/her tax liability. The taxpayer has the burden of proving that the following conditions, which are necessary prerequisites to establishing that the burden of proof is on the IRS, have been met: (1) All items at issue must be substantiated by the taxpayer in accordance with the Internal Revenue Code and relevant regulations. (2) All records required by the Internal Revenue Code and regulations must be maintained by the taxpayer. (3) The taxpayer must cooperate with the IRS regarding reasonable requests for witnesses, information, documents, meetings and interviews. (4) Taxpayers other than individuals or estates must meet the net worth limitations (no more than $7 million) that apply to awarding attorney's fees. This provision applies to court proceedings arising in connection with examinations commencing after July 22, 1998, or if there is no examination, to court proceedings arising in connection with taxable periods or events beginning or occurring after July 22, 1998.

Proceedings by Taxpayers

Expand authority to award costs and certain 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 attorney's fees awarded cannot exceed a statutorily limited rate. Under prior law, taxpayers who were represented pro bono, and thus bore no actual attorney's fees and costs, could not recover such amounts. This Act allows the awarding 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 statutorily limited rate is increased from $110 per hour (indexed for inflation) to $125 per hour (indexed for inflation). The Act also clarifies that an award of attorney's fees from the United States is permitted in actions for civil damages for unauthorized inspection or disclosure of taxpayer returns and return information only when the defendant is the United States and the plaintiff is a prevailing party. Other defendants (such as State employees or contractors) may be liable for attorney's fees and costs in cases where the United States is not a party, whenever they are found to have made a wrongful disclosure. Finally, the Act provides that attorney's fees and costs may be recovered if the taxpayer makes a "qualified offer" to the IRS, the IRS rejects the offer, and the ultimate resolution of the case is less favorable to the IRS than the rejected "qualified offer." These provisions are effective for costs incurred and services performed after January 18, 1999.

Expand civil damages for collection actions.—Taxpayers have the 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. Under prior law, actions could only be brought by the injured taxpayer (not by an injured third party) and could not be brought against any officer or employee of the IRS who negligently disregarded any provision of the Internal Revenue Code or any regulation thereunder. In addition, suit could not be brought against any officer or employee of the IRS who willfully violated the automatic stay or discharge provisions of the Bankruptcy Code. Effective for actions occurring after July 22, 1998, this Act expands the ability to sue for civil damages as follows: (1) A taxpayer may sue for up to $100,000 in civil damages caused by an officer or employee of the IRS who negligently disregards provisions of the Internal Revenue Code or any regulation thereunder in connection with the collection of Federal tax from the taxpayer. (2) A taxpayer may sue for up to $1 million in civil damages caused by an officer or employee of the IRS who willfully violates provisions of the Bankruptcy Code relating to automatic stays or discharges. (3) Injured third parties are permitted to sue for civil damages for unauthorized collection actions.

Increase Tax Court's "small case" limit.—Taxpayers may choose to contest many tax disputes in the Tax Court. Under prior law, special "small case procedures" applied to disputes involving $10,000 or less, if the taxpayer chose to utilize these procedures (and the Tax Court concurred). This Act increases the cap for small case treatment in the Tax Court from $10,000 to $50,000, effective for proceedings commencing after July 22, 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. Effective for claims filed after July 22, 1998, this Act grants the courts refund jurisdiction to determine the correct liability of such an estate, so long as the estate has properly elected to pay in installments, all payments are current, the payments due have not been accelerated, there are no suits for declaratory judgment pending, and there are no outstanding deficiency notices against the estate. The Act also includes a number of technical and conforming amendments to implement this change.

Modify appeals process with regard to adverse determinations regarding the tax-exempt status of certain bond issues.—Interest on debt incurred by States or local governments generally is excluded from gross income if the proceeds of the borrowing are used to carry out governmental functions of those entities and the debt is repaid with governmental funds. A jurisdiction that seeks to issue bonds can request a ruling from the IRS regarding the eligibility of such bonds for tax-exemption. The prospective issuer can challenge the IRS's determination (or failure to make a timely determination) in a declaratory judgment proceeding in the Tax Court. Under prior law there was no mechanism that explicitly allowed tax-exempt bond issuers examined by the IRS to appeal adverse examination determinations to the Appeals Division of the IRS as a matter of right. This Act directs the IRS to modify its administrative procedures to allow tax-exempt bond issuers examined by the IRS to appeal adverse examination determinations to the Appeals Division as a matter of right, effective July 22, 1998. These appeals must be heard by senior appeals officers having experience in resolving complex cases.

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. This Act creates administrative and judicial remedies for a third party subject to an erroneous tax lien, effective July 22, 1998. Under this procedure, the owner of property (other than the taxpayer) can obtain a certificate discharging property from the Federal tax lien as a matter of right, provided certain conditions are met. The certificate of discharge enables the property owner to sell the property free and clear of the Federal tax lien in all circumstances. The Act also establishes a judicial cause of action for persons challenging a Federal tax lien.

Relief for Innocent Spouses and Persons with Disabilities

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. Under prior law, relief from liability was available for "innocent spouses" in certain circumstances, but the conditions were frequently hard to meet and the Tax Court did not have jurisdiction to review all denials of innocent spouse relief. This Act generally makes innocent spouse status easier to obtain by eliminating certain applicable dollar thresholds for understatements of tax; requiring that the understatement of tax be attributable to an erroneous item of the other spouse, rather than a grossly erroneous item as required under prior law; giving the IRS the discretion to provide equitable relief; and providing the Tax Court with jurisdiction to review the IRS's denial of innocent spouse relief and to order appropriate relief. The Act also modifies the innocent spouse provision to permit a spouse who is divorced, legally separated, or living apart for 12 months, to elect to limit his/her liability for unpaid taxes on a joint return to his/her separate liability amount. Unless the electing taxpayer had knowledge, when the return was signed, that an item on the return was incorrect, such an electing taxpayer essentially is responsible for any deficiency only to the extent his/her own items contributed to the deficiency. The separate liability election must be made no later than two years after the date on which collection activities have begun with respect to the individual seeking the relief. Except in limited cases, the IRS is not permitted to collect the tax until the Tax Court case is final (although the running of the statute of limitations will be suspended while the Tax Court case is pending). Finally, the Act requires the IRS to develop a separate form with instructions for taxpayers to use in applying for innocent spouse relief by January 18, 1999. These changes apply to liability for tax arising after July 22, 1998, as well as to any liability arising on or before that date that remains unpaid on that date.

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, this Act permits "equitable tolling" of the limitation period on claims for refund for the period of time during which an individual taxpayer is unable to manage his/her financial affairs because of a medically determined physical or mental disability that can be expected to result in death or to last for a continuous period of not less than 12 months. Tolling does 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 provision applies to periods of disability before, on, or after July 22, 1998, but does not apply to any claim for refund or credit that (without regard to the provision) is barred by the

operation of any law, including the statute of limitation, as of July 22, 1998.

Provisions Relating to Interest and Penalties

Allow "global" interest netting of underpayments and overpayments of tax.—The rate of interest charged taxpayers on their tax underpayments differs from the rate paid to taxpayers on overpayments. Under prior law, the IRS ameliorated the effect of this interest rate differential by "netting" offsetting underpayments and overpayments in some situations (that is, applying a net interest rate of zero on equivalent amounts of overpayment and underpayment); however, there was no authority to net when either the overpayment or the underpayment had been satisfied already ("global" netting). This Act permits global interest netting for all taxes (not just income taxes), effective for interest applicable to periods beginning after July 22, 1998. It also applies to interest for periods beginning before that date if: (1) as of July 22, 1998, the statute of limitations has not expired with respect to either the underpayment or overpayment; (2) the taxpayer identifies the periods of underpayment and overpayment for which the zero rate applies; and (3) on or before December 31, 1999, the taxpayer asks the Secretary of the Treasury to apply the zero rate.

Increase interest rate applicable to overpayments of tax by noncorporate taxpayers.—Under prior law, interest on overpayments of tax was payable at a rate equal to the Federal short term interest rate (AFR) plus two percentage points. Effective for interest payable on overpayments by noncorporate taxpayers after December 31, 1998, the rate is increased to the AFR plus three percentage points (the same rate applicable to underpayments of tax). The rate remains at AFR plus two percentage points for corporations.

Mitigate failure to pay penalty during installment agreements.—Taxpayers who fail to pay their taxes are subject to a penalty of 0.5 percent per month on the unpaid amount, up to a maximum of 25 percent. Under prior law, taxpayers who made installment payments pursuant to an agreement with the IRS could also be subject to the penalty. Effective for installment agreement payments made after December 31, 1999, the penalty for failure to pay taxes applicable to the unpaid amount is reduced to 0.25 percent per month.

Mitigate failure to deposit penalty.—Under prior law, deposits of payroll taxes were allocated to the earliest period for which such deposit was due. If a taxpayer missed or made an insufficient deposit for a given period, later deposits were first applied to satisfy the shortfall for the earlier period. Cascading penalties often resulted, as payments that would otherwise be sufficient to satisfy current liabilities were applied to satisfy earlier shortfalls. For deposits required to be made after January 18, 1999, this Act allows the taxpayer to designate the period to which each deposit is to be applied. The designation must be made no later than 90 days after the related IRS penalty notice is sent. For deposits required to be made after December 31, 2001, any deposit is to be applied to the most recent period to which the deposit relates, unless the taxpayer explicitly designates otherwise.

Suspend interest and certain penalties if the IRS fails to contact the taxpayer.—In general, interest and penalties accrue during the period for which taxes are unpaid, without regard to whether the taxpayer is aware that tax is due. Effective for taxable years ending after July 22, 1998 and beginning before January 1, 2004, for taxpayers who file a timely return, the accrual of penalties and interest are suspended if the IRS has not sent the taxpayer a notice of deficiency within 18 months following the date which is the later of: (1) the due date of the return (without regard to extensions) or (2) the date on which the individual taxpayer timely filed the return. The provision applies only to individuals and does not apply to the failure to pay penalty, in the case of fraud, or with respect to criminal penalties. The suspension of interest and penalties continues until 21 days after the IRS sends a notice to the taxpayer specifically stating the taxpayer's liability and the basis for the liability. Effective for taxable years beginning after December 31, 2003, the 18-month period is reduced to one year.

Modify procedural requirements for imposition of penalties.—Under prior law the IRS was not required to show how penalties were computed on the notice of penalty and in some cases, penalties could be imposed without supervisory approval. Effective for notices issued and penalties assessed after December 31, 2000, this Act requires that each notice imposing a penalty include the name of the penalty, the code section imposing the penalty, and a computation of the penalty. In addition, unless excepted, all non-computer-generated penalties require the specific approval of IRS management. The provision does not apply to failure-to-file penalties, failure-to-pay penalties, or to penalties for failure to pay estimated tax.

Permit personal delivery of 100-percent penalty notices.—Any person who willfully fails to collect, truthfully account for, and pay over any tax imposed by the Internal Revenue Code is liable for a penalty equal to the amount of the tax. Before the IRS may assess any such "100-percent penalty" it must mail a written preliminary notice informing the person of the proposed penalty. The mailing of such notice must precede any notice and demand for payment of the penalty by at least 60 days. Effective July 22, 1998, this Act permits personal delivery of such preliminary notices, as an alternative to delivery by mail.

Modify procedural requirements for interest charges.—Effective for all notices issued by the IRS after December 31, 2000 that include an amount of interest required to be paid by the taxpayer, a detailed computation of the interest charges and a citation of the Code section under which such interest is imposed are required.

Abate interest on underpayments of tax by taxpayers in Presidentially declared disaster areas.—Effective for disasters declared after December 31, 1997, with re-

spect to taxable years beginning after December 31, 1997 (a provision of the Taxpayer Relief Act of 1997 had provided the same benefit to disasters declared during 1997), taxpayers located in a Presidentially declared disaster area do not have to pay interest on taxes due for the length of any extension for filing their tax returns granted by the Secretary of the Treasury.

Protections for Taxpayers Subject to Audit or Collection Activities

Establish formal procedures to insure due process in IRS collection actions.—The IRS is entitled to seize a taxpayer's property by levy to pay the taxpayer's tax liability. Effective for collections initiated after January 18, 1999, this Act establishes formal procedures designed to insure due process where the IRS seeks to collect taxes by levy. Under these procedures, the IRS is required to provide the taxpayer with a "Notice of intent to Levy" by personal delivery, by leaving it at the taxpayer's dwelling or usual place of business, or by registered or certified mail, return receipt requested, at least 30 days before the taxpayer's property is seized. During the 30-day period following issuance of the intent to levy, the taxpayer may demand a hearing before an appeals officer who has had no prior involvement with the taxpayer's case. If such a hearing is requested, no levy may occur until a determination by the appeals officer is rendered. The determination of the appeals officer may be appealed to the Tax Court or, where appropriate, the Federal district court. No seizure of a dwelling that is the principal residence of the taxpayer, the taxpayer's spouse, the taxpayer's former spouse, or minor child is allowed without prior judicial approval.

Extend confidentiality privilege to taxpayer communications with federally authorized practitioners.—The attorney-client privilege of confidentiality is extended to communications between taxpayers and individuals (in noncriminal proceedings) who are authorized under Federal law to practice before the IRS. The provision, which is effective with regard to communications made on or after July 22, 1998, does not apply to a written communication between federally authorized tax practitioners and any director, shareholder, officer, employee, agent, or representative of a corporation in connection with the promotion of any tax shelter.

Limit financial status audit techniques.—Effective July 22, 1998, the IRS is prohibited from using financial status or economic reality examination techniques to determine the existence of unreported income of any taxpayer unless the IRS has a reasonable indication that there is a likelihood of unreported income.

Establish protections against the disclosure and improper use of computer software and source codes.—In a civil action, the IRS is prohibited from issuing a summons for any portion of any third-party tax-related computer source code unless certain requirements are satisfied. The Act also establishes a number of protections against the disclosure and improper use of trade secrets and computer software and source code that come into possession of the IRS in the course of the examination of a taxpayer's return. These protections generally are effective for summonses issued and computer software and source code acquired after July 22, 1998.

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. Effective July 22, 1998, the IRS is required 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.

Allow taxpayers to quash all third-party summonses.—Under prior law, summonses issued to "third-party recordkeepers" were subject to different procedures than other summonses: notice of the summons was required to be given to the taxpayer, and the taxpayer had an opportunity to bring a court proceeding to quash the summons, during which time the third-party recordkeeper was prohibited from complying with the summons. This Act expands the "third-party recordkeeper" procedures to apply to all summonses issued to persons other than the taxpayer. The provision is effective for summonses served after July 22, 1998.

Permit service of summonses by mail.—This Act permits the IRS to serve summonses by certified or registered mail, as an alternative to the prior law requirement that all summonses be personally served. The provision is effective for summonses served after July 22, 1998.

Provide notice of IRS contact with third party.—Third parties may be contacted by the IRS in connection with the examination of a taxpayer or the collection of the tax liability of the taxpayer. In general, under prior law, the IRS was required to notify the taxpayer of the service of summons on a third party within three days of the date of service. This Act provides that the IRS may not contact any person other than the taxpayer with respect to the determination or collection of the tax liability of the taxpayer without providing reasonable notice in advance to the taxpayer that the IRS may contact persons other than the taxpayer. This provision, which is effective with respect to contacts made after January 18, 1999, does not apply to criminal tax matters, if the collection of the tax liability is in jeopardy, if the Secretary determines that disclosure may involve reprisal against any person, or if the taxpayer authorized the contact.

Require supervisory approval for certain liens, levies, and seizures.—Under prior law, supervisory approval of liens, levies or seizures was only required under cer-

tain circumstances. This Act requires the IRS to implement an approval process under which any lien, levy or seizure would, when appropriate, be approved by a supervisor, who would review the taxpayer's information, verify that a balance is due, and affirm that a lien, levy or seizure is appropriate under the circumstances. Circumstances to be taken into account include the amount due and the value of the asset. The provision applies to automated collection system actions initiated after December 31, 2000 and to all other collections actions initiated after July 22, 1998.

Modify levy exemption amounts.—IRS may levy on all non-exempt property of the taxpayer. Under prior law, property exempt from levy included up to $2,500 in value of fuel, provisions, furniture, and personal effects in the taxpayer's household and up to $1,250 in value of books and tools necessary for the trade, business or profession of the taxpayer. This Act increases the value of personal effects exempt from levy to $6,250 and the value of books and tools exempt from levy to $3,125. These amounts are indexed annually for inflation and apply to levys issued after July 22, 1998.

Require release of levy upon agreement that amount is uncollectible.—Effective for levys imposed after December 31, 1999, the IRS is required to release a wage levy as soon as practicable upon agreement with the taxpayer that the tax is not collectible.

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). Effective for refund suits brought with respect to taxable years beginning after December 31, 1998, this Act requires the IRS to suspend collection by levy of liabilities that are the subject of a refund suit during the pendency of the litigation. This only applies where refund suits can be brought without the full payment of the tax, i.e., divisible taxes. Collection by levy is suspended unless jeopardy exists or the taxpayer waives the suspension of collection in writing. The statute of limitations on collection is stayed for the period during which collection by levy is prohibited.

Require review of jeopardy and termination assessments and jeopardy levies.—Special procedures allow 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 or termination 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. This Act requires IRS Counsel review and approval before the IRS can make a jeopardy assessment, a termination assessment, or a jeopardy levy. If the Counsel's approval is not obtained, the taxpayer is entitled to obtain abatement of the assessment or release of the levy, and, if the IRS fails to offer such relief, to appeal first to the collections appeals process and then to the U.S. District Court. This provision is effective with respect to taxes assessed and levies made after July 22, 1998.

Increase "superpriority" dollar limits.—A Federal tax lien attaches to all property and rights in property of the taxpayer, if the taxpayer fails to pay the assessed tax liability after notice and demand. However, the Federal tax lien is not valid as to certain "superpriority" interests. Two of these "superpriorities" are subject to dollar limitations. For example, under prior law, purchasers of personal property at a casual sale were protected against a Federal tax lien attached to such property to the extent the sale was for less than $250; protection for mechanics lienors who provide home improvement work for residential real property was $1,000. Effective July 22, 1998, this Act increases these dollar limits, which are indexed for inflation, to $1,000 and $5,000, respectively. Under prior law, superpriorities were granted to banks and building and loan associations that made passbook loans to their customers, provided that those institutions retained the passbooks in their possession until the loan was completely paid off. This Act clarifies the superpriorities law to reflect current banking practices, where a passbook-type loan may be made even though an actual passbook is not used.

Waive early withdrawal penalty for IRS levies on retirement plans.—Early withdrawals from qualified retirement plans and Individual Retirement Accounts (IRAs) that are includible in the gross income of the taxpayer generally are subject to a 10-percent early withdrawal tax, unless an exception to the tax applies. Effective for distributions after December 31, 1999, this Act provides an exception from the 10-percent early withdrawal tax for amounts withdrawn from an employer-sponsored retirement plan or an IRA that are subject to a levy by the IRS. The exception applies only if the plan or IRA is levied; it does not apply if the taxpayer withdraws funds to pay taxes in the absence of a levy, or if the taxpayer withdraws funds in order to release a levy on other interests.

Prohibit sales of seized property at less than minimum bid.—A minimum bid price must be established for seized property offered for sale. Effective for sales after July 22, 1998, the IRS is prohibited from selling seized property for less than the minimum bid price.

Require a written accounting of all sales of seized property.—The IRS is required to provide a written accounting of all sales of seized property to the taxpayer, effective for seizures occurring after July 22, 1998. The accounting must include a receipt for the amount credited to the taxpayer's account.

Implement a uniform asset disposal mechanism.—The IRS must sell property seized by levy either by public auction or by public sale under sealed bids. These sales are often conducted by the revenue officer charged with collecting the tax liability. By July 22, 2000, this Act requires the IRS to implement a uniform asset disposal mechanism for sales of seized property. The disposal mechanism should be designed to remove any participa-

tion in the sale by revenue officers and outsourcing of the disposal mechanism may be considered.

Codify administrative procedures for seizures.—The IRS Manual provides general guidelines for seizure actions, requiring that if it is determined that the taxpayer's equity in the seized property is insufficient to yield net proceeds from sale to apply to the unpaid tax, the revenue officer must immediately release the seized property. This Act codifies these administrative procedures effective July 22, 1998.

Establish procedures for seizure of residences and businesses.—Effective July 22, 1998, the following procedures apply with respect to the seizure of residences and businesses: (1) Seizure of any nonrental residential real property to satisfy an unpaid liability of $5,000 or less (including interest and penalties) generally is prohibited. (2) All other payment options must be exhausted before the taxpayer's business assets or principal residence may be seized. (3) Seizure of a principal residence is permitted only if approved in writing by a U.S. District Court. (4) Future income derived from the sale of fish or wildlife under specified State permits or licenses must be taken into account in evaluating other payment options before seizing the taxpayer's business assets.

Require disclosures relating to extension of statute of limitations by agreement.— Under prior law, taxpayers and the IRS could agree in writing to extend statute of limitations on assessment or collection, either for a specified period or for an indefinite period. Under this Act, the statute of limitations on collections may no longer be extended by agreement between the taxpayer and the IRS, except in connection with an installment agreement, but the extension is only for the period for which the installment agreement by its terms extends beyond the end of the otherwise applicable 10-year period plus 90 days. The Act also requires that on each occasion that the taxpayer is requested by the IRS to extend the statue of limitations on assessment, 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 or to a particular time period. These requirements generally apply to requests to extend the statute of limitations made after December 31, 1999.

Expand authority of the IRS to accept 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 owed, or doubt as to the taxpayer's ability to pay the full amount owed. This Act requires 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. This information is to be used to ensure that taxpayers entering into an offer-in-compromise will have adequate means to provide for basic living expenses. The IRS is prohibited from rejecting an offer-in-compromise from a low-income taxpayer solely on the basis of the amount of the offer. The Act also prohibits the IRS from collecting a tax liability by levy during any period that a taxpayer's offer-in-compromise for that liability is being processed, during the 30 days following rejection of an offer, during any period in which an appeal of the rejection of an offer is being considered, and while an installment agreement is pending. The Act also provides that the IRS must implement procedures to review all proposed rejections of taxpayer offers-in-compromise and requests for installment agreements prior to the rejection being communicated to the taxpayer. These changes generally are effective for offers-in-compromise and installment agreements submitted after July 22, 1998. The provision suspending levy is effective with respect to offers-in-compromise pending on or made after December 31, 1999.

Require notice of deficiency to specify Tax Court filing deadlines.—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. This Act requires 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 is treated as timely filed. The provision applies to notices mailed after December 31, 1998.

Refund or credit of overpayments before final determination.—The IRS may not take action to collect a deficiency during the period a taxpayer may petition the Tax Court, or, if the taxpayer petitions the Tax court, until the decision of the Tax Court becomes final. Actions to collect a deficiency attempted during this period may be enjoined, but under prior law, there was no authority for ordering the refund of any amount collected by the IRS during the prohibited period. If a taxpayer contested a deficiency in the Tax Court, no credit or refund of income tax for the contested taxable year generally could be made, except in accordance with a final decision of the Tax Court. Where the Tax Court determined that an overpayment had been made and a refund was due, and a portion of the decision was appealed, there was no provision for the refund of any portion of any overpayment that was not contested in the appeal. Effective July 22, 1998, this Act provides that a proper court may order a refund of any amount that was collected within the period during which collection of the deficiency by levy or other proceeding is prohibited. This Act also allows the refund of any overpayment determined by the Tax Court, to the extent the overpayment is not contested on appeal.

Modify IRS procedures related to appeal of examinations and collections.—Effective July 22, 1998, this Act

codifies existing IRS procedures with respect to early referrals to Appeals and the Collections Appeals Process. This Act also codifies the existing Alternative Dispute Resolution procedures, as modified by eliminating the prior law dollar threshold of more than $10 million in dispute.

Codify certain Fair Debt Collection procedures.—Government agencies, including the IRS, are generally exempt from the Fair Debt Collection Practices Act (FDCPA). Effective July 22, 1998, this Act applies to the IRS the FDCPA restrictions relating to communication with the taxpayer/debtor (prohibition on telephone calls outside the hours of 8:00 a.m. to 9:00 p.m. local time) and prohibitions on harassing or abusing a debtor.

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. This Act requires the IRS to enter into an installment agreement (at the taxpayer's option) for liabilities of $10,000 or less, provided certain conditions are met. The provision is effective July 22, 1998.

Prohibit requests to waive rights to bring actions.—Effective July 22, 1998, the government cannot ask a taxpayer to waive the right to sue the United States or one of its employees for actions taken concerning a tax matter, in order to settle another tax matter unless the taxpayer knowingly and voluntarily waives the right or the request is made to an authorized taxpayer representative (such as an attorney).

Disclosures to Taxpayers

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. This Act requires the IRS to establish procedures no later than January 18, 1999, to alert married taxpayers clearly of their joint and several liability on all appropriate publications and instructions.

Provide explanation of taxpayer rights in interviews with the IRS.—The IRS is required to rewrite Publication 1 (*Your Rights as a Taxpayer*) no later than January 18, 1999. The revision must inform taxpayers more clearly of their rights to be represented by a representative, and, if the taxpayer is so represented, that interviews with the IRS may not proceed without the presence of the representative unless the taxpayer consents.

Require disclosure of criteria for examination selection.—This Act requires that the IRS add to Publication 1 (*Your Rights as a Taxpayer*) a statement setting forth, in simple and nontechnical terms, the criteria and procedures for selecting taxpayers for examination. The statement must not include any information that would be detrimental to law enforcement, and must specify the general procedures used by the IRS, including whether taxpayers are selected for examination on the basis of information in the media or from informants. These additions to Publication 1 must be made no later than January 18, 1999.

Provide explanation of appeals and collection process.—The IRS is required to provide to taxpayers a description of the entire appeals and collection process, from examination through collection, including the assistance available to taxpayers from the Taxpayer Advocate at various points in the process. This information must be provided with the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the IRS Office of Appeals, beginnng no later than January 18, 1999.

Provide explanation of reason for refund disallowance.—Effective January 18, 1999, the IRS is required to notify the taxpayer of the specific reasons for the disallowance (or partial disallowance) of a refund claim.

Provide statements regarding installment agreements.—Effective July 1, 2000, the IRS is required to send every taxpayer in an installment agreement an annual statement of the initial balance owed, the payments made during the year, and the remaining balance.

Provide notification of change in tax matters partner.—In general, the tax treatment of items of partnership income, loss, deductions and credits are determined at the partnership level in a unified partnership proceeding rather than in separate proceedings with each partner. In providing notice to taxpayers with respect to partnership proceedings, the IRS relies on information furnished by a party designated as the tax matters partner (TMP) of the partnership. The TMP is required to keep each partner informed of all administrative and judicial proceedings with respect to the partnership. Under certain circumstances, the IRS may require the resignation of the incumbent TMP and designate another partner as the TMP of the partnership. Effective for selections of TMPs made by the IRS after July 22, 1998, this Act requires the IRS to notify all partners of any resignation of the TMP that is required by the IRS, and to notify the partners of any successor TMP.

Provide description of conditions under which taxpayer returns may be disclosed.—Effective July 22, 1998, this Act requires that instruction booklets for general tax forms include a description of conditions under which tax return information may be disclosed outside the IRS (including to States).

Provide procedure for disclosure of Chief Counsel advice.—This Act establishes a structured process by which the IRS will make certain work products, designated as "Chief Counsel Advice," open to public inspection on an ongoing basis. The provision, which applies to Chief Counsel Advice issued after October 20, 1998, is designed to protect taxpayer privacy while allowing the public inspection of public documents in a manner generally consistent with the mechanism for the public inspection of written determinations.

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 Secretary of the Treasury is authorized to provide up to $6 million per year in matching grants (no more than $100,000 per year per eligible clinic) to certain low-income taxpayer clinics, effective July 22, 1998. To be eligible, a clinic may charge no more than a nominal fee to either represent low-income taxpayers in controversies with the IRS or to provide tax information to individuals for whom English is a second language.

Require cataloging of complaints.—Beginning in 1997, the IRS is required to make an annual report to Congress regarding allegations of misconduct by IRS employees. Effective January 1, 2000, the IRS is required to maintain records of taxpayer complaints of misconduct by IRS employees, on an individual employee basis, although individual records are not to be listed in the report to Congress.

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. Under prior law, there was no exception authorizing the disclosure of return information to NARA. This Act provides 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 U.S. 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 apply to NARA. The provision is effective for requests made by the Archivist after July 22, 1998.

Modify payment of taxes.—The Secretary of the Treasury is authorized to accept payments by checks or money orders, as provided in regulations. Under prior law, checks or money orders were made payable to the "Internal Revenue Service." Under this Act the Secretary of the Treasury or his delegate is required to amend the rules, regulations, and procedures to allow payment of taxes by check or money order to be made payable to the "United States Treasury," effective July 22, 1998.

Clarify authority to prescribe manner of making elections.—Except as otherwise provided by statute, prior law provided that elections under the Internal Revenue Code must be made in such manner as the Secretary of the Treasury "shall by regulations or forms prescribe." This Act clarifies that, except as otherwise provided, the Secretary may prescribe the manner of making any election by any reasonable means. This change is effective July 22, 1998.

Additional Provisions

Eliminate 18-month holding period for capital gains.—Under the Taxpayer Relief Act of 1997 (TRA97), the maximum capital gains tax rate for individuals generally was 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 was retained for collectibles and, effective July 29, 1997, for assets held between 1 year and 18 months. In addition, TRA97 provided a maximum rate of 25 percent for the long-term capital gain attributable to depreciation from real estate held more than 18 months. Under this Act, effective January 1, 1998, property held by an individual for more than one year (rather than 18 months) is eligible for the lower maximum capital gains tax rates (10, 20, and 25 percent) provided in TRA97.

Modify tax treatment of meals provided for the convenience of the employer.—Under prior law, meals provided on the business premises to employees were excluded from the employees' income and fully deductible to the employer if substantially all of the employees (interpreted to be approximately 90 percent) were provided such meals for the convenience of the employer. Effective for taxable years beginning before, on, or after July 22, 1998, all meals furnished to employees at a place of business are excluded from the employees' income and fully deductible to the employer if more than one-half of the employees are provided such meals for the convenience of the employer.

Revenue Offsets

Overrule Schmidt Baking with respect to vacation and severance pay.—Any method or arrangement that has the effect of deferring the receipt of compensation or other benefits for employees is treated as a deferred compensation plan. In general, contributions under a deferred compensation plan (other than certain pension, profit-sharing and similar plans) are deductible to the employer in the taxable year in which an amount attributable to the contribution is includible in the income of the employee. Temporary Treasury regulations provide that a plan, method, or arrangement that defers the receipt of compensation or benefits by the employee more than 2½ months after the end of the employer's taxable year in which the services creating the right to such compensation or benefits are performed, is to be treated as a deferred compensation plan. The Tax Court recently addressed the issue of when vacation pay and severance pay are considered deferred compensation in *Schmidt Baking Co., Inc.,*. In that case the taxpayer, who was an accrual basis taxpayer with a fiscal year that ended December 28, 1991, funded its accrued vacation and severance pay liabilities for 1991 by purchasing an irrevocable letter of credit on March 13, 1992. The parties stipulated that the letter of credit represented a transfer of substantially vested interest in property to employees and that the fair market value of such interest was includible in the employees' gross incomes for 1992 as a result of the transfer.

The Tax Court held that the purchase of the letter of credit, and the resulting income inclusion, constituted payment of the vacation and severance pay within the 2½ month period, thus the vacation and severance pay were not treated as deferred compensation. This ruling allowed the employer to deduct the cost in 1991, and the employees to pay the taxes on the benefits in 1992. This Act overrules *Schmidt Baking Co., Inc.*, by providing that for purposes of determining whether an item of compensation (including vacation pay and severance pay), is deferred compensation, the compensation is not considered to be paid or received until actually received by the employee. Actual receipt does not include an amount transferred as a loan, refundable deposit, or contingent payment. Also, amounts set aside in a trust for employees are not considered to be actually received by the employee. This change is effective for taxable years ending after July 22, 1998.

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. This Act limits the ability of grandfathered stapled REITs to grow and actively manage certain types of properties within the stapled structure. Specifically, for purposes of determining whether any grandfathered entity is a REIT, the stapled entities (and certain subsidiary entities) are treated as one entity with respect to properties acquired on or after March 26, 1998 and with respect to activities or services relating to such properties that are undertaken or performed by one of the entities on or after such date.

Preclude certain taxpayers from prematurely claiming losses from receivables.—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"). Under prior law, significant numbers of taxpayers whose principal activities are selling nonfinancial goods or providing nonfinancial services (such as retailers and utilities) were making the customer paper election as a means of restoring bad debt reserves. The customer paper election was also being used inappropriately to mark-to-market trade receivables that bear little or no interest in order to recognize loss. Under this Act, certain trade receivables are no longer eligible for mark-to-market treatment. Specifically, generally effective for taxable years ending after July 22, 1998, sellers of nonfinancial goods and services may not mark-to-market receivables generated on the sale of goods or services sold on credit when such receivables are retained by the seller or a related person.

Disregard minimum distributions in determining adjusted gross income (AGI) for conversions to a Roth Individual Retirement Account (IRA)—Under current law, uniform minimum distribution rules generally apply to all types of tax-favored retirement vehicles, including qualified retirement plans and annuities, IRAs (other than Roth IRAs), and tax-sheltered annuities. Distributions are required to begin no later than the individual's required beginning date. In the case of an IRA, the required beginning date is April 1 of the calendar year following the calendar year in which the IRA owner attains age 70½. Extensive regulations have been issued for purposes of calculating minimum distributions, which generally are includible in the taxpayer's gross income in the year of distribution. A 50-percent excise tax applies to the extent a minimum distribution is not made. Under current law, taxpayers with AGI of less than $100,000 are eligible to roll over or convert an existing IRA to a Roth IRA. Effective for taxable years beginning after December 31, 2004, minimum required distributions from IRAs will be excluded from the definition of AGI, solely for purposes of determining eligibility to convert from an IRA to a Roth IRA. As under present law, the required minimum distribution will not be eligible for conversion and will be includible in gross income.

The Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999.—This Act, which was signed by President Clinton on October 21, 1998, represents a significant step forward for America, helping to protect the surplus until Social Security is reformed, forging a bipartisan agreement on funding the International Monetary Fund and putting in place critical investments in education and training. This Act also extends several business and trade tax provisions that had expired or were about to expire, provides tax breaks for farmers and ranchers, and includes several other tax changes. The major provisions of the Act affecting receipts are described below.

Emergency Tax Relief for Farmers

Extend permanently income-averaging for farmers.—Under prior law, effective for taxable years beginning after December 31, 1997 and before January 1, 2001, an electing individual taxpayer generally was 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. This Act permanently extends this provision, effec-

tive for taxable years beginning after December 31, 2000.

Modify taxation of farm production flexibility contract payments.—A taxpayer generally is required to include an item in income no later than the time of its actual or constructive receipt, unless such amount properly is accounted for in a different period under the taxpayer's method of accounting. If a taxpayer has an unrestricted right to demand the payment of an amount, the taxpayer is in constructive receipt of that amount whether or not the taxpayer makes the demand and actually receives the payment. Under production flexibility contracts entered into between certain eligible owners and producers and the Secretary of Agriculture (as provided in the Federal Agriculture Improvement and Reform Act of 1996), annual payments are made at specific times during the Federal government's fiscal year. One-half of each annual payment is to be made on either December 15 or January 15 of the fiscal year, at the option of the recipient; the remaining one-half is to be paid no later than September 30 of the fiscal year. The option to receive the payment on December 15 potentially results in the constructive receipt (and thus potential inclusion in income) of one-half of the annual payment at that time, even if the option to receive the amount on January 15 is elected. For fiscal year 1999, as provided under The Emergency Farm Financial Relief Act of 1998, all payments are to be paid at such time or times during the fiscal year as the recipient may specify. This option to receive all of the 1999 payment in calendar year 1998 potentially results in constructive receipt (and thus potential inclusion in income) in that year, whether or not the amounts are actually received. Under this Act, effective for production flexibility contract payments made in taxable years ending after December 31, 1995, the time a production flexibility contract payment is to be included in income is to be determined without regard to the options granted for payment.

Extend the net operating loss carryback period for farmers.—A net operating loss (NOL) is, generally, the amount by which business deductions of a taxpayer exceed business gross income. Generally, an NOL may be carried back two years and carried forward 20 years to offset taxable income in those years. One exception provides that, in the case of an NOL attributable to Presidentially declared disasters for taxpayers engaged in a farming business or a small business, the NOL can be carried back three years, as provided under prior law. Under this provision, a special five-year carryback period is provided for a farming loss, regardless of whether the loss is incurred in a Presidentially declared disaster area; the carryforward period remains at 20 years. The provision is effective for such NOLs arising in taxable years beginning after December 31, 1997.

Extension of Expiring Tax and Trade Provisions

Extend research and experimentation tax credit.—The 20-percent tax credit for certain incremental research and experimentation expenditures is extended to apply to qualifying expenditures paid or incurred during the period July 1, 1998 through June 30, 1999.

Extend the work opportunity tax credit.—The work opportunity tax credit, which provides an incentive for employers to hire individuals from certain targeted groups, is extended to apply to individuals who begin work on or after July 1, 1998 and before July 1, 1999.

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. This credit is extended to apply to individuals who begin work after April 30, 1999 and before July 1, 1999.

Extend permanently the 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 July 1, 1998 to deduct the full fair market value of the stock, rather than the adjusted basis of the contributed stock. This Act permanently extends the rule for private foundations effective for contributions of qualified appreciated stock made on or after July 1, 1998.

Extend and modify exceptions provided under subpart F for certain active financing income.—Under the Subpart F rules, certain U.S. shareholders of a controlled foreign corporation (CFC) are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes "foreign personal holding company income" and insurance income. The U.S. 10-percent shareholders of a CFC also are subject to current inclusion with respect to their shares of the CFC's foreign base company services income (income derived from services performed for a related person outside the country in which the CFC is organized). Under prior law, certain income derived in the active conduct of a banking, financing, insurance, or similar business (only for taxable years beginning in 1998) was excepted from the Subpart F rules regarding the taxation of foreign personal holding company income and foreign base company services income. This Act extends the exception for one year, with modifications, to apply to such income derived in taxable year 1999.

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 June 30, 1998, is temporarily extended through June 30, 1999. Refunds of any duty paid between June 30, 1998 and October 21, 1998 are provided upon request of the importer.

Other Provisions

Allow personal tax credits fully against regular tax liability.—Certain nonrefundable personal tax credits

(dependent care credit, credit for the elderly and disabled, adoption credit, child tax credit, credit for interest on certain home mortgages, HOPE Scholarship and Lifetime Learning credit, and the D.C. homebuyer's credit) are provided under current law. Generally, these credits are allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax. An additional child tax credit is provided under current law to families with three or more qualifying children. This credit, which may be offset against social security payroll tax liability (provided that liability exceeds the amount of the earned income credit), is reduced by the amount of the individual's minimum tax liability (that is, the amount by which the individual's tentative minimum tax exceeds the individual's regular tax liability). For taxable year 1998, this Act allows nonrefundable personal tax credits to offset regular income tax liability in full (as opposed to only the amount by which the regular tax liability exceeds the tentative minimum tax). In addition, for taxable year 1998, the additional child credit provided to families with three or more qualifying children is not reduced by the amount of the individual's minimum tax liability.

Accelerate 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: 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. This Act increases the allowable deduction to 100 percent as follows: 60 percent for 1999 through 2001; 70 percent for 2002; and 100 percent for 2003 and subsequent years.

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. For any individual with an AGI of more than $150,000 as shown on the return for the preceding taxable year, the 100 percent of last year's safe harbor generally is modified to be a 110 percent of last year's liability safe harbor. However, under prior law, the 110 percent of last year's liability safe harbor for individuals with AGI of more than $150,000 was modified for taxable years beginning in 1999 through 2002, as follows: for taxable years beginning in 1999, 2000, and 2001 the safe harbor is 105 percent; and for taxable years beginning in 2002, the safe harbor is 112 percent. Under this Act the estimated tax safe harbor for individuals with AGI of more than $150,000 is modified as follows: for taxable years beginning in 2000 and 2001 the safe harbor is 106 percent.

Increase State volume limits on private activity tax-exempt bonds.—Interest on bonds issued by States and local governments to finance activities carried out and paid for by private persons (private activity bonds) is taxable unless the activities are specified in the Internal Revenue Code. The volume of tax-exempt private activity bonds that State and local governments may issue in each calendar year is limited by State-wide volume limits. Under prior law, the annual volume limit for any State was equal to the greater of $50 per resident of the State or $150 million. Under this Act the annual private activity bond volume limit is increased to the greater of $75 per resident or $225 million for 2007 and subsequent years. The increase is phased-in annually, beginning in 2003, as follows: for 2003, the greater of $55 per resident or $165 million; for 2004, the greater of $60 per resident or $180 million; for 2005, the greater of $65 per resident or $195 million; and for 2006, the greater of $70 per resident or $210 million.

Allow States a limited period of time to exempt student employees from social security.—The Social Security Amendments of 1972 provided an opportunity for States to obtain exemptions from social security coverage for student employees of public schools, colleges, and universities. Three States chose not to seek an exemption from social security coverage for these employees. Under this Act States are allowed a limited window of time (January 1 through March 31, 1999), to modify existing State agreements to exempt such students from social security coverage effective with respect to wages earned after June 30, 2000.

Revenue Offset Provisions

Modify treatment of certain deductible liquidating distributions of real estate investment trusts (REITs) and regulated investment companies (RICs).—REITs and RICs are allowed a deduction for dividends paid to their shareholders. The deduction for dividends paid includes amounts distributed in liquidation that are properly chargeable to earnings and profits. In addition, in the case of a complete liquidation occurring within 24 months after the adoption of a plan of complete liquidation, any distribution made pursuant to such plan is deductible to the extent of earnings and profits. Rules that govern the receipt of dividends from REITs and RICs generally provide for including the amount of the dividend in the income of the shareholder receiving the dividend that was deducted by the REIT or RIC. However, in the case of a liquidating distribution by a REIT or RIC to a corporation owning at least 80 percent of its stock, a separate rule under prior law generally provided that the distribution was tax-free to the parent corporation. As a result, a liquidating REIT or RIC was able to deduct amounts paid to its parent corporation without the parent corporation including corresponding amounts in its income. Effective for distributions on or after May 22, 1998 (regardless of when the plan of liquidation was adopted), any amount that a liquidating REIT or RIC takes as a deduction for

dividends paid with respect to an 80-percent corporate owner is includible in the income of the recipient corporation. As under prior law, the liquidating corporation may designate the amount distributed as a capital gain dividend or, in the case of a RIC, a dividend eligible for the 70-percent dividends-received deduction or an exempt interest dividend.

Expand list of taxable vaccines.—Under prior law an excise tax of $.75 per dose is levied on the following vaccines: diphtheria, pertussis, tetanus, measles, mumps, rubella, polio, HIB (haemophilus influenza type B), hepatitis B, and varicella (chickenpox). This Act adds any vaccine against rotavirus gastroenteritis to the list of taxable vaccines, effective for vaccines sold by a manufacturer or importer after October 21, 1998.

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. This Act provides 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 TIN" used on a tax return is defined as the TIN assigned to such individual by the Social Security Administration (SSA), or in certain limited cases, the IRS. Second, the IRS is 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 include the individual's name, age or date of birth, and Social Security number. Third, the IRS is authorized to use math error procedures to deny eligibility for those tax benefits 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 that the IRS determines, using data from SSA, does not meet the statutory age restrictions. These changes are effective for taxable years ending after October 21, 1998.

Restrict special net operating loss carryback rules for specified liability losses.— 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. This Act modifies the specified liability loss provisions to provide that only a limited class of liabilities qualifies as a specified liability loss. Effective for liability losses arising in taxable years ending after October 21, 1998, specified liability losses 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.

Modify taxation of prizes and awards.—A taxpayer generally is required to include an item in income no later than the time of its actual or constructive receipt, unless the item properly is accounted for in a different period under the taxpayer's method of accounting. If a taxpayer has an unrestricted right to demand the payment of an amount, the taxpayer is in constructive receipt of that amount whether or not the taxpayer makes the demand and actually receives the payment. Under prior law, the winner of a contest who was given the option of receiving either a lump-sum distribution or an annuity was considered to be in constructive receipt of the award on becoming entitled to the award, and was required to include the value of the award in gross income, even if the annuity option was exercised. Under this Act the existence of a "qualified prize option" is disregarded in determining the taxable year for which any portion of a qualified prize is to be included in income. A qualified prize option is an option that entitles a person to receive a single cash payment in lieu of a qualified prize (or portion thereof), provided such option is exercisable not later than 60 days after the prize winner becomes entitled to the prize. Thus, a qualified prize winner who is provided the option to choose either cash or an annuity is not required to include amounts in gross income immediately if the annuity option is exercised. This change applies to any qualified prize to which a person first becomes entitled after October 21, 1998. In order to give previous prize winners a one-time option to alter previous payment arrangements, the change also applies to any qualifed prize to which a person became entitled on or before October 21, 1998 if the person has an option to receive a lump-sum cash payment only during some portion of the 18-month period beginning on July 1, 1999.

ADMINISTRATION PROPOSALS

The President's plan targets tax relief to provide child-care assistance to working families and support to Americans with long-term care needs. The President's plan also provides several incentives to promote education, including a school construction and modernization proposal. In addition, the President's plan includes initiatives to promote energy efficiency and environmental objectives and incentives to promote retirement savings, as well as extensions of certain expiring tax provisions.

Make Health Care More Affordable

Provide tax relief for long-term care needs.—Current law provides a tax deduction for certain long-term care expenses. However, the deduction does not assist with all long-term care expenses, especially the costs of informal family caregiving. The Administration proposes to provide a new long-term care tax credit of $1,000. The credit could be claimed by a taxpayer for himself or herself or for a spouse or dependent with long-term care needs. To qualify for the credit, an individual with long-term care needs must be certified by a licensed physician as being unable for at least six months to perform at least three activities of daily living without substantial assistance from another individual due to loss of functional capacity. An individual may also qualify if he or she requires substantial supervision to be protected from threats to his or her own health and safety due to severe cognitive impairment and has difficulty with one or more activities of daily living or certain other age-appropriate activities. For purposes of the proposed credit, the current-law dependency tests would be liberalized, raising the gross income limit and allowing taxpayers to use a residency test rather than a support test. The credit would be phased out—in combination with the child credit and the disabled worker credit—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 proposal would be effective for taxable years beginning after December 31, 1999.

Provide tax relief for workers with disabilities.—Under current law, disabled taxpayers may claim an itemized deduction for impairment-related work expenses. The Administration proposes to allow disabled workers to claim a $1,000 credit. This credit would help compensate people with disabilities for both formal and informal costs associated with work (e.g., personal assistance to get ready for work or special transportation). In order to be considered a worker with disabilities, a taxpayer must submit a licensed physician's certification that the taxpayer has been unable for at least 12 months to perform at least one activity of daily living without substantial assistance from another individual. A severely disabled worker could potentially qualify for both the long-term care and disabled workers tax credits. The credit would be phased out—in combination with the child credit and the disabled worker credit—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 proposal would be effective for taxable years beginning after December 31, 1999.

Provide tax relief to encourage small business health plans.—Small businesses generally face higher costs than do larger employers in setting up and operating health plans in the current insurance market. Health benefit purchasing coalitions provide an opportunity for small businesses to purchase health insurance for their workers at reduced cost and to offer a greater choice of health plans. However, the formation of health benefit purchasing coalitions has been hindered by their limited access to capital. To facilitate the formation of these coalitions, the Administration proposes to establish a temporary, special rule that would facilitate private foundation grants and loans to fund the initial operating expenses of qualified health benefit purchasing coalitions (i.e., those certified by a Federal or State agency as meeting specified criteria) by treating such grants and loans as made for exclusively charitable purposes. In addition, to encourage use of qualified health benefit purchasing coalitions by small businesses, the Administration proposes a temporary tax credit for qualifying small employers that currently do not provide health insurance to their workforces. The credit would be equal to 10 percent of employer contributions to employee health plans purchased through a qualified coalition. The maximum credit amount would be $200 per year for individual coverage and $500 per year for family coverage (to be reduced proportionately if coverage is provided for less than 12 months during the employer's taxable year). The credit would be allowed to a qualifying small employer only with respect to contributions made during the first 24 months that the employer purchases health insurance through a qualified coalition, and would be subject to the overall limitations of the general business credit. The proposal would be effective for taxable years beginning after December 31, 1999, for health plans established before January 1, 2004. The special foundation rule would apply to grants and loans made prior to January 1, 2004 for initial operating expenses incurred prior to January 1, 2006.

Expand Education Initiatives

Provide incentives for public school construction and modernization.—The Taxpayer Relief Act of 1997 enacted a provision 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 elementary and secondary school construction and modernization. Under the proposal, State and local governments (including U.S. possessions) would be able to issue up to $22 billion of "qualified school modernization bonds" ($11 billion in each of 2000 and 2001). In addition, $400 million of bonds ($200 million in each of 2000 and 2001) would be allocated for the construction and renovation of Bureau of Indian Affairs funded schools. 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. Issuers would be responsible for repayment of principal. At least 95 percent of the bond proceeds of a qualified school modernization bond must be used to finance public school construction or rehabilitation. The Administration also proposes to authorize the issuance of additional qualified zone academy bonds in 2000 and 2001 of $1.0 billion and $1.4 billion, respectively, and to allow the proceeds of these bonds to be used for school construction.

Extend employer-provided educational assistance and include graduate education.—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 for eighteen months to apply to undergraduate courses beginning before January 1, 2002. In addition, the exclusion would be expanded to cover graduate expenses beginning after June 30, 1999 and before January 1, 2002.

Provide tax credit for workplace literacy and basic education programs.—Given the increased reliance on technology in the workplace, workers with low levels of education face greater risk of unemployment than their more educated coworkers. Although the costs of providing workplace literacy and basic education programs to employees are generally deductible to employers under current law, no tax credits are allowed for any employer-provided education. As a result, employers lack sufficient incentive to provide basic education and literacy programs, the benefits of which are more difficult for employers to capture through increased productivity than the benefits of job-specific education. The Administration proposes to allow employers who provide certain workplace literacy, English literacy, or basic education programs for their eligible employees to claim a credit against Federal income taxes equal to 10 percent of the employer's qualified expenses, up to a maximum credit of $525 per participating employee. Qualified education would be limited to basic instruction at or below the level of a high school degree and to English literacy instruction. Eligible employees in basic education programs generally would not have received a high school degree or its equivalent. Instruction would be provided either by the employer, with curriculum approved by the State adult education authority, or by local education agencies or other providers certified by the Department of Education. The credit would be available for taxable years beginning after December 31, 1999.

Encourage sponsorship of qualified zone academies.—Under current law, State and local governments can issue qualified zone academy bonds to fund improvements in certain "qualified zone academies" which provide elementary or secondary education. To encourage corporations to become sponsors of such academies, a credit against Federal income tax would be provided equal to 50 percent of the amount of corporate sponsorship payments made to a qualified zone academy located in (or adjacent to) a designated empowerment zone or enterprise community. The credit would be available only if a credit allocation has been made with respect to the corporate sponsorship payment by the local governmental agency with responsibility for implementing the strategic plan of the empowerment zone or enterprise community. Up to $4 million of credits could be allocated with respect to each of the 31 designed empowerment zones; and up to $1 million of credits could be allocated with respect to each of the 95 designated enterprise communities. The credit would be subject to present law general business credit rules, and would be effective for sponsorship payments made after December 31, 1999.

Eliminate 60-month limit on student loan interest deduction.—Current law provides an income tax deduction for certain interest paid on a qualified education loan during the first 60 months that interest payments are required, effective for interest due and paid after December 31, 1997. The maximum deduction available is $2,500 for years after 2000 (for years 1998, 1999 and 2000, the limits are $1,000, $1,500 and $2,000, respectively) and the deduction is phased-out for taxpayers with adjusted gross income between $40,000 and $55,000 (between $60,000 and $75,000 for joint filers). The 60-month limitation under current law adds significant complexity and administrative burdens for taxpayers, lenders, loan servicing agencies, and the IRS. Thus, to simplify the calculation of deductible interest payments, reduce administrative burdens, and provide longer-term relief to low-and middle-income taxpayers with large educational debt, the Administration proposes to eliminate the 60-month limitation. This proposal would be effective for interest due and paid on qualified education loans after December 31, 1999.

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, 1999.

Provide tax relief for participants in certain Federal education programs.—Present law provides tax-free treatment for certain scholarship and fellowship grants used to pay qualified tuition and related expenses, but not to the extent that any grant represents compensation for services. In addition, tax-free treatment is provided for certain discharges of student loans on condition that the individual works for a certain period of time in certain professions for any of a broad class of employers. To extend tax-free treatment to education awards under certain Federal programs, the Administration proposes to amend current law to provide that any amounts received by an individual under the National Health Service Corps (NHSC) Scholarship Program or the Armed Forces Health Professions Scholarship and Financial Assistance Program are "qualified scholarships" excludable from income, without regard to the recipient's future service obligation. In addition, the proposal also would provide an exclusion from income for any repayment or cancellation of a student loan under the NHSC Scholarship Program, the Americorps Education Award Program, or the Armed Forces Health Professions Loan Repayment Program. The exclusion would apply only to the extent that the student incurred qualified tuition and related expenses for which no education credit was claimed during academic periods when the student loans were incurred. The proposals would be effective for awards received after December 31, 1999.

Make Child Care More Affordable

Increase, expand, 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 believes that the maximum credit rate is too low. Moreover, because it phases down at a very low threshold of adjusted gross income, many families who have significant child care costs and relatively low incomes are not eligible for the maximum credit. To alleviate the burden of child care costs for these families, 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.

Under current law, no additional tax assistance under the child and dependent care tax credit is provided to families with infants, who require intense and sustained care. Furthermore, parents who themselves care for their infants, instead of incurring out-of-pocket child care expenses, receive no benefit under the child and dependent care tax credit. In order to provide assistance to these families, the Administration proposes to supplement the credit for all taxpayers with children under the age of one, whether or not they incur out-of-pocket child care expenses. The amount of additional credit would be the applicable credit rate multiplied by $500 for a child under the age of one ($1,000 for two or more children under the age of one).

The Administration also proposes to simplify eligibility for the credit by eliminating a complicated household maintenance test. Certain credit parameters would be indexed. The proposal would be effective for taxable years beginning after December 31, 1999.

Provide tax incentives for employer-provided child-care facilities.—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, 1999.

Provide Incentives to Revitalize Communities

Increase low-income housing tax credit per capita cap to $1.75.—Low-income housing tax credits provide an incentive to build and make available affordable rental housing units to households with low incomes. The amount of first-year credits that can be awarded in each State is currently limited to $1.25 per capita. That limit has been unchanged since it 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 1999. 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.

Provide Better America Bonds to improve the environment.—Under current law, State and local governments may issue tax-exempt bonds to finance purely public environmental projects. Certain other environmental projects may also be financed with tax-exempt bonds, but are subject to an overall cap on private-purpose tax-exempt bonds. The subsidy provided with tax-exempt bonds may not provide a deep enough subsidy to induce State and local governments to undertake beneficial environmental infrastructure projects. The Administration proposes to allow State and local

governments (including U.S. possessions and Native American tribal governments) to issue tax credit bonds (similar to existing Qualified Zone Academy Bonds) to finance projects to protect open spaces or to otherwise improve the environment. Significant public benefits would be provided by creating more livable urban and rural environments; creating forest preserves near urban areas; protecting water quality; rehabilitating land that has been degraded by toxic or other wastes or destruction of its ground cover; and improving parks and reestablishing wetlands. The Environmental Protection Agency will allocate $1.9 billion in annual bond authority for five years starting in 2000 based on competitive applications. The bonds would have a maximum maturity of 15 years and the bond issuer effectively would receive an interest-free loan for the term of the bonds. During that interval, bond holders receive Federal income tax credits in lieu of interest.

Provide New Markets Tax Credit.—Businesses located in low-income urban and rural communities often lack access to sufficient equity capital. To help attract new capital to these businesses, taxpayers would be allowed a credit against Federal income taxes for certain investments made to acquire stock or other equity interests in a community development investment entity selected by the Treasury Department to receive a credit allocation. Selected community development investment entities generally would be required to use the investment proceeds to provide capital to businesses located in low-income communities. During the period 2000–2004, the Treasury Department would authorize selected community development investment entities to issue $6 billion of new stock or equity interests with respect to which credits could be claimed. The credit would be allowed for each year during the five-year period after the stock or equity interest is acquired from the selected community development investment entity, and the credit amount that could be claimed for each of the five years would equal six percent of the amount paid to acquire the stock or equity interest from the community development investment entity. The credit would be subject to current-law general business credit rules, and would be available for qualified investments made after December 31, 1999.

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 upon ceasing activity as a SSBIC or at any time that it disposes 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. Third, the proposal would make it easier for a SSBIC to meet the qualifying income, distribution of income, and diversification of assets tests to qualify as a tax-favored regulated investment company. 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. The regulated investment company provisions would be effective for taxable years beginning on or after the date of enactment.

Extend wage credit for 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 were 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 that the wage credit for the two additional EZs would remain in effect until January 1, 2010, and would be phased down using the same percentages that apply to the original empowerment zones designated under OBRA 93.

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 10 or 20 percent of the amount of qualified investment depending upon the energy efficiency of the qualified item, subject to a cap. The 10-percent credit generally would be available for equip-

ment purchased during the two-year period beginning January 1, 2000 and ending December 31, 2001. The 20-percent credit would be available for equipment purchased during the four-year period beginning January 1, 2000 and ending December 31, 2003.

Provide tax credit for 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 $1,000, $1,500 or $2,000 depending upon the home's energy efficiency. The $1,000 credit would be available for homes purchased between January 1, 2000 and December 31, 2001 that are at least 30 percent more energy efficient than the standard under the 1998 International Energy Conservation Code (IECC). The $1,500 credit would be available for homes purchased between January 1, 2000 and December 31, 2002 that are at least 40 percent more energy efficient than the IECC standard. The $2,000 credit would be available for homes purchased between January 1, 2000 and December 31, 2004 that are at least 50 percent more energy efficient than the IECC standard.

Transportation

Extend the electric vehicle tax credit; provide tax credit for fuel-efficient vehicles.—Under current law, a 10-percent tax credit up to $4,000 is provided for the cost of a qualified electric vehicle. The full amount of the credit is available for purchases prior to 2002. The credit begins to phase down in 2002 and is not available after 2004. The Administration proposes to extend the present $4,000 credit through 2006 and to allow the full amount of the credit to be available for qualified electric vehicles through 2006. The Administration also proposes to provide a tax credit for the purchase of certain fuel-efficient hybrid vehicles. The credit would be: (a) $1,000 for each vehicle that is one-third more fuel efficient than a comparable vehicle in its class, effective for purchases of qualifying vehicles after December 31, 2002 and before January 1, 2005; (b) $2,000 for each vehicle that is two-thirds more fuel efficient than a comparable vehicle in its class, effective for purchases of qualifying vehicles after December 31, 2002 and before January 1, 2007; (c) $3,000 for each vehicle that is twice as fuel efficient as a comparable vehicle in its class, effective for purchases of qualifying vehicles after December 31, 2003 and before January 1, 2007; and (d) $4,000 for each vehicle that is three times as fuel efficient as a comparable vehicle in its class, effective for purchases of qualifying vehicles after December 31, 2003 and before January 1, 2007.

Industry

Provide investment tax credit for combined heat and power (CHP) systems.—Combined heat and power (CHP) assets are used to produce electricity (and/or mechanical power) and usable heat from the same primary energy source. No tax credits are currently available for investment in CHP property. The Administration proposes to establish an eight-percent investment credit for qualifying CHP systems in order to encourage more efficient energy usage. The credit would apply to property placed in service in the United States after December 31, 1999 and before January 1, 2003.

Renewables

Provide tax credit for rooftop solar systems.—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 a new tax credit for purchasers of roof-top 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, 1999 and before January 1, 2005 for solar water heating systems and after December 31, 1999 and before January 1, 2007 for rooftop photovoltaic systems.

Extend wind and biomass tax credit and expand eligible biomass sources.—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 and to expand eligible biomass to include certain biomass from forest-related resources, and agricultural and other sources. A 1.0 cent-per-kilowatt-hour tax credit would also be allowed for cofiring biomass in coal plants.

Promote Expanded Retirement Savings, Security, and Portability

Building on recent legislation, the Administration proposes further expansions of retirement savings incentives, including 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. Other 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 in-

creasing retirement security for women, expanding workers' and spouses' rights to know about their retirement benefits, and simplifying the pension rules. Finally, the Administration proposes to increase the portability of pension coverage, which will enhance retirement savings opportunities when employees change jobs. These provisions generally are effective beginning in 2000, except as provided below.

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 for 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 small business 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. 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 IRAs.

Create simplified pension plan for small business.—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 at a reduced premium, together with individual account balances that can benefit from favorable investment returns and have enhanced portability.

Provide faster vesting of employer matching contributions.—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).

Count Family and Medical Leave Act leave for vesting and eligibility purposes.—Under the Family and Medical Leave Act (FMLA), eligible workers are entitled to up to 12 weeks of unpaid leave to care for a new child, to care for a family member who has a serious health condition, or because the worker has a serious health condition. Under the Administration's proposal, workers who take time off under the FMLA could count that time toward retirement plan vesting and eligibility to participate. This would ensure that workers do not lose retirement benefits they have earned because they take time off under FMLA.

Require joint and 75-percent annuity option for pension plans.—Current law requires certain pension plans to offer to pay pension benefits as a joint and survivor annuity; frequently, the benefit for the employee's surviving spouse is reduced to 50 percent of the monthly benefit paid when both spouses were alive. Under the proposal, plans that are subject to the joint and survivor annuity rules would be required to offer an option that pays a survivor benefit equal to at least 75 percent of the benefit the couple received while both were alive. This option would be especially helpful to women because they tend to live longer than men and because many aged widows have incomes below the poverty level.

Improve disclosure; simplify pensions.—The Administration proposes to enhance workers' and spouses' rights to know about their pension benefits by, 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 adequate notification and have timely election periods 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.

Allow immediate participation in the Thrift Savings Plan (TSP) by new Federal employees.—Current law requires a newly-hired Federal employee to wait six to twelve months after being hired before contributing to the TSP. Rehired employees wait up to six months. Under the Administration's proposal, all waiting periods for employee elective contributions to the TSP would be eliminated for new hires and rehires.

Allow rollovers from private plans to TSP.—Current law limits employee contributions to a TSP account to salary reduction amounts, as opposed to rollover contributions from a qualified trust. The Administration

proposes to allow an employee to roll over an "eligible rollover distribution" from a qualified trust sponsored by a previous employer to the employee's TSP account.

Allow rollovers between qualified retirement plans and 403(b) tax-sheltered annuities.—Under current law, rollovers are not allowed between qualified retirement plans and section 403(b) tax-sheltered annuities. The Administration proposes that eligible rollover distributions from a qualified retirement plan could be rolled over to a section 403(b) tax-sheltered annuity and vice versa.

Allow rollovers from regular IRAs to qualified plans or 403(b) tax-sheltered annuities.—The Administration's proposal would allow individuals to consolidate their IRA funds and their workplace retirement savings in a single place. Under current law, individuals may roll over only amounts in "conduit" IRAs (IRAs containing only amounts rolled over from workplace retirement plans) to their qualified retirement plans or section 403(b) tax-sheltered annuities. Under the Administration's proposal, individuals who have IRAs with deductible IRA contributions will be offered the opportunity to transfer funds from their IRAs into their qualified defined contribution retirement plan or 403(b) tax-sheltered annuity—provided that the retirement plan trustee meets the same standards as an IRA trustee.

Allow rollovers of after-tax contributions.—While pre-tax contributions to retirement plans are perhaps the most common form of employee contribution, some plans also allow participants to make after-tax contributions. Under current law, these after-tax contributions cannot be rolled over when employees switch jobs. The proposal would allow individuals to roll over their after-tax contributions to their new employer's defined contribution plan or to an IRA if the plan or IRA provider agrees to track and report the after-tax portion of the rollover for the individual.

Allow rollovers of contributions from governmental 457 plans to an IRA.—Generally, amounts held under qualified retirement plans or section 403(b) tax-sheltered annuities plans may be rolled over to an IRA. However, under current law, amounts held under nonqualified deferred compensation plans of State or local governments (governmental section 457 plans) may not be rolled over into an IRA and are taxable upon distribution. The Administration's proposal would allow individuals to roll over the money they have saved in a governmental section 457 plan to an IRA.

Facilitate the purchase of service credits in governmental defined benefit plans.—Employees of State and local governments, particularly teachers, often move between States and school districts in the course of their careers. Under State law, they often can purchase service credits in their State defined benefit pension plans for time spent in another State or district and earn a pension reflecting a full career of employment in the State in which they conclude their career. Under current law, these employees cannot make a tax-free transfer of the money they have saved in their 403(b) plan or governmental section 457 plan to purchase these credits and often lack other resources to use for this purpose. Under the proposal, State and local government employees will be able to use funds from these retirement savings plans to purchase service credits on a tax-free basis, i.e., through a direct transfer without first having to take a taxable distribution of these amounts.

Extend Expiring Provisions

Allow personal tax credits against the alternative minimum tax (AMT).—The Administration is concerned that the individual alternative minimum tax (AMT) may impose financial and compliance burdens upon taxpayers that have few tax preference items and were not the originally intended targets of the AMT. In particular, the Administration is concerned that the individual AMT may act to erode the benefits of nonrefundable tax credits (such as the education credits, the child credit, adoption credit, and the child and dependent care credit) that are intended to provide tax relief for middle-income taxpayers. In response, the Administration proposes to extend, for two years, the provision enacted in 1998 that allows an individual to offset his or her regular tax liability by nonrefundable tax credits regardless of the amount of the individual's tentative minimum tax. The Administration hopes to work with Congress to develop a longer-term solution to the individual AMT problem.

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, 1999. The Administration proposes to extend the work opportunity tax credit so that the credit would be effective for individuals who begin work before July 1, 2000. The proposal also clarifies the interaction of the work opportunity tax credit and the welfare-to-work tax credit. This proposed clarification would be effective for taxable years beginning on or after the date of first committee action.

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 July 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 July 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, 1999, for one year through June 30, 2000.

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.

Extend tax credit for first-time D.C. homebuyers.—The Administration proposes to extend the tax credit provided for the first-time purchase of a principal residence in the District of Columbia, which is scheduled to expire after December 31, 2000, for one year through December 31, 2001.

Simplify The Tax Laws

Provide optional Self-employment Contributions Act (SECA) computations.—Self-employed individuals currently may elect to increase their self-employment income for puposes 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, 1999.

Provide statutory hedging and other rules to ensure business property is treated as ordinary property.—Under current law, there is an 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 the 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 and provide more equitable timing of losses under the straddle rules. 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 (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 the application of the foreign tax credit limitation significantly 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, 1998.

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 complica-

tions 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.

Expand declaratory judgment remedy for noncharitable organizations seeking determinations of tax-exempt status. —Under current law, organizations seeking tax-exempt status as charities under section 501(c)(3) are allowed to seek a declaratory judgment as to their tax status if their application is denied or delayed by the IRS. A noncharity (an organization not described in section 501(c)(3)) that applies to the IRS for recognition of its tax-exempt status faces potential tax liability if its application ultimately is denied by the IRS. This creates uncertainty for the noncharity, particularly when the IRS determination is delayed for a significant period of time. To reduce this uncertainty, the declaratory judgment procedure available to charities under current-law section 7428 would be expanded, so that if the application of any organization seeking tax-exempt status under section 501(c) is pending with the IRS for more than 270 days, and the organization has exhausted all administrative remedies available within the IRS, then the organization could seek a declaratory judgment as to its tax-exempt status from the United States Tax Court. The proposal would be effective for applications for recognition of tax-exempt status filed after December 31, 1999.

Simplify the active trade or business requirement for tax-free spin-offs.—In order to satisfy the active trade or business requirement for tax-free spin-offs, split-offs, and split-ups, the distributing corporation and the controlled corporation both must be engaged in the active conduct of a trade or business. If a corporation is not itself active, it may satisfy the active trade or business test indirectly, but only if substantially all of its assets consist of stock and securities of a controlled corporation that is engaged in an active trade or business. Because the substantially all standard is much higher than that required if the corporation is active itself, a taxpayer often must engage in predistribution restructurings that it otherwise would not have undertaken. There is no clear policy reason that the standards for meeting the active trade or business requirement should differ depending upon whether a corporation is considered to be active on a direct or indirect basis. Therefore, the Administration proposes to simplify the requirement by removing the substantially all test and generally allowing an affiliated group to satisfy the active trade or business requirement as long as the affiliated group, taken as a whole, is considered active. This proposal would be effective for transactions after the date of enactment.

Miscellaneous Provisions

Make first $2,000 of severance pay exempt from income tax.—Under current law, payments received by 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 $75,000. The exclusion would be effective for severance pay received in taxable years beginning after December 31, 1999 and before January 1, 2003.

Allow steel companies to carryback net operating losses (NOLs) up to five years.—Under current law, a net operating loss of a taxpayer generally may be carried back two years and forward 20 years. The Administration proposes to provide an immediate cash flow benefit to troubled companies in the steel industry by extending the carryback period for the NOLs of a steel company to five years. The proposal would be effective for taxable years ending after the date of enactment, regardless of when the NOL arose, and would sunset after five years.

Electricity Restructuring

Revise tax-exempt bond rules for electric power facilities.—As part of Federal legislation to encourage restructuring the nation's electric power industry so that consumers benefit from competition, rules relating to the use of tax-exempt bonds to finance electric power facilities would be modified. To encourage public power systems to implement retail competition, outstanding bonds issued to finance transmission facilities would continue their tax-exempt status even if private use resulted from allowing nondiscriminatory open access to those facilities. Similarly, outstanding bonds issued to finance generation or distribution facilities would continue their tax-exempt status even if the issuer implements retail competition. To support fair competition within the restructured industry, interest on bonds to finance electric generation or transmission facilities issued after enactment of such legislation would not be exempt. Distribution facilities could continue to be financed with tax-exempt bonds. These changes would be effective upon enactment.

Modify taxation of contributions to nuclear decommissioning funds.—Under current law, deductible contributions to nuclear decommissioning funds are limited to the amount included in the taxpayer's cost of service for ratemaking purposes. For deregulated utilities, this limitation may result in the denial of any deduction for contributions to a nuclear decommissioning fund. The Administration proposes to repeal the limitation for taxable years beginning after December 31, 1999. As under current law, deductible contributions would not be permitted to exceed the amount the IRS determines to be necessary to provide for level

funding of an amount equal to the taxpayer's decommissioning costs.

Modify International Trade Provisions

Extend and modify Puerto Rico economic-activity tax credit.—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 conducted in taxable years beginning before January 1, 2006, subject to base-period caps. To provide a more efficient tax incentive for the economic development of Puerto Rico and to continue the shift from an income-based credit to an economic-activity-based credit that was begun in the 1993 Act, the budget would modify the phase-out of the economic-activity-based credit for Puerto Rico (under section 30A of the Code) by (1) opening it to newly established business operations during the phase-out period, effective for taxable years beginning after December 31, 1998, and (2) extending the phase-out period through taxable years beginning before January 1, 2009.

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, 1999, through June 30, 2000. The Administration is proposing permanent enhanced trade benefits for subsaharan African countries undertaking strong economic reforms. The Administration also proposes to provide, through June 30, 2001, expanded trade benefits mainly on textiles and apparel to Caribbean Basin countries that meet new eligibility criteria. These benefits will help Caribbean Basin countries prepare for a future free trade agreement with the United States and respond to the effects of Hurricanes George and Mitch. The Administration also proposes to implement the OECD Shipbuilding Agreement.

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.

ELIMINATE UNWARRANTED BENEFITS AND ADOPT OTHER REVENUE MEASURES

The President's plan curtails unwarranted corporate tax subsidies, closes tax shelters and other loopholes, improves tax compliance and adopts other revenue measures.

Limit Benefits of Corporate Tax Shelter Transactions

The Administration is concerned about the proliferation of corporate tax shelters and their effect upon both the corporate tax base and the integrity of the tax system as a whole. The primary goals of corporate tax shelters are to manufacture tax benefits that can be used to offset unrelated income of the taxpayer or to create tax-favored or tax-exempt economic income.

Corporate tax shelters may take several forms but often share certain common characteristics. Corporate tax shelter schemes are often marketed by their designers or promoters to multiple corporate taxpayers. The transactions typically involve arrangements among corporate taxpayers and persons not subject to U.S. tax. Shelters are also often associated with high transactions costs, contingent or refundable fees, unwind clauses, financial accounting treatment that is significantly more favorable than the corresponding tax treatment, and property or transactions unrelated to the corporate participant's core business.

The Administration proposes several general remedies to curb the growth of corporate tax shelters. In addition, the Administration proposes to modify the treatment of certain specific transactions that provide sheltering potential. No inference is intended as to the treatment of any of these trnsactions under current law.

Modify substantial understatement penalty for corporate tax shelters.—The current 20-percent substantial understatement penalty imposed on corporate tax shelter items can be avoided if the corporate taxpayer had reasonable cause for the tax treatment of the item and good faith. The Administration proposes to increase the substantial understatement penalty on corporate tax shelter items to 40 percent. The penalty will be reduced to 20 percent if the corporate taxpayer discloses to the National Office of the Internal Revenue Service within 30 days of the closing of the transaction appropriate documents describing the corporate tax shelter and files a statement with, and provides adequate disclosure on, its tax return. The penalty could not be avoided by a showing of reasonable cause and good faith. The proposal is effective for transactions entered into after the date of first committee action.

Deny certain tax benefits in corporate tax shelters.—Under curent law, if a person acquires control of a corporation or a corporation acquires carryover basis property of a corporation not controlled by the acquiring corporation or its shareholders, and the prin-

cipal purpose for such acquisition is evasion or avoidance of Federal income tax by securing certain tax benefits, the Secretary may disallow such benefits to the extent necessary to eliminate such evasion or avoidance of tax. However, this current rule has been interpreted narrowly. The Administration proposes to expand the current rules to authorize the Secretary to disallow a deduction, credit, exclusion, or other allowance obtained in a corporate tax shelter. The proposal would apply to transactions entered into on or after the date of first committee action.

Deny deductions for certain tax advice and impose an excise tax on certain fees received.—Buyers of corporate tax shelter advice may deduct the fees paid for such advice. The proposal would deny a deduction for fees paid or accrued in connection with the promotion of corporate tax shelters and the rendering of certain tax advice related to corporate tax shelters. The proposal would also impose a 25-percent excise tax on fees received in connection with the promotion of corporate tax shelters and the rendering of certain tax advice related to corporate tax shelters. The proposal would be effective for payments made on or after the date of first committee action.

Impose excise tax on certain rescission provisions and provisions guaranteeing tax benefits.—Because taxpayers entering into corporate tax shelter transactions know that such transactions are risky, particularly because the expected tax benefits are not justified economically, purchasers of corporate tax shelters often require the seller or a counterparty to enter into a tax benefit protection arrangement. The Administration proposes to impose on the purchaser of a corporate tax shelter an excise tax of 25 percent on the maximum payment to be made under the arrangement. For this purpose, a tax benefit protection arrangement would include certain rescission clauses, guarantee of tax benefits arrangement or any other arrangement that has the same economic effect (e.g., insurance purchased with respect to the transaction). The proposal would apply to arrangements entered into on or after the date of first committee action.

Preclude taxpayers from taking tax positions inconsistent with the form of their transactions.—Under current law, if a taxpayer enters into a transaction in which the economic substance and the legal form are different, the taxpayer may take the position that, notwithstanding the form of the transaction, the substance is controlling for Federal income tax purposes. Many taxpayers enter into such transactions in order to arbitrage tax and regulatory laws. Under the proposal, except to the extent the taxpayer discloses the inconsistent position on its tax return, a corporate taxpayer, but not the Internal Revenue Service, would be precluded from taking any position (on a tax return or otherwise) that the Federal income tax treatment of a transaction is different from that dictated by its form, if a tax indifferent person has a direct or indirect interest in such transaction. No inference is intended regarding the tax treatment of transactions not covered by the proposal. The proposal would be effective for transactions entered into on or after the date of first committee action.

Tax income from corporate tax shelters involving tax-indifferent parties.—The Federal income tax system has many participants who are indifferent to tax consequences (e.g., foreign persons, tax-exempt organizations, and Native American tribal organizations). Many corporate tax shelters have tax-indifferent participants who absorb taxable income generated by the shelters so that corresponding losses or deductions can be allocated to taxable participants. The proposal would provide that any income received by a tax-indifferent person with respect to a corporate tax shelter would be taxable. The proposal would be effective for transactions entered into on or after the date of first committee action.

Require accrual of income on forward sale of corporate stock.—There is little substantive difference between a corporate issuer's current sale of its stock for a deferred payment and an issuer's forward sale of the same stock. In both cases, a portion of the deferred payment compensates the issuer for the time-value of money during the term of the contract. Under current law, the issuer must recognize the time-value element of the deferred payment as interest if the transaction is a current sale for deferred payment but not if the transaction is a forward contract. Under the proposal, the issuer would be required to recognize the time-value element of the forward contract as well. The proposal would be effective for forward contracts entered into on or after the date of first committee action.

Modify treatment of built-in losses and other attribute trafficking.—Under current law, a taxpayer that becomes subject to U.S. taxation may take the position that it determines its beginning bases in its assets under U.S. tax principles as if the taxpayer had historically been subject to U.S. tax. Other tax attributes are computed similarly. A taxpayer may thus "import" built-in losses or other favorable tax attributes incurred outside U.S. taxing jurisdiction (e.g., from foreign or tax-exempt parties) to offset income or gain that would otherwise be subject to U.S. tax. The proposal would prevent the importation of attributes by eliminating tax attributes (including built-in items) and marking to market bases when an entity or an asset becomes relevant for U.S. tax purposes. The proposal would be effective for transactions in which assets or entities become relevant for U.S. tax purposes on or after the date of enactment.

Modify treatment of ESOP as S corporation shareholder.—Pursuant to provisions enacted in 1996 and 1997, an employee stock ownership plan (ESOP) may be a shareholder of an S corporation and the ESOP's share of the income of the S corporation is

not subject to tax until distributed to the plan beneficiaries. The Administration proposes to require an ESOP to pay tax on S corporation income (including capital gains on the sale of stock) as the income is earned and to allow the ESOP a deduction for distributions of such income to plan beneficiaries. The deduction would only apply to the extent distributions exceed all prior undistributed amounts that were previously not subject to unrelated business income tax. The proposal would be effective for taxable years beginning on or after the date of first committee action. In addition, the proposal would be effective for acquisitions of S corporation stock by an ESOP after such date and for S corporation elections made on or after such date.

Prevent serial liquidation of U.S. subsidiaries of foreign corporations.—When a domestic corporation distributes a dividend to a foreign corporation, it is subject to U.S. withholding tax. In contrast, if a domestic corporation distributes earnings in a subsidiary liquidation under section 332, the foreign shareholder generally is not subject to any withholding tax. Relying on section 332, some foreign corporations establish U.S. holding companies to receive tax-free dividends from operating subsidiaries, and then liquidate the holding companies, thereby avoiding the withholding tax. Subsequently, they re-establish the holding companies to receive future dividends. The proposal would impose withholding tax on any distribution made to a foreign corporation in complete liquidation of a U.S. holding company if the holding company was in existence for less than five years. The proposal would also achieve a similar result with respect to serial terminations of U.S. branches. The proposal would be effective for liquidations and terminations occurring on or after the date of first committee action.

Prevent capital gains avoidance through basis shift transactions involving foreign shareholders.—A distribution in redemption of stock generally is treated as a dividend if it does not result in a meaningful reduction in the shareholder's proportionate interest in the distributing corporation, measured with reference to certain constructive ownership rules, including option attribution. If an amount received in redemption of stock is treated as a distribution of a dividend, the basis of the remaining stock generally is increased to reflect the basis of the redeemed stock. The basis of the remaining stock is not increased, however, to the extent that the basis of the redeemed stock was reduced or eliminated pursuant to the extraordinary dividend rules. In certain circumstances, these rules require a corporate shareholder to reduce the basis of stock with respect to which a dividend is received by the nontaxed portion of the dividend, which generally equals the amount of the dividend that is offset by the dividends received deduction. To prevent taxpayers from attempting to offset capital gains by generating artificial capital losses through basis shift transactions involving foreign shareholders, the Administration proposes to treat the portion of a dividend that is not subject to current U.S. tax as a nontaxed portion. Similar rules would apply in the event that the foreign shareholder is not a corporation. The proposal is effective for distributions on or after the date of first committee action.

Limit inappropriate tax benefits for lessors of tax-exempt use property.—Under current law, certain property leased to governments, tax-exempt organizations, or foreign persons is considered to be "tax-exempt use property." There are a number of restrictions on the ability of lessors of tax-exempt use property to claim tax benefits from transactions related to the tax-exempt use property. The Administration is concerned that certain structures involving tax-exempt use property are being used to generate inappropriate tax benefits for lessors. The proposal would deny a lessor the ability to recognize a net loss from a leasing transaction involving tax-exempt use property during the lease term. A lessor would be able to carry forward a net loss from a leasing transaction and use it to offset net gains from the transaction in subsequent years. The proposal would be effective for leasing transactions entered into on or after the date of enactment.

Prevent mismatching of deductions and income inclusions in transactions with related foreign persons.—Current law provides that if any debt instrument having original issue discount (OID) is held by a related foreign person, any portion of such OID shall not be allowable as a deduction to the issuer until paid. Section 267 and the regulations thereunder apply similar rules to other expenses and interest owed to related foreign persons. These general rules are modified, however, so that a deduction is allowed when the OID is includible in the income of a foreign personal holding company (FPHC), controlled foreign corporation (CFC) or passive foreign investment company (PFIC). The Treasury has learned of certain structured transactions (involving both U.S. payors and U.S.-owned foreign payors) designed to allow taxpayers inappropriately to take advantage of the current rules by accruing deductions to related FPHCs, CFCs or PFICs, without the U.S. owners of such related entities taking into account for U.S. tax purposes an amount of income appropriate to the accrual. This results in an improper mismatch of deductions and income. The proposal would provide that deductions for amounts accrued but unpaid to related foreign CFCs, PFICs or FPHCs would be allowable only to the extent the amounts accrued by the payor are, for U.S. tax purposes, reflected in the income of the direct or indirect U.S. owners of the related foreign person. The proposal would contain an exception for certain short term transactions entered into in the ordinary course of business. The Secretary would be granted regulatory authority to provide exceptions from these rules. The proposal would be effective for amounts accrued on or after the date of first committee action.

Restrict basis creation through section 357(c).—A transferor generally is required to recognize gain on a transfer of property in certain tax-free exchanges to the extent that the sum of the liabilities assumed, plus those to which the transferred property is subject, exceeds the basis in the property. This gain recognition to the transferor generally increases the basis of the transferred property in the hands of the transferee. If a recourse liability is secured by multiple assets, it is unclear under current 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 generally would be eliminated. Generally, a recourse liability would be treated as assumed to the extent that the transferee has agreed and is expected to satisfy the liability (whether or not the transferor has been relieved of the liability). A nonrecourse liability would be treated as assumed by the transferee of any asset subject to the liability, but the amount of nonrecourse liability treated as assumed would be reduced by the amount of the liability which an owner of other assets not transferred to the transferee and also subject to the liability has agreed with the transferee and is expected to satisfy, up to the fair market value of such other assets. The transferor's recognition of gain as a result of assumption of liability would not increase the transferee's basis in the transferred asset to an amount in excess of its fair market value. Moreover, if no person is subject to U.S. tax on gain recognized as the result of the assumption of a nonrecourse liability, then the transferee's basis in the transferred assets would be increased only to the extent such basis would be increased if the transferee had assumed only a ratable portion of the liability, based on the relative fair market values of all assets subject to such nonrecourse liability. The Treasury Department would have the authority to prescribe regulations necessary to carry out the purposes of the proposal, and to apply the treatment set forth in this proposal where appropriate elsewhere in the Code.

Modify anti-abuse rule related to assumption of liabilities.—The assumption of a liability in an otherwise tax-free transaction is treated as boot to the transferor if the principal purpose of having the transferee assume the liability was the avoidance of tax on the exchange. The current language is inadequate to address the avoidance concerns that underlie the provision. The Administration proposes to modify the anti-abuse rule by deleting the limitation that it only applies to tax avoidance on the exchange itself, and changing "the principal purpose" standard to "a principal purpose." Additional conforming changes would be made. This proposal would be effective for assumptions of liabilities on or after the date of first committee action.

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 on contracts insuring certain classes of individuals. 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 life insurance contracts to the 20-percent owner exception in the COLI proration rules. The proposal would be effective for taxable years beginning after the date of enactment.

Other Proposals

Require banks to accrue interest on short-term obligations.—Under current law, a bank (regardless of its accounting method) must accrue as ordinary income interest, including original issue discount, on short-term obligations. Recent court cases have held that banks that use the cash receipts and disbursements method of accounting do not have to accrue stated interest and original issue discount on short-term loans made in the ordinary course of the bank's business. The Administration believes it is inappropriate to treat these short-term loans differently than other short-term obligations held by the bank. The Administration's proposal would clarify that banks must accrue interest and original issue discount on all short-term obligations, including loans made in the ordinary course of the bank's business, regardless of the banks' overall accounting method. The proposal would be effective for obligations acquired (including originated) on or after the date of enactment. No inference is intended regarding the current-law treatment of these transactions.

Require current accrual of market discount by accrual method taxpayers.—Under current law, a taxpayer that holds a debt instrument with market discount is not required to include the discount in income as it accrues, even if the taxpayer uses an accrual method of accounting. Under the proposal, a taxpayer that uses an accrual method of accounting would be required to include market discount in income as it accrues. The proposal also would cap the amount of market discount on distressed debt instruments, be-

cause a portion of such discount, if realized, may be more in the nature of capital gain than interest. The proposal would be effective for debt instruments acquired on or after the date of enactment.

Limit conversion of character of income from constructive ownership transactions with respect to partnership interests.—Under current law, a taxpayer can enter into a derivatives transaction that is designed to give the taxpayer the economic equivalent of an ownership interest in a partnership but that is not itself a current ownership interest in the partnership. These so-called "constructive ownership" transactions purportedly allow taxpayers to defer income and to convert ordinary income and short-term capital gain into long-term capital gain. The proposal would treat long-term capital gain recognized from a constructive ownership transaction as ordinary income to the extent the long-term capital gain recognized from the transaction exceeds the long-term capital gain that could have been recognized had the taxpayer invested in the partnership interest directly. In addition, the proposal would impose an interest charge on these transactions to compensate for their inherent deferral and would allow taxpayers to elect mark-to-market treatment in lieu of applying the gain recharacterization and interest charge rule. The proposal would be effective for gains recognized on or after the date of first committee action.

Modify rules for debt-financed portfolio stock.—Under current law, a corporation must reduce its dividends-received deduction with respect to dividends paid on portfolio stock to the extent the portfolio stock is debt financed. For the portfolio stock to be debt financed, the indebtedness must be "directly attributable to investment in the portfolio stock." This "directly attributable" standard is too easily avoided. Under the proposal, the percentage of portfolio stock considered to be debt financed would be equal to the sum of (1) the percentage of stock that is directly financed, and (2) the percentage of remaining stock that is indirectly financed. The proposal would be effective for portfolio stock acquired on or after the date of enactment.

Modify and clarify certain rules relating to debt-for-debt exchanges.—Under current law, an issuer can inappropriately accelerate interest deductions by refinancing a debt instrument in a debt-for-debt exchange at a time when the issuer's cost of borrowing has declined. The proposal would spread the issuer's net deduction for bond repurchase premium in a debt-for-debt exchange over the term of the new debt instrument using constant yield principles. In addition, the proposal would modify the measurement of the net income or deduction in debt-for-debt exchanges involving contingent payment debt instruments. Finally, the proposal would modify the measurement of taxable boot to the holder in debt-for-debt exchanges that are part of corporate reorganizations. The proposal would apply to debt-for-debt exchanges occurring on or after the date of enactment.

Modify and clarify the straddle rules.—A "straddle" is the holding of two or more offsetting positions with respect to actively-traded personal property. An exception from the definition is provided for certain offsetting positions with respect to actively-traded stock. If a taxpayer enters into a straddle, the taxpayer must defer the recognition of loss from the "loss leg" of the straddle until the taxpayer recognizes the offsetting gain from the "gain leg" of the straddle. Further, the taxpayer must capitalize the net interest and carrying charges properly attributable to the straddle. The proposal would clarify that net interest expense and carrying charges arising from structured financial products that contain a leg of a straddle must be capitalized. In addition, the proposal would repeal the current-law exception for certain straddles of actively-traded stock. The proposal would be effective for straddles entered into on or after the date of enactment.

Conform control test for tax-free incorporations, distributions, and reorganizations.—For tax-free incorporations, tax-free distributions, and reorganizations, "control" is defined as the ownership of 80 percent of the voting stock and 80 percent of the number of shares of all other classes of stock of the corporation. This test is easily manipulated by allocating voting power among the shares of a corporation, allowing corporations to retain control of a corporation but sell a significant amount of the value of the corporation. In contrast, the necessary "ownership" for tax-free liquidations, qualified stock purchases, and affiliation is at least 80 percent of the total voting power of the corporation's stock and at least 80 percent of the total value of the corporation's stock. The Administration proposes to conform the control requirement for tax-free incorporations, distributions, and reorganizations with that used for determining affiliation. This proposal is effective for transactions on or after the date of enactment.

Tax issuance of tracking stock.—"Tracking stock" is an economic interest that is intended to relate to and track the economic performance of one or more separate assets of the issuer, and gives its holder a right to share in the earnings or value of less than all of the corporate issuer's earnings or assets. The use of tracking stock is clearly outside the contemplation of subchapter C and other sections of the Code. As a result, a principal consequence of treating such a stock interest as stock of the issuer is the potential avoidance of these provisions. The Administration proposes to define "tracking stock" as stock that is linked to the performance of assets of the issuing corporation with one or more identified characteristics and provide that gain will be recognized on the issuance of tracking stock. Under this proposal, the Secretary would have authority to treat tracking stock as nonstock (e.g., debt, a notional principal contract, etc.) or as stock of another entity as appropriate to prevent avoidance. No inference is intended regarding the tax treatment of tracking

stock under current law. This proposal is effective for tracking stock issued on or after the date of enactment.

Require consistent treatment and provide basis allocation rules for transfers of intangibles in certain nonrecognition transactions.—No gain or loss will be recognized if one or more persons transfer property to a controlled corporation (or partnership) solely in exchange for stock in the corporation (or a partnership interest). Where there is a transfer of less than "all substantial rights" to use property, the Internal Revenue Service's position is that such transfer will not qualify as a tax-free exchange. However, the Claims Court rejected the Service's position in *E.I. Du Pont de Nemours and Co. v. U.S.*, holding that any transfer of something of value could be a "transfer" of "property." The inconsistency between the positions has resulted in whipsaw of the government. The Administration proposes to provide that the transfer of an interest in intangible property constituting less than all of the substantial rights of the transferor in the property is a transfer of property entitled to tax-free treatment, and the transferor must allocate the basis of the intangible between the retained rights and the transferred rights based upon respective fair market values. Consistent reporting by the transferor and the transferee would be required. This proposal is effective for transfers on or after the date of enactment.

Modify tax treatment of downstream mergers.—If a target corporation owns stock in an acquiring corporation and wants to combine with the acquiring corporation in a downstream transaction, the target corporation transfers its assets to the acquiring corporation, and the shareholders of the target corporation receive stock of the acquiring corporation in exchange for their target corporation stock. Downstream transactions have been held to qualify as tax-free reorganizations. In substance, however, this transaction is a distribution by the target corporation of its acquiring corporation stock to its shareholders, which otherwise would result in gain recognized by the target corporation. Under the proposal, where a target corporation holds less than 80 percent of the stock of an acquiring corporation, and the target corporation combines with the acquiring corporation in a reorganization in which the acquiring corporation is the survivor, the target corporation must recognize gain, but not loss, as if it distributed the acquiring corporation stock that it held immediately prior to the reorganization. Nonrecognition treatment would continue to apply to other assets transferred by the target corporation and to the target corporation shareholders. The proposal would apply to similar transactions: for example, where stock of the target corporation is acquired by the acquiring corporation in a transaction qualifying as a reorganization, and the target corporation is liquidated pursuant to a plan of liquidation adopted not more than two years after the acquisition date. This proposal applies to transactions that occur on or after the date of enactment.

Provide mandatory basis adjustments with respect to partnership distributions.—The basis of partnership property is not adjusted upon a distribution of property to a partner unless a special election is in effect. If such an election is in effect, a partnership must increase the basis of partnership property in certain circumstances and decrease its basis in partnership property in other situations. The electivity of these adjustments provides substantial opportunities for taxpayer abuse. Accordingly, the Administration proposes that basis adjustments in connection with partnership distributions be made mandatory. In addition, unlike current law, the basis adjustment would be measured by reference to the difference between the basis of the distributed property and the amount by which the distributee partner's proportionate share of the adjusted basis of partnership property is reduced by the distribution. This proposal would apply to partnership distributions made on or after the date of enactment.

Modify rules for allocation of basis adjustments for partnership distributions.—Under current law, a partner's basis in distributed property is allocated first to unrealized receivables and inventory items in an amount equal to the adjusted basis of each such property to the partnership, with any remaining basis being allocated among the other distributed property. This basis allocation scheme is intended to prevent partners from shifting basis from capital assets to ordinary income assets. While generally accomplishing this goal, the allocation scheme still allows for a shifting of basis from non-depreciable assets to depreciable assets. The proposal would modify the rule for basis allocations in the event of a liquidation of a partner's interest to include three asset classes: (1) inventory, unrealized receivables and other inventory assets, (2) depreciable assets, and (3) non-depreciable assets. Basis would be allocated in the first two categories up to the partnership's basis in such assets. Residual basis would be allocated to the third category of assets. The partnership's inside asset basis adjustments made in connection with partnership distributions would be determined in the same manner. Basis adjustments relating to transfers of partnership interests would not be affected by this proposal. This proposal would apply to partnership distributions made on or after the date of enactment.

Modify rules for partial liquidations of a partnership.—A partner recognizes gain or loss upon a distribution from a partnership in certain limited circumstances. The basis of property distributed to a partner other than in liquidation of the partner's interest generally is its adjusted basis to the partnership, while the basis of property distributed to a partner in liquidation of the partner's interest is equal to the adjusted basis of such partner's interest in the partnership reduced by any money distributed in the same transaction. These rules provide for an inappropriate deferral of gain with respect to certain partnership distributions and also allow for a misallocation of basis in many

instances. The Administration proposes to treat a partial liquidation of a partner's interest in a partnership as a complete liquidation of that portion of the partner's interest. A partial liquidation would be a reduction in a partner's percentage share of capital, and the percentage that is reduced would be treated as a separate interest that was completely liquidated in the distribution. This proposal would apply to partnership distributions made on or after the date of enactment.

Repeal rules relating to distributions treated as sales or exchanges with respect to unrealized receivables and inventory items.—Under current law, to the extent that a partner receives (1) unrealized receivables or substantially appreciated inventory in exchange for all or part of its interest in other partnership property, or (2) partnership property other than unrealized receivables or substantially appreciated inventory in exchange for all or part of its interest in partnership property that is unrealized receivables or substantially appreciated inventory, such transactions are, under regulations, treated as a sale or exchange of such property between the distributee and the partnership. This rule, which often has been criticized as being overly complex, was designed to prevent taxpayers from converting ordinary income to capital gains through partnership distributions where the distributee partner essentially transferred his share of ordinary income assets to the partnership in exchange for capital gain assets or vice versa. The proposals discussed above would prevent positive basis adjustments from being made to ordinary income assets, which would greatly reduce the ability to carry out such abuses. Accordingly, the Administration proposes that this rule be repealed. This proposal would apply to partnership distributions made on or after the date of enactment.

Require basis adjustments when a partnership distributes certain stock to a corporate partner.—The basis of property distributed to a partner in liquidation of the partner's interest is equal to the adjusted basis of such partner's interest in the partnership reduced by any money distributed in the same transaction. Generally, no gain or loss is recognized on the receipt by a corporation of property distributed in complete liquidation of an 80-percent-owned subsidiary corporation. The basis of property received by the distributee in such a corporate liquidation is the same as it was in the hands of the transferor. These corporate liquidation rules provide taxpayers with the ability to negate the effect of downward basis adjustments by having a partnership contribute property to a corporation prior to a liquidating distribution to a corporate partner. The proposal would require that if stock of a corporation is distributed to a corporate partner that, as a result of the distribution and related transactions, owns 80 percent or more of the stock of such corporation, then the distributed corporation must reduce the basis of its assets by an amount equal to the amount by which the stock basis is reduced as a result of the distribution. The basis must be reduced using the same methodology as is used in the partnership liquidation rules, determined as if the corporation's assets were being distributed. This proposal would apply to partnership distributions made on or after the date of enactment.

Deny change in method treatment to tax-free formations.—Generally, a taxpayer that desires to change its method of accounting must obtain the consent of the Commissioner. In addition, in a transaction to which section 381 applies, a corporation acquiring assets generally is required to use the method of accounting used for those assets by the distributor or transferor corporation. Under current law, section 381 does not apply to tax-free contributions to a corporation or to a partnership. Consequently, taxpayers who transfer assets to a subsidiary or a partnership in a transaction to which section 351 or section 721 applies may avail themselves of a new method of accounting without obtaining the consent of the Commissioner. The Administration proposes to expand the transactions to which the carryover of method of accounting rules in section 381 and the regulations thereunder apply to include tax-free contributions to corporations or partnerships effective for transfers on or after the date of enactment.

Repeal installment method for accrual basis taxpayers.—Generally, an accrual method requires a taxpayer to recognize income when all events have occurred that fix the right to its receipt and its amount can be determined with reasonable accuracy. The installment method of accounting provides an exception to these general recognition principles by allowing a taxpayer to defer recognition of income from the disposition of certain property until payment is received. To the extent that an installment obligation is pledged as security for any indebtedness, the net proceeds of the secured indebtedness are treated as a payment on such obligation, thereby triggering the recognition of income. The installment method is inconsistent with an accrual method of accounting and effectively allows an accrual method taxpayer to recognize income from certain property using the cash receipts and disbursements method. Consequently, the method fails to reflect the economic results of a taxpayer's business during the taxable year. In addition, the pledging rules, which are designed to require the recognition of income when the taxpayer receives cash related to an installment obligation, are inadequate. The Administration proposes to repeal the installment method of accounting for accrual method taxpayers and to eliminate the inadequacies in the pledging rules for installment sales entered into on or after the date of enactment.

Deny deduction for punitive damages.—The current deductibility of most punitive damage payments undermines the role of such damages in discouraging and penalizing certain undesirable actions or activities. The Administration proposes to disallow any deduction for punitive damages paid or incurred by the taxpayer, whether upon a judgment or in settlement of a claim.

Where the liability for punitive damages is covered by insurance, such damages paid or incurred by the insurer would be included in the gross income of the insured person. The insurer would be required to report such payments to the insured person and to the Internal Revenue Service. The proposal would apply to damages paid or incurred on or after the date of enactment.

Apply uniform capitalization rules to tollers.—The uniform capitalization rules require the capitalization of the direct costs, and an allocable portion of the indirect costs, of real or tangible personal property produced by a taxpayer or of real or personal property that is acquired by a taxpayer for resale. Costs attributable to producing or acquiring property generally must be capitalized by charging such costs to basis or, in the case of property which is inventory in the hands of the taxpayer, by including such costs in inventory. In general, a toller charges a fee (known as a toll) to perform certain manufacturing or processing operations on property which is provided by its customers. Since the toller does not take title to the property, it contends that it does not produce property or acquire property for resale. As a result, a toller does not capitalize certain direct and indirect costs attributable to its tolling activities. The Administration believes that the disparate treatment between tollers and manufacturers based on ownership of the raw materials leads to inequitable results. Thus, the uniform capitalization rules would be modified to require tollers to capitalize both their direct costs, and a portion of their indirect costs, allocable to property tolled. An exception would be provided for small businesses. The proposal would be effective for taxable years beginning on or after the date of enactment.

Provide consistent amortization periods for intangibles.—Under current law, start-up and organizational expenditures are amortized at the election of the taxpayer over a period of not less than 5 years. Current law requires certain acquired intangible assets (goodwill, trademarks, franchises, patents, etc.) to be amortized over 15 years. The Administration believes that, to encourage the formation of new businesses, a fixed amount of start-up and organizational expenditures should be currently deductible. Thus, the proposal would allow a taxpayer to elect to deduct up to $5,000 each of start-up or organizational expenditures. However, for each taxpayer, the $5,000 amount is reduced (but not below zero) by the amount by which the cumulative cost of start-up or organizational expenditures exceeds $50,000. Start-up and organizational expenditures not currently deductible would be amortized over a 15-year period consistent with the amortization period for acquired intangible assets. The proposal generally would be effective for start-up and organizational expenditures incurred in taxable years beginning on or after the date of enactment.

Clarify recovery period of utility grading costs.—A taxpayer is allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property that is used in a trade or business or held for the production of income. For most tangible property placed in service after 1986, the amount of the depreciation deduction is determined under the modified accelerated cost recovery system (MACRS) using a statutorily prescribed depreciation method, recovery period, and placed in service convention. The recovery period may be determined by reference to the statutory recovery period or to the list of class lives provided by the Treasury Department. Electric and gas utility clearing and grading costs incurred to extend distribution lines and pipelines have not been assigned a class life. By default, such assets have a seven-year recovery period under MACRS. The Administration believes that the recovery period used for electric and gas utility clearing and grading costs does not reflect the economic useful life of such costs. For example, the electric utility transmission and distribution lines and the gas utility trunk pipelines benefitted by the clearing and grading costs have MACRS recovery periods of 20 years and 15 years, respectively. The proposal would assign depreciable electric and gas utility clearing and grading costs incurred to locate transmission and distribution lines and pipelines to the class life assigned to the benefitted assets, giving these costs a recovery period of 20 years and 15 years, respectively. The proposal would be effective for electric and gas utility clearing and grading costs incurred on or after the date of enactment.

Require recapture of policyholder surplus accounts.—Between 1959 and 1984, stock life insurance companies deferred tax on a portion of their profits. These untaxed profits were added to a policyholders surplus account (PSA). In 1984, Congress precluded life insurance companies from continuing to defer tax on future profits through PSAs. However, companies were permitted to continue to defer tax on their existing PSAs, and to pay tax on the previously untaxed profits in the PSAs only in certain circumstances. There is no remaining justification for allowing these companies to continue to defer tax on profits they earned between 1959 and 1984. Most pre-1984 policies have terminated, because pre-1984 policyholders have surrendered their pre-1984 contracts for cash, ceased paying premiums on those contracts, or died. The Administration proposes that companies generally would be required to include in their gross income over ten years their PSA balances as of the beginning of the first taxable year starting on or after the date of enactment.

Modify rules for capitalizing policy acquisition costs of life insurance companies.—Under current law, insurance companies capitalize varying percentages of their net premiums for certain types of insurance contracts, and generally amortize these amounts over 10 years (five years for small companies). These capitalized amounts are intended to serve as proxies for each company's actual commissions and other policy acquisition expenses. However, data reported by insur-

ance companies to State insurance regulators each year indicates that the insurance industry is capitalizing less than half of its policy acquisition costs, which results in a mismatch of income and deductions. The Administration proposes that insurance companies be required to capitalize modified percentages of their net premiums for certain lines of business. The percentages would be modified once in the first taxable year beginning after the date of enactment, and a second time in the sixth taxable year beginning after the date of enactment. The final modified percentages would more accurately reflect the ratio of actual policy acquisition expenses to net premiums and the typical useful lives of the contracts. To ensure that companies are not required to capitalize more under this proxy approach than they would capitalize under normal tax accounting rules, companies that have low policy acquisition costs generally would be permitted to capitalize their actual policy acquisition costs.

Subject investment income of trade associations to tax.—Trade associations described in section 501(c)(6) generally are exempt from Federal income tax, but are subject to tax on their unrelated business income. Under the proposal, trade associations that have net investment income in excess of $10,000 for any taxable year would be subject to the unrelated business income tax on their excess net investment income. As under current-law section 512(a)(3), investment income would not be subject to tax under the proposal to the extent that it is set aside for a charitable purpose specified in section 170(c)(4). In addition, any gain from the sale of property used directly in the performance of the trade association's exempt function would not be subject to tax under the proposal to the extent that the sale proceeds are used to purchase replacement exempt-function property. The proposal would be effective for taxable years beginning on or after the date of enactment.

Restore phaseout of unified credit for large estates.—Prior to the Taxpayer Relief Act of 1997, the benefit of both the estate tax graduated rate brackets below fifty-five percent and the unified credit were phased out by imposing a five-percent surtax on estates with a value above $10 million. When the Taxpayer Relief Act of 1997 increased the unified credit amount, the phase out of the unified credit was inadvertently omitted. The Administration proposes to restore the surtax in order to phase out the benefits of the unified credit as well as the graduated estate tax brackets. The proposal would be effective for decedents dying after the date of enactment.

Require consistent valuation for estate and income tax purposes.—The basis of property acquired from a decedent generally is its fair market value on the date of death. Property included in the gross estate of a decedent is valued also at its fair market value on the date of death. Recipients of lifetime gifts generally take a carryover basis in the property received. The Administration proposes to impose a duty of consistency on heirs receiving property from a decedent, requiring such heirs to use the value as reported on the estate tax return as the basis for the property for income tax purposes. Estates would be required to notify heirs (and the IRS) of such values. In addition, donors making lifetime gifts would be required to notify the recipients of such gifts (and the IRS) of the donor's basis in the property at the time of the gift, as well as any gift tax paid with respect to the gift. This proposal would be effective for gifts made after, and decedents dying after, the date of enactment.

Require basis allocation for part sale/part gift transactions.—In a part gift, part sale transaction, the donee/purchaser takes a basis equal to the greater of the amount paid by the donee or the donor's adjusted basis at the time of the transfer. The donor/seller uses adjusted cost basis in computing the gain or loss on the sale portion of the transaction. The Administration proposes to rationalize basis allocation in a part gift, part sale transaction by requiring the basis of the property to be allocated ratably between the gift portion and the sale portion based on the fair market value of the property on the date of transfer and the consideration paid. This proposal would be effective for transactions entered into on or after the date of enactment.

Conform treatment of surviving spouses in community property States.—If joint property is owned by spouses in a non-community property state, a surviving spouse receives a stepped-up basis only in the half of the property owned by the deceased spouse. In contrast, when a spouse dies owning community property, the surviving spouse is entitled to a stepped-up basis not only in the half of the property owned by the deceased spouse, but also in the half of the property already owned by the surviving spouse prior to the decedent's death. The Administration proposes to eliminate the stepped-up basis in the part of the community property owned by the surviving spouse prior to the deceased spouse's death. The half of the community property owned by the deceased spouse would continue to be entitled to a stepped-up basis upon death. This treatment will be consistent with the treatment of joint property owned by spouses in a non-community property State. This proposal would be effective for decedents dying after the date of enactment.

Expand section 864(c)(4)(B) to interest and dividend equivalents.—Under U.S. domestic law, a foreign person is subject to taxation in the United States on a net income basis with respect to income that is effectively connected with a U.S. trade or business (ECI). The test for determining whether income is effectively connected to a U.S. trade or business differs depending on whether the income at issue is U.S. source or foreign source. Only enumerated types of foreign source income—rents, royalties, dividends, interest, gains from the sale of inventory property, and insurance income—constitute ECI, and only in certain cir-

cumstances. The proposal would expand the categories of foreign-source income that could constitute ECI to include interest equivalents (including letter of credit fees) and dividend equivalents in order to eliminate arbitrary distinctions between economically equivalent transactions.

Recapture overall foreign losses when CFC stock is disposed.—Under the interest allocation rules of section 864(e), the value of stock in a controlled foreign corporation (CFC) is added to the value of directly-owned foreign assets, and then compared to the value of domestic assets of a corporation (or a group of affiliated U.S. corporations) for purposes of determining how much of the corporation's interest deductions should be allocated against foreign income and how much against domestic income. If these deductions against foreign income result in (or increase) an overall foreign loss which is then set against U.S. income, section 904(f) has recapture rules that require subsequent foreign income or gain to be recharacterized as domestic. Recapture can take place when directly-owned foreign assets, for example, are disposed of. However, there may be no recapture when stock in a CFC is disposed of. The proposal would correct that asymmetry by providing that property subject to the recapture rules upon disposition under section 904(f)(3) would include stock in a CFC.

Increase elective withholding rate for nonperiodic distributions from deferred compensation plans.—The Administration proposes to increase the current 10-percent elective withholding rate for nonperiodic distributions (such as certain lump sums) from pensions, IRAs and annuities to 15 percent, which more closely approximates the taxpayer's income tax liability for the distribution effective for distributions after 1999. The withholding would not apply to eligible rollover distributions.

Increase section 4973 excise tax for excess IRA contributons.—Excess IRA contributions are currently subject to an annual six-percent excise tax. With high investment returns, this annual six-percent rate may be insufficient to discourage contributions in excess of the current limits for IRAs. The Administration proposes to increase from six percent to 10 percent the excise tax on excess contributions to traditional and Roth IRAs for taxable years after the year the excess contribution is made. Thus, the six-percent rate would continue to apply for the year of the excess contribution and a higher annual rate would apply if excess amounts remain in the IRA. This increase would be effective for taxable years beginning after 1999.

Limit pre-funding of welfare benefits for 10 or more employer plans.—Current law generally limits the ability of employers to claim a deduction for amounts used to prefund welfare benefits. An exception is provided for certain arrangements where 10 or more employers participate because it is believed that such relationships involve risk-sharing similar to insurance which will effectively eliminate any incentive for participating employers to prefund benefits. However, as a practical matter, it has proven difficult to enforce the risk-sharing requirements in the context of certain arrangements. The Administration proposes to limit the 10 or more employer plan funding exception to medical, disability, and group-term life insurance benefits because these benefits do not present the same risk of prefunding abuse. Thus, effective for contributions paid on or after the date of enactment, the existing deduction rules would apply to prevent an employer who contributes to a 10 or more employer plan from claiming a current deduction for supplemental unemployment benefits, severance pay or life insurance (other than group-term life insurance) benefits to be paid in future years.

Subject signing bonuses to employment taxes.—Bonuses paid to individuals for signing a first contract of employment are ordinary income in the year received. The Administration proposes to clarify that these amounts are treated as wages for purposes of income tax withholding and FICA taxes effective after the date of enactment. No inference is intended with respect to the application of prior law withholding rules to signing bonuses.

Expand reporting of cancellation of indebtedness income.—Under current law, gross income generally includes income from the discharge of indebtedness. If a bank, thrift institution, or credit union discharges $600 or more of any indebtedness of a debtor, the institution must report such discharge to the debtor and the IRS. The proposal would extend these reporting requirements to additional entities involved in the trade or business of lending for discharges of indebtedness occurring on or after the date of enactment.

Require taxpayers to include rental income of residence in income without regard to the period of rental.—Under current law, rental income is generally includable in income and the deductibility of expenses attributable to the rental property is subject to certain limitations. An exception to this general treatment applies if a dwelling is used by the taxpayer as a residence and is rented for less than 15 days during the taxable year. The income from such a rental is not included in gross income and no expenses arising from the rental are deductible. The Administration proposes to repeal this 15-day exception. The proposal would apply to taxable years beginning after December 31, 1999.

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 or 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 similar 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.

Defer interest deduction and original issue discount (OID) on certain 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.

Modify deposit requirement for Federal Unemployment Act (FUTA).—Beginning in 2005, 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.

Reinstate Oil Spill Liability Trust Fund 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, 2009. 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.

Deny 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 dividends-received deduction for dividends on nonqualified preferred stock (as defined in section 351(g)), except in the case of "qualifying dividends." This proposal is effective for nonqualified preferred stock issued after the date of first committee action.

Disallow interest on debt allocable to tax-exempt obligations.—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.

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.

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.

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.

Require withholding on certain gambling winnings —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.

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, 1999.

Replace sales-source rules with activity-based rules.—If inventory is manufactured in the United States and sold abroad, Treasury regulations provide that 50 percent of the income from such sales is treated as earned by production activities and 50 percent by sales activities. The income from the production activities is sourced on the basis of the location of assets held or used to produce the income. The income from the sales activity (the remaining 50 percent) is sourced based on where title to the inventory transfers. If inventory is purchased in the United States and sold abroad, 100 percent of the sales income generally is deemed to be foreign source. These rules generally produce more foreign source income for United States tax purposes than is subject to foreign tax. Thus, the rules generally increase the U.S exporters' foreign tax credit limitation and thereby allow U.S. exporters that operate in high-tax foreign countries to credit tax in excess of the U.S. rate against their U.S. tax liability. The proposal would require that the allocation between production activities and sales activities be based on actual economic activity. The proposal would be effec-

tive for taxable years beginning after the date of enactment.

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 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, 2000 and to acquisitions of a C corporation by an S corporation made after December 31, 1999.

Eliminate the income recognition exception for accrual method service providers.—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 beginning after the date of enactment.

Modify structure of businesses indirectly conducted by REITs.—REITs generally are restricted to owning passive investments in real estate and certain securities. No single corporation can account for more than five percent of the total value of a REIT's assets, and a REIT cannot own more than 10 percent of the outstanding voting securities of any issuer. Through the use of non-voting preferred stock and multiple subsidiaries, up to 25 percent of the value of a REIT's assets can consist of subsidiaries that conduct otherwise impermissible activities. Under the proposal, the 10-percent vote test would be changed to a "vote or value" test. This would prevent REITs from undertaking impermissible activities through preferred stock subsidiaries. However, the proposal also would provide an exception to the five- and 10-percent asset tests so that REITs could have "taxable REIT subsidiaries" that would be allowed to perform non-customary and other currently prohibited services with respect to REIT tenants and other customers. Under the proposal, there would be two types of taxable REIT subsidiaries, a "qualified independent contractor subsidiary" and a "qualified business subsidiary." A qualified business subsidiary would be allowed to undertake non-tenant related activities that currently generate bad income for a REIT. A qualified independent contractor subsidiary would be allowed to perform non-customary and other currently prohibited services with respect to REIT tenants as well as activities that could be performed by a qualified business subsidiary. All taxable REIT subsidiaries owned by a REIT could not represent more than 15 percent of the value of the REIT's total assets, and within that 15-percent limitation, no more than five percent of the total value of a REIT's assets could consist of qualified independent contractor subsidiaries. A number of additional constraints would be imposed on a taxable REIT subsidiary to ensure that the taxable REIT subsidiary pays a corporate level tax on its earnings. This proposal would be effective after the date of enactment. REITs would be allowed to combine and convert preferred stock subsidiaries into taxable REIT subsidiaries tax-free prior to a certain date.

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 50 percent or more of the total combined voting power of all classes of voting stock or 50 percent or more of the total value of all 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.

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 40-percent excise tax on the difference between the amount paid by the purchaser to the injured person and the undiscounted value of the purchased payment stream 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 on or 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.

Amend 80/20 company rules.—Interest or 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 on or after 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 nonresident'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 of section 883.—Under section 887, a foreign corporation is subject to a four-percent tax on its United States source gross transportation income. Under section 883, however, the tax will not apply 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 to current U.S. 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. Residents of non-exemption countries, however, 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 four-percent U.S. tax. The proposal would stop that abuse. It would be effective for taxable years beginning on or 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.

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 non-business assets. The proposal would be effective for gifts made after, and decedents dying after, the date of enactment.

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 trust 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.

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, banks and brokerage firms, 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 deductible 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 25 percent.

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, 1998 and before January 1, 2010.

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, 2009. These taxes expired on December 31, 1995.

Convert a portion of the excise taxes deposited in the Airport and Airway Trust Fund to cost-based user fees assessed for Federal Aviation Administration (FAA) services.—The excise taxes that are levied on domestic air passenger tickets and flight segments, international departures and arrivals, and domestic air cargo are proposed to be reduced over time as more efficient, cost-based user fees for air traffic services are phased in beginning in fiscal year 2000. The excise taxes are proposed to be reduced as necessary to ensure that the amount collected each year from the new user fees and the excise taxes together is equal to the total budget resources requested for the FAA in each succeeding year.

Receipts from tobacco legislation.—The Administration includes receipts from tobacco legislation in the 2000 budget. These receipts, which total approximately $34 billion for the five years 2000 through 2004, would provide reimbursements for tobacco-related health care costs.

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.

Restore premiums for the United Mine Workers of America Combined Benefit Fund.—The Administration proposes legislation to restore the previous calculation of premiums charged to coal companies that employed the retired miners that have been assigned to them. By reversing the court decision of *National Coal v. Chater*, this legislation will restore a premium calculation that supports medical cost containment.

Assess mortgage transaction fees for flood hazard determination.—The Administration proposes to establish a $15 fee on mortgage originations and refinancings to support a multi-year program to update and modernize FEMA's inventory of floodplain maps (100,000 maps). Accurate and easy to use flood hazard maps are essential in determining if a property is located in a floodplain. The maps allow lenders to meet their statutory obligation of requiring risk-prone homes with a mortgage to carry flood insurance, and allow homeowners to assess their risk of flood damage. These maps are the basis for developing appropriate risk-based flood insurance premium charges, and improved maps will result in a more actuarially sound insurance program.

Replace Harbor Maintenance Tax with the Harbor Services User Fee (receipt effect).—The Administration proposes to replace the ad valorem Harbor Maintenance Tax with a cost-based user fee, the Harbor Services User Fee. The user fee will finance harbor construction, operation, and maintenance activities performed by the Army Corps of Engineers, the costs of operating and maintaining the Saint Lawrence Seaway, and the costs of administering the fee. The fee will raise an average of $980 million annually through FY 2004, which is less than would have been raised by the Harbor Maintenance Tax before the Supreme Court decision that the ad valorem tax on exports was unconstitutional.

Allow members of the clergy to revoke exemption from Social Security and Medicare coverage.—Under current law, ministers of a church who are opposed to participating in the Social Security and Medicare programs on religious principles may reject coverage by filing with the Internal Revenue Service before the tax filing date for their second year of work in the ministry. This proposal would provide an opportunity for members of the clergy to revoke their exemptions from Social Security and Medicare coverage.

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 millions of dollars)

	Estimate						
	1999	2000	2001	2002	2003	2004	2000–2004
Provide tax relief and extend expiring provisions:							
Make health care more affordable:							
Provide tax relief for long-term care needs	.....	–52	–1,107	–1,144	–1,312	–1,408	–5,023
Provide tax relief for workers with disabilities	.....	–21	–151	–169	–187	–196	–724
Provide tax relief to encourage small business health plans	.....	–1	–5	–10	–15	–13	–44
Subtotal, make health care more affordable	.....	–74	–1,263	–1,323	–1,514	–1,617	–5,791
Expand education initiatives:							
Provide incentives for public school construction and modernization	.....	–146	–570	–939	–1,035	–1,045	–3,735
Extend employer-provided educational assistance and include graduate education	–72	–267	–719	–236	.....	.....	–1,222
Provide tax credit for workplace literacy and basic education programs	.....	–3	–18	–25	–38	–55	–139
Encourage sponsorship of qualified zone academies	.....	–22	–43	–55	–24	.....	–144
Eliminate 60-month limit on student loan interest deduction	.....	–18	–61	–62	–67	–73	–281
Eliminate tax when forgiving student loans subject to income contingent repayment	.....	.....	.....	.....	.....	.....	.....
Provide tax relief for participants in certain Federal education programs	.....	–3	–7	–7	–7	–6	–30
Subtotal, expand education initiatives	–72	–459	–1,418	–1,324	–1,171	–1,179	–5,551
Make child care more affordable:							
Increase, expand, and simplify child and dependent care tax credit	.....	–338	–1,585	–1,426	–1,471	–1,503	–6,323
Provide tax incentives for employer-provided child-care facilities	.....	–40	–84	–114	–131	–140	–509
Subtotal, make child care more affordable	.....	–378	–1,669	–1,540	–1,602	–1,643	–6,832

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

(In millions of dollars)

	Estimate						
	1999	2000	2001	2002	2003	2004	2000–2004
Provide incentives to revitalize communities:							
Increase low-income housing tax credit per capita cap	.....	–46	–186	–330	–474	–620	–1,656
Provide Better America Bonds to improve the environment	.....	–8	–49	–127	–205	–284	–673
Provide New Markets Tax Credit	.....	–12	–88	–207	–297	–376	–980
Expand tax incentives for SSBICs	–*	–*	–*	–*	–*	–*	–*
Extend wage credit for two new EZs	.....	.....	.....	.....	.....	.....	.....
Subtotal, provide incentives to revitalize communities	.....	–66	–323	–664	–976	–1,280	–3,309
Promote energy efficiency and improve the environment:							
Provide tax credit for energy-efficient building equipment	.....	–230	–407	–376	–393	–127	–1,533
Provide tax credit for new energy-efficient homes	.....	–60	–109	–92	–72	–96	–429
Extend electric vehicle tax credit; provide tax credit for fuel-efficient vehicles	.....	.....	.....	–4	–178	–712	–894
Provide investment tax credit for CHP systems	–1	–64	–99	–110	–52	–7	–332
Provide tax credit for rooftop solar systems	.....	–9	–19	–25	–34	–45	–132
Extend wind and biomass tax credit and expand eligible biomass sources	.....	–20	–48	–73	–88	–94	–323
Subtotal, promote energy efficiency and improve the environment	–1	–383	–682	–680	–817	–1,081	–3,643
Promote expanded retirement savings, security and portability	–27	–144	–204	–218	–213	–218	–997
Extend expiring provisions:							
Allow personal tax credits against the AMT	–67	–679	–707	.....	.....	.....	–1,386
Extend work opportunity tax credit	–23	–116	–164	–81	–38	–16	–415
Extend welfare-to-work tax credit	–3	–19	–36	–21	–9	–2	–87
Extend R&E tax credit	–311	–933	–656	–281	–133	–53	–2,056
Make permanent the expensing of brownfields remediation costs	.....	.....	–106	–170	–168	–167	–611
Extend tax credit for first-time DC homebuyers	1	–1	–10	–1	.....	.....	–12
Subtotal, extend expiring provisions	–403	–1,748	–1,679	–554	–348	–238	–4,567
Simplify the tax laws	–64	–141	–159	–154	–104	–41	–599
Miscellaneous provisions:							
Make first $2,000 of severance pay exempt from income tax	.....	–42	–168	–173	–133	.....	–516
Allow steel companies to carryback NOLs up to five years	–19	–190	–28	–30	–24	–20	–292
Subtotal, miscellaneous provisions	–19	–232	–196	–203	–157	–20	–808
Electricity restructuring:							
Deny tax-exempt status for new electric utility bonds except for distribution related expenses; repeal cost of service limitation for determining deductible contributions to nuclear decommissioning funds	.....	4	11	20	30	41	106
Subtotal, electricity restructuring	.....	4	11	20	30	41	106
Modify international trade provisions:							
Extend and modify Puerto Rico economic-activity tax credit	.....	–24	–46	–71	–106	–141	–388
Extend GSP and modify other trade provisions [1]	–84	–484	–223	–93	–96	–99	–995
Levy tariff on certain textiles/apparel produced in the CNMI [1]	.....	.....	187	187	187	187	748
Expand Virgin Island tariff credits [1]	.....	.....	–*	–*	–2	–1	–3
Subtotal, modify international trade provisions	–84	–508	–82	23	–17	–54	–638
Subtotal, provide tax relief and extend expiring provisions	**–670**	**–4,129**	**–7,664**	**–6,617**	**–6,889**	**–7,330**	**–32,629**
Eliminate unwarranted benefits and adopt other revenue measures:							
Limit benefits of corporate tax shelter transactions:							
Deny tax benefits resulting from non-economic transactions; modify substantial understatement penalty for corporate tax shelters; deny deductions for certain tax advice and impose excise taxes on certain fees, rescission provisions and provisions guaranteeing tax benefits	.....	11	76	162	194	214	657
Preclude taxpayers from taking tax positions inconsistent with the form of their transactions	5	50	52	55	58	62	277
Tax income from corporate tax shelters involving tax-indifferent parties	15	150	155	165	175	185	830
Require accrual of income on forward sale of corporate stock	1	4	9	13	21	31	78
Modify treatment of built-in losses and other attribute trafficking	9	113	185	192	200	208	898
Modify treatment of ESOP as S corporation shareholder	17	64	102	145	183	202	696
Prevent serial liquidation of U.S. subsidiaries of foreign corporations	.....	12	20	19	19	19	89
Prevent capital gains avoidance through basis shift transactions involving foreign shareholders	65	301	114	64	45	27	551
Limit inappropriate tax benefits for lessors of tax-exempt use property	1	35	79	119	147	163	543
Prevent mismatching of deductions and income exclusions in transactions with related foreign persons	.....	60	104	108	112	117	501

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

(In millions of dollars)

	Estimate						
	1999	2000	2001	2002	2003	2004	2000–2004
Restrict basis creation through Section 357(c)	3	9	19	28	39	50	145
Modify anti-abuse rule related to assumption of liabilities	1	2	4	5	7	9	27
Modify COLI rules	.....	240	366	398	427	451	1,882
Subtotal, limit benefits of corporate tax shelter transactions	117	1,051	1,285	1,473	1,627	1,738	7,174
Other proposals:							
Require banks to accrue interest on short-term obligations	.....	72	2	3	4	4	85
Require current accrual of market discount by accrual method taxpayers	3	7	11	15	20	25	78
Limit conversion of character of income from constructive ownership transactions with respect to partnership interests	19	30	37	32	32	35	166
Modify rules for debt-financed portfolio stock	1	5	9	14	20	26	74
Modify and clarify certain rules relating to debt-for-debt exchanges	15	76	109	108	107	106	506
Modify and clarify straddle rules	16	40	50	48	47	49	234
Conform control test for tax-free incorporations, distributions, and reorganizations	7	18	22	22	21	21	104
Tax issuance of tracking stock	40	105	128	127	127	127	614
Require consistent treatment and provide basis allocation rules for transfers of intangibles in certain nonrecognition transactions	2	66	83	86	90	95	420
Modify tax treatment of downstream mergers	14	42	55	59	63	67	286
Modify partnership distribution rules	–28	131	162	173	162	147	775
Deny change in method treatment to tax-free formations	6	94	64	65	67	70	360
Repeal installment method for accrual basis taxpayers	.....	685	757	438	114	16	2,010
Deny deduction for punitive damages	16	88	124	130	137	143	622
Apply uniform capitalization rules to tollers	.....	25	39	40	42	21	167
Provide consistent amortization periods for intangibles	.....	–219	–189	48	255	435	330
Clarify recovery period of utility grading costs	9	30	49	61	69	75	284
Require recapture of policyholder surplus accounts	.....	134	222	219	217	215	1,007
Modify rules for capitalizing policy acquisition costs of life insurance companies	.....	379	977	946	914	880	4,096
Subject investment income of trade associations to tax	.....	172	294	309	325	341	1,441
Restore phaseout of unified credit for large estates	.....	27	61	66	72	76	302
Require consistent valuation for estate and income tax purposes	.....	3	8	13	17	22	63
Require basis allocation for part sale/part gift transactions	.....	2	3	4	5	6	20
Conform treatment of surviving spouses in community property States	3	15	33	46	59	72	225
Expand section 864(c)(4)(B) to interest and dividend equivalents	.....	9	15	16	16	17	73
Recapture overall foreign losses when CFC stock is disposed	.....	6	6	6	6	7	31
Increase elective withholding rate for nonperiodic distributions from deferred compensation plans	.....	42	2	2	2	2	50
Increase section 4973 excise tax for excess IRA contributions	.....	1	12	12	13	14	52
Limit pre-funding of welfare benefits for 10 or more employer plans	.....	92	156	159	150	149	706
Subject signing bonuses to employment taxes	.....	5	3	3	3	3	17
Expand reporting of cancellation of indebtedness income	.....	7	7	7	7	7	35
Require taxpayers to include rental income of residence in income without regard to the period of rental	.....	4	11	11	12	12	50
Repeal lower-of-cost-or-market inventory accounting method	18	422	525	431	433	201	2,012
Defer interest deduction and OID on certain convertible debt	2	9	20	32	44	55	160
Modify deposit requirement for FUTA	.....	.....	.....	.....	.....	.....	.....
Reinstate Oil Spill Liability Trust Fund tax [1]	26	254	256	257	261	264	1,292
Deny DRD for certain preferred stock	4	13	26	38	52	66	195
Disallow interest on debt allocable to tax-exempt obligations	4	11	17	23	28	33	112
Repeal percentage depletion for non-fuel minerals mined on Federal and formerly Federal lands	.....	92	94	96	97	99	478
Modify rules relating to foreign oil and gas extraction income	.....	5	65	107	112	118	407
Increase penalties for failure to file correct information returns	.....	6	12	15	19	13	65
Tighten the substantial understatement penalty for large corporations	.....	.....	25	42	43	37	147
Require withholding on certain gambling winnings	.....	17	4	1	1	1	24
Simplify foster child definition under EITC	.....	.....	6	7	7	7	27
Replace sales-source rules with activity-based rules	.....	310	540	570	600	630	2,650
Repeal tax-free conversions of large C corporations into S corporations	.....	10	32	46	56	68	212
Eliminate the income recognition exception for accrual method service providers	1	32	44	46	48	50	220
Modify structure of businesses indirectly conducted by REITs	4	27	27	27	28	28	137
Modify treatment of closely held REITs	.....	24	10	12	14	15	75
Impose excise tax on purchase of structured settlements	6	8	6	3	1	–2	16
Amend 80/20 company rules	28	48	49	51	52	53	253
Modify foreign office material participation exception applicable to inventory sales attributable to nonresident's U.S. office	1	7	10	10	11	11	49
Stop abuse of CFC exception to ownership requirements of section 883	.....	4	9	7	5	5	30
Include QTIP trust assets in surviving spouse's estate	.....	.....	2	2	2	2	8
Eliminate non-business valuation discounts	.....	206	425	443	477	494	2,045

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

(In millions of dollars)

	Estimate						
	1999	2000	2001	2002	2003	2004	2000–2004
Eliminate gift tax exemption for personal residence trusts	.....	–1	–1	–1	3	12	12
Increase proration percentage for P&C insurance companies	.....	–4	49	64	87	107	303
Subtotal, other proposals	217	3,693	5,574	5,617	5,676	5,652	26,212
Subtotal, eliminate unwarranted benefits and adopt other revenue measures [1]	**334**	**4,744**	**6,859**	**7,090**	**7,303**	**7,390**	**33,386**
Other provisions that affect receipts:							
Reinstate environmental tax on corporate taxable income [2]	.....	794	460	463	476	481	2,674
Reinstate Superfund excise taxes [1]	109	738	747	756	766	778	3,785
Convert Airport and Airway Trust Fund taxes to a cost-based user fee system [1]	.....	1,122	1,184	1,091	1,007	910	5,314
Receipts from tobacco legislation [1]	–77	7,987	7,105	6,589	6,418	6,400	34,499
Assess fees for examination of bank holding companies and State-chartered member banks (receipt effect) [1]	.....	82	86	90	94	98	450
Restore premiums for United Mine Workers of America Combined Benefit Fund	8	15	14	13	12	12	66
Assess mortgage transaction fees for flood hazard determination [1]	.....	58	59	62	65	68	312
Replace Harbor Maintenance tax with the Harbor Services User Fee (receipt effect) [1]	.....	–472	–505	–541	–578	–619	–2,715
Allow members of the clergy to revoke exemption from Social Security and Medicare coverage	.....	5	8	10	10	11	44
Create solvency incentive for State unemployment trust fund accounts [1]	.....	224	312	96	.....	.....	632
Subtotal, other provisions that affect receipts [1]	**40**	**10,553**	**9,470**	**8,629**	**8,270**	**8,139**	**45,061**
Total effect of proposals [1]	**–296**	**11,168**	**8,665**	**9,102**	**8,684**	**8,199**	**45,818**

*$500,000 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	1998 Actual	Estimate					
		1999	2000	2001	2002	2003	2004
Individual income taxes (federal funds):							
Existing law	828,586	869,160	902,059	918,399	947,596	975,721	1,022,940
Proposed Legislation (PAYGO)	.....	–144	–1,484	–5,181	–4,277	–4,516	–4,727
Legislative proposal, discretionary offset	.....	–71	–834	–741	–569	–502	–478
Total individual income taxes	**828,586**	**868,945**	**899,741**	**912,477**	**942,750**	**970,703**	**1,017,735**
Corporation income taxes:							
Federal funds:							
Existing law	188,598	182,346	186,496	192,604	199,217	207,884	217,189
Proposed Legislation (PAYGO)	.....	–123	2,056	3,452	3,679	3,837	3,662
Legislative proposal, discretionary offset	.....	–13	–418	–208	–171	–151	–138
Total Federal funds corporation income taxes	188,598	182,210	188,134	195,848	202,725	211,570	220,713
Trust funds:							
Hazardous substance superfund	79	.....	.....	.....	.....	.....	.....
Legislative proposal, discretionary offset	.....	.....	1,222	707	713	732	740
Total corporation income taxes	**188,677**	**182,210**	**189,356**	**196,555**	**203,438**	**212,302**	**221,453**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	358,784	383,176	398,777	412,564	428,922	446,411	464,104
Proposed Legislation (non-PAYGO)	.....	.....	3	6	8	8	9
Disability insurance (Off-budget)	57,015	60,860	66,534	70,065	72,833	75,804	78,813
Proposed Legislation (non-PAYGO)	.....	.....	.....	1	1	1	1
Hospital insurance	119,863	127,363	131,982	136,933	142,483	148,429	154,624
Proposed Legislation (PAYGO)	.....	.....	2	2	2	2	2
Railroad retirement:							
Social Security equivalent account	1,769	1,685	1,720	1,749	1,769	1,792	1,813
Rail pension and supplemental annuity	2,583	2,656	2,693	2,750	2,789	2,824	2,848
Total employment and general retirement	540,014	575,740	601,711	624,070	648,807	675,271	702,214
On-budget	124,215	131,704	136,397	141,434	147,043	153,047	159,287
Off-budget	415,799	444,036	465,314	482,636	501,764	522,224	542,927
Unemployment insurance:							
Deposits by States [1]	21,047	22,208	23,464	24,689	26,165	25,934	26,371
Proposed Legislation (PAYGO)	.....	.....	280	390	120	.....	.....
Federal unemployment receipts [1]	6,369	6,446	6,536	6,557	6,650	6,699	6,773
Proposed Legislation (PAYGO)	.....	.....	.....	.....	.....	.....	.....
Railroad unemployment receipts [1]	68	111	77	37	70	124	130
Total unemployment insurance	27,484	28,765	30,357	31,673	33,005	32,757	33,274
Other retirement:							
Federal employees' retirement—employee share	4,259	4,248	4,396	4,493	4,482	3,912	3,659
Non-Federal employees retirement [2]	74	71	65	60	54	44	39
Total other retirement	4,333	4,319	4,461	4,553	4,536	3,956	3,698
Total social insurance and retirement receipts	**571,831**	**608,824**	**636,529**	**660,296**	**686,348**	**711,984**	**739,186**
On-budget	156,032	164,788	171,215	177,660	184,584	189,760	196,259
Off-budget	415,799	444,036	465,314	482,636	501,764	522,224	542,927
Excise taxes:							
Federal funds:							
Alcohol taxes	7,215	7,240	7,249	7,251	7,235	7,220	7,207
Tobacco taxes	5,657	5,028	6,264	6,705	7,370	7,575	7,553
Legislative proposal, discretionary offset	.....	185	1,441	906	217	.....	.....
Transportation fuels tax	589	811	717	735	720	739	746
Telephone and teletype services	4,910	5,213	5,489	5,780	6,097	6,439	6,801
Ozone depleting chemicals and products	98	52	26	13	3	.....	.....
Other Federal fund excise taxes	3,196	–564	1,766	1,721	1,686	1,606	1,607

Table 3–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	1998 Actual	Estimate					
		1999	2000	2001	2002	2003	2004
Proposed Legislation (PAYGO)	.....	8	13	15	16	18	19
Legislative proposal, discretionary offset	.....	–381	381	.....	.....	.....	.....
Total Federal fund excise taxes	21,665	17,592	23,346	23,126	23,344	23,597	23,933
Trust funds:							
Highway	26,628	38,464	33,097	33,642	34,252	34,890	35,539
Airport and airway	8,111	10,397	9,251	9,693	10,441	11,060	11,736
Legislative proposal, discretionary offset	.....	.....	1,496	1,579	1,455	1,341	1,214
Aquatic resources	290	376	334	340	377	381	398
Black lung disability insurance	636	638	656	674	690	705	720
Inland waterway	91	102	105	107	109	111	113
Hazardous substance superfund	.....	.....	.....	.....	.....	.....	.....
Legislative proposal, discretionary offset	.....	147	985	996	1,008	1,022	1,037
Oil spill liability	.....	.....	.....	.....	.....	.....	.....
Proposed Legislation (PAYGO)	.....	35	339	341	344	348	351
Vaccine injury compensation	116	112	113	114	116	116	117
Leaking underground storage tank	136	212	180	183	187	190	194
Total trust funds excise taxes	36,008	50,483	46,556	47,669	48,979	50,164	51,419
Total excise taxes	**57,673**	**68,075**	**69,902**	**70,795**	**72,323**	**73,761**	**75,352**
Estate and gift taxes:							
Federal funds	24,076	25,932	26,740	27,880	29,979	31,046	33,318
Proposed Legislation (PAYGO)	.....	.....	232	487	510	554	584
Total estate and gift taxes	**24,076**	**25,932**	**26,972**	**28,367**	**30,489**	**31,600**	**33,902**
Customs duties:							
Federal funds	17,585	17,110	18,941	19,953	21,219	22,767	24,663
Proposed Legislation (PAYGO)	.....	–112	–645	–48	125	119	115
Trust funds	712	656	697	744	792	844	901
Legislative proposal, discretionary offset	.....	.....	–629	–674	–721	–771	–825
Total customs duties	**18,297**	**17,654**	**18,364**	**19,975**	**21,415**	**22,959**	**24,854**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	112	120	123	126	128	131	134
Receipts from tobacco legislation (discretionary offset)	.....	165	6,525	6,426	6,426	6,418	6,400
United Mine Workers of America combined benefit fund	340	281	291	282	275	270	263
Proposed Legislation (PAYGO)	.....	8	15	14	13	12	12
Deposit of earnings, Federal Reserve System	24,540	26,354	25,121	26,008	26,941	27,973	28,896
Proposed Legislation (PAYGO)	.....	.....	110	115	120	125	130
Defense cooperation	.....	6	6	6	6	6	6
Fees for permits and regulatory and judicial services	5,560	5,629	7,752	9,713	14,244	14,620	15,033
Proposed Legislation (PAYGO)	.....	.....	78	80	83	87	91
Fines, penalties, and forfeitures	1,925	1,962	1,963	1,984	1,968	1,977	1,988
Gifts and contributions	222	206	181	134	128	131	129
Refunds and recoveries	–41	–37	–37	–37	–37	–37	–37
Total miscellaneous receipts	**32,658**	**34,694**	**42,128**	**44,851**	**50,295**	**51,713**	**53,045**
Total budget receipts	**1,721,798**	**1,806,334**	**1,882,992**	**1,933,316**	**2,007,058**	**2,075,022**	**2,165,527**
On-budget	1,305,999	1,362,298	1,417,678	1,450,680	1,505,294	1,552,798	1,622,600
Off-budget	415,799	444,036	465,314	482,636	501,764	522,224	542,927
MEMORANDUM							
Federal funds	1,113,467	1,146,637	1,200,714	1,224,894	1,271,291	1,312,435	1,374,499
Trust funds	385,631	413,274	426,370	443,257	461,895	479,001	496,908
Interfund transactions	–193,099	–197,613	–209,406	–217,471	–227,892	–238,638	–248,807
Total on-budget	**1,305,999**	**1,362,298**	**1,417,678**	**1,450,680**	**1,505,294**	**1,552,798**	**1,622,600**
Off-budget (trust funds)	**415,799**	**444,036**	**465,314**	**482,636**	**501,764**	**522,224**	**542,927**

Table 3–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	1998 Actual	Estimate					
		1999	2000	2001	2002	2003	2004
Total	**1,721,798**	**1,806,334**	**1,882,992**	**1,933,316**	**2,007,058**	**2,075,022**	**2,165,527**

[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 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.

4. USER FEES AND OTHER COLLECTIONS

The Federal Government sometimes charges user fees to those who directly benefit from a particular activity. The term "user fee" is defined as fees, charged, and assessments levied on a class directly benefitting 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 to those benefitting 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 collections for agricultural quarantine inspection).

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. Both categories include collections from other accounts within the Government as well as the public. 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 23, "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; 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 $146.9 billion in 2000, rising to $170.1 billion in 2004. User fee collections by the United States Postal Service, Medicare premiums, service charges on foreign military sales, the Tennessee Valley Authority and other power marketing agencies, and fees collected by the Department of Defense at commissaries, for housing, and for other miscellaneous activities are estimated to be nearly 80 percent of all existing user fee collections.

User fee collections are used to offset outlays in both the discretionary and mandatory categories of the budget. User fee collections are estimated to provide $17.4 billion to offset discretionary spending. These offsets include both offsetting collections credited directly to appropriations accounts and collections credited to offsetting receipt accounts. The Administration is proposing to augment offsetting collections available for discretionary spending by making collections from Federal Aviation Administration (FAA) cost-based user fees and the new harbor services fee, approximately $2.1 billion, available for discretionary spending.

Mandatory user fee collections are estimated to provide $127.4 billion in 2000. Of this amount, approximately $126.5 billion offsets mandatory outlays, while the remaining collections, from the Harbor Services fee, would be made available to offset discretionary spending.

A small portion of governmental receipts are considered to be user fee collections. In 2000, an estimated $2.1 billion in governmental receipts are user fees. Of these fees, about 72 percent are part of the proposal that would make FAA's cost-based user fees available to offset discretionary spending. The remaining fees in this category are made available to finance the regulatory program or activity for which they are charged through the appropriations process.

Table 4–3 provides more detail for offsetting receipts collected from the public and includes offsetting receipts collected from other accounts within the Government.

Table 4–1. TOTAL USER FEE COLLECTIONS

(In millions of dollars)

	1998 actual	Estimates						Total 1999–2004
		1999	2000	2001	2002	2003	2004	
Governmental receipts:								
Proposed FAA user fees to replace excise taxes [1]	.....	.....	1,496	1,579	1,455	1,341	1,214	7,085
Harbor maintenance and inland waterway fees [2]	622	588	.....	.....	.....	.....	.....	588
Agricultural quarantine inspection fees	152	160	219	232	239	246	253	1,349
FEMA, flood map modernization	.....	.....	78	80	83	87	91	419
Other governmental receipt user fees	223	244	295	298	303	304	308	1,508
Total, governmental receipts	997	992	2,088	2,189	2,080	1,978	1,866	10,201
Offsetting collections by function and category:								
Discretionary								
National Defense, Housing and commissary fees paid by military personnel and other fees	7,594	7,313	7,253	7,255	7,239	7,239	7,239	43,538
Energy, Nuclear Regulatory Commission, Federal Energy Regulatory Commission and other fees	814	858	870	870	870	870	870	5,208
Science, Reimbursement for the use of NASA services	682	863	838	838	838	838	838	5,053
Commerce and Housing Credit, Patent and Trademark Office, Federal Communications Commission, Securities and Exchange Commission and other fees	1,754	1,703	1,931	1,914	1,906	1,893	1,829	11,176
Transportation, Panamal Canal and other fees	884	896	434	558	558	558	558	3,562
Health, Food and Drug Administration, Health Care Financing Administration, food safety and other fees	404	400	1,202	1,202	1,202	1,202	1,202	6,410
Veterans, medical care and other fees	700	641	765	929	1,146	1,153	1,179	5,813
Justice, Customs, bankruptcy and other fees	259	283	771	771	771	771	771	4,138
General Government, Bureau of Engraving and Printing, U.S. Mint and IRS fees	1,573	1,821	1,848	1,848	1,848	1,848	1,848	11,061
All other functions, discretionary	753	944	1,444	1,448	1,449	1,451	1,453	8,189
Total discretionary offsetting collections	15,417	15,722	17,356	17,633	17,827	17,823	17,787	104,148
Mandatory								
International, Service charges on foreign military sales	14,135	13,280	12,690	12,140	12,050	9,720	8,610	68,490
Energy, Tennessee Valley Authority and other power marketing fees	10,046	8,951	9,136	9,332	9,325	9,531	9,795	56,070
Natural resources and the environment:								
Harbor Services fees [2]	.....	966	963	960	996	1,014	4,899	
Recreation and admission fees and other fees	649	629	651	661	697	706	724	4,068
Subtotal, Natural resources and environmental fees	649	629	1,617	1,624	1,657	1,702	1,738	8,967
Agriculture, Crop insurance premiums, inspection, grading and other fees	801	1,080	1,125	1,166	1,200	1,240	1,285	7,096
Commerce and Housing Credit:.								
United States Postal Service	59,757	62,639	65,036	67,900	71,000	74,000	77,000	417,575
Deposit Insurance and other fees	900	698	834	944	1,075	1,353	1,690	6,594
Subtotal, Commerce and housing credit	60,657	63,337	65,870	68,844	72,075	75,353	78,713	424,192
Community development, Flood insurance and other fees	1,355	1,461	1,560	1,666	1,773	1,887	2,018	10,365
Health, Federal Employee Health Benefits and other fees	4,492	4,845	5,489	6,011	6,519	7,066	7,585	37,515
Medicare premiums	20,747	21,299	22,834	25,279	27,615	30,647	32,939	160,613
Income Maintenance, Pension Benefit Guaranty Corporation, Federal employees life insurance premiums	1,930	1,965	2,163	2,331	2,461	2,601	2,733	14,254
Veterans, Insurance premiums and other fees	1,739	1,706	1,683	1,643	1,603	1,566	1,525	9,726
Justice, Immigration, Customs and other justice fees	2,430	2,542	2,794	2,837	2,895	2,976	3,039	17,083
All other functions, mandatory	406	455	1,424	1,428	1,414	1,452	1,496	7,669
Total mandatory offsetting collections	119,387	121,550	127,419	133,338	139,627	144,745	150,439	817,118
Total offsetting collections	**134,804**	**137,272**	**144,775**	**150,971**	**157,454**	**162,568**	**168,226**	**921,266**
Total, User fees	**135,801**	**138,264**	**146,863**	**153,160**	**159,534**	**164,546**	**170,092**	**932,459**

[1] Gross revenue increase from proposed fees. Current aviation excise taxes, which are not user fees, will gradually be converted to cost-based user fees. While considered governmental receipts, the following proceeds from the fees, net of income tax offsets, would be made available to offset discretionary spending:

	1998	1999	2000	2001	2002	2003	2004	1999–04
FAA collections available for spending	.....	.....	1,122	1,184	1,091	1,007	910	5,314

[2] The Budget proposes to convert proceeds to offsetting collections. While the fee collection will be mandatory, proceeds from the fee will be made available to offset discretionary spending.

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 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.

The Budget contains a variety of new and expanded user fee and other collections proposals that would yield $4.2 billion in 2000 and $25.8 billion from 2000 through 2004. These proposals establish, increase, or extend fees in order to recover more of the costs of providing government services. The proposals, would make the program funding levels at least partly dependent on the amount of fees actually collected. Therefore, in many cases, resources available for the program could be greater or less than estimated. 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.

Table 4–2. PROPOSED USER FEE COLLECTIONS

(In millions of dollars)

Discretionary fee proposals	2000	2001	2002	2003	2004	2000–2004
User Fee Proposals To Offset Discretionary Spending						
Offsetting collections deposited in appropriations accounts:						
Department of Agriculture:						
Food Safety Inspection Service fees	504	504	504	504	504	2,520
Tobacco program support fees	60	60	60	60	60	300
Animal and Plant Health Inspection Service fees	9	9	9	9	9	45
Grain Inspection, Packers, and Stockyards fees	19	19	19	19	19	95
Forest Service timber sales preparation fees	20	20	20	20	20	100
Department of Commerce:						
National Oceanic and Atmospheric Administration Navigational assistance fees	14	14	14	14	14	70
Fisheries management fees	20	20	20	20	20	100
Patent and Trademark Office, indirect health and life insurance cost fee	20	20	20	20	20	100
International Trade Administration, trade promotion service fees	3	3	3	3	3	15
Department of Health and Human Services:						
Food and Drug Administration increased user fees	17	17	17	17	17	85
Health Care Financing Administration fee proposals:.						
Physician, provider, and supplier enrollment registration fees	20	20	20	20	20	100
Managed care organization application and renewal fees	37	37	37	37	37	185
Initial provider certification fees	10	10	10	10	10	50
Provider recertification fees	55	55	55	55	55	275
Paper claims submission fees	55	110	110	110	110	495
Duplicate and unprocessable claims fees	18	36	36	36	36	162
Increase Medicare+Choice fees	50	50	50	50	50	250
Department of Justice:						
Increase Bankruptcy filing fee	28	28	28	28	28	140
Department of Labor:						
Alien Labor Certification fees	65	65	65	65	65	325
Employment Tax Credit fees	20	20	20	20	20	100
Department of Transportation:						
Coast Guard, navigational services fees	41	165	165	165	165	701

Table 4–2. PROPOSED USER FEE COLLECTIONS—Continued

(In millions of dollars)

Discretionary fee proposals	2000	2001	2002	2003	2004	2000–2004
Hazardous Material Transportation safety fee	18	18	18	18	18	90
Surface Transportation Board fees	14	14	14	14	14	70
Department of the Treasury:						
Customs, air and sea passenger fee	312	312	312	312	312	1,560
Customs, access fee	163	163	163	163	163	815
Army Corps of Engineers:						
Regulatory program fees	7	7	7	7	7	35
National Transportation Safety Board:						
Commercial accident investigation fees	10	10	10	10	10	50
Subotal, Offsetting collections deposited in appropriations accounts	1,608	1,806	1,806	1,806	1,806	8,833
Offsetting collections deposited in receipt accounts:						
Department of Transportation:						
Federal Railroad Administration, rail safety inspection fees	88	88	88	88	88	440
Department of Housing and Urban Development:						
Government Sponsored Enterprise (GSE) oversight fees	10	10	10	10	10	50
Environmental Protection Agency:						
Pre-Manufacture Notice (PMN) fee	4	8	8	8	8	36
Pesticide Registration Fees	16	16	16	16	16	80
Federal Communications Commission:						
Analog spectrum lease fee	200	200	200	200	200	1,000
Nuclear Regulatory Commission:						
Extend NRC user fees	300	300	300	300	300	1,500
Social Security Administration:						
Social Security Administration, claimant representative fees	19	19	19	19	19	95
Subotal, offsetting collections deposited in receipt accounts	637	641	641	641	641	3,201
Mandatory collections made available to offset discretionary spending:						
Department of Transportation:						
Federal Aviation Administration, proposed user fees [1]	1,496	1,579	1,455	1,341	1,214	7,085
Army Corps of Engineers:						
Harbor Services Fees (Replacing Harbor Maintenance Tax [2]	337	296	245	231	248	1,357
Subtotal, mandatory collections available to offset discretionary	1,833	1,875	1,700	1,572	1,462	8,442
Total, user fees to offset discretionary spending	**4,078**	**4,322**	**4,147**	**4,019**	**3,909**	**20,476**
User Fee Proposals to Offset Mandatory Spending						
Offsetting collections deposited in appropriations accounts:						
Federal Deposit Insurance Corporation:						
FDIC State Bank exam fees	84	88	91	95	100	458
Offsetting collections deposited in receipt accounts:						
Department of Health and Human Services:						
Medicare Premiums	–135	275	482	560	686	1,868
Department of Agriculture:						
Forest Service, increased recreation and entrance fees	.....	.....	24	34	44	102
Department of the Interior:						
Increased recreation and entrance fees	.....	68	70	72	210	
Filming and special use permits	3	3	4	4	5	19
Hardrock mining production fees	.....	8	26	26	26	86
Department of Justice:						
Increase Immigration user fee	121	128	135	142	150	676
Department of the Treasury:						
Extend Customs conveyance and passenger fees	.....	.....	.....	.....	497	497
Extend Customs merchandise processing fees	.....	.....	.....	.....	1,025	1,025
Subotal, offsetting collections deposited in receipt accounts	–11	414	739	836	2,505	4,483
Total, user fee proposals to offset mandatory spending	**73**	**502**	**830**	**931**	**2,605**	**4,941**
Collections deposited to governmental receipt accounts:						
Federal Emergency Management Agency:						
Mortgage transaction fees for flood plain certification [3]	75	76	77	78	80	386
Total, user fee proposals	**4,226**	**4,900**	**5,054**	**5,028**	**6,594**	**25,803**

[1] Gross revenue increase from proposed fees. Current aviation excise taxes, which are not user fees, will gradually be converted to cost-based user fees. While considered governmental receipts, the following proceeds from the fees, net of income tax offsets, would be made available to offset discretionary spending:

	1998	1999	2000	2001	2002	2003	2004	1999–04
FAA collections available for spending	.....	.....	1,122	1,184	1,091	1,007	910	5,314

[2] Collections shown for the Harbor Services user fee represent the increase in receipts over current law collections remaining after collections from exporters were halted.

[3] Represents the gross revenue. Approximately $58 million would be available to spend in FY 2000.

Discretionary offsetting collections:

The following proposed fees are classified as discretionary because they would result from provisions in appropriations acts. In most cases, the Administration will propose authorizing legislation to establish, increase, or extend fees. However, the legislation will make both the fee collection and spending contingent on appropriations action, so that both can be scored as discretionary. The budget includes the appropriations language needed to trigger the fee collection. When the user fees are enacted, they will finance part or all of the cost of the affected programs in lieu of some amount of the general fund appropriation for the program. While the appropriations language proposed under current law includes the full amount of funding needed for the program, the trigger language would reduce that amount upon enactment of the fee authorization. (If general fund appropriations were not reduced, the total resources provided would exceed the funding requirements for the programs.)

Collections from the following proposals are to be deposited directly in appropriations accounts:

DEPARTMENT OF AGRICULTURE

Food Safety and Inspection Service meat, poultry and egg inspection fee.—The 2000 Budget proposes a new user fee for the Department of Agriculture'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. 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.

Tobacco program support fees.—The 2000 Budget proposes to extend and increase the marketing assessment on price supported tobacco and on similar imported tobacco. The current assessment equal to 1 percent of the support price expires with the 1998 crop year. The assessment on domestic tobacco is equally divided between producers and purchasers, while importers pay the entire assessment on imported tobacco. The proposal would extend the assessment to 2000 and thereafter at a rate of about two percent of the support price. The current rate of 0.5 percent of the support price paid by producers would be continued, while purchasers and importers would be assessed at an increased rate. The assessment would raise revenues equivalent to the estimated costs incurred by the Agriculture Department's for activities that support the production and marketing of tobacco.

Animal and Plant Health Inspection Service (APHIS).—The budget proposes to establish fees to cover the cost of providing animal welfare inspections to recipients of APHIS services such as animal research centers, humane societies, and kennels. Fees would also be established to cover the cost of issuing biotechnology certificates to firms that manufacture products derived through biotechnological innovation.

Grain Inspection, Packers and Stockyards Administration (GIPSA) licensing fees.—The budget proposes to charge the grain industry GIPSA's costs to review and maintain standards (such as 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.

Forest Service, timber sales preparation fee pilot.—The Administration proposes to require timber companies to reimburse the Forest Service for the costs of timber sales preparation on National Forests. Timber purchasers would bear the direct costs for timber sales preparation (direct costs do not include legal and certain environmental planning costs) for commodity-oriented timber sales.

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration (NOAA), navigational assistance fees.—The Administration proposes to levy 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.

Fisheries management fees.—The budget proposes to levy a fee to recover a portion of the costs of providing fisheries management and enforcement services.

Patent and Trademark Office indirect cost fees.—The Administration proposes to increase Patent and Trademark Office fees to cover the costs associated with current PTO employees' post-retirement health and life insurance. Under current law, the FY 2000 program level is expected to impose $20 million in future costs on the Federal Treasury. Collections from the fee increase would be transferred to the Office of Personnel Management.

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 budget seeks $17 million in new fees to finance FDA activities for the review of medical device applications, food additive petitions, and pre-market notifications for food contact substances. These fees will be used to augment current funding for these activities.

Health Care Financing Administration (HCFA).—These proposals 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 phy-

sicians, 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 to offset Contractor funding related to enrollment costs.

Managed care organization application and renewal fees.—The Administration proposes to charge managed care organizations a fee to cover the cost of reviewing initial applications and renewing annual contracts with Medicare. Proceeds from this fee would be used to offset Federal Administration funding related to managed care organization applications and renewals.

Initial provider certification fee.—The Administration proposes to levy a fee on providers (e.g., home health agencies and skilled nursing facilities) 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 funding.

Provider recertification fee.—The Administration proposes to levy a fee on providers who are recertified for the Medicare program. By statute, skilled nursing facilities must be surveyed every year, home health agencies 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 funding.

Paper claims submission fee.—The Administration proposes to charge providers $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 to offset Contractor funding related to claims processing.

Duplicate and unprocessable claims fees.—The Administration 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 to offset Contractor funding related to claims processing.

Increase in the Medicare+Choice fee.—The Administration proposes to increase the fee on Medicare+Choice plans by $50 million in FY 2000. The fee was authorized at $100 million in the Balanced Budget Act of 1997. This increase would be used to maintain the current level of effort in providing information to Medicare beneficiaries regarding the Medicare+Choice program.

DEPARTMENT OF JUSTICE

Bankruptcy filing fee.—The Administration proposes to increase the filing fee for cases filed under chapters 7 (liquidation) and 13 (wage earner repayment) of the Bankruptcy Code by $25, from $130 to $155, with the increased collections to be used by the U.S. Trustee Program. This would allow the program to continue to be funded entirely through bankruptcy fees. The U.S. trustees supervise the administration of bankruptcy cases and private trustees in the Federal Bankruptcy Courts. The program currently receives $30 of the $130 filing fee.

DEPARTMENT OF LABOR

Alien labor certification fee.—The proposal would establish a new fee, charged to businesses, for processing of alien labor certification applications by the Department of Labor. The fee proceeds would offset the costs of administering and enforcing the alien labor program, and provide reemployment and training assistance to U.S. workers who have been dislocated from their jobs.

Employment tax credit fees.—The proposal would establish a new fee, charged to businesses, for processing requests for certifications under the Work Opportunity Tax Credit and the Welfare-to-Work Tax Credit. These fees would be used to cover the State administrative costs of certifying the eligibility of new hires under these tax credits.

DEPARTMENT OF TRANSPORTATION

Coast Guard, navigational assistance fee.—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.

Federal Railroad Administration, rail safety inspection fees.—This proposed would offset the costs of the Federal Railroad Administration's safety inspection program. An estimated $88 million in fees would be collected from railroad carriers based upon a calculation of their rail usage.

Hazardous Materials Transportation Safety fees.—Beginning late in 2000, hazardous materials transportation safety activities previously financed by general fund appropriations to the Research and Special Programs Administration are proposed to be financed instead by an increase in hazardous materials registration fees. Authorizing legislation will be proposed to increase the fees paid by shippers and carriers of hazardous materials by an estimated $18 million in 2000 to fund these safety activities.

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 THE TREASURY

Customs, air/sea passenger fee.—The Administration proposes to increase an existing fee paid by travelers arriving by commercial aircraft and commercial vessels

from a place outside of the United States, and to remove certain exemptions from this fee. Proceeds of the fee increase would partially offset Customs costs associated with air and sea passenger processing. Subsequent to the budget, authorization legislation will be transmitted to allow the Secretary to increase the fee paid by air and sea passengers and to remove existing exemptions from this fee.

Customs, automation enhancement fee.—The Administration proposes to establish a fee for the use of Customs automated systems. The fee would be charged to users of any Customs automated system based on the amount of user data input. Proceeds of the fee would offset the costs of modernizing Customs automated commercial operations and an international trade data system, and would be available for obligation after FY 2000. Subsequent to the budget, authorization legislation will be transmitted to allow the Secretary to establish a fee for the use of Customs automated systems.

ARMY CORPS OF ENGINEERS

Regulatory program fees.—The Army Corps of Engineers has not changed the fee structure of its regulatory program since 1977. The Budget proposes to pursue reasonable changes that would reduce the fees paid from many applicants and increase recovery from commercial applicants.

NATIONAL TRANSPORTATION SAFETY BOARD

Commercial accident investigation fees.—To offset a portion of the NTSB's growing cost of commercial accident investigations, a new aviation accident recovery and investigation fee is proposed. This fee, which would be paid by commercial air, motor, ocean, and rail carriers based on a proxy for risk, would collect an estimated $10 million in 2000.

Collections from the following discretionary proposals be deposited in offsetting receipt accounts:

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

GSE Oversight Assessment Fee.—This proposal would assess Fannie Mae and Freddie Mac for the cost incurred by HUD offices (other than the Office of Federal Housing Enterprise Oversight) from regulating the activities of these government-sponsored enterprises. The fee would offset the actual costs incurred by HUD.

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.

FEDERAL COMMUNICATIONS COMMISSION

Analog spectrum lease fee.—The Administration proposes to set a lease fee on commercial television broadcasters' use of spectrum for analog broadcasting. The lease fee would raise $200 million annually to fund programs in the Department of Justice, the Department of the Treasury, and the Department of the Interior to expand and upgrade public safety wireless communications.

NUCLEAR REGULATORY COMMISSION

Nuclear Regulatory Commission.—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 1999. Unless the law is extended, the fee covering requirement will revert to 33 percent of NRC's cost of operations. The Administration proposes to extend fees at approximately 100 percent of the NRC's cost of operations through 2004.

SOCIAL SECURITY ADMINISTRATION

Claimant representation fee.—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.

Mandatory Receipts used to offset discretionary spending

In some cases, the Administration is proposing to authorize collections that are not subject to action by the appropriators, while making those collections available to offset discretionary spending. The budget proposes authorizing legislation that will increase governmental or mandatory offsetting receipts. The savings from these proposals would be applied to discretionary spending.

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration (FAA), cost based user fees.—The Budget proposes to reduce the existing aviation excise taxes over time as more efficient, cost-based user fees for air traffic services are phased in beginning in 2000. Under this proposal, the collections each year from the new cost-based user fees and the existing excise taxes combined would be equal to the total budget resources requested for the FAA in each succeeding year. In FY 2000, this proposal would result in the collection of $1.5 billion in additional aviation user charges. These charges will be deposited into a governmental receipt account and be made available for discretionary spending.

ARMY CORPS OF ENGINEERS

Harbor services fees.—The Administration proposes to replace collection of the ad valorem Harbor Maintenance Tax with a cost-based user fee, the Harbor Services User Fee. The user fee will finance construction and operation and maintenance of harbor activities performed by the Army Corps of Engineers, the costs of operating and maintaining the Saint Lawrence Seaway, and the costs of administering the fee. Through appropriations acts, the fee will raise an average of $980 million annually through FY 2004, which is less than would have been raised by the Harbor Maintenance Tax before the Supreme Court decision that the ad valorem tax on exports was unconstitutional. While the collections from the harbor services fee would be mandatory, collections would be available to offset discretionary spending.

Mandatory Fee 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 proposal are to be deposited directly an appropriations accounts:

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 a user fee, but will be reflected in higher governmental receipts, and are discussed in the preceding chapter on governmental receipts.

Collections from the following proposals are to be deposited in receipt accounts:

DEPARTMENT OF HEALTH AND HUMAN SERVICES

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 collectons is partially offset by the reduction in premium collections due to the Medicare savings proposals.

DEPARTMENT OF THE INTERIOR AND AGRICULTURE

Increased recreation and entrance fee.—The Administration proposes to permanently extend the current pilot program which expires in 2001. The National Park Service, Fish and Wildlife Service, the Bureau of Land Management, and the Forest Service would be allowed to collect increased recreation and entrance fees and use the receipts without further appropriation for facility improvements and new services. The Forest Service would also be authorized to use collections from existing fees for similar improvements and services.

Hardrock mining production fees.—The Administration proposes to charge mining companies a 5% fee on net smelter production from hard rock mining on Federal Lands.

Filming and special use permits fee.—The Administration proposes to authorize the National Park Service and other land management agencies, including the Department of Agriculture's Forest Service to increase fees for permits to use land and facilities for the making of motion pictures, television productions, still photos, sound tracks and other similar purposes. Collections would be available without further appropriations to cover related Government costs (as currently authorized) and provide a fair return to the Government.

DEPARTMENT OF JUSTICE

Immigration user fee.—The Administration proposes to increase the fee for inspection of passengers at air and seaports by the Immigration and Naturalization Service (INS) by $2.00 to $8.00. The immigration user fee recovers the costs of INS' air and seaport inspection of passengers entering the United States and other activities authorized to be funded by the fee. The current fee of $6.00 per passenger is insufficient to maintain fee operations. In addition, the Administration is proposing to charge $3.00 for the inspection of commercial vessel passengers whose journey originated in Mexico, Canada, the United States or its territories and possession or any adjacent island. This inspection fee would be expanded to cover cruise ship passengers who, in the past, have been exempt from any inspection fee.

DEPARTMENT OF THE TREASURY

Extend Customs conveyance and passenger and merchandise processing fees.—Under existing legislation, the Customs Conveyance/Passenger Fee and the Merchandise Processing Fee will expire on September 30, 2003. The Administration proposes to extend both of these fees starting on October 1, 2003.

The following proposal is classified as mandatory because it will be included in authorizing legislation, and their collection will not be contingent on appropriations language. Collections are recorded as governmental receipts, not as an offset to outlays.

FEDERAL EMERGENCY MANAGEMENT AGENCY (FEMA)

Mortgage transaction fees for flood hazard determination.—The Administration proposes to establish a $15 on all fee mortgage originations and refinancings to support a multi-year program to update and modernize FEMA's inventory of flood plain maps (100,000 maps). Accurate and easy to use flood hazard maps are essential in determining if a property is located in a flood

plain. The maps allow lenders to meet their statutory obligation of requiring the risk-prone homes they insure to carry flood insurance, and allow homeowners to assess their risk of flood damage. These maps are the basis for developing appropriate risk-based flood insurance premium charges, and improved maps will result in a more actuarially sound insurance program.

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 $371.3 billion in 2000.

Table 4–3. OFFSETTING RECEIPTS BY TYPE

(In millions of dollars)

Source	1998 Actual	Estimate					
		1999	2000	2001	2002	2003	2004
INTRAGOVERNMENTAL TRANSACTIONS							
On-budget receipts:							
Federal intrafund transactions:							
Distributed by agency:							
Interest from the Federal Financing Bank	4,141	2,736	2,352	2,153	1,996	1,845	1,859
Interest on Government capital in enterprises	1,758	1,443	1,371	1,217	1,093	995	916
Other	4,157	1,656	1,716	1,810	1,908	2,024	2,130
Proposed Legislation (non-PAYGO)	.....	.....	50	50	50	50	50
Total Federal intrafunds	10,056	5,835	5,489	5,230	5,047	4,914	4,955
Trust intrafund transactions:							
Distributed by agency:							
Payments to railroad retirement	3,819	3,712	3,630	3,528	3,638	3,640	3,636
Other	.....	1	1	1	1	1	1
Total trust intrafunds	3,819	3,713	3,631	3,529	3,639	3,641	3,637
Total intrafund transactions	13,875	9,548	9,120	8,759	8,686	8,555	8,592
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Contributions to insurance programs:							
Military retirement fund	15,119	15,250	15,900	16,500	17,200	17,800	18,600
Supplementary medical insurance	59,919	61,879	68,690	75,479	82,157	89,322	95,276
Proposed Legislation (non-PAYGO)	.....	.....	–469	–648	–713	–775	–728
Hospital insurance	5,259	7,056	7,091	7,232	7,638	8,088	8,551
Railroad social security equivalent fund	58	94	74	74	75	77	78
Rail industry pension fund	196	195	201	204	207	211	216
Civilian supplementary retirement contributions	21,654	21,952	22,117	22,317	22,559	22,977	23,357
Unemployment insurance	508	473	496	571	574	570	584
Other contributions	383	416	407	408	411	412	420
Proposed Legislation (PAYGO)	.....	.....	42	.....	.....	.....	.....
Miscellaneous payments	568	581	429	436	437	413	405
Subtotal	103,664	107,896	114,978	122,573	130,545	139,095	146,759
Trust fund payments to Federal funds:							
Quinquennial adjustment for military service credits	.....	.....	.....	1,121	.....	.....	.....
Other	1,123	1,062	1,052	1,076	1,103	1,131	1,160
Proposed Legislation (non-PAYGO)	.....	.....	1,847	.....	.....	.....	.....
Subtotal	1,123	1,062	2,899	2,197	1,103	1,131	1,160
Total interfunds distributed by agency	104,787	108,958	117,877	124,770	131,648	140,226	147,919
Undistributed by agency:							
Employer share, employee retirement (on-budget):							
Civil service retirement and disability insurance	8,682	8,817	9,163	9,657	10,073	10,152	10,704
CSRDI from Postal Service	6,109	6,071	6,274	6,451	6,620	6,760	6,849
Hospital insurance (contribution as employer) [1]	1,892	1,957	2,046	2,112	2,223	2,327	2,440
Postal employer contributions to FHI	607	610	638	663	690	718	747
Military retirement fund	10,421	10,534	10,740	10,981	11,268	11,585	11,969
Legislative proposal, discretionary offset	.....	.....	849	1,058	1,159	1,231	1,270
Other Federal employees retirement	109	114	120	125	131	134	139
Total employer share, employee retirement (on-budget)	27,820	28,103	29,830	31,047	32,164	32,907	34,118
Interest received by on-budget trust funds	67,208	67,160	68,454	69,545	70,826	72,229	73,441
Proposed Legislation (non-PAYGO)	.....	73	157	251	369	458	529
Legislative proposal, discretionary offset	.....	.....	.....	93	195	296	396
Total interfund transactions undistributed by agency	95,028	95,336	98,441	100,936	103,554	105,890	108,484
Total interfund transactions	199,815	204,294	216,318	225,706	235,202	246,116	256,403

Table 4–3. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	1998 Actual	Estimate					
		1999	2000	2001	2002	2003	2004
Total on-budget receipts	213,690	213,842	225,438	234,465	243,888	254,671	264,995
Off-budget receipts:							
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Old-age, survivors, and disability insurance	9,140	11,278	10,340	10,818	11,383	12,033	12,785
Undistributed by agency:							
Employer share, employee retirement (off-budget)	7,052	7,355	7,969	8,442	9,102	9,746	10,442
Proposed Legislation (non-PAYGO)	.....	.....	–264	–271	–261	–260	–261
Interest received by off-budget trust funds	46,629	51,869	56,492	62,107	68,500	75,448	82,749
Total off-budget receipts:	62,821	70,502	74,537	81,096	88,724	96,967	105,715
Total intragovernmental transactions	**276,511**	**284,344**	**299,975**	**315,561**	**332,612**	**351,638**	**370,710**
PROPRIETARY RECEIPTS FROM THE PUBLIC							
Distributed by agency:							
Interest:							
Interest on foreign loans and deferred foreign collections	799	768	638	684	641	706	695
Interest on deposits in tax and loan accounts	1,228	1,050	1,115	1,105	1,105	1,105	1,105
Other interest (domestic—civil)[2]	6,036	7,142	8,149	9,193	10,231	11,264	12,234
Total interest	8,063	8,960	9,902	10,982	11,977	13,075	14,034
Royalties and rents	1,248	1,324	1,368	1,378	1,399	1,420	1,433
Proposed Legislation (PAYGO)	.....	.....	.....	8	26	26	26
Sale of products:							
Sale of timber and other natural land products	461	466	487	466	450	434	433
Sale of minerals and mineral products	237	31	35	35	49	49	20
Sale of power and other utilities	754	733	680	771	766	762	752
Other	28	61	59	51	67	63	54
Total sale of products	1,480	1,291	1,261	1,323	1,332	1,308	1,259
Fees and other charges for services and special benefits:							
Medicare premiums and other charges (trust funds)	20,747	21,299	22,969	25,004	27,127	30,085	32,252
Proposed Legislation (PAYGO)	.....	.....	–135	275	488	562	687
Nuclear waste disposal revenues	600	642	632	632	631	632	632
Veterans life insurance (trust funds)	217	207	196	184	171	159	147
Other[2]	2,279	1,909	1,890	1,894	1,825	1,831	1,840
Proposed Legislation (non-PAYGO)	.....	.....	19	19	19	19	19
Proposed Legislation (PAYGO)	.....	.....	3	3	95	107	120
Legislative proposal, discretionary offset	.....	.....	966	963	960	996	1,014
Total fees and other charges	23,843	24,057	26,540	28,974	31,316	34,391	36,711
Sale of Government property:							
Sale of land and other real property	58	34	85	70	571	71	70
Proposed Legislation (PAYGO)	.....	.....	2	4	11	11	11
Military assistance program sales (trust funds)	14,135	13,280	12,690	12,140	12,050	9,720	8,610
Other	146	541	346	177	177	143	83
Total sale of Government property	14,339	13,855	13,123	12,391	12,809	9,945	8,774
Realization upon loans and investments:							
Dollar repayments of loans, Agency for International Development	1	.....	.....	.....	.....	.....	.....
Foreign military credit sales	534	371	.....	.....	.....	.....	.....
Negative subsidies and downward reestimates	4,300	8,296	933	691	2,491	2,577	2,814
Repayment of loans to foreign nations	134	285	251	252	134	72	80
Other	153	76	78	82	131	111	108
Total realization upon loans and investments	5,122	9,028	1,262	1,025	2,756	2,760	3,002
Recoveries and refunds[2]	3,375	3,844	3,977	4,244	5,416	4,350	4,443
Proposed Legislation (PAYGO)	.....	142	168	300	349	276	194
Legislative proposal, discretionary offset	.....	.....	788	.....	.....	.....	.....

Table 4–3. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	1998 Actual	Estimate					
		1999	2000	2001	2002	2003	2004
Miscellaneous receipt accounts [2]	2,493	4,730	1,375	1,380	1,379	1,380	1,379
Total proprietary receipts from the public distributed by agency	59,963	67,231	59,764	62,005	68,759	68,931	71,255
Undistributed by agency:							
Other interest: Interest received from Outer Continental Shelf escrow account	3	1,264	9	.....	.....	.....	.....
Rents and royalties on the Outer Continental Shelf:							
Rents and bonuses	1,500	846	327	324	248	194	194
Royalties	3,022	2,277	2,452	2,474	2,558	2,479	2,414
Sale of major assets	5,158	.....	323	.....	.....	.....	.....
Total proprietary receipts from the public undistributed by agency	9,683	4,387	3,111	2,798	2,806	2,673	2,608
Total proprietary receipts from the public [3]	**69,646**	**71,618**	**62,875**	**64,803**	**71,565**	**71,604**	**73,863**
OFFSETTING GOVERNMENTAL RECEIPTS							
Distributed by agency:							
Regulatory fees	2,861	3,164	3,360	3,395	3,360	3,437	1,975
Proposed Legislation (non-PAYGO)	.....	.....	20	20	20	20	20
Proposed Legislation (PAYGO)	.....	.....	.....	.....	.....	.....	1,522
Other	73	75	77	79	81	6	6
Undistributed by agency:							
Spectrum auction proceeds	2,642	1,447	4,819	2,801	7,065	1,770	775
Proposed Legislation (non-PAYGO)	.....	.....	200	200	200	200	200
Total offsetting governmental receipts	5,576	4,686	8,476	6,495	10,726	5,433	4,498
Total offsetting receipts	**351,733**	**360,648**	**371,326**	**386,859**	**414,903**	**428,675**	**449,071**

[1] Includes provision for covered Federal civilian employees and military personnel.
[2] Includes both Federal funds and trust funds.
[3] Consists of:

	1998 Actual	*Estimate*					
		1999	*2000*	*2001*	*2002*	*2003*	*2004*
On-budget:							
Federal funds	33,181	32,184	26,053	26,150	30,726	30,097	31,204
Trust funds	36,445	39,414	36,783	38,614	40,800	41,468	42,620
Off-budget	20	20	39	39	39	39	39

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 pension contributions and earnings, employer contributions for medical insurance, mortgage interest payments on owner-occupied homes, capital gains, and payments of State and local individual income and property 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 1998–2004 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 included by reference in 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, 1998. The analysis includes new tax expenditures that were enacted in the Tax and Trade Relief Extension Act of 1998. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 1998. 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 1998–2004 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 could be stockholders, employees, customers, or others, depending on economic forces.

Table 5–3 ranks the major tax expenditures by fiscal year 2000 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 1999 which cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 1999 would cause a deferral of tax payments on wages in 1999 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 1999 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							
		1998	1999	2000	2001	2002	2003	2004	2000–2004
	National Defense:								
1	Exclusion of benefits and allowances to armed forces personnel	2,095	2,120	2,140	2,160	2,180	2,200	2,220	10,900
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	1,990	2,235	2,500	2,800	3,125	3,460	3,830	15,715
3	Exclusion of income of foreign sales corporations	2,150	2,250	2,400	2,550	2,700	2,900	3,100	13,650
4	Inventory property sales source rules exception	1,000	1,050	1,100	1,150	1,250	1,350	1,450	6,300
5	Deferral of income from controlled foreign corporations (normal tax method)	5,500	5,800	6,200	6,600	7,000	7,450	7,900	35,150
6	Deferred taxes for financial firms on certain income earned overseas	400	1,075	65	0	0	0	0	65
	General science, space, and technology:								
7	Expensing of research and experimentation expenditures (normal tax method)	260	330	510	610	675	735	765	3,295
8	Credit for increasing research activities	2,125	1,655	980	425	180	60	0	1,645
	Energy:								
9	Expensing of exploration and development costs, fuels	–110	–70	–10	–15	0	30	40	45
10	Excess of percentage over cost depletion, fuels	250	260	265	270	275	280	290	1,380
11	Alternative fuel production credit	860	810	760	720	675	435	125	2,715
12	Exception from passive loss limitation for working interests in oil and gas properties	30	35	35	35	40	40	40	190
13	Capital gains treatment of royalties on coal	60	65	65	70	70	75	80	360
14	Exclusion of interest on energy facility bonds	110	110	110	115	115	115	115	570
15	Enhanced oil recovery credit	140	160	180	210	240	275	320	1,225
16	New technology credit	25	30	35	40	40	35	35	185
17	Alcohol fuel credits [1]	15	15	15	15	15	15	15	75
18	Tax credit and deduction for clean-fuel burning vehicles	75	80	90	95	90	75	60	410
19	Exclusion from income of conservation subsidies provided by public utilities	80	80	80	75	75	75	80	385
	Natural resources and environment:								
20	Expensing of exploration and development costs, nonfuel minerals	25	25	25	25	25	30	30	135
21	Excess of percentage over cost depletion, nonfuel minerals	225	240	245	255	270	280	295	1,345
22	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	440	440	445	455	455	460	465	2,280
23	Capital gains treatment of certain timber income	60	65	65	70	70	75	80	360
24	Expensing of multiperiod timber growing costs	485	500	510	530	550	570	590	2,750
25	Investment credit and seven-year amortization for reforestation expenditures	10	10	10	10	15	15	15	65
26	Tax incentives for preservation of historic structures	215	235	255	275	285	305	315	1,435
	Agriculture:								
27	Expensing of certain capital outlays	65	70	70	75	75	80	85	385
28	Expensing of certain multiperiod production costs	80	85	85	90	95	100	105	475
29	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	605	630	655	685	715	750	785	3,590
31	Income averaging for farmers	10	75	75	80	80	80	85	400
32	Deferral of gain on sale of farm refiners	10	10	10	10	10	15	15	60
	Commerce and housing:								
	Financial institutions and insurance:								
33	Exemption of credit union income	785	840	905	970	1,040	1,120	1,200	5,235
34	Excess bad debt reserves of financial institutions	70	30	10	5	5	5	0	25
35	Exclusion of interest on life insurance savings	13,465	14,200	14,990	15,810	16,680	17,595	18,840	83,915
36	Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	210	225	240	260	275	310	325	1,410
38	Small life insurance company deduction	100	100	100	105	105	110	100	520
	Housing:								
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	860	875	880	885	900	905	915	4,485
40	Exclusion of interest on rental housing bonds	150	150	150	150	155	155	155	765
41	Deductibility of mortgage interest on owner-occupied homes	51,700	52,990	55,100	57,590	60,415	63,425	66,615	303,145
42	Deductibility of State and local property tax on owner-occupied homes	17,770	18,595	19,495	20,535	21,625	22,635	23,645	107,935
43	Deferral of income from post-1987 installment sales	975	995	1,015	1,035	1,055	1,075	1,095	5,275
44	Capital gains exclusion on home sales	17,475	18,000	18,540	19,095	19,670	20,260	20,870	98,435
45	Exception from passive loss rules for $25,000 of rental loss	4,735	4,455	4,215	4,000	3,785	3,575	3,375	18,950
46	Credit for low-income housing investments	3,120	3,225	3,335	3,485	3,540	3,620	3,615	17,595
47	Accelerated depreciation on rental housing (normal tax method)	2,405	2,740	3,095	4,170	4,590	4,495	4,570	20,920
	Commerce:								
48	Cancellation of indebtedness	50	30	20	15	20	20	25	100
49	Exceptions from imputed interest rules	155	160	160	160	165	165	165	815
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	38,275	39,415	40,585	41,795	43,035	44,310	45,625	215,350
51	Capital gains exclusion of small corporation stock	0	5	5	5	5	5	5	25
52	Step-up basis of capital gains at death	24,570	25,800	27,090	28,240	29,370	30,545	31,765	147,010
53	Carryover basis of capital gains on gifts	170	175	185	195	205	210	220	1,015
54	Ordinary income treatment of loss from small business corporation stock sale	35	35	35	40	40	40	40	195
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	6,270	4,895	3,430	2,385	2,365	1,875	585	10,640

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							
		1998	1999	2000	2001	2002	2003	2004	2000–2004
56	Accelerated depreciation of machinery and equipment (normal tax method)	28,885	32,505	35,465	36,830	36,985	36,510	35,855	181,645
57	Expensing of certain small investments (normal tax method)	1,185	1,235	1,275	1,175	1,730	1,605	995	6,780
58	Amortization of start-up costs (normal tax method)	205	215	220	225	225	230	240	1,140
59	Graduated corporation income tax rate (normal tax method)	5,400	5,360	5,360	5,620	6,120	6,680	7,120	30,900
60	Exclusion of interest on small issue bonds	295	300	305	305	305	310	310	1,535
	Transportation:								
61	Deferral of tax on shipping companies	15	15	15	15	15	15	15	75
62	Exclusion of reimbursed employee parking expenses	1,560	1,595	1,630	1,690	1,750	1,815	1,885	8,770
63	Exclusion for employer-provided transit passes	70	80	95	105	130	155	170	655
	Community and regional development:								
64	Investment credit for rehabilitation of structures (other than historic)	30	30	30	30	30	30	30	150
65	Exclusion of interest for airport, dock, and similar bonds	695	705	710	715	725	730	740	3,620
66	Exemption of certain mutuals' and cooperatives' income	45	50	50	50	50	50	55	255
67	Empowerment zones and enterprise communities	290	380	430	435	415	305	290	1,875
68	Expensing of environmental remediation costs	90	110	145	60	–10	–25	–35	135
	Education, training, employment, and social services:								
	Education:								
69	Exclusion of scholarship and fellowship income (normal tax method)	910	955	995	1,040	1,085	1,135	1,185	5,440
70	HOPE tax credit	200	4,015	4,855	5,325	5,730	5,765	5,950	27,625
71	Lifetime Learning tax credit	110	2,510	2,655	2,970	3,015	3,355	4,565	16,560
72	Education Individual Retirement Accounts	20	100	230	380	540	710	885	2,745
73	Deductibility of student-loan interest	70	245	265	315	360	385	425	1,750
74	Deferral for State prepaid tuition plans	85	125	180	235	285	330	365	1,395
75	Exclusion of interest on student-loan bonds	235	235	240	245	245	250	250	1,230
76	Exclusion of interest on bonds for private nonprofit educational facilities	560	570	570	575	580	590	595	2,910
77	Credit for holders of zone academy bonds	0	10	20	30	35	35	35	155
78	Exclusion of interest on savings bonds redeemed to finance educational expenses	10	10	15	15	15	15	20	80
79	Parental personal exemption for students age 19 or over	875	915	965	1,015	1,055	1,105	1,155	5,295
80	Child credit [2]	3,525	18,740	18,725	18,430	18,160	17,745	17,155	90,215
81	Deductibility of charitable contributions (education)	2,880	2,940	3,065	3,195	3,350	3,505	3,680	16,795
82	Exclusion of employer-provided educational assistance	215	215	210	15	0	0	0	225
	Training, employment, and social services:								
83	Work opportunity tax credit	170	335	330	160	40	5	0	535
84	Welfare-to-work tax credit	15	35	35	20	10	5	0	70
85	Exclusion of employer-provided child care	1,325	1,385	1,445	1,510	1,575	1,645	1,715	7,890
86	Adoption assistance	125	295	345	390	385	235	170	1,525
87	Exclusion of employee meals and lodging (other than military)	620	650	680	710	740	775	810	3,715
88	Credit for child and dependent care expenses	2,485	2,455	2,425	2,395	2,365	2,340	2,310	11,835
89	Credit for disabled access expenditures	45	50	50	50	55	60	60	275
90	Expensing of costs of removing certain architectural barriers to the handicapped	0	5	5	5	5	5	5	25
91	Deductibility of charitable contributions, other than education and health	18,580	19,150	20,055	21,005	22,050	23,150	24,335	110,595
92	Exclusion of certain foster care payments	35	35	40	40	45	45	50	220
93	Exclusion of parsonage allowances	315	340	360	385	410	440	470	2,065
	Health:								
94	Exclusion of employer contributions for medical insurance premiums and medical care	67,920	72,535	77,670	83,095	88,830	94,960	101,520	446,075
95	Self-employed medical insurance premiums	765	980	1,310	1,405	1,550	2,055	2,905	9,225
96	Workers' compensation insurance premiums	4,260	4,420	4,585	4,755	4,935	5,120	5,315	24,710
97	Medical Savings Accounts	15	20	25	25	20	20	15	105
98	Deductibility of medical expenses	3,615	3,775	3,985	4,215	4,475	4,750	5,035	22,460
99	Exclusion of interest on hospital construction bonds	1,160	1,170	1,185	1,190	1,205	1,220	1,230	6,030
100	Deductibility of charitable contributions (health)	2,560	2,630	2,730	2,860	3,000	3,145	3,300	15,035
101	Tax credit for orphan drug research	40	50	55	60	70	80	90	355
02	Special Blue Cross/Blue Shield deduction	210	230	250	280	325	290	250	1,395
	Income security:								
103	Exclusion of railroad retirement system benefits	420	420	425	425	430	435	440	2,155
104	Exclusion of workers' compensation benefits	5,140	5,330	5,475	5,940	6,205	6,480	6,755	30,855
105	Exclusion of public assistance benefits (normal tax method)	440	345	360	375	390	405	420	1,950
106	Exclusion of special benefits for disabled coal miners	85	80	75	70	70	65	60	340
107	Exclusion of military disability pensions	120	125	130	135	140	140	145	690
	Net exclusion of pension contributions and earnings:								
108	Employer plans	82,215	82,195	84,350	86,670	89,155	91,810	94,455	446,440
109	Individual Retirement Accounts	10,565	10,770	11,170	11,440	11,550	11,485	11,270	56,915
110	Keogh plans	3,930	4,025	4,255	4,495	4,750	5,010	5,285	23,795
	Exclusion of other employee benefits:								
111	Premiums on group term life insurance	2,030	2,075	2,120	2,170	2,220	2,270	2,335	11,115

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							
		1998	1999	2000	2001	2002	2003	2004	2000–2004
112	Premiums on accident and disability insurance	175	185	195	205	215	225	235	1,075
113	Income of trusts to finance supplementary unemployment benefits	5	5	5	5	5	5	5	25
114	Special ESOP rules	920	950	980	1,020	1,060	1,100	1,140	5,300
115	Additional deduction for the blind	30	30	30	30	35	35	35	165
116	Additional deduction for the elderly	1,690	1,720	1,740	1,795	1,880	1,945	2,020	9,380
117	Tax credit for the elderly and disabled	40	40	40	40	40	40	40	200
118	Deductibility of casualty losses	225	235	245	255	270	280	290	1,340
119	Earned income tax credit[3]	6,351	5,118	4,971	5,142	5,275	5,471	5,672	26,531
	Social Security:								
	Exclusion of social security benefits:								
120	Social Security benefits for retired workers	16,780	17,210	18,125	19,045	20,100	21,260	22,460	100,990
121	Social Security benefits for disabled	2,265	2,420	2,615	2,820	3,060	3,325	3,625	15,445
122	Social Security benefits for dependents and survivors	3,725	3,785	3,910	4,065	4,235	4,405	4,575	21,190
	Veterans benefits and services:								
123	Exclusion of veterans death benefits and disability compensation	2,820	2,940	3,070	3,210	3,350	3,495	3,650	16,775
124	Exclusion of veterans pensions	65	65	70	75	80	85	85	395
125	Exclusion of GI bill benefits	65	75	85	90	90	95	100	460
126	Exclusion of interest on veterans housing bonds	40	40	40	40	40	40	40	200
	General purpose fiscal assistance:								
127	Exclusion of interest on public purpose bonds	20,050	20,250	20,450	20,660	20,865	21,075	21,285	104,335
128	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	32,795	34,925	37,000	39,235	41,715	44,490	47,400	209,840
129	Tax credit for corporations receiving income from doing business in U.S. possessions	3,960	4,000	4,120	4,245	4,285	4,150	4,215	21,015
	Interest:								
130	Deferral of interest on U.S. savings bonds	965	1,015	1,065	1,115	1,175	1,235	1,295	5,885
	Addendum—Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	17,770	18,595	19,495	20,535	21,625	22,635	23,645	107,935
	Nonbusiness State and local taxes other than on owner-occupied homes	32,795	34,925	37,000	39,235	41,715	44,490	47,400	209,840
	Exclusion of interest on:								
	Public purpose State and local debt	20,050	20,250	20,450	20,660	20,865	21,075	21,285	104,335
	IDBs for certain energy facilities	110	110	110	115	115	115	115	570
	IDBs for pollution control and sewage and waste disposal facilities	440	440	445	455	455	460	465	2,280
	Small-issue IDBs	295	300	305	305	305	310	310	1,535
	Owner-occupied mortgage revenue bonds	860	875	880	885	900	905	915	4,485
	State and local debt for rental housing	150	150	150	150	155	155	155	765
	IDBs for airports, docks, and sports and convention facilities	695	705	710	715	725	730	740	3,620
	State and local student loan bonds	235	235	240	245	245	250	250	1,230
	State and local debt for private nonprofit educational facilities	560	570	570	575	580	590	595	2,910
	State and local debt for private nonprofit health facilities	1,160	1,170	1,185	1,190	1,205	1,220	1,230	6,030
	State and local debt for veterans housing	40	40	40	40	40	40	40	200

[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: 1998 $680; 1999 $725; 2000 $755; 2001 $765; 2002 $790; 2003 $805; and 2004 $830.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1998 $0; 1999 $415; 2000 $528; 2001 $496; 2002 $483; 2003 $453; and 2004 $425.

[3] 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: 1998 $23,239; 1999 $26,273; 2000 $26,882; 2001 $27,667; 2002 $28,632; 2003 $29,566; and 2004 $30,578.

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. Provisions with estimates that rounded to zero in each year are not included in the table.

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

(In millions of dollars)

		Revenue Loss															
		Corporations								Individuals							
		1998	1999	2000	2001	2002	2003	2004	2000–2004	1998	1999	2000	2001	2002	2003	2004	2000–2004
	National Defense																
1	Exclusion of benefits and allowances to armed forces personnel	...	...	...	...	...	...	...	...	2,095	2,120	2,140	2,160	2,180	2,200	2,220	10,900
	International affairs:																
2	Exclusion of income earned abroad by U.S. citizens	...	...	...	...	...	...	...	...	1,990	2,235	2,500	2,800	3,125	3,460	3,830	15,715
3	Exclusion of income of foreign sales corporations	2,150	2,250	2,400	2,550	2,700	2,900	3,100	13,650	...	...	...	...	...	...	...	...
4	Inventory property sales source rules exception	1,000	1,050	1,100	1,150	1,250	1,350	1,450	6,300	...	...	...	...	...	...	...	...
5	Deferral of income from controlled foreign corporations (normal tax method)	5,500	5,800	6,200	6,600	7,000	7,450	7,900	35,150	...	...	...	...	...	...	...	...
6	Deferred taxes for financial firms on certain income earned overseas	400	1,075	65	0	0	0	0	65	...	...	...	...	...	...	...	...
	General science, space, and technology:																
7	Expensing of research and experimentation expenditures (normal tax method)	255	325	500	600	665	720	750	3,235	5	5	10	10	10	15	15	60
8	Credit for increasing research activities	2,095	1,625	965	425	180	60	0	1,630	30	30	15	0	0	0	0	15
	Energy:																
9	Expensing of exploration and development costs, fuels	–90	–55	–10	–15	0	25	30	30	–20	–15	0	0	0	5	10	15
10	Excess of percentage over cost depletion, fuels	200	205	210	215	220	225	235	1,105	50	55	55	55	55	55	55	275
11	Alternative fuel production credit	815	765	720	680	640	420	120	2,580	45	45	40	40	35	15	5	135
12	Exception from passive loss limitation for working interests in oil and gas properties	...	...	...	...	...	...	...	...	30	35	35	35	40	40	40	190
13	Capital gains treatment of royalties on coal	...	...	...	...	...	...	...	...	60	65	65	70	70	75	80	360
14	Exclusion of interest on energy facility bonds	30	30	30	30	30	30	30	150	80	80	80	85	85	85	85	420
15	Enhanced oil recovery credit	130	150	170	195	225	260	300	1,150	10	10	10	15	15	15	20	75
16	New technology credit	25	30	35	40	40	35	35	185	...	...	...	...	...	...	...	...
17	Alcohol fuel credits [1]	10	10	10	10	10	10	10	50	5	5	5	5	5	5	5	25
18	Tax credit and deduction for clean-fuel burning vehicles	60	65	75	80	75	60	50	340	15	15	15	15	15	15	10	70
19	Exclusion from income of conservation subsidies provided by public utilities	...	...	...	...	...	...	...	...	80	80	80	75	75	75	80	385
	Natural resources and environment:																
20	Expensing of exploration and development costs, nonfuel minerals	20	20	20	20	20	25	25	110	5	5	5	5	5	5	5	25
21	Excess of percentage over cost depletion, nonfuel minerals	180	190	195	205	215	225	235	1,075	45	50	50	50	55	55	60	270
22	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	115	115	115	120	120	120	120	595	325	325	330	335	335	340	345	1,685
23	Capital gains treatment of certain timber income	...	...	...	...	...	...	...	...	60	65	65	70	70	75	80	360
24	Expensing of multiperiod timber growing costs	300	310	315	330	340	355	365	1,705	185	190	195	200	210	215	225	1,045
25	Investment credit and seven-year amortization for reforestation expenditures	...	...	...	...	...	...	...	...	10	10	10	10	15	15	15	65
26	Tax incentives for preservation of historic structures	175	195	210	225	235	250	260	1,180	40	40	45	50	50	55	55	255
	Agriculture:																
27	Expensing of certain capital outlays	10	10	10	10	10	10	10	50	55	60	60	65	65	70	75	335
28	Expensing of certain multiperiod production costs	10	10	10	10	10	10	10	50	70	75	75	80	85	90	95	425
29	Treatment of loans forgiven for solvent farmers	...	...	...	...	...	...	...	...	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	...	...	...	...	...	...	...	...	605	630	655	685	715	750	785	3,590
31	Income averaging for farmers	...	...	...	...	...	...	...	...	10	75	75	80	80	80	85	400
32	Deferral of gain on sale of farm refiners	10	10	10	10	10	15	15	60								
	Commerce and housing:																
	Financial institutions and insurance:																
33	Exemption of credit union income	785	840	905	970	1,040	1,120	1,200	5,235	...	...	...	...	...	...	...	...
34	Excess bad debt reserves of financial institutions	70	30	10	5	5	5	0	25	...	...	...	...	...	...	...	...
35	Exclusion of interest on life insurance savings	200	210	225	235	250	260	275	1,245	13,265	13,990	14,765	15,575	16,430	17,335	18,565	82,670
36	Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25	...	...	...	...	...	...	...	...
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	210	225	240	260	275	310	325	1,410	...	...	...	...	...	...	...	...

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

(In millions of dollars)

		Revenue Loss															
		Corporations								Individuals							
		1998	1999	2000	2001	2002	2003	2004	2000–2004	1998	1999	2000	2001	2002	2003	2004	2000–2004
38	Small life insurance company deduction	100	100	100	105	105	110	100	520	...	...	...	...	...	...	...	...
	Housing:																
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	225	230	230	230	235	235	240	1,170	635	645	650	655	665	670	675	3,315
40	Exclusion of interest on rental housing bonds	40	40	40	40	40	40	40	200	110	110	110	110	115	115	115	565
41	Deductibility of mortgage interest on owner-occupied homes	...	...	...	...	...	...	...	...	51,700	52,990	55,100	57,590	60,415	63,425	66,615	303,145
42	Deductibility of State and local property tax on owner-occupied homes	...	...	...	...	...	...	...	...	17,770	18,595	19,495	20,535	21,625	22,635	23,645	107,935
43	Deferral of income from post-1987 installment sales	255	260	265	270	275	280	285	1,375	720	735	750	765	780	795	810	3,900
44	Capital gains exclusion on home sales	...	...	...	...	...	...	...	...	17,475	18,000	18,540	19,095	19,670	20,260	20,870	98,435
45	Exception from passive loss rules for $25,000 of rental loss	...	...	...	...	...	...	...	...	4,735	4,455	4,215	4,000	3,785	3,575	3,375	18,950
46	Credit for low-income housing investments	2,340	2,420	2,500	2,615	2,655	2,715	2,710	13,195	780	805	835	870	885	905	905	4,400
47	Accelerated depreciation on rental housing (normal tax method)	1,650	1,880	2,125	2,845	3,135	3,090	3,155	14,350	755	860	970	1,325	1,455	1,405	1,415	6,570
	Commerce:																
48	Cancellation of indebtedness	...	...	...	...	...	...	...	...	50	30	20	15	20	20	25	100
49	Exceptions from imputed interest rules	...	...	...	...	...	...	...	...	155	160	160	160	165	165	165	815
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	...	...	...	...	...	...	...	...	38,275	39,415	40,585	41,795	43,035	44,310	45,625	215,350
51	Capital gains exclusion of small corporation stock	...	...	...	...	...	...	...	...	0	5	5	5	5	5	5	25
52	Step-up basis of capital gains at death	...	...	...	...	...	...	...	...	24,570	25,800	27,090	28,240	29,370	30,545	31,765	147,010
53	Carryover basis of capital gains on gifts	...	...	...	...	...	...	...	...	170	175	185	195	205	210	220	1,015
54	Ordinary income treatment of loss from small business corporation stock sale	...	...	...	...	...	...	...	...	35	35	35	40	40	40	40	195
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	4,635	3,620	2,550	1,785	1,720	1,360	450	7,865	1,635	1,275	880	600	645	515	135	2,775
56	Accelerated depreciation of machinery and equipment (normal tax method)	22,025	24,645	26,800	27,835	28,050	27,790	27,380	137,855	6,860	7,860	8,665	8,995	8,935	8,720	8,475	43,790
57	Expensing of certain small investments (normal tax method)	805	840	875	820	1,200	1,125	730	4,750	380	395	400	355	530	480	265	2,030
58	Amortization of start-up costs (normal tax method)	120	125	130	130	130	135	140	665	85	90	90	95	95	95	100	475
59	Graduated corporation income tax rate (normal tax method)	5,400	5,360	5,360	5,620	6,120	6,680	7,120	30,900	...	...	...	...	...	...	...	...
60	Exclusion of interest on small issue bonds	75	80	80	80	80	80	80	400	220	220	225	225	225	230	230	1,135
	Transportation:																
61	Deferral of tax on shipping companies	15	15	15	15	15	15	15	75	...	...	...	...	...	...	...	...
62	Exclusion of reimbursed employee parking expenses	...	...	...	...	...	...	...	...	1,560	1,595	1,630	1,690	1,750	1,815	1,885	8,770
63	Exclusion for employer-provided transit passes	...	...	...	...	...	...	...	...	70	80	95	105	130	155	170	655
	Community and regional development:																
64	Investment credit for rehabilitation of structures (other than historic)	15	15	15	15	15	15	15	75	15	15	15	15	15	15	15	75
65	Exclusion of interest for airport, dock, and similar bonds	180	185	185	185	190	190	195	945	515	520	525	530	535	540	545	2,675
66	Exemption of certain mutuals' and cooperatives' income	45	50	50	50	50	50	55	255	...	...	...	...	...	...	...	...
67	Empowerment zones and enterprise communities	135	185	205	190	170	130	115	810	155	195	225	245	245	175	175	1,065
68	Expensing of environmental remediation costs	75	90	120	50	–10	–20	–30	110	15	20	25	10	0	–5	–5	25
	Education, training, employment, and social services:																
	Education:																
69	Exclusion of scholarship and fellowship income (normal tax method)	...	...	...	...	...	...	...	...	910	955	995	1,040	1,085	1,135	1,185	5,440
70	HOPE tax credit	...	...	...	...	...	...	...	...	200	4,015	4,855	5,325	5,730	5,765	5,950	27,625
71	Lifetime Learning tax credit	...	...	...	...	...	...	...	...	110	2,510	2,655	2,970	3,015	3,355	4,565	16,560
72	Education Individual Retirement Accounts	...	...	...	...	...	...	...	...	20	100	230	380	540	710	885	2,745
73	Deductibility of student-loan interest	...	...	...	...	...	...	...	...	70	245	265	315	360	385	425	1,750
74	Deferral for State prepaid tuition plans	...	...	...	...	...	...	...	...	85	125	180	235	285	330	365	1,395
75	Exclusion of interest on student-loan bonds	60	60	65	65	65	65	65	325	175	175	175	180	180	185	185	905
76	Exclusion of interest on bonds for private nonprofit educational facilities	145	150	150	150	150	155	155	760	415	420	420	425	430	435	440	2,150

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

(In millions of dollars)

		Revenue Loss															
		Corporations								Individuals							
		1998	1999	2000	2001	2002	2003	2004	2000–2004	1998	1999	2000	2001	2002	2003	2004	2000–2004
77	Credit for holders of zone academy bonds	0	10	20	30	35	35	35	155								
78	Exclusion of interest on savings bonds redeemed to finance educational expenses	...	...	...	...	...	...	...	...	10	10	15	15	15	15	20	80
79	Parental personal exemption for students age 19 or over	...	...	...	...	...	...	...	...	875	915	965	1,015	1,055	1,105	1,155	5,295
80	Child credit [2]	...	...	...	...	...	...	...	...	3,525	18,740	18,725	18,430	18,160	17,745	17,155	90,215
81	Deductibility of charitable contributions (education)	970	970	990	1,020	1,065	1,105	1,160	5,340	1,910	1,970	2,075	2,175	2,285	2,400	2,520	11,455
82	Exclusion of employer-provided educational assistance	...	...	...	...	...	...	...	...	215	215	210	15	0	0	0	225
	Training, employment, and social services:																
83	Work opportunity tax credit	145	285	280	135	35	5	0	455	25	50	50	25	5	0	0	80
	Welfare-to-work tax credit	15	30	30	15	10	5	0	60	0	5	5	5	0	0	0	10
85	Exclusion of employer-provided child care	...	...	...	...	...	...	...	...	1,325	1,385	1,445	1,510	1,575	1,645	1,715	7,890
86	Adoption assistance	...	...	...	...	...	...	...	...	125	295	345	390	385	235	170	1,525
87	Exclusion of employee meals and lodging (other than military)	...	...	...	...	...	...	...	...	620	650	680	710	740	775	810	3,715
88	Credit for child and dependent care expenses	...	...	...	...	...	...	...	...	2,485	2,455	2,425	2,395	2,365	2,340	2,310	11,835
89	Credit for disabled access expenditures	15	15	15	15	15	20	20	85	30	35	35	35	40	40	40	190
90	Expensing of costs of removing certain architectural barriers to the handicapped	0	5	5	5	5	5	5	25								
91	Deductibility of charitable contributions, other than education and health	1,190	1,190	1,215	1,255	1,310	1,360	1,425	6,565	17,390	17,960	18,840	19,750	20,740	21,790	22,910	104,030
92	Exclusion of certain foster care payments	...	...	...	...	...	...	...	...	35	35	40	40	45	45	50	220
93	Exclusion of parsonage allowances	...	...	...	...	...	...	...	...	315	340	360	385	410	440	470	2,065
	Health:																
94	Exclusion of employer contributions for medical insurance premiums and medical care	...	...	...	...	...	...	...	...	67,920	72,535	77,670	83,095	88,830	94,960	101,520	446,075
95	Self-employed medical insurance premiums	...	...	...	...	...	...	...	...	765	980	1,310	1,405	1,550	2,055	2,905	9,225
96	Workers' compensation insurance premiums	...	...	...	...	...	...	...	...	4,260	4,420	4,585	4,755	4,935	5,120	5,315	24,710
97	Medical Savings Accounts	...	...	...	...	...	...	...	...	15	20	25	25	20	20	15	105
98	Deductibility of medical expenses	...	...	...	...	...	...	...	...	3,615	3,775	3,985	4,215	4,475	4,750	5,035	22,460
99	Exclusion of interest on hospital construction bonds	305	305	310	310	315	320	320	1,575	855	865	875	880	890	900	910	4,455
100	Deductibility of charitable contributions (health)	610	610	620	640	670	695	730	3,355	1,950	2,020	2,110	2,220	2,330	2,450	2,570	11,680
101	Tax credit for orphan drug research	40	50	55	60	70	80	90	355	...	...	...	...	...	...	...	...
102	Special Blue Cross/Blue Shield deduction	210	230	250	280	325	290	250	1,395	...	...	...	...	...	...	...	...
	Income security:																
103	Exclusion of railroad retirement system benefits	...	...	...	...	...	...	...	...	420	420	425	425	430	435	440	2,155
104	Exclusion of workers' compensation benefits	...	...	...	...	...	...	...	...	5,140	5,330	5,475	5,940	6,205	6,480	6,755	30,855
105	Exclusion of public assistance benefits (normal tax method)	...	...	...	...	...	...	...	...	440	345	360	375	390	405	420	1,950
106	Exclusion of special benefits for disabled coal miners	...	...	...	...	...	...	...	...	85	80	75	70	70	65	60	340
107	Exclusion of military disability pensions	...	...	...	...	...	...	...	...	120	125	130	135	140	140	145	690
	Net exclusion of pension contributions and earnings:																
108	Employer plans	...	...	...	...	...	...	...	...	82,215	82,195	84,350	86,670	89,155	91,810	94,455	446,440
109	Individual Retirement Accounts	...	...	...	...	...	...	...	...	10,565	10,770	11,170	11,440	11,550	11,485	11,270	56,915
110	Keogh plans	...	...	...	...	...	...	...	...	3,930	4,025	4,255	4,495	4,750	5,010	5,285	23,795
	Exclusion of other employee benefits:																
111	Premiums on group term life insurance	...	...	...	...	...	...	...	...	2,030	2,075	2,120	2,170	2,220	2,270	2,335	11,115
112	Premiums on accident and disability insurance	...	...	...	...	...	...	...	...	175	185	195	205	215	225	235	1,075
113	Income of trusts to finance supplementary unemployment benefits	...	...	...	...	...	...	...	...	5	5	5	5	5	5	5	25
114	Special ESOP rules	660	680	700	730	760	790	820	3,800	260	270	280	290	300	310	320	1,500
115	Additional deduction for the blind	...	...	...	...	...	...	...	...	30	30	30	30	35	35	35	165
116	Additional deduction for the elderly	...	...	...	...	...	...	...	...	1,690	1,720	1,740	1,795	1,880	1,945	2,020	9,380
117	Tax credit for the elderly and disabled	...	...	...	...	...	...	...	...	40	40	40	40	40	40	40	200
118	Deductibility of casualty losses	...	...	...	...	...	...	...	...	225	235	245	255	270	280	290	1,340
119	Earned income tax credit [3]	...	...	...	...	...	...	...	...	6,351	5,118	4,971	5,142	5,275	5,471	5,672	26,531
	Social Security:																
	Exclusion of social security benefits:																
120	Social Security benefits for retired workers	...	...	...	...	...	...	...	...	16,780	17,210	18,125	19,045	20,100	21,260	22,460	100,990
121	Social Security benefits for disabled	...	...	...	...	...	...	...	...	2,265	2,420	2,615	2,820	3,060	3,325	3,625	15,445

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

(In millions of dollars)

		Revenue Loss															
		Corporations								Individuals							
		1998	1999	2000	2001	2002	2003	2004	2000–2004	1998	1999	2000	2001	2002	2003	2004	2000–2004
122	Social Security benefits for dependents and survivors	.....	.....	.....	.....	.....	.....	.....	.....	3,725	3,785	3,910	4,065	4,235	4,405	4,575	21,190
	Veterans benefits and services:																
123	Exclusion of veterans death benefits and disability compensation	.....	.....	.....	.....	.....	.....	.....	.....	2,820	2,940	3,070	3,210	3,350	3,495	3,650	16,775
124	Exclusion of veterans pensions	.....	.....	.....	.....	.....	.....	.....	.....	65	65	70	75	80	85	85	395
125	Exclusion of GI bill benefits	.....	.....	.....	.....	.....	.....	.....	.....	65	75	85	90	90	95	100	460
126	Exclusion of interest on veterans housing bonds	10	10	10	10	10	10	10	50	30	30	30	30	30	30	30	150
	General purpose fiscal assistance:																
127	Exclusion of interest on public purpose bonds	5,240	5,295	5,345	5,400	5,455	5,510	5,565	27,275	14,810	14,955	15,105	15,260	15,410	15,565	15,720	77,060
128	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	.....	32,795	34,925	37,000	39,235	41,715	44,490	47,400	209,840
129	Tax credit for corporations receiving income from doing business in U.S. possessions	3,960	4,000	4,120	4,245	4,285	4,150	4,215	21,015	.....	.....	.....	.....	.....	.....	.....	.....
	Interest:																
130	Deferral of interest on U.S. savings bonds	.....	.....	.....	.....	.....	.....	.....	.....	965	1,015	1,065	1,115	1,175	1,235	1,295	5,885
	Addendum—Aid to State and local governments:																
	Deductibility of:																
	Property taxes on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	.....	17,770	18,595	19,495	20,535	21,625	22,635	23,645	107,935
	Nonbusiness State and local taxes other than on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	.....	32,795	34,925	37,000	39,235	41,715	44,490	47,400	209,840
	Exclusion of interest on:																
	Public purpose State and local debt	5,240	5,295	5,345	5,400	5,455	5,510	5,565	27,275	14,810	14,955	15,105	15,260	15,410	15,565	15,720	77,060
	IDBs for certain energy facilities	30	30	30	30	30	30	30	150	80	80	80	85	85	85	85	420
	IDBs for pollution control and sewage and waste disposal facilities	115	115	115	120	120	120	120	595	325	325	330	335	335	340	345	1,685
	Small-issue IDBs	75	80	80	80	80	80	80	400	220	220	225	225	225	230	230	1,135
	Owner-occupied mortgage revenue bonds	225	230	230	230	235	235	240	1,170	635	645	650	655	665	670	675	3,315
	State and local debt for rental housing	40	40	40	40	40	40	40	200	110	110	110	110	115	115	115	565
	IDBs for airports, docks, and sports and convention facilities	180	185	185	185	190	190	195	945	515	520	525	530	535	540	545	2,675
	State and local student loan bonds	60	60	65	65	65	65	65	325	175	175	175	180	180	185	185	905
	State and local debt for private nonprofit educational facilities	145	150	150	150	150	155	155	760	415	420	420	425	430	435	440	2,150
	State and local debt for private nonprofit health facilities	305	305	310	310	315	320	320	1,575	855	865	875	880	890	900	910	4,455
	State and local debt for veterans housing	10	10	10	10	10	10	10	50	30	30	30	30	30	30	30	150

[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: 1998 $680; 1999 $725; 2000 $755; 2001 $765; 2002 $790; 2003 $805; and 2004 $830.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1998 $0; 1999 $415; 2000 $528; 2001 $496; 2002 $483; 2003 $453; and 2004 $425.

[3] 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: 1998 $23,239; 1999 $26,273; 2000 $26,882; 2001 $27,667; 2002 $28,632; 2003 $29,566; and 2004 $30,578.

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. Provisions with estimates that rounded to zero in each year are not included in the table.

Table 5–3. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 2000 REVENUE LOSS

(In millions of dollars)

Provision	2000	2000–2004
Net exclusion of pension contributions and earnings: Employer plans	84,350	446,440
Exclusion of employer contributions for medical insurance premiums and medical care	77,670	446,075
Deductibility of mortgage interest on owner-occupied homes	55,100	303,145
Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	40,585	215,350
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	37,000	209,840
Accelerated depreciation of machinery and equipment (normal tax method)	35,465	181,645
Step-up basis of capital gains at death	27,090	147,010
Deductibility of charitable contributions, total	25,850	142,425
Exclusion of interest on public purpose bonds	20,450	104,335
Deductibility of State and local property tax on owner-occupied homes	19,495	107,935
Child credit [2]	18,725	90,215
Capital gains exclusion on home sales	18,540	98,435
Exclusion of Social Security benefits for retired workers	18,125	100,990
Exclusion of interest on life insurance savings	14,990	83,915
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	11,170	56,915
Deferral of income from controlled foreign corporations (normal tax method)	6,200	35,150
Exclusion of workers' compensation benefits	5,475	30,855
Graduated corporation income tax rate (normal tax method)	5,360	30,900
Earned income tax credit [3]	4,971	26,531
HOPE tax credit	4,855	27,625
Exclusion of interest on non-public purpose State and local debt	4,635	23,625
Workers' compensation insurance premiums	4,585	24,710
Net exclusion of pension contributions and earnings: Keogh plans	4,255	23,795
Exception from passive loss rules for $25,000 of rental loss	4,215	18,950
Tax credit for corporations receiving income from doing business in U.S. possessions	4,120	21,015
Deductibility of medical expenses	3,985	22,460
Exclusion of Social Security benefits for dependents and survivors	3,910	21,190
Accelerated depreciation of buildings other than rental housing (normal tax method)	3,430	10,640
Credit for low-income housing investments	3,335	17,595
Accelerated depreciation on rental housing (normal tax method)	3,095	20,920
Exclusion of veterans death benefits and disability compensation	3,070	16,775
Lifetime Learning tax credit	2,655	16,560
Exclusion of Social Security benefits for disabled	2,615	15,445
Exclusion of income earned abroad by U.S. citizens	2,500	15,715
Credit for child and dependent care expenses	2,425	11,835
Exclusion of income of foreign sales corporations	2,400	13,650
Exclusion of benefits and allowances to armed forces personnel	2,140	10,900
Exclusion of other employee benefits: Premiums on group term life insurance	2,120	11,115
Additional deduction for the elderly	1,740	9,380
Exclusion of reimbursed employee parking expenses	1,630	8,770
Exclusion of employer-provided child care	1,445	7,890
Self-employed medical insurance premiums	1,310	9,225
Expensing of certain small investments (normal tax method)	1,275	6,780
Inventory property sales source rules exception	1,100	6,300
Deferral of interest on U.S. savings bonds	1,065	5,885
Deferral of income from post-1987 installment sales	1,015	5,275
Exclusion of scholarship and fellowship income (normal tax method)	995	5,440
Credit for increasing research activities	980	1,645
Special ESOP rules	980	5,300
Parental personal exemption for students age 19 or over	965	5,295
Exemption of credit union income	905	5,235
Alternative fuel production credit	760	2,715
Exclusion of employee meals and lodging (other than military)	680	3,715
Capital gains treatment of certain income	655	3,590
Expensing of research and experimentation expenditures (normal tax method)	510	3,295
Expensing of multiperiod timber growing costs	510	2,750
Excess of percentage over cost depletion, fuels and nonfuel minerals	510	2,725
Empowerment zones and enterprise communities	430	1,875
Exclusion of railroad retirement system benefits	425	2,155
Exclusion of parsonage allowances	360	2,065
Exclusion of public assistance benefits (normal tax method)	360	1,950
Adoption assistance	345	1,525
Work opportunity tax credit	330	535
Deductibility of student-loan interest	265	1,750
Tax incentives for preservation of historic structures	255	1,435
Special Blue Cross/Blue Shield deduction	250	1,395
Deductibility of casualty losses	245	1,340
Tax exemption of certain insurance companies owned by tax-exempt organizations	240	1,410
Education Individual Retirement Accounts	230	2,745

Table 5–3. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 2000 REVENUE LOSS—Continued

(In millions of dollars)

Provision	2000	2000–2004
Amortization of start-up costs (normal tax method)	220	1,140
Exclusion of employer-provided educational assistance	210	225
Exclusion of other employee benefits: Premiums on accident and disability insurance	195	1,075
Carryover basis of capital gains on gifts	185	1,015
Deferral for State prepaid tuition plans	180	1,395
Enhanced oil recovery credit	180	1,225
Exceptions from imputed interest rules	160	815
Expensing of environmental remediation costs	145	135
Exclusion of military disability pensions	130	690
Small life insurance company deduction	100	520
Exclusion for employer-provided transit passes	95	655
Tax credit and deduction for clean-fuel burning vehicles	90	410
Exclusion of GI bill benefits	85	460
Expensing of certain multiperiod production costs	85	475
Exclusion from income of conservation subsidies provided by public utilities	80	385
Exclusion of special benefits for disabled coal miners	75	340
Income averaging for farmers	75	400
Exclusion of veterans pensions	70	395
Expensing of certain capital outlays	70	385
Capital gains treatment of certain timber income	65	360
Deferred taxes for financial firms on certain income earned overseas	65	65
Capital gains treatment of royalties on coal	65	360
Tax credit for orphan drug research	55	355
Credit for disabled access expenditures	50	275
Exemption of certain mutuals' and cooperatives' income	50	255
Exclusion of certain foster care payments	40	220
Tax credit for the elderly and disabled	40	200
Exception from passive loss limitation for working interests in oil and gas properties	35	190
New technology credit	35	185
Ordinary income treatment of loss from small business corporation stock sale	35	195
Welfare-to-work tax credit	35	70
Investment credit for rehabilitation of structures (other than historic)	30	150
Additional deduction for the blind	30	165
Medical Savings Accounts	25	105
Expensing of exploration and development costs, nonfuel minerals	25	135
Cancellation of indebtedness	20	100
Credit for holders of zone academy bonds	20	155
Deferral of tax on shipping companies	15	75
Exclusion of interest on savings bonds redeemed to finance educational expenses	15	80
Alcohol fuel credits [1]	15	75
Treatment of loans forgiven for solvent farmers	10	50
Excess bad debt reserves of financial institutions	10	25
Deferral of gain on sale of farm refiners	10	60
Investment credit and seven-year amortization for reforestation expenditures	10	65
Capital gains exclusion of small corporation stock	5	25
Expensing of costs of removing certain architectural barriers to the handicapped	5	25
Income of trusts to finance supplementary unemployment benefits	5	25
Special alternative tax on small property and casualty insurance companies	5	25
Expensing of exploration and development costs, fuels	(10)	45

[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: 1998 $680; 1999 $725; 2000 $755; 2001 $765; 2002 $790; 2003 $805; and 2004 $830

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1998 $0; 1999 $415; 2000 $528; 2001 $496; 2002 $483; 2003 $453; and 2004 $425.

[3] 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: 1998 $23,239; 1999 $26,273; 2000 $26,882; 2001 $27,667; 2002 $28,632; 2003 $29,566; and 2004 $30,578.

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. Provisions with estimates that rounded to zero in each year are not included in the able.

Note: Three categories in the table are aggregated: Deductibility of chartable contributions, exclusion of interest for non-public purpose State and local debt, and excess of percentage over cost depletion, fuels and nonfuel minerals.

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
1	Deferral of income from controlled foreign corporations (normal tax method)	5,700
2	Deferred taxes for financial firms on income earned overseas	550
3	Expensing of research and experimentation expenditures (normal tax method)	1,650
4	Expensing of exploration and development costs—fuels	90
5	Expensing of exploration and development costs—nonfuels	20
6	Expensing of multiperiod timber growing costs	250
7	Expensing of certain multiperiod production costs—agriculture	90
8	Expensing of certain capital outlays—agriculture	75
9	Deferral of income on life insurance and annuity contracts	20,615
10	Accelerated depreciation of rental housing (normal tax method)	3,415
11	Accelerated depreciation of buildings other than rental housing (normal tax method)	560
12	Accelerated depreciation of machinery and equipment (normal tax method)	39,670
13	Expensing of certain small investments (normal tax method)	1,375
14	Amortization of start-up costs (normal tax method)	180
15	Deferral of tax on shipping companies	15
16	Credit for holders of zone academy bonds	180
17	Credit for low-income housing investments	2,745
18	Exclusion of pension contributions—employer plans	84,430
19	Exclusion of IRA contributions and earnings	13,285
20	Exclusion of contributions and earnings for Keogh plans	3,555
21	Exclusion of interest on public-purpose bonds	22,360
22	Exclusion of interest on non-public purpose bonds	3,435
23	Deferral of interest on U.S. savings bonds	390

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							
		1998	1999	2000	2001	2002	2003	2004	2000–2004
	National Defense:								
1	Exclusion of benefits and allowances to armed forces personnel	2,445	2,470	2,495	2,520	2,545	2,570	2,595	12,725
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	2,640	2,965	3,315	3,710	4,145	4,590	5,080	20,840
3	Exclusion of income of foreign sales corporations	3,310	3,460	3,700	3,920	4,150	4,460	4,770	21,000
4	Inventory property sales source rules exception	1,550	1,620	1,690	1,770	1,920	2,080	2,230	9,690
5	Deferral of income from controlled foreign corporations (normal tax method)	5,500	5,800	6,200	6,600	7,000	7,450	7,900	35,150
6	Deferred taxes for financial firms on income earned overseas	400	1,075	65	0	0	0	0	65
	General science, space, and technology:								
7	Expensing of research and experimentation expenditures (normal tax method)	260	330	510	610	675	735	765	3,295
8	Credit for increasing research activities	3,270	2,550	1,500	650	275	90	15	2,530
	Energy:								
9	Expensing of exploration and development costs, fuels	(130)	(90)	(20)	(25)	0	40	45	40
10	Excess of percentage over cost depletion, fuels	285	295	300	310	320	325	335	1,590
11	Alternative fuel production credit	1,100	1,030	975	915	860	555	165	3,470
12	Exception from passive loss limitation for working interests in oil and gas properties	30	35	35	35	40	40	40	190
13	Capital gains treatment of royalties on coal	80	85	85	95	95	100	105	480
14	Exclusion of interest on energy facility bonds	155	155	155	165	165	165	165	815
15	Enhanced oil recovery credit	215	245	285	325	375	425	490	1,900
16	New technology credit	30	40	45	50	55	55	40	245
17	Alcohol fuel credits [1]	15	15	15	15	15	15	15	75
18	Tax credit and deduction for clean-fuel burning vehicles	95	105	115	130	120	95	65	525
19	Exclusion from income of conservation subsidies provided by public utilities	110	110	105	105	100	105	105	520
	Natural resources and environment:								
20	Expensing of exploration and development costs, nonfuel minerals	30	30	30	30	30	40	40	170
21	Excess of percentage over cost depletion, nonfuel minerals	275	280	300	310	325	340	350	1,625
22	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	630	630	640	650	650	655	665	3,260
23	Capital gains treatment of certain timber income	80	85	85	95	95	100	105	480
24	Expensing of multiperiod timber growing costs	485	500	510	530	550	570	590	2,750
25	Investment credit and seven-year amortization for reforestation expenditures	15	15	15	15	15	15	15	75
26	Tax incentives for preservation of historic structures	215	235	255	275	285	305	315	1,435
	Agriculture:								
27	Expensing of certain capital outlays	65	70	70	75	75	80	85	385
28	Expensing of certain multiperiod production costs	80	85	85	90	95	100	105	475
29	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	805	840	875	915	955	1,000	1,045	4,790
31	Income averaging for farmers	10	75	75	80	80	80	85	400
32	Deferral of gain on sale of farm refiners	10	10	10	10	10	15	15	60
	Commerce and housing:								
	Financial institutions and insurance:								
33	Exemption of credit union income	1,000	1,070	1,150	1,235	1,325	1,425	1,530	6,665
34	Excess bad debt reserves of financial institutions	70	30	10	5	5	5	0	25
35	Exclusion of interest on life insurance savings	13,465	14,200	14,990	15,810	16,680	17,595	18,840	83,915
36	Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	290	315	335	345	365	415	450	1,910
38	Small life insurance company deduction	140	140	140	150	150	150	150	740
	Housing:								
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	1,230	1,255	1,260	1,270	1,290	1,295	1,315	6,430
40	Exclusion of interest on rental housing bonds	215	215	215	215	220	220	220	1,090
41	Deductibility of mortgage interest on owner-occupied homes	51,700	52,990	55,100	57,590	60,415	63,425	66,615	303,145
42	Deductibility of State and local property tax on owner-occupied homes	17,770	18,595	19,495	20,535	21,625	22,635	23,645	107,935
43	Deferral of income from post-1987 installment sales	975	995	1,015	1,035	1,055	1,075	1,095	5,275
44	Capital gains exclusion on home sales	21,845	22,500	23,175	23,870	24,590	25,325	26,090	123,050
45	Exception from passive loss rules for $25,000 of rental loss	4,735	4,455	4,215	4,000	3,785	3,575	3,375	18,950
46	Credit for low-income housing investments	4,065	4,210	4,340	4,540	4,610	4,720	4,705	22,915
47	Accelerated depreciation on rental housing (normal tax method)	2,405	2,740	3,095	4,170	4,590	4,495	4,570	20,920
	Commerce:								
48	Cancellation of indebtedness	50	30	20	15	20	20	25	100
49	Exceptions from imputed interest rules	155	160	160	160	165	165	165	815
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	51,035	52,555	54,115	55,725	57,380	59,080	60,835	287,135
51	Capital gains exclusion of small corporation stock	0	5	5	5	5	5	5	25
52	Step-up basis of capital gains at death	32,760	34,400	36,120	37,655	39,160	40,725	42,355	196,015
53	Carryover basis of capital gains on gifts	170	175	185	195	205	210	220	1,015
54	Ordinary income treatment of loss from small business corporation stock sale	45	45	45	55	55	55	55	265
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	6,270	4,895	3,430	2,385	2,365	1,875	585	10,640

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

(In millions of dollars)

		Outlay Equivalents							
		1998	1999	2000	2001	2002	2003	2004	2000–2004
56	Accelerated depreciation of machinery and equipment (normal tax method)	28,885	32,505	35,465	36,830	36,985	36,510	35,855	181,645
57	Expensing of certain small investments (normal tax method)	1,185	1,235	1,275	1,175	1,730	1,605	995	6,780
58	Amortization of start-up costs (normal tax method)	205	215	220	225	225	230	240	1,140
59	Graduated corporation income tax rate (normal tax method)	7,400	7,340	7,340	7,700	8,385	9,150	9,755	42,330
60	Exclusion of interest on small issue bonds	425	430	435	435	435	445	445	2,195
	Transportation:								
61	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
62	Exclusion of reimbursed employee parking expenses	2,010	2,060	2,105	2,180	2,260	2,345	2,430	11,320
63	Exclusion for employer-provided transit passes	95	115	130	150	180	215	240	915
	Community and regional development:								
64	Investment credit for rehabilitation of structures (other than historic)	30	30	30	30	30	30	30	150
65	Exclusion of interest for airport, dock, and similar bonds	995	1,010	1,015	1,025	1,040	1,045	1,060	5,185
66	Exemption of certain mutuals' and cooperatives' income	45	50	50	50	50	50	55	255
67	Empowerment zones and enterprise communities	290	380	430	435	415	305	290	1,875
68	Expensing of environmental remediation costs	120	145	195	80	(15)	(35)	(45)	180
	Education, training, employment, and social services:								
	Education:								
69	Exclusion of scholarship and fellowship income (normal tax method)	1,015	1,060	1,105	1,155	1,210	1,265	1,320	6,055
70	HOPE tax credit	255	5,150	6,225	6,830	7,345	7,390	7,625	35,415
71	Lifetime Learning tax credit	140	3,215	3,405	3,805	3,865	4,305	5,850	21,230
72	Education Individual Retirement Accounts	25	125	295	480	685	895	1,120	3,475
73	Deductibility of student-loan interest	90	305	330	390	450	485	530	2,185
74	Deferral for State prepaid tuition plans	85	125	180	235	285	330	365	1,395
75	Exclusion of interest on student-loan bonds	340	340	345	350	350	360	360	1,765
76	Exclusion of interest on bonds for private nonprofit educational facilities	800	820	820	825	835	845	850	4,175
77	Credit for holders of zone academy bonds	0	15	30	45	50	50	50	225
78	Exclusion of interest on savings bonds redeemed to finance educational expenses	15	15	20	20	20	20	30	110
79	Parental personal exemption for students age 19 or over	970	1,010	1,070	1,125	1,165	1,225	1,280	5,865
80	Child credit [2]	4,700	24,985	24,965	24,575	24,215	23,660	22,875	120,290
81	Deductibility of charitable contributions (education)	3,995	4,090	4,250	4,435	4,650	4,870	5,125	23,330
82	Exclusion of employer-provided educational assistance	270	270	260	20	0	0	0	280
	Training, employment, and social services:								
83	Work opportunity tax credit	170	335	330	160	40	5	0	535
84	Welfare-to-work tax credit	15	35	35	20	10	5	0	70
85	Exclusion of employer-provided child care	1,765	1,845	1,925	2,015	2,100	2,195	2,285	10,520
86	Adoption assistance	155	355	415	470	460	285	205	1,835
87	Exclusion of employee meals and lodging (other than military)	760	795	830	865	905	945	990	4,535
88	Credit for child and dependent care expenses	3,315	3,275	3,235	3,195	3,155	3,115	3,080	15,780
89	Credit for disabled access expenditures	60	65	65	65	75	80	85	370
90	Expensing of costs of removing certain architectural barriers to the handicapped	0	5	5	5	5	5	5	25
91	Deductibility of charitable contributions, other than education and health	25,000	25,780	27,015	28,320	29,770	31,310	32,980	149,395
92	Exclusion of certain foster care payments	45	45	50	50	50	55	60	265
93	Exclusion of parsonage allowances	390	415	445	475	505	540	580	2,545
	Health:								
94	Exclusion of employer contributions for medical insurance premiums and medical care	86,925	92,985	99,735	106,890	114,465	122,580	131,280	574,950
95	Self-employed medical insurance premiums	935	1,195	1,600	1,715	1,890	2,505	3,545	11,255
96	Workers' compensation insurance premiums	5,320	5,520	5,730	5,945	6,170	6,400	6,645	30,890
97	Medical Savings Accounts	20	30	30	35	30	30	25	150
98	Deductibility of medical expenses	3,615	3,775	3,985	4,215	4,475	4,750	5,035	22,460
99	Exclusion of interest on hospital construction bonds	1,665	1,680	1,695	1,705	1,725	1,750	1,765	8,640
100	Deductibility of charitable contributions (health)	3,520	3,600	3,760	3,930	4,120	4,330	4,560	20,700
101	Tax credit for orphan drug research	60	75	80	90	105	115	130	520
102	Special Blue Cross/Blue Shield deduction	280	310	335	375	435	385	335	1,865
	Income security:								
103	Exclusion of railroad retirement system benefits	420	420	425	425	430	435	440	2,155
104	Exclusion of workers' compensation benefits	5,140	5,330	5,475	5,940	6,205	6,480	6,755	30,855
105	Exclusion of public assistance benefits (normal tax method)	440	345	360	375	390	405	420	1,950
106	Exclusion of special benefits for disabled coal miners	85	80	75	70	70	65	60	340
107	Exclusion of military disability pensions	120	125	130	135	140	140	145	690
	Net exclusion of pension contributions and earnings:								
108	Employer plans	106,170	106,840	109,760	112,750	116,015	119,475	122,975	580,975
109	Individual Retirement Accounts	14,115	14,475	15,095	15,570	15,855	15,940	15,845	78,305
110	Keogh plans	5,010	5,105	5,400	5,705	6,025	6,360	6,710	30,200
	Exclusion of other employee benefits:								
111	Premiums on group term life insurance	2,690	2,750	2,815	2,880	2,945	3,015	3,085	14,740

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

(In millions of dollars)

		Outlay Equivalents							
		1998	1999	2000	2001	2002	2003	2004	2000–2004
112	Premiums on accident and disability insurance	225	235	250	260	275	290	305	1,380
113	Income of trusts to finance supplementary unemployment benefits	5	5	5	5	5	5	5	25
114	Special ESOP rules	1,280	1,320	1,360	1,415	1,470	1,530	1,585	7,360
115	Additional deduction for the blind	35	35	35	35	40	40	45	195
116	Additional deduction for the elderly	2,045	2,085	2,105	2,175	2,275	2,355	2,440	11,350
117	Tax credit for the elderly and disabled	50	50	50	50	50	50	55	255
118	Deductibility of casualty losses	245	260	270	285	295	310	320	1,480
119	Earned income tax credit[3]	7,056	5,687	5,523	5,714	5,861	6,079	6,303	29,480
	Social Security:								
	Exclusion of social security benefits:								
120	Social Security benefits for retired workers	16,780	17,210	18,125	19,045	20,100	21,260	22,460	100,990
121	Social Security benefits for disabled	2,265	2,420	2,615	2,820	3,060	3,325	3,625	15,445
122	Social Security benefits for dependents and survivors	3,725	3,785	3,910	4,065	4,235	4,405	4,575	21,190
	Veterans benefits and services:								
123	Exclusion of veterans death benefits and disability compensation	2,820	2,940	3,070	3,210	3,350	3,495	3,650	16,775
124	Exclusion of veterans pensions	65	65	70	75	80	85	85	395
125	Exclusion of GI bill benefits	65	75	85	90	90	95	100	460
126	Exclusion of interest on veterans housing bonds	60	60	60	60	60	60	60	300
	General purpose fiscal assistance:								
127	Exclusion of interest on public purpose bonds	28,720	29,005	29,290	29,595	29,890	30,190	30,490	149,455
128	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	32,795	34,925	37,000	39,235	41,715	44,490	47,400	209,840
129	Tax credit for corporations receiving income from doing business in U.S. possessions	3,960	4,000	4,120	4,245	4,285	4,150	4,215	21,015
	Interest:								
130	Deferral of interest on U.S. savings bonds	965	1,015	1,065	1,115	1,175	1,235	1,295	5,885
	Addendum—Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	17,770	18,595	19,495	20,535	21,625	22,635	23,645	107,935
	Nonbusiness State and local taxes other than on owner-occupied homes	32,795	34,925	37,000	39,235	41,715	44,490	47,400	209,840
	Exclusion of interest on:								
	Public purpose State and local debt	28,720	29,005	29,290	29,595	29,890	30,190	30,490	149,455
	IDBs for certain energy facilities	155	155	155	165	165	165	165	815
	IDBs for pollution control and sewage and waste disposal facilities	630	630	640	650	650	655	665	3,260
	Small-issue IDBs	425	430	435	435	435	445	445	2,195
	Owner-occupied mortgage revenue bonds	1,230	1,255	1,260	1,270	1,290	1,295	1,315	6,430
	State and local debt for rental housing	215	215	215	215	220	220	220	1,090
	IDBs for airports, docks, and sports and convention facilities	995	1,010	1,015	1,025	1,040	1,045	1,060	5,185
	State and local student loan bonds	340	340	345	350	350	360	360	1,765
	State and local debt for private nonprofit educational facilities	800	820	820	825	835	845	850	4,175
	State and local debt for private nonprofit health facilities	1,665	1,680	1,695	1,705	1,725	1,750	1,765	8,640
	State and local debt for veterans housing	60	60	60	60	60	60	60	300

[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: 1998 $680; 1999 $725; 2000 $755; 2001 $765; 2002 $790; 2003 $805; and 2004 $830.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1998 $0; 1999 $415; 2000 $528; 2001 $496; 2002 $483; 2003 $453; and 2004 $425.

[3] 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: 1998 $23,240; 1999 $25,650; 2000 $26,525; 2001 $27,265; 2002 $27,975; 2003 $28,705; and 2004 $29,655.

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. Provisions with estimates that rounded to zero in each year are not included in the table.

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 set of tax expenditures under its normal tax baseline than is considered here.

[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.

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 within the Office of Tax Analysis in each of the three main areas—individual, business, and international taxation. 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.

Over the next few years, the Administration's plan is to undertake additional studies that will focus on the availability of the data needed to assess the effects of selected significant tax expenditures, primarily those designed to increase savings. 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 benefit 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.

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

[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 1999–1993," JCS-7–98, December 14, 1998; 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 consumption deemed meritorious.

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, many different 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—provide flexibility for policy design. On the other hand, 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. This reliance can diminish their economic 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 not of paramount importance. 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.

There are examples of policy objectives that employ multiple approaches. Minimum wage legislation, the earned income tax credit, and the food stamp program are examples of programs that utilize regulatory, tax expenditure, and direct outlay approaches, respectively, in order to improve the economic welfare of low-wage workers. Their relative strengths and weaknesses have merited significant attention.

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. 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.***—In 1998, a U.S. citizen or resident alien who resides or stays overseas for at least 11 of the past 12 months may exclude $72,000 per year of foreign-earned income. The exclusion limit increases in $2,000 annual increments until it reaches $80,000 in 2002. 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 ($61,656 in 1998). 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 benefitting 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.

6. ***Exceptions under subpart F for active financing income.***—Financial firms can defer taxes on income earned overseas in an active business. This provision was originally enacted in the Taxpayer Relief Act of 1997, was canceled by a line-item veto by the President, and was restored by the Supreme Court decision declaring the line-item veto unconstitutional.

General Science, Space, and Technology

7. ***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.

8. ***R&E credit.***—The research and experimentation (R&E) credit, which expired on June 30, 1998, was reinstated (retroactively) in the Tax and Trade Relief Extension Act of 1998 for one year (through June 30, 1999). 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

9. ***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.

[8] Section 911 was also the subject of a January 1993 Treasury report to Congress, "Taxation of Americans Working Overseas."

10. ***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.

11. ***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.

12. ***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.

13. ***Capital gains treatment of royalties on coal.***—Sales of certain coal under royalty contracts can be treated as capital gains rather than ordinary income.

14. ***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.

15. ***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.

16. ***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.

17. ***Alcohol fuel credits.***—An income tax credit is provided for ethanol that is derived from renewable sources and used as fuel. The credit equals 54 cents per gallon in 1998, 1999, and 2000. The Transportation Equity Act of the 21st Century made the credit 53 cents per gallon in 2001 and 2002; 52 cents per gallon in 2003 and 2004; and 51 cents per gallon in 2005, 2006, and 2007. To the extent that ethanol is mixed with taxable motor fuel to create gasohol, taxpayers may claim an exemption of the federal excise tax rather than the income tax credit. In addition, small ethanol producers are eligible for a separate 10 cents per gallon credit.

18. ***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.

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

Natural Resources and Environment

20. ***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.

21. ***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.

22. ***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.

23. ***Capital gains treatment of certain timber.***—Certain timber sold under a royalty contract can be treated as capital gains rather than ordinary income.

24. ***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.

25. ***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.

26. ***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

27. ***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.

28. ***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.

29. ***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.

30. ***Capital gains treatment of certain income.***—Certain agricultural income, such as unharvested crops, can be treated as capital gains rather than ordinary income.

31. ***Income averaging for farmers.***—The Tax and Trade Relief Extension Act of 1998 permanently extended the provision that allows taxpayers to lower their tax liability by averaging, over the prior three-year period, their taxable income from farming. Without extension, the provision generally would have expired on December 31, 2000.

32. ***Deferral of gain on sales of farm refiners.***—A taxpayer who sells stock in a farm refiner to a farmers' cooperative can defer recognition of gain if the taxpayer reinvests the proceeds in qualified replacement property. This provision was originally enacted in the Taxpayer Relief Act of 1997, was canceled by a line-item veto by the President, and was restored by the Supreme Court decision declaring the line-item veto unconstitutional.

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.

[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.

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. The Tax and Trade Relief Extension Act of 1998 increased the volume cap to $55 per capita ($165 million minimum) in 2003 and ratably annually thereafter until the cap reaches $75 per capita ($225 million minimum) in 2007. States may issue mortgage credit certificates (MCCs) in lieu of mortgage revenue 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 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 may not be used more than once every two years.

45. ***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.

46. ***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. State agencies determine who receives the credit; states are limited in the amount of credit they may authorize annually to $1.25 per resident.

47. ***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.

48. ***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.

49. ***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

[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, 1999, 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 1999.

farms and small businesses worth between $250,000 and $1 million.

50. ***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 after December 31, 1997, the top tax rate is 20 percent (10 percent for taxpayers who would otherwise pay capital gains tax at the 15-percent rate). The IRS Restructuring and Reform Act of 1998 eliminated the 28-percent capital gains rate by lowering the holding period for the 20-percent capital gains rate from 15 years to 1 year.

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.

51. ***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.

52. ***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.

53. ***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.

54. ***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.

55. ***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.

56. ***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.

57. ***Expensing of certain small investments.***—In 1998, 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 1998, the amount expensed is completely phased out when qualifying investments exceed $218,500.

58. ***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.

59. ***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.

60. ***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

61. ***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, 1987.62. ***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 1998, the maximum amount of the parking exclusion is $175 (indexed, except in 1999) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

63. ***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 1998, the limit is $65 (indexed, except in 1999) per month.

Community and Regional Development

64. ***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.

65. ***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.

66. ***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.

67. ***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.

68. ***Expensing of environmental remediation costs.***— Taxpayers who clean up hazardous substances at a qualified site may 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. he expensing only applies to clean-up costs incurred after August 5, 1997 and before January 1, 2001.

Education, Training, Employment, and Social Services

69. ***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).

70. ***HOPE tax credit.***— The non-refundable HOPE tax credit 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).

71. ***Lifetime Learning tax credit.***—The non-refundable Lifetime Learning tax credit 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.

72. ***Education Individual Retirement Accounts.***—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. 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.

73. ***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 pay-

ments 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.

74. ***State prepaid tuition plans.***—Some states have adopted prepaid tuition plans and prepaid room and board plans, which allow persons to pay in advance for college expenses for designated beneficiaries. Taxes on the earnings from these plans are paid by the beneficiaries and are deferred until the tuition is actually paid.

75. ***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.

76. ***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.

77. ***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.

78. ***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 $78,350 and $108,350 ($52,250 and $67,250 for singles) in 1998.

79. ***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.

80. ***Child credit.***—Taxpayers with children under age 17 can qualify for a $500 child credit beginning January 1, 1999 ($400 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.

81. ***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.

82. ***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.

83. ***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, 1999 and who are certified as members of various targeted groups. The Tax and Trade Relief Extension Act of 1998 extended the expiration date from July 1, 1998 to July 1, 1999. 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.

84. ***Welfare-to-work tax credit.***—An employer is eligible for a 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 July 1, 1999. The Tax and Trade Relief Extension Act of 1998 extended the expiration date from May 1, 1999 to July 1, 1999.

85. ***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.

86. ***Adoption credit and exclusion.***—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.

87. ***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.

88. ***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.

89. ***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.

90. ***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.

91. ***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.

92. ***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.

93. ***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

94. ***Employer-paid medical insurance and expenses.***—Employer-paid health insurance premiums and other medical expenses (including long-term care) are deducted as a business expense by employers, but they are not included in employee gross income. The self-employed also may deduct part of their family health insurance premiums.

95. ***Self-employed medical insurance premiums.***—Self-employed taxpayers may deduct a percentage of their family health insurance premiums. Taxpayers without self-employment income are not eligible for the special percentage deduction. The deductible percentage is 45 percent in 1998, 60 percent in 1999 through 2001, 70 percent in 2002, and 100 percent in 2003 and thereafter.

96. ***Workers' compensation insurance premiums.***—Workers' compensation insurance premiums are paid by employers and deducted as a business expense, but the premiums are not included in employee gross income.

97. ***Medical savings accounts.***—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. ***Workers' compensation benefits.***—Workers—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 1998, an employee could exclude up to $10,000 (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 taxpayers with AGI between $50,000 and $60,000 ($30,000 and $40,000 for singles). The phase-out range increases annually until it reaches $80,000 to $100,000 in 2007 ($50,000 to $60,000 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.

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 59–½, (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 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.

112. ***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.

113. ***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.

114. ***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 corporations 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.

115. ***Additional deduction for the blind.***—Taxpayers who are blind may take an additional $1,000 standard deduction if single, or $800 if married.

116. ***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.

117. ***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.

118. ***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.

119. ***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 $6,680 of earned income in 1998. The credit is 40 percent of the first $9,390 of income for a family with two or more qualifying children. When the taxpayer's income exceeds $12,260, 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 $26,473 of modified adjusted gross income ($30,095 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 $4,460 of earned income. When the taxpayer's income exceeds $5,570, the credit is phased out at the rate of 7.65 percent. It is completely phased out at $10,030 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

120. ***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.

121. ***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.

122. ***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

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

124. ***Veterans pension payments.***—Pension payments made by the Veterans Administration are excluded from gross income.

125. ***G.I. Bill benefits.***—G.I. Bill benefits paid by the Veterans Administration are excluded from gross income.

126. ***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

127. ***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.

128. ***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.

129. ***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

130. ***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 1998–2004 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. Up to 40 percent of the value of land subject to certain conservation easements may 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.

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. For estates of decedents dying after December 31, 1997, the applicable interest rates are lower and the interest is non-deductible.

Commerce and Housing

4. ***Special-use valuation of closely-held businesses.***—The special-use valuation rule available for

[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.

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.***—Certain family-owned businesses that are bequeathed to qualified heirs can be excluded from taxable estates. The exclusion generally 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.

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	1998	1999	2000	2001	2002	2003	2004	2000–2004
	Natural Resources and Environment:								
1	Donations of conservation easements	0	10	25	40	55	75	95	290
	Agriculture:								
2	Special use valuation of farm real property	80	95	110	115	120	125	135	605
3	Tax deferral of closely held farms	0	0	0	5	5	10	10	30
	Commerce:								
4	Special use valuation of real property used in closely held businesses	5	5	5	5	5	10	10	35
5	Tax deferral of closely held business	15	0	10	20	30	50	65	175
6	Exclusion for family owned businesses	0	490	490	495	525	530	555	2,595
	Education, training, employment, and social services:								
7	Deduction for charitable contributions (education)	1,115	1,195	1,245	1,305	1,395	1,470	1,560	6,975
8	Deduction for charitable contributions (other than education and health)	3,295	3,525	3,670	3,850	4,115	4,345	4,605	20,585
	Health:								
9	Deduction for charitable contributions (health)	1,010	1,080	1,125	1,180	1,260	1,330	1,410	6,305
	General government:								
10	Credit for State death taxes	4,650	4,970	5,175	5,410	5,670	5,965	6,200	28,420

3. FEDERAL RECEIPTS

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

The Federal Government also collects income from the public from market-oriented activities. Collections from these activities, which are subtracted from gross outlays, rather than added to taxes and other governmental receipts, are discussed in the following chapter.

Growth in receipts.—Total receipts in 2001 are estimated to be $2,019.0 billion, an increase of $62.8 billion or 3.2 percent relative to 2000. 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 3.8 percent between 2001 and 2005, rising to $2,340.9 billion.

As a share of GDP, receipts are projected to decline from 20.4 percent in 2000 to 19.4 percent in 2005.

Table 3–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	1999 actual	Estimate					
		2000	2001	2002	2003	2004	2005
Individual income taxes	879.5	951.6	972.4	995.2	1,025.6	1,066.1	1,116.8
Corporation income taxes	184.7	192.4	194.8	195.4	195.7	200.0	205.9
Social insurance and retirement receipts	611.8	650.0	682.1	712.2	741.7	771.3	815.3
(On-budget)	(167.4)	(173.3)	(182.2)	(189.9)	(197.4)	(204.7)	(216.7)
(Off-budget)	(444.5)	(476.8)	(499.9)	(522.2)	(544.2)	(566.7)	(598.6)
Excise taxes	70.4	68.4	76.7	79.8	80.8	81.8	83.4
Estate and gift taxes	27.8	30.5	32.3	34.9	36.3	38.7	37.0
Customs duties	18.3	20.9	20.9	22.6	24.3	25.7	27.9
Miscellaneous receipts	34.9	42.5	39.9	41.2	43.2	52.6	54.5
Total receipts	**1,827.5**	**1,956.3**	**2,019.0**	**2,081.2**	**2,147.5**	**2,236.1**	**2,340.9**
(On-budget)	*(1,383.0)*	*(1,479.5)*	*(1,519.1)*	*(1,559.0)*	*(1,603.2)*	*(1,669.4)*	*(1,742.3)*
(Off-budget)	*(444.5)*	*(476.8)*	*(499.9)*	*(522.2)*	*(544.2)*	*(566.7)*	*(598.6)*

Table 3–2. EFFECT ON RECEIPTS OF CHANGES IN THE SOCIAL SECURITY TAXABLE EARNINGS BASE

(In billions of dollars)

	Estimate				
	2001	2002	2003	2004	2005
Social security (OASDI) taxable earnings base increases:					
$76,200 to $80,100 on Jan. 1, 2001	1.8	4.8	5.2	5.7	6.3
$80,100 to $83,700 on Jan. 1, 2002	.....	1.6	4.3	4.7	5.2
$83,700 to $87,300 on Jan. 1, 2003	.....	.....	1.6	4.3	4.7
$87,300 to $90,600 on Jan. 1, 2004	.....	.....	.....	1.5	4.0
$90,600 to $93,900 on Jan. 1, 2005	.....	.....	.....	.....	1.5

ENACTED LEGISLATION

Several laws were enacted in 1999 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

To Extend the Tax Benefits Available With Respect to Services Performed in a Combat Zone to Services Performed in the Federal Republic of Yugoslavia (Serbia/Montenegro) and Certain Other Areas, and for Other Purposes.—This Act, which was signed by President Clinton on April 19, 1999, provides the same tax relief to military personnel participating in Operation Allied Force as that provided as a consequence of the Executive Order that designates the Kosovo area of operations as a combat zone. In addition, this Act extends the tax filing and payment deadlines provided as a consequence of the Executive Order to military personnel outside the United States who are deployed outside their duty station as part of Operation Allied Force.

Under the Executive Order, which was issued by President Clinton on April 13, 1999, the Kosovo area of operations, including the above airspace, encompasses The Federal Republic of Yugoslavia (Serbia/Montenegro), Albania, the Adriatic Sea, and the Ionian Sea above the 39th parallel. The tax benefits provided military personnel serving in those areas include extension of deadlines for filing and paying taxes; exemption of military pay earned while serving in the combat zone (subject to a dollar limit for commissioned officers) from withholding and income tax; and, exemption of toll telephone calls originating in the combat zone from the telephone excise tax.

Miscellaneous Trade and Technical Corrections Act of 1999—This Act makes miscellaneous technical and clerical corrections to U.S. trade laws, corrects obsolete references, and authorizes the temporary suspension or refund of tariffs on over 120 categories of imported items. These items include 13 inch televisions, chemicals (some of which are used to develop cancer and AIDS-fighting drugs), textile printing machines, weaving machines, manufacturing equipment, certain rocket engines, and a number of pigments and dyes. The Act also extends tariff credits for wages paid in the production of watches in the Virgin Islands to the production of fine jewelry. The receipt losses associated with the tariff refunds and suspensions are offset by a provision that clarifies the tax treatment of certain corporate restructuring transactions, which is described below.

Restrict basis creation through section 357(c).—A transferor generally is required to recognize gain on a transfer of property in certain tax-free exchanges to the extent that the sum of the liabilities assumed, plus those to which the transferred property is subject, exceeds the transferor's basis in the property. This gain recognition to the transferor generally increases the basis of the transferred property in the hands of the transferee. However, if a recourse liability is secured by multiple assets, prior law was unclear as to 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 this provision, the distinction between the assumption of a liability and the acquisition of an asset subject to a liability generally is eliminated. Except as provided in regulations, a recourse liability is treated as assumed to the extent that the transferee has agreed and is expected to satisfy the liability (whether or not the transferor has been relieved of the liability). Except as provided in regulations, a nonrecourse liability is treated as assumed by the transferee of any asset subject to the liability. However, the amount of nonrecourse liability treated as assumed is reduced by the amount of the liability that an owner of other assets not transferred to the transferee and also subject to the liability has agreed with the transferee to satisfy, and is expected to satisfy, up to the fair market value of such other assets. The transferor's recognition of gain as a result of assumption of liability shall not increase the transferee's basis in the transferred asset to an amount in excess of its fair market value. Moreover, if no person is subject to U.S. tax on gain recognized as the result of the assumption of a nonrecourse liability, then the transferee's basis in the transferred assets is increased only to the extent such basis would be increased if the transferee had assumed only a ratable portion of the liability, based on the relative fair market value of all assets subject to such nonrecourse liability. The Treasury Department has authority to prescribe regulations necessary to carry out the purposes of the provision, and to apply the treatment set forth in this provision where appropriate elsewhere in the Internal Revenue Code. This provision applies to transfers made after October 18, 1998.

Consolidated Appropriations Act for FY 2000.—This Act, which was signed by President Clinton on November 30, 1999, makes progress on several important fronts: it puts education first, makes America a safer place, strengthens our effort to preserve natural areas and protect our environment, and strengthens America's leadership role in the world. Although most of the provisions in this Act affect Federal spending programs, a transfer from the surplus funds of the Federal Reserve System to the Treasury of $3.752 billion in FY 2000 affects governmental receipts.

Ticket to Work and Work Incentives Improvement Act of 1999.—This Act, which was signed by President Clinton on December 17, 1999, ensures that individuals with disabilities have a greater opportunity to participate in the workforce and in the American Dream and extends important tax provisions. Despite these accomplishments, the President is disappointed that this Act includes a provision for a special allowance adjustment for student loans, that it delays the implementation of a proposed Department of Health

and Human Services final rule on the distribution of human organs for transplantation, and that the revenue losses are not fully offset. The major provisions of this Act affecting governmental receipts are described below.

Expired and Expiring Provisions

Extend minimum tax relief for individuals.—Certain nonrefundable personal tax credits (dependent care credit, credit for the elderly and disabled, adoption credit, child tax credit, credit for interest on certain home mortgages, HOPE Scholarship and Lifetime Learning credit, and the D.C. homebuyer's credit) are provided under current law. Generally, these credits are allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax. An additional child tax credit is provided under current law to families with three or more qualifying children. This credit, which may be offset against social security payroll tax liability (provided that liability exceeds the amount of the earned income credit), is reduced by the amount of the individual's minimum tax liability (that is, the amount by which the individual's tentative minimum tax exceeds the individual's regular tax liability). For taxable year 1998, prior law allowed nonrefundable personal tax credits to offset regular income tax liability in full (as opposed to only the amount by which the regular tax liability exceeded the tentative minimum tax). In addition, for taxable year 1998, the additional child credit provided to families with three or more qualifying children was not reduced by the amount of the individual's minimum tax liability. This Act extends the provision that allows the nonrefundable personal tax credits to offset regular income tax liability in full to taxable years beginning in 1999. For taxable years beginning in 2000 and 2001 the nonrefundable personal credits may offset both the regular tax and the minimum tax. In addition, for taxable years beginning in 1999, 2000, and 2001, the additional child credit provided to families with three or more qualifying children will not be reduced by the amount of the individual's minimum tax liability.

Extend and modify research and experimentation tax credit.—The 20-percent tax credit for certain research and experimentation expenditures is extended to apply to qualifying expenditures paid or incurred during the period July 1, 1999 through June 30, 2004. In addition, effective for taxable years beginning after June 30, 1999, the credit rate applicable under the alternative incremental research credit is increased by one percentage point per step, and the definition of qualified research is expanded to include research undertaken in Puerto Rico and possessions of the United States. Under this Act, credits attributable to the period beginning on July 1, 1999 and ending on September 30, 2000 may not be taken into account in determining any amount required to be paid for any purpose under the Internal Revenue Code prior to October 1, 2000. On or after October 1, 2000, such credits may be taken into account through the filing of an amended return, an application for expedited refund, an adjustment of estimated taxes, or other means that are allowed by the Internal Revenue Code. Similarly, research credits that are attributable to the period beginning on October 1, 2000 and ending on September 30, 2001 may not be taken into account in determining any amount required to be paid for any purpose under the Internal Revenue Code prior to October 1, 2001.

Extend exceptions provided under subpart F for certain active financing income.—Under the Subpart F rules, certain U.S. shareholders of a controlled foreign corporation (CFC) are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes "foreign personal holding company income" and insurance income. The U.S. 10-percent shareholders of a CFC also are subject to current inclusion with respect to their shares of the CFC's foreign base company services income (income derived from services performed for a related person outside the country in which the CFC is organized). For taxable years beginning in 1998 and 1999, certain income derived in the active conduct of a banking, financing, insurance, or similar business is excepted from the Subpart F rules regarding the taxation of foreign personal holding company income and foreign base company services income. This Act extends the exception for two years, with very minor modifications, to apply to taxable years beginning in 2000 and 2001.

Extend suspension of net income limitation on percentage depletion from marginal oil and gas wells.—Taxpayers are allowed to recover their investment in oil and gas wells through depletion deductions. For certain properties, deductions may be determined using the percentage depletion method; however, in any year, the amount deducted generally may not exceed 100 percent of the net income from the property. For taxable years beginning after December 31, 1997 and before January 1, 2000, domestic oil and gas production from "marginal" properties is exempt from the 100-percent of net income limitation. This Act extends the exemption to apply to taxable years beginning after December 1, 1999 and before January 1, 2002.

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. This Act extends the credit to apply to individuals who begin work on or after July 1, 1999 and before January 1, 2002.

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. Under this Act the credit is extended to apply to individuals who begin work on or after July 1, 1999 and before January 1, 2002.

Extend 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. 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, which is limited to undergraduate courses, is extended to apply to courses beginning after May 31, 2000 and before January 1, 2002.

Extend and modify wind and biomass tax credit and expand eligible biomass sources.—Taxpayers are provided a 1.5-cent-per-kilowatt-hour tax credit, adjusted for inflation after 1992, for electricity produced from wind or "closed-loop" biomass. Under prior law, the credit applies to electricity produced by a facility placed in service before July 1, 1999, and is allowable for production during the 10-year period after a facility is originally placed in service. This Act extends the credit to apply to facilities placed in service after June 30, 1999 and before January 1, 2002. Electricity produced at a wind facility placed in service during this period does not qualify for the credit, however, if it is sold pursuant to a pre-1987 contract that has not been modified to limit the purchaser's obligation to acquire electricity at above-market prices. The Act also expands the credit to apply to poultry waste facilities placed in service after December 31, 1999 and before January 1, 2002.

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 June 30, 1999, is extended through September 30, 2001. Refunds of any duty paid between June 30, 1999 and December 17, 1999 are provided upon request of the importer.

Extend authority to issue Qualified Zone Academy Bonds.—The Taxpayer Relief Act of 1997 (TRA97) included a provision that allows State and local governments 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 must be used for teacher training, purchases of equipment, curricular development, and rehabilitation and repairs at certain public school facilities. Under TRA97, a nationwide total of $400 million of qualified zone academy bonds was authorized to be issued in each of calendar years 1998 and 1999. Effective December 17, 1999, an additional $400 million of qualified zone academy bonds is authorized to be issued in each of calendar years 2000 and 2001. In addition, unused authority arising in 1998 and 1999 may be carried forward for up to three years and unused authority arising in 2000 and 2001 may be carried forward for up to two years.

Extend tax credit for first-time D.C. homebuyers.—The tax credit (up to $5,000) provided for the first-time purchase of a principal residence in the District of Columbia, which was scheduled to expire after December 31, 2000, is extended to apply to residences purchased on or before December 31, 2001.

Extend expensing of brownfields remediation costs.—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 ability to deduct such expenditures is extended for one year, to apply to expenditures paid or incurred before January 1, 2002.

Time-Sensitive Provisions

Prohibit disclosure of advanced pricing agreements (APAs) and APA background files.—Returns and return information, as defined by the Internal Revenue Service (IRS), are confidential and cannot be disclosed unless authorized by the Internal Revenue Code. In contrast, written determinations issued by the IRS generally are available for public inspection. The APA program is an alternative dispute resolution program conducted by the IRS, which resolves international transfer pricing issues prior to the filing of the corporate tax return. To resolve such issues, the taxpayer submits detailed and confidential financial information, business plans and projections to the IRS for consideration. This Act confirms that APAs and related background information are confidential return information and not written determinations available for public inspection. Effective December 17, 1999, APAs or related background files are prohibited from being released to the public, regardless of whether the APA was executed before or after that date. The Treasury Department also is required to produce an annual report that contains general and statistical information about the APA program, and general descriptions of the APAs concluded during the year.

Provide authority to postpone certain tax-related deadlines by reason of year 2000 (Y2K) failures.—The Secretary of the Treasury is permitted to postpone, on a taxpayer-by-taxpayer basis, certain tax-related deadlines for a period of up to 90 days, if he determines that the taxpayer has been affected by an actual Y2K related failure. In order to be eligible for relief, the taxpayer must have made a good faith, reasonable effort to avoid any Y2K related failures.

Expand list of taxable vaccines.—Under prior law an excise tax of $.75 per dose is levied on the following vaccines: diphtheria, pertussis, tetanus, measles, mumps, rubella, polio, HIB (haemophilus influenza type B), hepatitis B, rotavirus gastroenteritis, and varicella (chickenpox). This Act adds any conjugate vaccine against streptococcus pneumoniae to the list of taxable vaccines, effective for vaccines sold by a manufacturer or importer after December 17, 1999.

Delay requirement that registered motor fuels terminals offer dyed fuel as a condition of registration.—With limited exceptions, excise taxes are imposed on all highway motor fuels when they are removed from a registered terminal facility, unless the fuel is indelibly dyed and is destined for a nontaxable use. Terminal facilities are not permitted to receive and store nontaxed motor fuels unless they are registered with the IRS. Prior law requires that effective July 1, 2000, in order to be registered, a terminal must offer for sale both dyed and undyed fuel (the "dyed-fuel mandate"). Under this Act the effective date of the dyed-fuel mandate is postponed until January 1, 2002.

Provide that Federal production payments to farmers are taxable in the year received. —A taxpayer generally is required to include an item in income no later than the time of its actual or constructive receipt, unless such amount properly is accounted for in a different period under the taxpayer's method of accounting. If a taxpayer has an unrestricted right to demand the payment of an amount, the taxpayer is in constructive receipt of that amount whether or not the taxpayer makes the demand and actually receives the payment. Under production flexibility contracts entered into between certain eligible owners and producers and the Secretary of Agriculture, as provided in the Federal Agriculture Improvement and Reform Act of 1996 (FAIR Act), annual payments are made at specific times during the Federal government's fiscal year. One-half of each annual payment is to be made on either December 15 or January 15 of the fiscal year, at the option of the recipient; the remaining one-half is to be paid no later than September 30 of the fiscal year. The option to receive the payment on December 15 potentially results in the constructive receipt (and thus potential inclusion in income) of one-half of the annual payment at that time, even if the option to receive the amount on January 15 is elected. For fiscal year 1999, as provided under The Emergency Farm Financial Relief Act of 1998, all payments are to be paid at such time or times during the fiscal year as the recipient may specify. This option to receive all of the 1999 payment in calendar year 1998 potentially results in constructive receipt (and thus potential inclusion in income) in that year, whether or not the amounts are actually received. The Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999, provided that effective for production flexibility contract payments made in taxable years ending after December 31, 1995, the time a production flexibility contract payment is to be included in income is to be determined without regard to the options granted for payment. Effective December 17, 1999, this Act provides that any unexercised option to accelerate the receipt of any payment under a production flexibility contract that is payable under the FAIR Act is to be disregarded in determining the taxable year in which such payment is properly included in gross income. Options to accelerate payments that are enacted in the future are covered by this rule, providing the payment to which they relate is mandated by the Fair Act as in effect on the date of enactment of this Act.

Revenue Offset Provisions

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. For any individual with an adjusted gross income (AGI) of more than $150,000 as shown on the return for the preceding taxable year, the 100 percent of last year's liability safe harbor generally is modified to be a 110 percent of last year's liability safe harbor. However, under prior law, the 110 percent of last year's liability safe harbor for individuals with AGI of more than $150,000 was modified for taxable years beginning in 1999 through 2002, as follows: for taxable years beginning in 1999 the safe harbor is 105 percent; for taxable years beginning in 2000 and 2001 the safe harbor is 106 percent, and for taxable years beginning in 2002, the safe harbor is 112 percent. Under this Act the estimated tax safe harbor for individuals with AGI of more than $150,000 is modified as follows: for taxable years beginning in 2000 the safe harbor is 108.6 percent and for taxable years beginning in 2001 the safe harbor is 110.0 percent.

Clarify the tax treatment of income and losses on derivatives.—Capital gain treatment applies to gain on the sale or exchange of a capital asset. Gain or loss on other assets (stock in trade or other types of inventory, property used in a trade or business that is real property or subject to depreciation, accounts or notes receivable acquired in the ordinary course of a trade or business, certain copyrights, and U.S. government publications) generally is considered ordinary. This Act adds three categories to the list of assets the gain or loss on which is considered ordinary for Federal income tax purposes: commodities derivatives held by commodities derivatives dealers, hedging transactions, and supplies of a type regularly consumed by the taxpayer in the ordinary course of a taxpayer's trade or business. In defining a hedging transaction, the Act replaces the "risk reduction" standard with a "risk management" standard with respect to ordinary property held or certain liabilities incurred, and provides that the definition of a hedging transaction includes a transaction entered into primarily to mange such other risks as the Secretary of the Treasury may prescribe in regulations. These changes are effective for any instrument held, acquired or entered into; any transaction entered into; and any supplies held or acquired on or after December 17, 1999.

Expand reporting of cancellation of indebtedness income.—Gross income generally includes income from the discharge of indebtedness. If a bank, thrift institu-

tion, or credit union discharges $600 or more of any indebtedness of a debtor, the institution must report such discharge to the debtor and the IRS. This Act extends these reporting requirements to additional entities involved in the trade or business of lending (such as finance companies and credit card companies, whether or not they are affiliated with a financial institution), effective for discharges of indebtedness occurring after December 31, 1999.

Limit conversion of character of income from constructive ownership transactions with respect to partnership interests.—A pass-thru entity, such as a partnership, generally is not subject to Federal income tax. Instead, each owner includes his/her share of a pass-thru entity's income, gain, deduction or credit in his/her own taxable income. The character of the income generally is determined at the entity level and flows through to the owners. A taxpayer can enter into a derivatives transaction that is designed to give the taxpayer the economic equivalent of an ownership interest in a partnership but that is not itself a current ownership interest in the partnership. These so-called "constructive ownership" transactions purportedly allow taxpayers to defer income and to convert ordinary income and short-term capital gain into long-term capital gain. This Act treats long-term capital gain recognized from a constructive ownership transaction as ordinary income to the extent the long-term capital gain recognized from the transaction exceeds the long-term capital gain that could have been recognized had the taxpayer invested in the partnership interest directly. In addition, an interest charge is imposed on the amount of gain that is treated as ordinary income. These changes are effective with respect to transactions entered into on or after July 12, 1999. Generally any contract, option or any other arrangement that is entered into or exercised on or after that date, which extends or otherwise modifies the terms of a transaction entered into prior to such date, will be treated as a transaction entered into on or after July 12, 1999.

Extend and modify qualified transfers of excess pension assets used for retiree health benefits.—A pension plan may provide medical benefits to retired employees through a section 401(h) account that is a part of the pension plan. Qualified transfers of excess assets of a defined benefit pension plan (other than a multiemployer plan) to a section 401(h) account are permitted, subject to amount and frequency limitations, use requirements, deduction limitations, and vesting and minimum benefit requirements. This Act extends the ability of employers to transfer excess defined benefit pension plan assets to 401(h) accounts through December 31, 2005. In addition, effective with respect to qualified transfers made after December 17, 1999, the minimum benefit requirement is replaced with a minimum cost requirement.

Modify installment method for accrual basis taxpayers.—Generally, an accrual method requires a taxpayer to recognize income when all events have occurred that fix the right to its receipt and its amount can be determined with reasonable accuracy. The installment method of accounting provides an exception to these general recognition principles by allowing a taxpayer to defer recognition of income from the disposition of certain property until payment is received. To the extent that an installment obligation is pledged as security for any indebtedness, the net proceeds of the secured indebtedness are treated as a payment on such obligation, thereby triggering the recognition of income. This Act generally prohibits the use of the installment method of accounting for dispositions of property that would otherwise be reported for Federal income tax purposes using an accrual method of accounting. The present-law exceptions regarding the availability of the installment method for use by cash method taxpayers, for dispositions of property used or produced in the trade or business of farming, and for dispositions of timeshares or residential lots are not affected by this change. This Act also modifies the pledge rule to provide that entering into any arrangement that gives the taxpayer the right to satisfy an obligation with an installment note will be treated in the same manner as the direct pledge of the installment note. These changes are effective with respect to sales or other dispositions entered into on or after December 17, 1999.

Deny charitable contribution deduction for transfers associated with split-dollar insurance arrangements.—A taxpayer who itemizes deductions generally is allowed to deduct charitable contributions paid during the taxable year. The amount of the deduction allowable for a taxable year with respect to any charitable contribution depends on the type of property contributed, the type of organization to which the property is contributed, and the income of the taxpayer. In general, to be deductible as a charitable contribution, a payment to charity must be a gift made without receipt of adequate consideration and with donative intent. Under a charitable split-dollar insurance arrangement, a taxpayer typically transfers funds to a charity with the understanding that the charity will use the funds to pay premiums on a cash value life insurance policy that benefits both the charity and members of the transferor's family, either directly or indirectly through a family trust or partnership. This Act eliminates such abuses of the charitable contributions deduction by denying a charitable contribution deduction for any transfer to a charity in connection with a charitable split-dollar insurance transaction. Specifically, the denial of the deduction applies if, in connection with the transfer, the charity directly or indirectly pays, or has previously paid, any premium on any "personal benefit contract" with respect to the transferor, or there is an understanding or expectation that any person will directly or indirectly pay any premium on any "personal benefit contract" with respect to the transferor. A personal benefit contract with respect to the transferor is any life insurance, annuity, or endowment contract for whom the direct or indirect beneficiary under the contract is the transferor, any member of the transferor's family

or any other person (other than a charitable organization) designated by the transferor. The Act also imposes an excise tax on any participating charity equal to the amount of any premiums paid by the charity on such a "personal benefit contract" in connection with a charitable split-dollar insurance transaction. The deduction is denied for any transfers after February 8, 1999 and the excise tax applies to premiums paid after December 17, 1999.

Require basis adjustments when a partnership distributes certain stock to a corporate partner.—Under prior law, generally no gain or loss was recognized on the receipt by a corporation of property distributed in complete liquidation of a subsidiary corporation in which it owned 80-percent of the stock. The basis of property received by the distributee in such a liquidation was the same as it was in the hands of the subsidiary. This Act provides for a reduction in basis of the assets of a corporation if stock in that corporation is distributed by the partnership to a corporate partner that, as a result of the distribution and related transactions, owns 80 percent or more of the stock of such corporation. The amount of the reduction generally equals the amount of the excess of the partnership's adjusted basis in the stock of the distributed corporation immediately before the distribution, over the corporate partner's basis in that stock immediately after the distribution, subject to certain limitations. The corporate partner must recognize long-term capital gain to the extent the amount of the basis reduction exceeds the basis of the property of the distributed corporation. This change generally is effective for distributions made after July 14, 1999, except that in the case of a corporation that is a partner in a partnership on July 14, 1999, the provision is effective for distributions by that partnership to the corporation after December 17, 1999 (or, for a corporation that so elects, distributions after June 30, 2001).

Modify rules relating to real estate investment trusts (REITs).—REITs generally are restricted to owning passive investments in real estate and certain securities. Under prior law, no single corporation could account for more than five percent of the total value of a REIT's assets, and a REIT could not own more than 10-percent of the outstanding voting securities of any issuer. Through the use of non-voting preferred stock and multiple subsidiaries, up to 25 percent of the value of a REIT's assets could consist of subsidiaries that conduct otherwise impermissible activities. Under this Act, the 10-percent vote test is changed to a 10-percent "vote or value" test, meaning that a REIT cannot own more than 10 percent of the outstanding voting securities or more than 10 percent of the total value of securities of a single issuer. In addition, taxable REIT subsidiaries owned by a REIT cannot represent more than 20 percent of the value of a REIT's assets. For purposes of the 10-percent value test, securities are generally defined to exclude safe harbor debt owned by a REIT. In addition, an exception to the limitation on ownership of securities of a single issuer applies in the case of a "taxable REIT subsidiary" that meets certain requirements. The Act also provides rules for the operation of hotels and health care facilities; defines "independent contractor" for certain purposes; modifies REIT distribution requirements to conform to the rules for regulated investment companies (RICs); modifies earnings and profits rules for RICs and REITs; and replaces the prior law adjusted basis comparison with a fair market comparison, in determining whether certain rents from personal property exceed a 15-percent limit. These provisions generally are effective for taxable years beginning after December 31, 2000, with transition for certain REIT holdings and leases in effect on July 12, 1999.

Modify estimated tax rules for closely held REITs.—If a person has a direct interest or a partnership interest in income-producing assets that produce income throughout the year, that person's estimated tax payments generally must reflect the quarterly amounts expected from the asset. However, a dividend distribution of earnings from a REIT is considered for estimated tax purposes when the dividend is paid. To take advantage of this deferral of estimated taxes, some corporations have established closely held REITS that may make a single distribution for the year, timed such that it need not be taken into account under the estimated tax rules as early as would be the case if the assets were directly held by the controlling entity. Effective for estimated tax payments due on or after November 15, 1999, with respect to a closely held REIT, this Act provides that any person owning at least 10 percent of the vote or value of the REIT is required to accelerate the recognition of year-end dividends attributable to the closely held REIT.

Other Provisions

Simplify foster child definition under the earned income tax credit (EITC).—This Act clarifies the definition of foster child for purposes of claiming the EITC. Effective for taxable years beginning after December 31, 1999, 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.

Allow members of the clergy to revoke exemption from Social Security and Medicare coverage.—Under current law, ministers of a church who are opposed to participating in the Social Security and Medicare programs on religious principles may reject coverage by filing with the IRS before the tax filing date for their second year of work in the ministry. This Act provides an opportunity for members of the clergy to revoke their exemptions from Social Security and Medicare coverage during a 2-year period beginning January 1, 2000.

ADMINISTRATION PROPOSALS

The President's plan targets tax relief to provide assistance in obtaining higher education for working families, to relieve poverty and revitalize lower-income communities, and to make health care more affordable. The President's plan also provides relief from the marriage penalty and provides child-care assistance, promotes retirement savings, provides relief from the alternative minimum tax and other simplifications of the tax laws, encourages philanthropy, and offers assistance in bridging the digital divide. The President's plan also contains measures that will curtail the proliferation of corporate tax shelters, restrict the use of overseas tax havens, and close other loopholes and tax subsidies.

PROVIDE TAX RELIEF

Expand Educational Opportunities

Provide College Opportunity tax cut—Under current law, individuals may claim a Lifetime Learning credit equal to 20 percent of qualified tuition and related expenses up to $5,000 (increasing to $10,000 in 2003) incurred during the year for post-secondary education for the taxpayer, the taxpayer's spouse, or one or more dependents. The credit phases out for taxpayers filing joint returns with modified AGI from $80,000 to $100,000, and $40,000 to $50,000 for single taxpayers. The phase-out ranges will be adjusted for inflation occurring after 2000. To further assist taxpayers in obtaining post-secondary education throughout their lifetimes, the Administration proposes that the Lifetime Learning credit rate be increased to 28 percent. In addition, the phase-out range for the credit would be increased to $100,000 to $120,000 of modified AGI for joint returns and $50,000 to $60,000 of modified AGI for single taxpayers. To guarantee that all eligible taxpayers receive the full value of this education assistance, taxpayers may elect to deduct qualified tuition and related expenses instead of claiming the credit.

Provide incentives for public school construction and modernization.—The Administration proposes to institute a new program of Federal tax assistance for public elementary and secondary school construction or rehabilitation. Under the proposal, State and local governments (including U.S. possessions) would be able to issue up to $22 billion of "qualified school modernization bonds," $11 billion in each of 2001 and 2002. In addition, $200 million of qualified school modernization bonds in each of 2001 and 2002 would be allocated for the construction and renovation of Bureau of Indian Affairs funded schools. 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. Issuers would be responsible for repayment of principal. These qualified school modernization bonds would be similar to qualified zone academy bonds (QZABs), created by TRA97 and extended by the Ticket to Work and Work Incentives Improvement Act of 1999. QZABs allow bonds to be issued for certain public schools with the interest on the bonds effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of these bonds can be used for teacher training, purchases of equipment, curricular development, and rehabilitation and repair of the school facilities. The Administration proposes to authorize the issuance of additional QZABs of $1.0 billion in 2001 and $1.4 billion in 2002, and to allow the proceeds of these bonds also to be used for school construction.

Expand exclusion for employer-provided educational assistance to include graduate education.—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 January 1, 2002. The exclusion previously applied to graduate courses that began before July 1, 1996. The Administration proposes to reinstate the exclusion for graduate education for courses beginning on or after July 1, 2000 and before January 1, 2002.

Eliminate 60-month limit on student loan interest deduction.—Current law provides an income tax deduction for certain interest paid on a qualified education loan during the first 60 months that interest payments are required, effective for interest due and paid after December 31, 1997. The maximum deduction available is $2,500 for years after 2000 (for years 1998, 1999 and 2000, the limits are $1,000, $1,500 and $2,000, respectively) and the deduction is phased out for taxpayers with AGI between $40,000 and $55,000 (between $60,000 and $75,000 for joint filers). The 60-month limitation under current law adds significant complexity and administrative burdens for taxpayers, lenders, loan servicing agencies, and the IRS. Thus, to simplify the calculation of deductible interest payments, reduce administrative burdens, and provide longer-term relief to low- and middle-income taxpayers with large educational debt, the Administration proposes to eliminate the 60-month limitation. This proposal would be effective for interest due and paid on qualified education loans after December 31, 2000.

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 pe-

riod 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, 2000.

Provide tax relief for participants in certain Federal education programs.—Present law provides tax-free treatment for certain scholarship and fellowship grants used to pay qualified tuition and related expenses, but not to the extent that any grant represents compensation for services. In addition, tax-free treatment is provided for certain discharges of student loans on condition that the individual works for a certain period of time in certain professions for any of a broad class of employers. To extend tax-free treatment to education awards under certain Federal programs, the Administration proposes to amend current law to provide that any amounts received by an individual under the National Health Service Corps (NHSC) Scholarship Program or the Armed Forces Health Professions Scholarship and Financial Assistance Program are "qualified scholarships" excludable from income, without regard to the recipient's future service obligation. In addition, the proposal would provide an exclusion from income for any repayment or cancellation of a student loan under the NHSC Scholarship Program, the Americorps Education Award Program, or the Armed Forces Health Professions Loan Repayment Program. The exclusion would apply only to the extent that the student incurred qualified tuition and related expenses for which no education credit was claimed during academic periods when the student loans were incurred. The proposal would be effective for awards received after December 31, 2000.

Provide Poverty Relief and Revitalize Communities

Increase and simplify the Earned Income Tax Credit (EITC).—Low- and moderate-income workers may be eligible for the EITC. For every dollar a low-income worker earns up to a limit, between 7 and 40 cents are provided as a tax credit. The applicable credit rate depends on the presence and number of children in the worker's family. Above $13,030 ($5,930 if the taxpayer does not reside with children), the size of the tax credit is gradually phased out. Although the EITC lifts millions out of poverty each year, poverty among children living in larger families remains at unacceptably high levels. Because the credit initially increases as income rises, the EITC rewards marriage for very low-income workers. But the EITC also causes marriage penalties among two-earner couples whose income falls in or above the credit's phase-out range. Further, while the EITC has been shown, on net, to increase work effort, phasing out the credit results in high marginal tax rates for recipients in the phase-out range. To address these problems, the Administration proposes that the credit rate be increased from 40 percent to 45 percent for families with three or more children. If both spouses work and earn at least $725, the credit would begin to phase out at $14,480 ($7,380 if the couple does not reside with children). For taxpayers with two or more children, the phase-out rate would be reduced from 21.06 percent to 19.06 percent.

Under current law, nontaxable earned income, such as 401(k) contributions, is included in earned income for purposes of calculating the EITC. To encourage retirement savings, simplify the calculation of earned income, and improve compliance, the Administration is proposing that these nontaxable forms of income would no longer count toward eligibility for the EITC. The proposal would be effective for taxable years beginning after December 31, 1999.

A proposed technical correction would clarify that taxpayers are eligible to receive the small credit for workers without qualifying children, if they cannot claim the credit for workers with children because their child does not have a social security number. The proposed change will also clarify that taxpayers may not receive any credit (even the small credit for workers without qualifying children), if their child is not taken into account because another taxpayer who may claim the child has higher modified AGI.

Increase and index low-income housing tax credit per-capita cap.—Low-income housing tax credits provide an incentive to build and make available affordable rental housing units to households with low incomes. The amount of the first-year credits that can be awarded in each State is currently limited to $1.25 per capita. That limit has not been changed since it was established in 1986. The Administration proposes to increase the annual State limitation to $1.75 per capita effective for calendar year 2001 and to index that amount for inflation, beginning with calendar year 2002. The proposed increases 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 best meet specific needs.

Provide New Markets Tax Credit.—Businesses located in low-income urban and rural communities often lack access to sufficient equity capital. To help attract new capital to these businesses, taxpayers would be allowed a credit against Federal income taxes for certain investments made to acquire stock or other equity interests in a community development investment entity selected by the Treasury Department to receive a credit allocation. Selected community development investment entities would be required to use the investment proceeds to provide capital to businesses located in low-income communities. During the period 2001-2005, the Treasury Department would authorize selected community development investment entities to issue $15 billion of new stock or equity interests with respect to which credits could be claimed. The credit would be allowed for each year during the five-year period after the stock or equity interest is acquired

from the selected community development investment entity, and the credit amount that could be claimed for each of the five years would equal six percent of the amount paid to acquire the stock or equity interest from the community development investment entity. The credit would be subject to current-law general business credit rules, and would be available for qualified investments made after December 31, 2000.

Expand Empowerment Zone (EZ) tax incentives and authorize additional EZs.—The Omnibus Budget Reconciliation Act of 1993 (OBRA93) authorized a Federal demonstration project in which nine EZs and 95 empowerment communities were designated in a competitive application process. Among other benefits, businesses located in the nine original EZs are eligible for four Federal tax incentives: an employment wage credit; an additional $20,000 per year of section 179 expensing; a new category of tax-exempt private activity bonds; and "brownfields" expensing for certain environmental remediation expenses. The Taxpayer Relief Act of 1997 (TRA97) authorized the designation of two additional EZs, which generally are eligible for the same tax incentives that are available within the EZs authorized by OBRA93. In addition, TRA97 authorized the designation of another 20 EZs (so-called "Round II EZs") that are eligible for the same tax incentives (other than the employment wage credit) available in the 11 other EZs. To date, the EZ program has promoted significant economic development, but these communities still do not fully share in the nation's general prosperity. Therefore, the Administration proposes that the EZ program be extended and strengthened by making the employment wage credit available in all existing 31 EZs through 2009. Furthermore, the Administration proposes that, beginning in 2001, an additional $35,000 (rather than $20,000) per year of section 179 expensing be allowed in all EZs, and that enhanced tax-exempt financing benefits for private business activities be available in all EZs. (As described below, the Administration's budget proposes a permanent extension of the "brownfields" expensing for EZs and other targeted areas.) Finally, the Administration proposes that an additional 10 EZs be designated as of January 1, 2002. Businesses located within these 10 new EZs will be eligible for the full range of tax incentives available in the other EZs.

Provide Better America Bonds to improve the environment.—Under current law, State and local governments may issue tax-exempt bonds to finance purely public environmental projects. Certain other environmental projects may also be financed with tax-exempt bonds, but are subject to an overall cap on private-purpose tax-exempt bonds. The subsidy provided with tax-exempt bonds may not provide a deep enough subsidy to induce State and local governments to undertake beneficial environmental infrastructure projects. The Administration proposes to allow State and local governments (including U.S. possessions and Indian tribal governments) to issue tax credit bonds (similar to existing Qualified Zone Academy Bonds) to finance projects to protect open spaces or otherwise to improve the environment. Significant public benefits would be provided by creating more livable urban and rural environments; creating forest preserves near urban areas; protecting water quality; rehabilitating land that has been degraded by toxic or other wastes or destruction of its ground cover; improving parks; and reestablishing wetlands. A total of $2.15 billion of bond authority would be authorized for each of the five years beginning in 2001. The Environmental Protection Agency, in consultation with other agencies, would allocate the bond authority based on competitive applications. The bonds would have a maximum maturity of 15 years and the bond issuer effectively would receive an interest-free loan for the term of the bonds. During that interval, bond holders would receive Federal income tax credits in lieu of interest.

Permanently extend the expensing of brownfields remediation costs.—Under TRA97, taxpayers can elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital accounts as deductible in the year paid or incurred. The provision does not apply to expenditures paid or incurred after December 31, 2001. The Administration proposes that the provision be made permanent.

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 upon ceasing activity as a SSBIC or at any time that it disposes 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. Third, the proposal would make it easier for a SSBIC to meet the qualifying income, distribution of income, and diversification of assets tests to qualify as a tax-favored regulated investment company. 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. The regulated investment company provisions would be effective for taxable years beginning on or after the date of enactment.

Bridge the Digital Divide

Encourage sponsorship of qualified zone academies and technology centers.—Under current law, State and local governments can issue qualified zone academy bonds to fund improvements in certain "qualified zone academies" which provide elementary or secondary education. To encourage corporations to become sponsors of such academies and technology centers, a tax credit would be provided equal to 50 percent of the amount of corporate sponsorship payments made to a qualified zone academy, or a public library or community technology center, located in (or adjacent to) a designated empowerment zone or enterprise community. The credit would be available for corporate cash contributions, but only if a credit allocation has been made with respect to the contribution by the local governmental agency with responsibility for implementing the strategic plan of the empowerment zone or enterprise community. Up to $8 million of credits could be allocated with respect to each of the existing 31 empowerment zones (and each of the 10 additional empowerment zones proposed to be designated under the Administration's budget); and up to $2 million of credits could be allocated with respect to each of the designated enterprise communities. The credit would be subject to the current-law general business credit rules, and would be effective for sponsorship payments made after December 31, 2000.

Extend and expand enhanced deduction for corporate donations of computers.—The current-law enhanced deduction for contributions of computer technology and equipment for elementary or secondary school purposes is scheduled to expire for taxable years beginning after December 31, 2000. The Administration proposes extending this provision through June 30, 2004. In addition, to promote access of all persons to computer technology and training, the enhanced deduction would be expanded to apply to contributions of computer equipment to a public library or community technology center located in a designated empowerment zone or enterprise community, or in a census tract with a poverty rate of 20 percent or more.

Provide tax credit for workplace literacy, basic education, and basic computer skills training.—Under current law, employers may deduct the costs of providing workplace literacy, basic education, and basic computer skill programs to employees, but no tax credits are allowed for any employer-provided education. As a result, employers lack sufficient incentive to provide basic education programs, the benefits of which are more difficult for employers to capture through increased productivity than the benefits of job-specific education. The Administration proposes to allow employers who provide certain workplace literacy, English literacy, basic education, or basic computer training for their eligible employees to claim a credit against Federal income taxes equal to 20 percent of the employer's qualified expenses, up to a maximum credit of $1,050 per participating employee. Qualified education would be limited to basic instruction at or below the level of a high school degree, English literacy instruction, or basic computer skills. Eligible employees in basic education or computer training generally would not have received a high school degree or its equivalent. Instruction would be provided either by the employer, with curriculum approved by the State Adult Education Authority, or by local education agencies or other providers certified by the Department of Education. The credit would be available for taxable years beginning after December 31, 2000.

Make Health Care More Affordable

Assist taxpayers with long-term care needs.—Current law provides a tax deduction for certain long-term care expenses. However, the deduction does not assist with all long-term care expenses, especially the costs of informal family caregiving. The Administration proposes to provide a new long-term care tax credit of $3,000. The credit could be claimed by a taxpayer for himself or herself or for a spouse or dependent with long-term care needs. To qualify for the credit, an individual with long-term care needs must be certified by a licensed physician as being unable for at least six months to perform at least three activities of daily living without substantial assistance from another individual due to loss of functional capacity. An individual may also qualify if he or she requires substantial supervision to be protected from threats to his or her own health and safety due to severe cognitive impairment and has difficulty with one or more activities of daily living or certain other age-appropriate activities. For purposes of the proposed credit, the current-law dependency tests would be liberalized, raising the gross income limit and allowing taxpayers to use a residency test rather than a support test. The credit would be phased out in combination with the child credit and the disabled worker credit for taxpayers with 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 credit would be phased in at $1,000 in 2001, $1,500 in 2002, $2,000 in 2003, $2,500 in 2004, and $3,000 in 2005 and subsequent years.

Encourage COBRA continuation coverage.—Current law provides a tax preference for employer-provided group health plans, but not for individually purchased health insurance coverage except to the extent that medical expenses exceed 7.5 percent of AGI or the individual has self-employment income. The Administration proposes to make health insurance more affordable for workers in transition and for retiring workers by providing a nonrefundable tax credit for the purchase of COBRA coverage. Individuals would receive a 25-percent tax credit for their own contributions towards COBRA coverage. The proposal would be effec-

tive for taxable years beginning after December 31, 2001.

Provide tax credit for Medicare buy-in program.—The Administration proposes to make health insurance more affordable for older workers, retirees and displaced workers by providing a 25-percent nonrefundable tax credit for individuals purchasing health insurance through a newly created Medicare buy-in program. Under a separate proposal, all individuals at least sixty-two years of age and under sixty-five years of age, and workers displaced from their jobs who are at least fifty-five years of age and under sixty-two years of age, would be eligible to buy into Medicare. Taxpayers would be eligible for a credit of 25 percent of premiums paid under the Medicare buy-in program prior to age sixty-five. The proposal would be effective for taxable years beginning after December 31, 2001.

Provide tax relief for workers with disabilities.—Under current law, disabled taxpayers may claim an itemized deduction for impairment-related work expenses. The Administration proposes to allow disabled workers to claim a $1,000 credit. This credit would help compensate people with disabilities for both formal and informal costs associated with work (e.g., personal assistance to get ready for work or special transportation). In order to be considered a worker with disabilities, a taxpayer must submit a licensed physician's certification that the taxpayer has been unable for at least 12 months to perform at least one activity of daily living without substantial assistance from another individual. A severely disabled worker could potentially qualify for both the proposed long-term care and disabled worker tax credits. The credit would be phased out in combination with the child credit and the proposed long-term care credit for taxpayers with 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 proposal would be effective for taxable years beginning after December 31, 2000.

Provide tax relief to encourage small business health plans.—Small businesses generally face higher costs in establishing and operating health plans than do larger employers. Health benefit purchasing coalitions provide an opportunity for small businesses to offer a greater choice of health plans to their workers and to purchase health insurance at a reduced cost. The formation of these coalitions, however, has been hindered by limited access to capital. The Administration proposes to establish a temporary, special tax rule in order to facilitate the formation of health benefit purchasing coalitions. The special rule would facilitate private foundation grants and loans to fund initial operating expenses of qualified coalitions by treating such grants and loans as being made for exclusively charitable purposes. The special foundation rule would apply to grants and loans made prior to January 1, 2009 for initial operating expenses incurred prior to January 1, 2011. In addition, in order to encourage the use of qualified coalitions by small businesses, the Administration proposes a temporary tax credit for small employers that currently do not provide health insurance to their workforces. The credit would equal 20 percent of small employer contributions to employee health plans purchased through a qualified coalition. The credit would be available to employers with at least two, but not more than 50 employees, counting only employees with annual compensation of at least $10,000 in the prior calendar year. The maximum per policy credit amount would be $400 per year for individual coverage and $1,000 per year for family coverage. The credit would be allowed with respect to employer contributions made during the first 24 months that the employer purchases health insurance through a qualified coalition, and would be subject to the overall limitations of the general business credit. The proposed credit would be effective for taxable years beginning after December 31, 2000 for health plans established before January 1, 2009.

Encourage development of vaccines for targeted diseases.—The proposed tax credit would encourage development of new vaccines for diseases that occur primarily in developing countries by providing a market for successful vaccines. The proposal would provide a credit against Federal income taxes for sales of a qualifying vaccine to a qualifying organization. The credit would equal 100 percent of the amount paid by the qualifying organization. A qualifying organization would be a nonprofit organization that purchases and distributes vaccines for developing countries. A qualifying vaccine would be a vaccine for targeted diseases that receives FDA approval as a new drug after the date of enactment. The targeted diseases would include malaria, tuberculosis, HIV/AIDS, and certain other infectious diseases. The credit would be available only if a credit allocation has been made with respect to the sale of a qualifying vaccine to a qualifying organization by the U.S. Agency for International Development (AID). For the period 2002 - 2010, AID would be allowed to designate up to $1 billion of sales as eligible for the credit ($100 million per year for 2002 through 2006 and $125 million per year for 2007 through 2010). Unallocated amounts for any year would be carried over and available for allocation in the ten following years.

Strengthen Families and Improve Work Incentives

Provide marriage penalty relief and increase standard deduction.—Under current law, the standard deduction for single filers is estimated to be $4,500 in 2001. For married couples who file joint individual returns, the standard deduction will be $7,550, which is less than the combined amount for two single individuals. To reduce marriage penalties, the Administration proposes to increase the standard deduction for two-earner couples to double the amount of the standard

deduction for single filers. The increase would be phased in evenly over five years. When fully phased in, the increase (at 2001 levels) would be $1,450. In addition, beginning in 2005, the Administration proposes to increase the standard deduction by $250 for single filers, $350 for heads of household, and $500 for joint filers.

Increase, expand, 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 AGI of $10,000 or less) to 20 percent (for taxpayers with AGI above $28,000). The Administration believes that the maximum credit rate is too low. Moreover, because it is nonrefundable, many families who have significant child care costs and relatively low incomes are not eligible for the maximum credit. To alleviate the burden of child care costs for these families, the Administration proposes to make the credit refundable. Under the proposal, the maximum credit rate would be increased from 30 percent to 40 percent in 2003, and to 50 percent in 2005 and subsequent years. The credit would become refundable in 2003. Eligibility for the maximum credit rate would be extended to taxpayers with AGI of $30,000 or less. The credit rate would be reduced by one percentage point for every $1,000 of AGI above $30,000 but would not be less than 20 percent.

Under current law, no additional tax assistance under the child and dependent care tax credit is provided to families with infants, who require intense and sustained care. Furthermore, parents who themselves care for their infants, instead of incurring out-of-pocket child care expenses, receive no benefit under the child and dependent care tax credit. In order to provide assistance to these families, the Administration proposes to supplement the credit with an additional, nonrefundable credit for all taxpayers with children under the age of one, whether or not they incur out-of-pocket child care expenses. The amount of additional credit would be the applicable credit rate multiplied by $500 for a child under the age of one ($1,000 for two or more children under the age of one).

The Administration also proposes to simplify eligibility for the credit by eliminating a complicated household maintenance test. Certain credit parameters would be indexed. The proposal would be effective for taxable years beginning after December 31, 2000.

Provide tax incentives for employer-provided child-care facilities.—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, 2000.

Promote Expanded Retirement Savings, Security, and Portability

The Administration proposes further expansions of retirement savings incentives, including initiatives that would expand retirement plan coverage and other workplace-based savings opportunities, particularly for moderate- and lower-income workers not currently covered by employer-sponsored plans. Many of the new provisions are focused on employees of small businesses, a group that currently has low pension coverage. Other proposals enhance the fairness of plans by improving existing retirement plans for employers of all sizes, increase retirement security for women, promote portability, expand workers' and spouses' rights to know about their retirement benefits, and simplify pension rules. These provisions generally are effective for taxable years beginning after 2000.

Encourage Retirement Savings

The Administration proposes two major initiatives designed to encourage retirement savings for moderate- and lower-income workers.

Establish Retirement Savings Accounts.—Current law tax incentives to save through Individual Retirement Accounts (IRAs) and pensions provide little impetus to saving by moderate- and lower-income workers. The Administration's proposal would create Retirement Savings Accounts, in which participants' voluntary contributions are matched by employers or financial institutions. The match will be provided in the form of a tax credit. Participation by financial institutions and taxpayers would be voluntary. Financial institutions could also claim a $10 tax credit to defray the administrative costs of establishing each new account.

Under the proposal, eligible taxpayers would qualify for a match. Participants would make voluntary contributions to an account at a participating financial institution or employer-sponsored qualified retirement plan. Workers would receive a basic match of as much as 100 percent for up to $1,000 in contributions ($500 from 2002 to 2004). They would also qualify for a supplemental match of up to $100 for the first $100 contributed to the account.

The basic match phases down to 20 percent for taxpayers with AGI in the following ranges: between $25,000 and $50,000 ($20,000 and $40,000 from 2002 to 2004) for married taxpayers filing a joint return, $18,750 to $37,500 ($15,000 to $30,000 from 2002 to 2004) for taxpayers filing a head-of-household return, and $12,500 to $25,000 ($10,000 to $20,000 from 2002 to 2004) for single taxpayers. The supplemental match phases out over the same income ranges. The 20 per-

cent basic match is available for taxpayers with AGI up to $80,000 ($40,000 from 2002 to 2004) on joint returns, $60,000 ($30,000 from 2002 to 2004) on head-of-household returns and $40,000 ($20,000 from 2002 to 2004) on single returns.

Taxpayers with at least $5,000 in earnings (which could be joint earnings for married taxpayers filing a joint return) and aged 25 to 60 would be eligible for the match. Withdrawals for certain special purposes would be permitted after five years; withdrawals for other purposes would not be permitted until retirement. The tax treatment would be similar to that afforded deductible IRAs or contributions to employer pensions: contributions would be excludable from income, earnings would not be taxed, but withdrawals would be included in taxable income.

The credits would be effective for tax years beginning after December 31, 2001.

Provide small business tax credit for automatic contributions for non-highly compensated employees.—Small employers could claim a nonrefundable tax credit equal to 50 percent of qualifying contributions made on behalf of non-highly compensated employees. Qualifying contributions are nonelective contributions to defined contribution plans of at least one percent of pay and nonelective or matching contributions of up to an additional two percent of pay (for a total of three percent of pay). Alternatively, qualifying contributions could be benefits accrued under a non-integrated defined benefit plan if equivalent to a three-percent nonelective contribution (in accordance with regulations that could provide simplified methods for defined benefit plans to qualify for the credit). Contributions must be vested at least as fast as either a three-year cliff or five-year graded schedule, must be subject to withdrawal restrictions, and must be allocated in proportion to pay. Credits claimed for subsequently forfeited contributions would be subject to recapture at a rate of 35 percent. An employer could claim the credit for three years. The credit would be effective for tax years beginning after December 31, 2001 and ending on or before December 31, 2009.

Expand Pension Coverage for Employees of Small Business

The Administration proposes a number of other incentives to encourage the adoption of retirement plans by small employers, generally those that have 100 or fewer employees with $5,000 or more of compensation in the preceding year.

Provide tax credit for plan start up and administrative expenses.—The Administration proposes a 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. The credit would be available for plans established after 1998 and before 2010.

Provide for payroll deduction IRAs.—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 saving 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 salary reductions would encourage participation.

Provide for the SMART plan.—In addition to tax credits for qualified retirement plans, the Administration is proposing a new small business defined benefit type plan (the "SMART" plan) for calendar years beginning after 2000. The SMART plan 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 the 401(k) SIMPLE plan.—The Administration proposes expanding the small business 401(k) SIMPLE plan and making it significantly more flexible without sacrificing fairness in the allocation of contributions to moderate- and lower-wage employees. The proposal would make three major changes to the existing 401(k) SIMPLE plan nonelective contribution alternative. First, non-highly compensated employees would be permitted to contribute up to $10,500 a year. Second, the employer's options under a 401(k) SIMPLE plan would be expanded: instead of being required to make a two-percent nonelective employer contribution (with a $6,000 employee contribution limit), employers could opt to make a one-percent, two-percent, three-percent or higher nonelective employer contribution (subject to the requirement that all eligible employees receive the same rate of nonelective contribution). The one-percent 401(k) SIMPLE plan would allow highly compensated employees to contribute up to $3,000 to the plan if the employer made a non-integrated, fully vested, with-

drawal-restricted one-percent automatic contribution on behalf of all employees. The proposal would not change the current-law two-percent 401(k) SIMPLE plan, with its $6,000 contribution limit, except to restrict application of the $6,000 limit to highly compensated employees, allowing others to contribute up to $10,500. In addition, as is the case under current law with the 401(k) nonelective safe harbor, an employer could make a three-percent (or greater) nonelective contribution, permitting all employees, including highly compensated ones, to contribute up to $10,500. Third, employers would have the flexibility to wait until as late as December 1 of the year for which the contribution is made to assess their financial situation for the year and decide on the level of their nonelective contribution.

Eliminate IRS user fees for small business plan determination letters.—The Administration proposes the elimination of user fees for requests made after the date of enactment for an initial determination letter from the IRS for a qualified retirement plan maintained by a small business. To obtain the relief, the request must be made during the first five plan years.

Permit certain S corporation shareholders and partners to borrow from plans.—S corporation shareholders and partners owning less than 20 percent of the business would be able to borrow from the employer's qualified retirement plan in which they participate under the same rules that apply to all qualified plan participants for loans first made or refinanced after 2000.

Enhance Fairness in Pension Plans

The Administration proposes modifications to the vesting rules, the contribution and deduction limits, and the 401(k) safe harbor plan rules to enhance the fairness of pensions to moderate- and lower-income workers.

Accelerate vesting for qualified plans.—The Administration proposes accelerating the current-law five-year (or seven-year graded) allowable vesting schedule for qualified retirement plans. Given the mobile nature of today's workforce, particularly of working women, there is a significant risk that many participants will leave employment before fully vesting in their retirement benefits. Under the proposal, plans would be required to provide that an employee would be fully vested after completing three years of service or would vest in annual 20 percent increments beginning after one year of service. In addition, time off under the Family and Medical Leave Act (FMLA) of up to 12 weeks of unpaid leave to care for a new child, to care for a family member who has a serious health condition, or because the worker has a serious health condition would be included in service for determining retirement plan vesting and eligibility to participate in the plan.

Modify contribution and annual addition limitations.—The deduction limits for profit sharing plans and the percentage-of-pay limitations of defined contribution plans would be liberalized to ensure that non-highly compensated employees' benefits are not inappropriately limited. The general 15-percent deduction limit for stock bonus and profit sharing plans would be increased by the amount of elective contributions on behalf of non-highly compensated employees participating in the plan that exceed, in the aggregate, 15 percent of compensation otherwise paid or accrued on behalf of such non-highly compensated employees. For purposes of determining the employer's deduction under the combined plan limit that applies when an employer has both a pension plan and a stock bonus or profit sharing plan in which the same employee participates, elective contributions on behalf of non-highly compensated employees would be disregarded. In addition, the 15-percent-of-compensation deduction limit would be further liberalized by treating certain salary reduction amounts as compensation in determining the deduction limits. The proposal also would increase the maximum allowable annual addition for defined contribution plans from 25 percent to 35 percent of compensation.

Expand coverage of non-highly compensated employees under 401(k) safe harbor plans.—The Administration would modify the section 401(k) matching formula safe harbor by requiring that, in addition to the matching contribution, either (1) the employer make a contribution of one percent of compensation for each eligible non-highly compensated employee, regardless of whether the employee makes elective contributions, or (2) the plan provide for current and newly hired employees to be automatically enrolled in the 401(k) plan at a three-percent contribution rate (where employees can elect other rates, including zero contribution). The proposal would also permit nonelective contributions to replace matching contributions in the 401(k) matching formula safe harbor.

Simplify the definition of highly compensated employee.—The Administration proposes to simplify the definition of highly compensated employee by eliminating the top-paid group election. Under the simplified definition, an employee would be treated as highly compensated if the employee (1) was a five-percent owner at any time during the year or the preceding year, or (2) had compensation in excess of $80,000 (as adjusted) for the preceding year.

Clarify the division of Section 457 assets upon divorce.—To make consistent the treatment of retirement benefits upon divorce, the Administration proposes to extend to section 457(b) plans the qualified domestic relations order (QDRO) regime that applies to distributions from a qualified plan made to a spouse, former spouse or alternate payee. Accordingly, the proposal would not tax the employee on distributions from a section 457(b) plan made to an alternate payee pursuant to a QDRO and also clarifies that a section 457(b)

plan will not be treated as violating the restrictions on distributions when it honors the terms of a QDRO.

Offer joint and 75-percent survivor annuity option.—Current law requires certain pension plans to offer to pay pension benefits as a joint and survivor annuity; frequently, the benefit for the surviving spouse is reduced to 50 percent of the monthly benefit paid when both spouses were alive. Under the proposal, plans that are subject to the joint and survivor annuity rules would be required to offer an option that pays a survivor benefit equal to at least 75 percent of the benefit the couple received while both were alive. This option would be especially helpful to women because they tend to live longer than men and because many aged widows have incomes below the poverty level.

Promote Retirement Savings Portability

The Administration proposes significant changes to promote the portability and encourage the preservation of retirement savings.

Encourage pension asset preservation by default rollover to IRA.—The direct rollover rules would be modified to encourage preservation of retirement assets by making a direct rollover the default option for eligible rollover distributions from a qualified retirement plan, section 403(b) annuity or governmental section 457(b) plan. The new rule would apply where a participant is entitled to an eligible rollover distribution from a qualified retirement plan, 403(b) annuity or governmental section 457(b) plan, the distribution is greater than $1,000, and the distribution is subject to nonconsensual cashout under the plan (i.e, does not exceed $5,000 or is made after normal retirement age). In these circumstances, the distribution would be required to be directly rolled over to an eligible retirement plan (including an IRA), unless the participant affirmatively elects to receive the distribution in cash. For convenience, the rollover IRA could be designated when the employee becomes a participant in the plan; alternatively, it could be designated at termination of employment. If the participant fails to designate a rollover plan or IRA and does not affirmatively elect to receive the distribution in cash, then involuntary cashout amounts could be transferred to an IRA designated by the payor (for the benefit of the participant) or, at the election of the plan sponsor, retained in the plan.

Expand permitted rollovers of employer-provided retirement savings.—Under current law, rollovers are not allowed between qualified retirement plans, section 403(b) tax-sheltered annuities and governmental section 457(b) plans. The Administration proposes that an eligible rollover distribution from a qualified retirement plan, a section 403(b) tax-sheltered annuity, or a governmental section 457(b) plan could be rolled over to a traditional IRA, a qualified retirement plan, a section 403(b) annuity, or a governmental section 457(b) plan. Amounts distributed from a governmental section 457(b) plan would be subject to the early withdrawal tax to the extent the distribution consists of amounts attributable to rollovers from another type of plan. A governmental section 457(b) plan would be required to separately account for such amounts. To facilitate the preservation of the retirement savings of participants in governmental section 457(b) plans and to rationalize the treatment of different types of broad-based retirement plans, the Administration also proposes to extend the direct rollover and withholding rules to governmental section 457(b) plans. These plans, like qualified plans, would be required to provide written notification to participants regarding eligible rollover distributions (but would not be required to accept rollovers). Finally, the proposal would allow eligible rollover distributions to be rolled over from a qualified trust sponsored by a previous employer to a Federal employee's Thrift Savings Plan (TSP) account.

Permit consolidation of retirement savings.—The Administration's proposal would allow individuals to consolidate their IRA funds and their workplace retirement savings in a single fund. Individuals who have IRAs with deductible IRA contributions would be permitted to transfer funds from their IRAs to their qualified defined contribution retirement plan, 403(b) tax-sheltered annuity or governmental section 457(b) plan, provided that the retirement plan trustee could qualify as an IRA trustee. In addition, the proposal would allow individuals to roll over after-tax IRA or employer plan contributions to their new employer's defined contribution plan or to an IRA if the plan or IRA provider agrees to track and report the after-tax portion of the rollover for the individual. Finally, surviving spouses would be permitted to roll over distributions to a qualified plan, 403(b) annuity or governmental section 457(b) plan.

Allow purchase of service credits in governmental defined benefit plans.—Employees of State and local governments, particularly teachers, often move between states and school districts in the course of their careers. Under State law, they often can purchase service credits in their State defined benefit pension plans for time spent in another state or district and earn a pension reflecting a full career of employment in the state in which they conclude their career. Under current law, these employees cannot make a tax-free transfer of the money they have saved in their 403(b) plan or governmental 457(b) plan to purchase these credits and often lack other resources to use for this purpose. Under the proposal, State and local government employees would be able to use funds from these retirement savings plans to purchase service credits through a direct transfer without first having to take a taxable distribution of these amounts.

Allow immediate participation in Federal Thrift Savings Plan (TSP).—Under the Administration's proposal, all waiting periods for Federal employees' participation in TSP (including matching and nonelective

contributions) would be eliminated for new hires and rehires.

Improve Pension Security

The Administration proposes a number of changes to improve pension security in defined benefit plans.

Modify pension plan deduction rules.—For defined benefit plans, the change in the full funding limitation based on current liability would be phased in more quickly, so that this limitation would be 170 percent of current liability for years beginning after December 31, 2003. In addition, the ten-percent excise tax on nondeductible contributions would not apply to the extent a contribution is nondeductible solely as a result of the current liability full funding limit. The special deduction rule for terminating plans would be modified so that, at plan termination, all contributions needed to satisfy the plan's liabilities would be immediately deductible. In the case of a plan with fewer than 100 participants, liabilities attributable to recent benefit increases for highly compensated employees would be disregarded for this purpose.

Simplify full funding limitation for multiemployer plans.—The limit on deductible contributions based on a specified percentage of current liability would be eliminated for multiemployer defined benefit plans. Therefore, the annual deduction for contributions to such a plan would be limited to the amount by which the plan's accrued liability exceeds the value of the plan's assets.

Modify defined benefit limit rules for multiemployer plans.—Defined benefit limits applicable to multiemployer defined benefit plans would be modified to eliminate the 100-percent-of-compensation limit (but not the $135,000 limit) for such plans. In addition, the special early retirement provisions for determining the defined benefit limit that currently apply to defined benefit plans sponsored by governments, tax-exempt organizations and merchant marine would be expanded to include multiemployer plans. Finally, the rule requiring aggregation of benefits provided from a single employer for purposes of the defined benefit limit would be modified so as not to require aggregation of a multiemployer defined benefit plan and a single employer defined benefit plan for purposes of the 100-percent-of-compensation limit.

Increase Disclosure and Right to Know

The Administration proposes to improve disclosure to workers and their spouses.

Improve disclosure for plan amendments that significantly reduce future benefit accruals.—The Administration's proposal would strengthen the existing disclosure requirements that apply when a pension plan is amended to significantly reduce the rate of future benefit accrual. The proposal would require that the notice summarize the important terms of the amendment, including identification of the effective date of the amendment, a statement that the amendment is expected to significantly reduce the rate of future benefit accrual, a general description of how the amendment significantly reduces the rate of future benefit accrual, and a description of the class or classes of participants to whom the amendment applies. Participants must receive the notice at least 45 days before the effective date of the plan amendment. If the plan has at least 100 active participants, the plan administrator would also be required to provide affected participants an enhanced advance notice of the amendment that describes, and illustrates using specific examples, the impact of the amendment on representative affected participants; to make available the formulas and factors used in those examples in order to permit similar calculations to be made; and to make available a follow-up individualized benefit statement estimating the participant's projected retirement benefits. Regulations could exempt certain amendments, such as amendments that do not make a fundamental change in a plan's formula.

Pension "right-to-know" proposals.—The Administration's proposal would enhance workers' and spouses' rights to know about their pension benefits by, 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.

Provide AMT Relief for Families and Simplify the Tax Laws

Provide adjustments for personal exemptions and the standard deduction in the individual alternative minimum tax (AMT).—The Administration is concerned that the AMT imposes financial and compliance burdens upon taxpayers that have few preference items and were not the originally intended targets. In particular, the Administration is concerned that the individual AMT may act to erode the benefits of dependent personal exemptions and standard deductions that are intended to provide relief for middle-income taxpayers—especially those with larger families. For example, under current law, a couple with five children and $70,000 of income that claims the standard deduction would be subject to the AMT in 2000. In response, the Administration proposes to phase out the tax preference status of dependent exemptions under the AMT; that is, when fully phased in, claiming children as personal exemptions on a tax return would not cause a taxpayer to be subject to the AMT. For tax years 2000 through 2007, only the first two dependent exemptions would be AMT preference items; in 2008 and 2009, only the first exemption would be a preference; in 2010 and thereafter, dependent exemptions would no longer be treated as an AMT preference. The Administration also proposes to allow taxpayers who claim the standard deduction for regular income tax purposes to claim the same standard deduction for AMT purposes for tax years 2000 and 2001. That provi-

sion would complement the provision enacted in 1999 that allows the use of personal credits against the AMT through 2001.

Simplify and increase standard deduction for dependent filers.—Currently, the standard deduction for tax filers who can be claimed as dependents by another taxpayer is the smaller of the standard deduction for single taxpayers ($4,400 for tax year 2000) or the special standard deduction for dependent filers. The special standard deduction is the larger of (1) $700 (for tax year 2000) or (2) the individual's earned income plus $250 (for tax year 2000). The current provision requires dependents to file a tax return if they have at least $250 of interest and dividends from their savings and their earnings plus income from savings is at least $700. To simplify the standard deduction and increase it for dependent filers, the Administration proposes that, beginning in 2000, the standard deduction for dependent filers would be the individual's earned income plus $700 (indexed after 2000), but not more than the regular standard deduction. This proposal would reduce the number of dependent filers required to file a tax return by 400,000 and simplify filing for other dependents with earned income.

Replace support test with residency test (limited to children).—Under current law, taxpayers must provide over half the support of individuals claimed as dependents on their tax return. Under the proposal, taxpayers would be allowed to claim their children as dependents by meeting a residency test instead of a support test. If the child is 18 or younger (23 or younger if a full-time student) and is the taxpayer's son, daughter, stepchild, or grandchild, then the support test may be waived if the taxpayer lives with the child for over half the year. A twelve-month test would apply to foster children. If more than one taxpayer could claim the child as a dependent under the proposed rule, the taxpayer with the highest AGI would be entitled to the dependency exemption. The proposal would be effective for taxable years beginning after December 31, 2000.

Index maximum exclusion for capital gains on sale of principal residence.—Under current law, taxpayers can generally exclude up to $250,000 ($500,000 for married taxpayers filing joint returns) of gain on the sale of a principal residence. To be eligible for the full exclusion, the taxpayer must have owned the residence and occupied it as a principal residence for at least two of the five years preceding the sale. A taxpayer may claim the deduction only once in any two-year period. Under the proposal, the maximum exclusion amounts would be indexed for inflation effective January 1, 2001. The proposal will prevent inflation from subjecting more taxpayers to tax when they sell their homes, and will prevent more taxpayers from having to maintain complex records regarding the cost of their homes.

Provide tax credit to encourage electronic filing of individual income tax returns.—Under current law, tax return preparation costs of individuals, including any costs of electronic filing, may be deducted only by taxpayers who itemize deductions and then only to the extent that such costs, in combination with most other miscellaneous itemized deductions, exceed two percent of AGI. The proposal would provide a temporary, refundable tax credit for the electronic filing of individual income tax returns. The credit would be for tax years 2001 through 2006 and would be $10 for each electronically filed return, and $5 for each TeleFile return (which are filed by entering information through the keypads of telephones). The credit would encourage taxpayers to try electronic return or Telefile submission, which reduces taxpayer errors and the need for subsequent contacts between the taxpayer and the IRS and which permits taxpayers to receive their tax refunds faster. The credit would help the IRS achieve the goal set in the 1998 IRS Restructuring and Reform Act of having 80 percent of 2006 returns filed electronically. No later than tax year 2002, the IRS would be required to offer one or more options to the public, through contract arrangements with the private sector, for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer.

Clarify the tax treatment of disabled workers in a sheltered workshop.—The Administration's proposal would provide a limited exclusion from the definition of "employment" for certain services rendered by disabled individuals in a sheltered workshop program effective the date of enactment. The exclusion would be limited to service (1) performed for a period of no more than 18 months under a minimum wage exemption certificate issued by the Department of Labor and (2) provided in a sheltered workshop operated by a section 501(c)(3) organization or a State or local government. However, organizations could voluntarily agree to provide coverage, pursuant to an agreement with the Social Security Administration. Corresponding changes would be made to the Social Security Act.

Simplify, retarget and expand expensing for small business.—In place of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $20,000 of the cost of qualifying property (generally depreciable tangible property) placed in service in taxable year 2000. The deductible amount rises to $24,000 in 2001 and 2002, and to $25,000 in 2003 and subsequent taxable years. The Administration proposes to increase the amount of investment that can be expensed to $25,000 in taxable year 2001; thereafter, this amount would be increased for inflation in increments of $1,000. In addition, the Administration proposes certain modifications to better target the applicability of expensing, to allow the deduction to be claimed at the entity level for flow-through businesses, and to make certain computer software eligible for expensing.

Provide 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, 2000.

Clarify rules relating to certain disclaimers.—Under current law, if a person refuses to accept (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.—TRA97 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 the application of the foreign tax credit limitation significantly 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, 1999.

Provide interest treatment for dividends paid by certain 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 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.

Expand declaratory judgment remedy for noncharitable organizations seeking determinations of tax-exempt status. —Under current law, organizations seeking tax-exempt status as charities are allowed to seek a declaratory judgment as to their tax status if their application is denied or delayed by the IRS. A noncharity (an organization not described in section 501(c)(3)) that applies to the IRS for recognition of its tax-exempt status faces potential tax liability if its application ultimately is denied by the IRS. This creates uncertainty for the noncharity, particularly when the IRS determination is delayed for a significant period of time. To reduce this uncertainty, the declaratory judgment procedure available to charities under current-law section 7428 would be expanded, so that if the application of any organization seeking tax-exempt status under section 501(c) is pending with the IRS for more than 270 days, and the organization has exhausted all administrative remedies available within the IRS, then the organization could seek a declaratory judgment as to its tax-exempt status from the United States Tax Court. The proposal would be effective for applications for recognition of tax-exempt status filed after December 31, 2000.

Simplify the active trade or business requirement for tax-free spin-offs.—In order to satisfy the active trade or business requirement for tax-free spin-offs, split-offs, and split-ups, the distributing corporation and the controlled corporation both must be engaged in the active conduct of a trade or business. If a corporation is not itself active, it may satisfy the active trade or business test indirectly, but only if substantially all of its assets consist of stock and securities of a controlled corporation that is engaged in an active trade or business. Because the substantially all standard is much higher than that required if the corporation is active itself, a taxpayer often must engage in pre-distribution restructurings that it otherwise would not have undertaken. There is no clear policy reason that the standards for meeting the active trade or business requirement should differ depending upon whether a corporation is considered to be active on a direct or indirect basis. Therefore, the Administration proposes to simplify the requirement by removing the substantially all test and generally allowing an affiliated group to satisfy the active trade or business requirement as long as the affiliated group, taken as a whole, is considered active. This proposal would be effective for transactions after the date of enactment.

Modify translation of foreign withholding taxes by accrual basis taxpayers.—Under current law, taxpayers who take foreign income taxes into account when accrued generally are required to translate such taxes into dollars by using the average exchange rate for the taxable year to which such taxes relate. This rule was intended to be a simplification measure that would reduce the need for accrual basis taxpayers to redetermine the amount of foreign tax credits claimed with respect to foreign taxes accrued prior to the date of payment. This rule may not clearly reflect income, however, in the case of foreign withholding taxes paid by an accrual basis taxpayer, because such taxes are never accrued prior to the date the tax is paid (regardless of the taxpayer's method of accounting). Moreover, certain taxpayers that receive income subject to withholding taxes (such as regulated investment companies with a taxable year that differs from the calendar year) may find it impossible to comply with current law. The proposal would provide that foreign withholding taxes are to be translated at the spot rate on the date of payment, regardless of the method of accounting of the taxpayer. The proposal would be effective for taxable years beginning after the date of enactment.

Eliminate duplicate penalties for failure to file annual reports.—Employer penalties for failure to file an annual report would be simplified by eliminating the Internal Revenue Code penalties for a plan to which ERISA applies. Certain other ERISA reporting penalties would be modified or eliminated.

Clarify foreign tax credit rules to provide the circumstances under which a domestic corporation that owns a foreign corporation through a partnership will be eligible for the deemed-paid credit.—A domestic corporation that is a U.S. shareholder of a controlled foreign corporation (CFC) can claim deemed-paid foreign tax credits with respect to foreign taxes paid by the CFC on the subpart F income that the U.S. shareholder currently includes in income to the same extent that it would be so allowed if the subpart F inclusion were treated as an actual dividend distribution. To be eligible for the deemed-paid credit on an actual dividend distribution, a domestic corporation must own 10% or more of the voting stock of the foreign corporation from which it receives the dividend. Under current law, it is not clear how to apply the deemed-paid foreign tax credit rules when a foreign corporation is owned through a partnership. The proposal would provide that the deemed-paid credit is available to a domestic corporation that, through a partnership, owns 10% or more of the voting stock of a foreign corporation from which it receives its proportionate share of dividend income. This rule would apply to both foreign and U.S. partnerships. For purposes of this provision, a foreign partnership would be treated as a tier under the rule that allows the deemed-paid credit only with respect to taxes paid by foreign corporations that are not below the sixth tier.

Encourage Philanthropy

Allow deduction for charitable contributions by non-itemizing taxpayers.—To provide an incentive for taxpayers who use the standard deduction to make large charitable contributions, the Administration proposes a deduction for substantial charitable contributions made by taxpayers who do not itemize their deductions. Under current law, individual taxpayers who itemize their deductions generally may claim a deduction (subject to certain percentage limitations) for contributions made to qualified charitable organizations. However, individual taxpayers who elect the standard deduction (so-called "non-itemizers") may not claim a deduction for charitable contributions, although the standard deduction theoretically includes an allowance for moderate amounts of charitable giving. The proposal would allow taxpayers who are non-itemizers to deduct 50 percent of their charitable contributions in excess of $1,000 ($2,000 for married taxpayers filing jointly) for taxable years beginning after December 31, 2000 and before January 1, 2006. For taxable years beginning after December 31, 2005, non-itemizers would be allowed to deduct 50 percent of their charitable contributions in excess of $500 ($1,000 for married taxpayers filing jointly).

Simplify and reduce the excise tax on foundation investment income.—Under current law, private foundations generally are subject to a two-percent excise tax on their net investment income. In some cases, the excise tax rate is reduced to one percent, provided that current-year grantmaking by the foundation is determined under a complex formula to not fall below the average level of the foundation's grantmaking in the five preceding taxable years (with certain adjustments). This complex formula creates a perverse incentive for foundations not to significantly increase their grantmaking for charitable purposes in any particular year, because if a foundation does so, it becomes more difficult for the foundation to qualify for the reduced one-percent excise tax rate in subsequent years. Accordingly, the Administration proposes that the excise tax on private foundation investment income be simplified by reducing the general two-percent excise tax rate to a 1.25-percent excise tax rate that would apply in all cases. The complex formula for determining whether a foundation is maintaining its historic level of charitable grantmaking, and the special excise tax rate available to only some foundations, would be repealed. Thus, private foundations would not suffer adverse excise tax consequences if they respond to charitable needs by significantly increasing their grantmaking in a particular year. The proposal would be effective for taxable years beginning after December 31, 2000.

Increase limit on charitable donations of appreciated property.—Under current law, charitable contributions made by individuals who do not claim the standard deduction are deductible for income tax purposes, up to certain limits depending on the type of

property donated and whether the donee organization qualifies as a public charity or private foundation. Contributions made by an individual to a public charity generally are deductible in an amount not exceeding 50 percent of the individual's AGI for the current year (with any remaining amount carried over for up to five taxable years). In the case of contributions made by an individual to a private foundation, a 30-percent AGI limitation generally applies. However, in the case of donated stock and other non-cash contributions, a 30-percent AGI limitation applies to gifts to public charities, and a 20-percent AGI limitation applies to gifts to private foundations. These special contribution limits for non-cash gifts create unnecessary complexity and could discourage gifts of valuable or unique property to charitable organizations. Therefore, the Administration proposes that the special contribution limits for non-cash gifts be repealed, effective for contributions made after December 31, 2000.

Clarify public charity status of donor advised funds.—-In recent years, there has been an explosive growth in so-called "donor advised funds" maintained by charitable corporations. These funds generally permit a donor to claim a current charitable contribution deduction for amounts contributed to a charity and to provide ongoing advice regarding the investment or distribution of such amounts, which are maintained by the charity in a separate fund or account. In the absence of clear guidelines, donor advised funds potentially may be used to provide donors with the benefits normally associated with private foundations (such as control over grantmaking), without the regulatory safeguards that apply to private foundations. Therefore, the Administration proposes that current-law rules be clarified so that a charitable corporation which, as its primary activity, operates donor advised funds may qualify as a publicly supported organization only if: (1) there is no material restriction or condition that prevents the corporation from freely and effectively employing the contributed assets in furtherance of its exempt purposes; (2) distributions from donor advised funds are made only to public charities (or private operating foundations); and (3) the corporation distributes annually for charitable purposes an amount equal to at least five percent of the fair market value of the corporation's aggregate investment assets. The proposal also would clarify that, for purposes of the section 4958 excise tax on certain excess benefit transactions, a person who provides advice with respect to a particular donor advised fund maintained by a public charity is treated as having substantial influence with respect to that particular fund.

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, and natural gas heat pumps. The credit would equal 20 percent of the amount of qualified investment, subject to caps of $500 per kilowatt for fuel cells, $500 per unit for electric heat pump water heaters, and $1,000 per unit for natural gas heat pumps. The credit would be available for the four-year period beginning January 1, 2001 and ending December 31, 2004.

Provide tax credit for 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 $1,000 or $2,000 depending upon the home's energy efficiency. The $1,000 credit would be available for homes purchased between January 1, 2001 and December 31, 2003 that reduce energy usage by at least 30 percent relative to the standard under the 1998 International Energy Conservation Code (IECC). The $2,000 credit would be available for homes purchased between January 1, 2001 and December 31, 2005 that reduce energy usage by at least 50 percent relative to the IECC standard.

Transportation

Extend electric vehicle tax credit and provide tax credit for hybrid vehicles.—Under current law, a 10-percent tax credit up to $4,000 is provided for the cost of a qualified electric vehicle. The full amount of the credit is available for purchases prior to 2002. The credit begins to phase down in 2002 and is not available after 2004. The Administration proposes to extend the present $4,000 credit through 2006 and to allow the full amount of the credit to be available for qualified electric vehicles through 2006. The Administration also proposes to provide a tax credit of up to $3,000 for purchases of a qualified hybrid vehicle after December 31, 2002 and before January 1, 2007. A qualified hybrid vehicle is a road vehicle that can draw propulsion energy from both of the following on-board sources of stored energy: a consumable fuel and a rechargeable battery. The amount of the credit would depend upon the vehicle's design performance. The credit would be available for all qualifying light vehicles including cars, minivans, sport utility vehicles, and light trucks.

Industry

Provide 15-year depreciable life for distributed power property.—Distributed power technologies can be more energy efficient and generate fewer greenhouse gases than conventional generation methods. To promote the use of these technologies, the Administration proposes to simplify and rationalize the current system for assigning cost recovery periods to certain depre-

ciable property by assigning a single 15-year recovery period to qualifying distributed power property. Distributed power property would include depreciable assets used by a taxpayer to produce electricity for use in a nonresidential or residential building that is used in the taxpayer's trade or business. Such property also would include depreciable assets used to generate electricity for primary use in an industrial manufacturer's process or plant activity, provided such assets had a rated total capacity in excess of 500 kilowatts. Qualifying property could be used to produce thermal energy or mechanical power for use in a heating or cooling application. However, at least 40 percent of the total useful energy produced in a commercial or residential setting must consist of electrical power. When used in an industrial setting, at least 40 percent of produced energy must be used in the taxpayer's manufacturing process or plant activity. In addition, a taxpayer would be required to have a reasonable expectation that no more than 50 percent of the produced electricity would be sold to, or used by, unrelated persons. The proposal would apply to assets placed in service after the date of enactment.

Clean Energy Sources

Extend and modify the tax credit for producing electricity from certain sources.—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 January 1, 2002, after which it expires. The Administration proposes to extend the current credit for wind and closed-loop biomass for two and one-half years, to facilities placed in service before July 1, 2004, and to expand eligible biomass to include certain biomass from forest-related resources, agricultural sources and other sources for facilities placed in service after December 31, 2000 and before January 1, 2006. Biomass facilities that were placed in service before July 1, 1999 would be eligible for a credit of 1.0 cent per kilowatt hour for electricity produced from the newly eligible sources from January 1, 2001 through December 31, 2003. A 0.5-cent-per-kilowatt-hour tax credit would also be allowed for cofiring biomass in coal plants from January 1, 2001 through December 31, 2005. In addition, electricity produced from methane from certain facilities would be eligible for the following credits: (1) 1.5 cent per kilowatt hour for methane produced from landfills not subject to EPA's 1996 New Source Performance Standards/Emissions Guidelines (NSPS/EG), or (2) 1.0 cent per kilowatt hour for methane produced from landfills subject to NSPS/EG. The credit would apply to facilities placed in service after December 31, 2000 and before January 1, 2006.

Provide tax credit for solar energy systems.—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 a new tax credit for purchasers of roof-top photovoltaic systems and solar water heating systems located on or adjacent to the building for uses other than heating swimming pools. 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. The credit would apply only to equipment placed in service after December 31, 2000 and before January 1, 2006 for solar water heating systems, and after December 31, 2000 and before January 1, 2008 for rooftop photovoltaic systems. (Taxpayers would choose between the proposed tax credit and the current-law tax credit for each investment.)

Electricity Restructuring

Revise tax-exempt bond rules for electric power facilities.—To encourage restructuring the nation's electric power industry so that consumers benefit from competition, rules relating to the use of tax-exempt bonds to finance electric power facilities would be modified. To encourage public power systems to implement retail competition, outstanding bonds issued to finance transmission facilities would continue their tax-exempt status if private use resulted from allowing nondiscriminatory open access to those facilities. Outstanding bonds issued to finance generation or distribution facilities would continue their tax-exempt status if the issuer implements retail competition. To support fair competition within the restructured industry, interest on newly issued bonds to finance electric generation or transmission facilities would not be exempt. Distribution facilities could continue to be financed with tax-exempt bonds. These changes would be effective upon enactment.

Modify taxation of contributions to nuclear decommissioning funds.—Under current law, deductible contributions to nuclear decommissioning funds are limited to the amount included in the taxpayer's cost of service for ratemaking purposes. For deregulated utilities, this limitation may result in the denial of any deduction for contributions to a nuclear decommissioning fund. The Administration proposes to repeal the limitation for taxable years beginning after December 31, 2000. As under current law, deductible contributions would not be permitted to exceed the amount the IRS determines to be necessary to provide for level funding of an amount equal to the taxpayer's decommissioning costs.

Modify International Trade Provisions

Extend and modify Puerto Rico economic-activity tax credit.—The Puerto Rico and possessions tax credit was repealed in 1996. However, both the income-based credit and the economic-activity-based credit remain available for certain business operations con-

ducted in taxable years beginning before January 1, 2006, subject to base-period caps. To provide a more efficient tax incentive for the economic development of Puerto Rico and to continue the shift from an income-based credit to an economic-activity-based credit that was begun in 1993, the proposal would modify the phase-out of the economic-activity-based credit for Puerto Rico by (1) opening it to newly established business operations during the phase-out period, effective for taxable years beginning after December 31, 1999, and (2) extending the phase-out period through taxable years beginning before January 1, 2009.

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 September 30, 2001, through June 30, 2004. The Administration also is proposing to: (1) enhance trade benefits, through December 31, 2010, for subsaharan African countries undertaking strong economic reforms; (2) grant, through September 30, 2004, duty-free treatment to certain imports from the Southeast Europe countries and territories of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia, Romania, Slovenia, Kosovo and Montenegro; and (3) provide, through December 31, 2004, expanded trade benefits mainly on textiles and apparel to Caribbean Basin countries that meet new eligibility criteria. These proposals will help Caribbean Basin countries prepare for a future free trade agreement with the United States and respond to the effects of Hurricanes George and Mitch, and will help the countries of Southeast Europe rebuild and reintegrate their economies and work toward achieving lasting political stability in the region.

Levy tariff on certain textiles and apparel products produced in the Commonwealth of the Northern Mariana Islands (CNMI).—The Administration is proposing a tariff on textile and apparel products that are 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.

Miscellaneous Provisions

Make first $2,000 of severance pay exempt from income tax.—Under current law, payments received by 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 $75,000. The exclusion would be effective for severance pay received in taxable years beginning after December 31, 2000 and before January 1, 2004.

Exempt Holocaust reparations from Federal income tax.—The Internal Revenue Code defines gross income as "gross income from whatever source derived," except for certain items specifically exempt or excluded by statute. Although the United States - Federal Republic of Germany Income Tax Convention and a series of rulings issued by the IRS provide that certain Holocaust-related reparations are exempt from Federal income tax, there is no explicit statutory exception from gross income for amounts received by Holocaust victims or their heirs. In recent years, several countries and companies within those countries have acknowledged that they have not made adequate compensation or restitution to victims or their heirs for the deprivations inflicted upon them during the Nazi Holocaust, and have agreed to establish funds or to make direct payments of cash or property to such individuals. To provide clarity and relief for Holocaust victims and their families, the Administration proposes a statutory exemption from gross income for any amount received by an individual or heir of an individual from Holocaust-related funds and settlements, including in compensation for or recovery of property confiscated in connection with the Holocaust. The proposal would be effective for amounts received on or after January 1, 2000. No inference is intended as to the tax treatment of amounts received prior to that date.

ELIMINATE UNWARRANTED BENEFITS AND ADOPT OTHER REVENUE MEASURES

The President's plan closes tax shelters and other loopholes, curtails unwarranted corporate tax subsidies, improves tax compliance and adopts other revenue measures.

Limit Benefits of Corporate Tax Shelter Transactions

The Administration continues to be concerned about the use and proliferation of corporate tax shelters and their effect upon both the corporate tax base and the integrity of the tax system as a whole. The primary goals of corporate tax shelters are to manufacture tax benefits that can be used to offset unrelated income of the taxpayer or to create tax-favored or tax-exempt economic income.

The growing use of corporate tax shelters was further described by the Treasury Department in its White Paper entitled, The Problem of Corporate Tax Shelters: Discussion, Analysis and Legislative Proposals, issued in July 1999. The paper concludes that corporate tax shelters are best addressed by increasing disclosure of corporate tax shelter activities, increasing and strengthening the substantial understatement penalty, codifying the judicially-created economic substance doctrine, and providing consequences to all parties to the transaction

(e.g., promoters, advisors, and tax-indifferent, accommodating parties.)

The Administration proposes several general remedies to curb the growth of corporate tax shelters that focus on these four themes. In addition, the Administration proposes to modify the treatment of certain specific transactions that provide sheltering potential. No inference is intended as to the treatment of any of these transactions under current law.

Increase disclosure of certain transactions.—Greater disclosure of corporate tax shelter transactions will discourage some corporations from engaging in such activity and would aid the IRS in identifying questionable transactions and enforcing current law. The Administration proposes to require disclosure of certain reportable transactions. Disclosure would be required if a transaction possesses certain objective characteristics common to corporate tax shelter transactions. Disclosure would be made on a short form or statement that provides the essence of the transaction, is filed with the IRS National Office and with the tax return by the due date of the return, and is signed by a corporate officer with the appropriate knowledge of the transaction. Significant monetary and procedural remedies would be imposed upon failure to provide the required disclosure. The proposal would be effective for transactions entered into after the date of first committee action.

Modify substantial understatement penalty for corporate tax shelters.—The current 20-percent substantial understatement penalty imposed on corporate tax shelter items can be avoided if the corporate taxpayer had reasonable cause for the tax treatment of the item and acted in good faith. In order to change the cost-benefit analysis of entering a corporate tax shelter, the Administration proposes to increase the substantial understatement penalty on corporate tax shelter items to 40 percent. In order to encourage disclosure, the penalty will be reduced to 20 percent if the corporate taxpayer provides the requisite disclosure of the transaction. The 20-percent penalty for disclosed transactions could be avoided by a showing that the taxpayer reasonably believed that it had a strong chance of sustaining its tax position and acted in good faith. The proposal would be effective for transactions entered into after the date of first committee action.

Codify the economic substance doctrine.—The "economic substance" doctrine is a longstanding, judicially-created standard providing that in order for a transaction to be respected for tax purposes, it must be imbued with economic substance. The economic substance doctrine requires an analysis and balancing of the claimed tax benefits from a transaction with the pre-tax profit of the transaction. The Administration proposes codifying the economic substance standard. Under the proposal, a transaction will not be respected for tax purposes if the present value of the expected economic profit from the transaction is insignificant compared to the present value of the expected tax benefits. Similar rules would apply to financing transactions. The proposal would apply to transactions entered into on or after the date of first committee action.

Tax income from corporate tax shelters involving tax-indifferent parties.—The Federal income tax system has many participants who are indifferent to tax consequences (e.g., foreign persons, tax-exempt organizations, and Native American tribal organizations). Many corporate tax shelters rely on tax-indifferent participants who absorb taxable income generated by the shelters so that corresponding losses or deductions can be allocated to taxable participants. The proposal would provide that any income received by a tax-indifferent person with respect to a corporate tax shelter would be taxable to the extent the person is trading on its special tax status. The proposal would be effective for transactions entered into on or after the date of first committee action.

Impose a penalty excise tax on certain fees received by promoters and advisors..—Users of corporate tax shelters often pay large fees to promoters and advisors with respect to the shelter transactions. The proposal would impose a 25-percent penalty excise tax on fees received in connection with the promotion of corporate tax shelters and the rendering of certain tax advice related to corporate tax shelters. The proposal would be effective for payments made on or after the date of first committee action.

Require accrual of income on forward sale of corporate stock.—There is little substantive difference between a corporate issuer's current sale of its stock for deferred payment and an issuer's forward sale of the same stock. In both cases, a portion of the deferred payment compensates the issuer for the time-value of money during the term of the contract. Under current law, the issuer must recognize the time-value element of the deferred payment as interest if the transaction is a current sale for deferred payment but not if the transaction is a forward contract. Under the proposal, the issuer would be required to recognize the time-value element of the forward contract as well. The proposal would be effective for forward contracts entered into after the date of first committee action.

Modify treatment of ESOP as S corporation shareholder.—Pursuant to provisions enacted in 1996 and 1997, an employee stock ownership plan (ESOP) may be a shareholder of an S corporation and the ESOP's share of the income of the S corporation is not subject to tax until distributed to the plan beneficiaries. The Administration proposes to require ESOPs that are not broad based to pay tax on S corporation income (including capital gains on the sale of stock) as the income is earned and to allow the ESOP a deduction for distributions of such income to plan beneficiaries. The deduction would apply only to the extent distributions exceed all prior undistributed amounts

that were previously not subject to unrelated business income tax. The proposal would be effective for taxable years beginning on or after the date of first committee action. In addition, the proposal would be effective for acquisitions of S corporation stock by an ESOP after such date and for S corporation elections made on or after such date.

Limit dividend treatment for payments on certain self-amortizing stock.—Under current law, distributions of property by a corporation to its shareholders are treated as dividends to the extent of the current or accumulated earnings and profits of the corporation. The Treasury Department previously became aware of certain abusive transactions involving so-called "fast-pay" stock. Under a typical fast-pay arrangement, a corporation that is subject to tax only at the shareholder level (a conduit entity) issues preferred stock to one class of investors and common stock to a second class of investors. The preferred stock is economically self-amortizing because the distributions made with respect to the stock (although treated entirely as dividends under current law) represent in part a return of the investors' investment and in part a return on their investment. While The Treasury Department has issued regulations that recharacterize a fast-pay arrangement involving certain domestic conduit entities, legislation limiting the dividend characterization on self-amortizing stock (including self-amortizing stock issued by foreign conduit entities) may be a more comprehensive solution. The proposal would provide that, in the case of a distribution with respect to self-amortizing stock issued by a conduit entity (including a foreign conduit entity), the amount treated as a dividend shall not exceed the amount of the distribution that would have been characterized as interest had the self-amortizing stock been a debt instrument. The proposal would be effective for distributions with respect to self-amortizing stock made after the date of enactment.

Prevent serial liquidation of U.S. subsidiaries of foreign corporations.—When a domestic corporation distributes a dividend to a foreign corporation, it is subject to U.S. withholding tax. In contrast, if a domestic corporation distributes earnings in a subsidiary liquidation under section 332, the foreign shareholder generally is not subject to any withholding tax. Relying on section 332, some foreign corporations have used holding companies to avoid the withholding tax. They establish U.S. holding companies to receive tax-free dividends from operating subsidiaries, and then liquidate the holding companies, thereby avoiding the withholding tax. Subsequently, they re-establish the holding companies to receive future dividends. The proposal would impose withholding tax on any distribution made to a foreign corporation in complete liquidation of a U.S. holding company if the holding company was in existence for less than 5 years. The proposal would also achieve a similar result with respect to serial terminations of U.S. branches. The proposal would be effective for liquidations and terminations occurring on or after the date of enactment.

Prevent capital gains avoidance through basis shift transactions involving foreign shareholders.—A distribution in redemption of stock generally is treated as a dividend if it does not result in a meaningful reduction in the shareholder's proportionate interest in the distributing corporation, measured with reference to certain constructive ownership rules, including option attribution. If an amount received in redemption of stock is treated as a distribution of a dividend, the basis of the remaining stock generally is increased to reflect the basis of the redeemed stock. The basis of the remaining stock is not increased, however, to the extent that the basis of the redeemed stock was reduced or eliminated pursuant to the extraordinary dividend rules. In certain circumstances, these rules require a corporate shareholder to reduce the basis of stock with respect to which a dividend is received by the nontaxed portion of the dividend, which generally equals the amount of the dividend that is offset by the dividends received deduction. To prevent taxpayers from attempting to offset capital gains by generating artificial capital losses through basis shift transactions involving foreign shareholders, the Administration proposes to treat the portion of a dividend that is not subject to current U.S. tax as a nontaxed portion. Similar rules would apply in the event that the foreign shareholder is not a corporation. The proposal would be effective for distributions on or after the date of first committee action.

Prevent mismatching of deductions and income inclusions in transactions with related foreign persons.—Current law provides that if any debt instrument having original issue discount (OID) is held by a related foreign person, any portion of such OID shall not be allowable as a deduction to the issuer until paid. Section 267 and the regulations thereunder apply similar rules to other expenses and interest owed to related foreign persons. These general rules are modified, however, so that a deduction is allowed when the OID is includible in the income of a foreign personal holding company (FPHC), controlled foreign Department corporation (CFC), or passive foreign investment company (PFIC). The Treasury Department has learned of certain structured transactions (involving both U.S. payors and U.S.-owned foreign payors) designed to allow taxpayers inappropriately to take advantage of the current rules by accruing deductions to related FPHCs, CFCs or PFICs, without the U.S. owners of such related entities taking into account for U.S. tax purposes an amount of income appropriate to the accrual. This results in an improper mismatch of deductions and income. The proposal would provide that deductions for amounts accrued but unpaid to related foreign CFCs, PFICs or FPHCs would be allowable only to the extent the amounts accrued by the payor are, for U.S. tax purposes, reflected in the income of the direct or indirect U.S. owners of the related foreign

person. The proposal would contain an exception for certain short term transactions entered into in the ordinary course of business. The Secretary of Treasury would be granted regulatory authority to provide exceptions from these rules. The proposal would be effective for amounts accrued on or after the date of first committee action.

Prevent duplication or acceleration of loss through assumption of certain liabilities.—Generally, if as part of a transaction in which one or more persons contribute property in exchange for the stock of a corporation that they control immediately thereafter, the corporation also assumes a liability of a transferor, the transferor's basis in the stock of the controlled corporation is reduced by the amount of the liability assumed. To facilitate the incorporation of certain businesses that have liabilities that have not yet given rise to a deduction, special rules apply to provide that the assumption of such liabilities does not reduce the transferor's basis in the stock of the controlled corporation. Relying on these special rules and other authority, some taxpayers have attempted to accelerate or duplicate deductions for certain losses by separating liabilities from the associated business or assets, contributing them to a corporation, and selling stock in that corporation at a purported loss. The Administration proposes that if the basis of stock received by a transferor as part of a tax-free exchange with a controlled corporation exceeds its fair market value, then the basis of the stock received would be reduced (but not below the fair market value) by the amount of a fixed or contingent liability that is assumed by the controlled corporation and that did not otherwise reduce the transferor's basis in the corporation's stock. Except as provided by the Secretary of Treasury , the proposal would not apply where the trade or business or substantially all the assets associated with the liability are also transferred to the controlled corporation. Regulations would be issued to prevent the acceleration or duplication of losses through the assumption of liabilities in transactions involving partnerships, and may also be issued to modify the rules of this proposal as applied to S corporations. The proposal and the regulations addressing transactions involving partnerships would be effective for assumptions of liability on or after October 19, 1999. Regulations addressing transactions involving S corporations would be effective on or after October 19, 1999, or such later date as may be prescribed by such rules.

Amend 80/20 company rules.—Interest or 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 the payment 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 limit the amount of interest and dividends exempt from withholding to the amount of foreign active business income received by the U.S. corporation during the 3-year testing period. The proposal would apply to interest or dividends paid or accrued more than 30 days after the date of enactment.

Modify corporate-owned life insurance (COLI) rules.—In general, interest on 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, 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 still permit leveraged businesses to fund significant amounts of deductible interest and other expenses with tax-exempt or tax-deferred inside buildup on contracts insuring employees, officers, directors, and shareholders. The Administration proposes to repeal the exception under the COLI proration rules for contracts insuring employees, officers or directors (other than certain contracts insuring 20-percent owners) of the business. The proposal also would conform the key person exception for disallowed interest deductions attributable to indebtedness with respect to life insurance contracts to the modified 20-percent owner exception in the COLI proration rules. The proposal would be effective for taxable years beginning after date of enactment.

Require lessors of tax-exempt-use property to include service contract options in lease term.—Under current law, a lessor of tax-exempt-use property is allowed depreciation deductions computed on a straight-line basis over a period of not less than 125 percent of the term of the lease. The existing depreciation rules do not consider service contracts, which can be structured to resemble leases. In recent years, lessors have attempted to accelerate depreciation deductions by structuring transactions that have a relatively short lease followed by a service contract. The proposal would require lessors to include the term of service contracts in the lease term for purposes of determining the depreciation period. The proposal would be effective for leases entered into after the date of enactment.

Financial Products

Require banks to accrue interest on short-term obligations.—Under current law, a bank (regardless of its accounting method) must accrue as ordinary income interest, including original issue discount, on

short-term obligations. Some court cases have held that banks that use the cash receipts and disbursements method of accounting do not have to accrue stated interest and original issue discount on short-term loans made in the ordinary course of the bank's business. The Administration believes it is inappropriate to treat these short-term loans differently than other short-term obligations held by the bank. The Administration's proposal would clarify that banks must accrue interest and original issue discount on all short-term obligations, including loans made in the ordinary course of the bank's business, regardless of the banks' overall accounting method. The proposal would be effective for obligations acquired (including originated) on or after the date of enactment. No inference is intended regarding the current-law treatment of these transactions.

Require current accrual of market discount by accrual method taxpayers.—Under current law, a taxpayer that holds a debt instrument with market discount is not required to include the discount in income as it accrues, even if the taxpayer uses an accrual method of accounting. Under the proposal, a taxpayer that uses an accrual method of accounting would be required to include market discount in income as it accrues. The proposal would also cap the amount of market discount on distressed debt instruments. The proposal would be effective for debt instruments acquired on or after the date of enactment.

Modify and clarify certain rules relating to debt-for-debt exchanges.—Under current law, an issuer can inappropriately accelerate interest deductions by refinancing a debt instrument in a debt-for-debt exchange at a time when the issuer's cost of borrowing has declined. The proposal would spread the issuer's net deduction for bond repurchase premium in a debt-for-debt exchange over the term of the new debt instrument using constant yield principles. In addition, the proposal would modify the measurement of the net income or deduction in debt-for-debt exchanges involving contingent payment debt instruments. Finally, the proposal would modify the measurement of taxable boot to the holder in debt-for-debt exchanges that are part of corporate reorganizations. The proposal would apply to debt-for-debt exchanges occurring on or after the date of enactment.

Modify and clarify the straddle rules.—A "straddle" is the holding of two or more offsetting positions with respect to actively-traded personal property. If a taxpayer enters into a straddle, the taxpayer must defer the recognition of loss from the "loss leg" of the straddle until the taxpayer recognizes the offsetting gain from the "gain leg" of the straddle. Further, the taxpayer must capitalize the net interest and carrying charges properly attributable to the straddle. The proposal would modify and clarify a number of provisions under the straddle rules. In particular, to match the timing of straddle losses with related gains, the proposal would provide that loss realized on one leg of a straddle would be capitalized into the other leg of the straddle. This capitalization would operate as an ordering rule eliminating the need for an identification rule when the legs are of different sizes. In addition, to ensure that the loss on a straddle leg is properly measured, the proposal would require taxpayers that physically settle certain derivatives contracts to determine the amount of the loss subject to deferral under the straddle rules immediately before the physical settlement. The proposal would also repeal the current-law exception from the straddle rules for certain offsetting positions in stock. Finally, the proposal would clarify that a debt instrument issued by a taxpayer may itself be a leg in a straddle and would clarify the situations in which interest and carrying charges are considered properly allocable to a straddle and, therefore, must be capitalized. The proposal would be effective for certain losses incurred and certain straddles entered into on or after the date of first committee action.

Provide generalized rules for all stripping transactions.—Under current law, it may be possible to separate the right to receive income from the ownership of underlying income-producing property (other than debt). In many cases, the tax treatment of income-stripping transactions does not clearly reflect the parties' economic income from the transactions. As a result, it is possible for taxpayers to structure income-stripping transactions that exploit deficiencies of current law. The proposal would eliminate these planning opportunities by treating income-stripping transactions as loans. Under this approach, the owner of the property would be required to account for income from the property in the period in which it was earned. The proposal would be effective for income-stripping transactions entered into after the date of first committee action.

Require ordinary treatment for certain dealers of commodities and equity options.—Under current law, certain dealers of commodities and equity options treat the income from their day-to-day trading or dealing activities as giving rise to capital gain. Dealers of other property typically treat the income from their day-to-day dealing activities as giving rise to ordinary income. The proposal would require commodities and equity-option dealers to treat the income from their day-to-day activities as giving rise to ordinary income, not capital gain. The proposal would be effective for tax years beginning after the date of enactment.

Prohibit tax deferral on contributions of appreciated property to swap funds.—A swap fund is an investment partnership that is designed to allow taxpayers holding large blocks of appreciated stock to diversify their stock investments without recognizing gain and paying tax. Typically, a fund is established into which wealthy individuals transfer their stock. In exchange for the transferred stock, these individuals receive an interest in the fund. Under current law, these individuals do not have to recognize gain if more than 20 percent of the fund's assets are comprised of non-

marketable securities. The proposal would prohibit the deferral of gain where the fund is a passive investment vehicle. The proposal would be effective for transfers occurring on or after the date of enactment.

Corporate Provisions

Conform control test for tax-free incorporations, distributions, and reorganizations.—For tax-free incorporations, tax-free distributions, and reorganizations, "control" is defined as the ownership of 80 percent of the voting stock and 80 percent of the number of shares of all other classes of stock of the corporation. This test is easily manipulated by allocating voting power among the shares of a corporation, allowing corporations to retain control of a corporation but sell a significant amount of the value of the corporation. In contrast, the necessary "ownership" for tax-free liquidations, qualified stock purchases, and affiliation is at least 80 percent of the total voting power of the corporation's stock and at least 80 percent of the total value of the corporation's stock. The Administration proposes to conform the control requirement for tax-free incorporations, distributions, and reorganizations with that used for determining affiliation. This proposal is effective for transactions on or after the date of enactment.

Treat receipt of tracking stock in certain distributions and exchanges as the receipt of property.—"Tracking stock" is an economic interest that is intended to relate to and track the economic performance of one or more separate assets of the issuer, and gives its holder a right to share in the earnings or value of less than all of the corporate issuer's earnings or assets. Tracking stock issued by a corporation represents an economic interest different than non-tracking stock of the issuer. Under the proposal, the receipt of tracking stock in a distribution made by a corporation with respect to its stock and tracking stock received in exchange for other stock in the issuing corporation would be treated as the receipt of property by the shareholders. Under this proposal, the Secretary of Treasury would have authority to treat tracking stock as nonstock (debt, a notional principal contract, etc.) or as stock of another entity as appropriate to prevent avoidance. No inference is intended regarding the tax treatment of tracking stock under current law. This proposal is effective for tracking stock issued on or after the date of enactment.

Require consistent treatment and provide basis allocation rules for transfers of intangibles in certain nonrecognition transactions.—No gain or loss will be recognized if one or more persons transfer property to a controlled corporation (or partnership) solely in exchange for stock in the corporation (or a partnership interest). Where there is a transfer of less than "all substantial rights" to use property, the Internal Revenue Service's position is that such transfer will not qualify as a tax-free exchange. However, the Claims Court rejected the Service's position in *E.I. Du Pont de Nemours and Co. v. U.S.,* holding that any transfer of something of value could be a "transfer" of "property." The inconsistency between the positions has resulted in whipsaw of the government. The Administration proposes to provide that a transfer of an interest in intangible property constituting less than all of the substantial rights of the transferor will not fail to qualify for tax-free treatment solely because the transferor does not transfer all rights, title and interest in an intangible asset, and the transferor must allocate the basis of the intangible between the retained rights and the transferred rights based upon respective fair market values. Consistent reporting by the transferor and the transferee would be required. This proposal is effective for transfers after the date of enactment.

Modify tax treatment of certain reorganizations involving portfolio stock.—If a target corporation owns stock in the acquiring corporation and wants to combine with the acquiring corporation in a downstream reorganization, the target corporation transfers its assets to the acquiring corporation and the shareholders of the target corporation receive stock of the acquiring corporation in exchange for their target corporation stock. Alternatively, if the acquiring corporation owns stock in the target corporation, the target corporation can merge upstream, transfer its assets upstream, or merge sideways into a subsidiary of the acquiring corporation with the other shareholders of target receiving acquiring corporation stock. Under current law, all of these reorganizations qualify for tax-free treatment. Under the proposal, where a target corporation holds less than 20 percent of the stock of an acquiring corporation and the target corporation combines with the acquiring corporation in a reorganization in which the acquiring corporation is the survivor, the target corporation must recognize gain, but not loss, as if it distributed the acquiring corporation stock that it held immediately prior to the reorganization. Alternatively, where an acquiring corporation owns less than 20 percent of a target corporation and the target corporation combines with the acquiring corporation or a subsidiary of the acquiring corporation, the acquiring corporation must recognize gain, but not loss, as if it had sold its target corporation stock immediately before the reorganization. Nonrecognition treatment would continue to apply to other assets transferred by the target corporation and to the target corporation shareholders. This proposal is effective for transactions on or after the date of enactment.

Modify definition of nonqualified preferred stock.—Subject to certain exceptions, in otherwise tax-free transactions, the receipt of nonqualified preferred stock is treated as money or other property and, thus, gain may be recognized. Under current law, nonqualified preferred stock is defined as stock which is "limited and preferred as to dividends and does not participate in corporate growth to any significant extent." Taxpayers may be taking positions that are in-

consistent with the policy of the nonqualified preferred stock provisions (i.e., nonrecognition treatment is inappropriate where taxpayers receive relatively secure instruments in exchange for relatively risky instruments), by including illusory participation rights or including terms that taxpayers argue create an "unlimited" dividend. The proposal would clarify the definition of preferred stock to eliminate taxpayer arguments that stock issued is nominally participating or unlimited as to dividends. The proposal would apply to transactions that occur after the date of first committee action.

Modify estimated tax provision for deemed asset sales—Taxpayers can make an election to treat certain sales of stock as sales of assets. This election may be made up to 8 1/2 months after the stock sale. Taxpayers may be taking the position that they do not have to pay any estimated taxes until after the 8 1/2 month period has expired and rely on current law as providing that there will be no penalty for nonpayment. The proposal would clarify the estimated tax provisions to require that estimated taxes be paid based upon gain from either the stock sale or the deemed asset sale. The proposal would apply to transactions that occur after the date of first committee action.

Modify treatment of transfers to creditors in divisive reorganizations.—In order to separate businesses in a tax-free spin-off, a corporation (distributing) will not recognize gain or loss on the contribution of property to a controlled corporation solely in exchange for stock or securities of the controlled corporation. Under current law, if the distributing corporation also receives other property or money, it will not recognize gain as long as it distributes the property or money to its creditors in connection with the reorganization. The amount of property or money that may be distributed to creditors without gain to the distributing corporation is unlimited. Thus, taxpayers may avoid gain that otherwise would be recognized if liabilities are assumed by the controlled corporation that exceed the basis of assets contributed. The proposal would limit the amount of property or money that the distributing corporation can distribute to creditors without gain to the amount of basis of the assets contributed to the controlled corporation in the reorganization. In addition, the proposal would provide that acquisitive reorganizations would no longer be subject to gain recognition where liabilities are assumed in excess of the basis of assets transferred. The proposal would be effective for transactions on or after the date of enactment.

Passthroughs

Provide mandatory basis adjustments for partners that have a significant net built-in loss in partnership property.—Currently, a partner's share of basis in partnership property is adjusted in the case of a distribution of partnership property or a sale of a partnership interest only if the partnership has a special election in effect. The electivity of these provisions has created numerous opportunities for abuse by taxpayers. Accordingly, the Administration proposes that the basis adjustment rules would be made mandatory with respect to any partner (treating related persons as one person), whose share of net built-in loss in partnership property is equal to the greater of $250,000 or ten percent of the partner's total share of partnership assets (measured by reference to fair market value). In calculating the ten-percent threshold, property acquired by the partnership with a principal purpose of allowing a partner or partners to avoid the limitation would be disregarded. The proposal would be effective for distributions and transfers of partnership interest after the date of enactment.

Modify treatment of closely held REITs.—When originally enacted, the real estate investment trust (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 is 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 50 percent or more of the total combined voting power of all classes of voting stock or 50 percent or more of the total value of all shares of all classes of stock. For purposes of determining a person's stock ownership, rules similar to current-law rules would apply and stapled entities would be treated as one person. The proposal would be effective for entities electing REIT status for taxable years beginning on or after the date of first committee action.

Apply regulated investment company (RIC) excise tax to undistributed profits of REITs.—As a result of legislation passed in 1999, a REIT, like a RIC, is only required to distribute 90 percent of its REIT taxable income in order to maintain REIT status. A RIC is subject to a four-percent excise tax on the excess of the required distribution for a calendar year over the distributed amount for such calendar year.

The required distribution is equal to the sum of 98 percent of the RIC's ordinary income for the calendar year and 98 percent of the RIC's capital gain net income for the one-year period ending on October 31 of such calendar year. REITs are subject to a similar rule, except that the required distribution is equal to the sum of 85 percent of the REIT's ordinary income for the calendar year and 95 percent of the REIT's capital gain net income for such calendar year. In order to conform the treatment of REITs and RICs, the Administration proposes to modify the definition of required distribution for REITs, requiring a distribution of 98 percent of ordinary and capital gain income in order to avoid the four-percent excise tax. The proposal would be effective for calendar years beginning after December 31, 2000.

Allow RICs a dividends paid deduction for redemptions only in cases where the redemption represents a contraction in the RIC.—Under current law, a RIC is allowed a dividends paid deduction for dividends paid to shareholders. If a RIC redeems a shareholder's stock, the RIC can generally treat a portion of the redemption payment as a dividend for purpose of computing the dividends paid deduction. In situations where the redemption represents a contraction in the size of the RIC, this treatment ensures that the remaining shareholders of the RIC are taxed on no more than their pro rata share of the RIC's income. In situations where the redemption is accompanied by near simultaneous investments in the RIC by other investors, the RIC is in essentially the same position it would be in had the redeeming shareholder sold its shares in the RIC directly to the new investors. In this case, it is inappropriate to give the RIC a dividends paid deduction for the redemption. The proposal, therefore, allows a RIC to claim a dividends paid deduction with respect to a redemption only if the redemption represents a net contraction in the size of the RIC. The proposal would be effective for taxable years beginning after the date of enactment.

Require Real Estate Mortgage Investment Conduits (REMICs) to be secondarily liable for the tax liability of REMIC residual interest holders.—A REMIC is a statutory pass-through vehicle designed to facilitate the securitization of mortgages. A REMIC holds mortgages and issues one or more classes of debt instruments, called REMIC regular interests, that are entitled to the cash flows from the underlying mortgages. A REMIC also issues a REMIC residual interest. The holder of the REMIC residual interest must include in income the taxable income of the REMIC. In many cases, when it is issued the REMIC residual interest has a negative value because the reasonably anticipated net tax liability associated with holding the residual is greater than the value of the cash flows on the residual. Many holders of REMIC residual interests do not pay their tax liabilities when due. To ensure that the tax on REMIC residuals is paid when due, the proposal would require a REMIC to be secondarily liable for the tax liability of its residual interest. Under the proposal, if the tax on the residual was not paid when due, the REMIC would be required to pay the tax. Similar rules would apply with respect to Financial Asset Securitization Investment Trusts (FASITs). The proposal would be effective for REMICs and FASITs created after the date of enactment.

Tax Accounting

Deny change in method treatment to tax-free formations.—Generally, a taxpayer that desires to change its method of accounting must obtain the consent of the IRS Commissioner. In addition, in certain reorganization transactions a corporation acquiring assets generally is required to use the method of accounting used for those assets by the distributor or transferor corporation. Under current law, this carryover rule does not apply to tax-free contributions to a corporation or to a partnership. Consequently, taxpayers who transfer assets to a subsidiary or a partnership in such transactions may avail themselves of a new method of accounting without obtaining the consent of the IRS Commissioner. The Administration proposes to expand the transactions to which the carryover of method of accounting rules and the regulations thereunder apply to include tax-free contributions to corporations or partnerships, effective for transfers on or after the date of enactment.

Deny deduction for punitive damages.—The current deductibility of most punitive damage payments undermines the role of such damages in discouraging and penalizing certain undesirable actions or activities. The Administration proposes to disallow any deduction for punitive damages paid or incurred by the taxpayer, whether upon a judgment or in settlement of a claim. Where the liability for punitive damages is covered by insurance, such damages paid or incurred by the insurer would be included in the gross income of the insured person. The insurer would be required to report such payments to the insured person and to the IRS. The proposal would apply to damages paid or incurred on or after the date of enactment.

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 or 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 similar 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.

Disallow interest on debt allocable to tax-exempt obligations.—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.

Require capitalization of mutual fund commissions.—An expenditure that results in significant future benefits generally must be capitalized in order to match the expenditure with the revenues of the taxable period to which it is properly attributable. Under current securities law, a distributor of mutual fund shares may be compensated by the fund over a period of years or by the investors on redemption with respect to "Class B" shares it distributes. However, the distributor typically will pay an up-front commission to a broker to sell Class B shares to an investor. In order to more accurately match the income and expenses of mutual fund distributors, the Administration proposes that commissions paid to a broker by a distributor would be capitalized and recovered over six years (the period investors would have to hold shares without incurring a fee on redemption). The proposal would be effective for commissions paid or incurred in taxable years ending after the date of enactment. No inference is intended with respect to the treatment of distributor's commissions under current law.

Cost Recovery

Provide consistent amortization periods for intangibles.—Under current law, start-up and organizational expenditures are amortized at the election of the taxpayer over a period of not less than five years. Current law requires certain acquired intangible assets (goodwill, trademarks, franchises, patents, etc.) to be amortized over 15 years. The Administration believes that, to encourage the formation of new businesses, a fixed amount of start-up and organizational expenditures should be currently deductible. Thus, the proposal would allow a taxpayer to elect to deduct up to $5,000 each of start-up or organizational expenditures. However, for each taxpayer, the $5,000 amount is reduced (but not below zero) by the amount by which the cumulative cost of start-up or organizational expenditures exceeds $50,000. Start-up and organizational expenditures not currently deductible would be amortized over a 15-year period consistent with the amortization period for acquired intangible assets. The proposal generally would be effective for start-up and organizational expenditures incurred in taxable years beginning on or after the date of enactment.

Clarify recovery period of utility grading costs.—A taxpayer is allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property that is used in a trade or business or held for the production of income. For most tangible property placed in service after 1986, the amount of the depreciation deduction is determined under the modified accelerated cost recovery system (MACRS) using a statutorily prescribed depreciation method, recovery period, and placed in service convention. The recovery period may be determined by reference to the statutory recovery period or to the list of class lives provided by the Treasury Department. Electric and gas utility clearing and grading costs incurred to extend distribution lines and pipelines have not been assigned a class life. By default, such assets have a seven-year recovery period under MACRS. The Administration believes that applying the default rule to electric and gas utility clearing and grading costs is inappropriate. For example, the electric utility transmission and distribution lines and the gas utility trunk pipelines benefitted by the clearing and grading costs have MACRS recovery periods of 20 years and 15 years, respectively. The proposal would assign depreciable electric and gas utility clearing and grading costs incurred to locate transmission and distribution lines and pipelines to the class life assigned to the benefitted assets, giving these costs a recovery period of 20 years and 15 years, respectively. The proposal would be effective for electric and gas utility clearing and grading costs incurred on or after the date of enactment.

Apply rules generally applicable to acquisitions of intangible assets to acquisitions of professional sports franchises.—In general, the purchase price allocated to most intangible assets (including franchise rights) acquired in connection with the acquisition of a trade or business must be capitalized and amortized over a 15-year period. These rules were enacted in 1993 to minimize disputes regarding the proper treatment

of acquired intangible assets. Special rules apply to intangible assets acquired in connection with a professional sports franchise. The 15-year amortization rules do not apply and special allocation rules apply to the purchase price. In order to provide consistent treatment among different trades or businesses and to minimize disputes regarding intangible assets acquired in connection with a professional sports franchise, the Administration proposes to repeal the special rules applicable to professional sports franchise acquisitions and apply the rules generally applicable to most intangible assets. The proposal would be effective for acquisitions after the date of enactment.

Insurance

Require recapture of policyholder surplus accounts.—Between 1959 and 1984, stock life insurance companies deferred tax on a portion of their profits. These untaxed profits were added to a policyholders surplus account (PSA). In 1984, Congress precluded life insurance companies from continuing to defer tax on future profits through PSAs. However, companies were permitted to continue to defer tax on their existing PSAs, and to pay tax on the previously untaxed profits in the PSAs only in certain circumstances. There is no remaining justification for allowing these companies to continue to defer tax on profits they earned between 1959 and 1984. Most pre-1984 policies have terminated, because pre-1984 policyholders have surrendered their pre-1984 contracts for cash, ceased paying premiums on those contracts, or died. The Administration proposes that companies generally would be required to include in their gross income over five years their PSA balances as of the beginning of the first taxable year starting after the date of enactment.

Modify rules for capitalizing policy acquisition costs of life insurance companies.—Under current law, insurance companies capitalize varying percentages of their net premiums for certain types of insurance contracts, and generally amortize these amounts over 10 years (5 years for small companies). These capitalized amounts are intended to serve as proxies for each company's commissions and other policy acquisition expenses. However, data reported by insurance companies to State insurance regulators each year indicate that the insurance industry is capitalizing substantially less than its actual policy acquisition costs, which results in a mismatch of income and deductions. The Administration proposes that insurance companies be required to capitalize modified percentages of their net premiums for certain lines of business. This change would be treated as a change in the insurance company's method of accounting. The modified percentages would more accurately reflect the ratio of actual policy acquisition expenses to premiums and the typical useful lives of the contracts. To ensure that companies never are required to capitalize more under this proxy approach than they would capitalize under normal tax accounting rules, companies that have low policy acquisition costs generally would be permitted to capitalize their actual policy acquisition costs.

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, banks and brokerage firms, 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 25 percent.

Modify rules that apply to sales of life insurance contracts.—The sale of a life insurance contract insuring a person who is neither terminally nor chronically ill results in taxable income to the seller equal to the difference between the sales price and the seller's basis in the contract. Buyers generally are not required to report information to the IRS on these transactions. The buyer, who receives the death benefit when the insured dies, generally is liable for tax on his profit from the transaction under the "transfer for value" rules. However, the life insurance company generally is not required to report the death benefit payment. Moreover, the rule that the buyer's profits are taxable can be circumvented. The proposal would modify the transfer for value rules so they could no longer be circumvented. The proposal also would modify the reporting rules to require the buyer of a life insurance contract with a large death benefit to report information on the sale to the IRS, to the issuer of the life insurance contract, and to the seller of the life insurance contract. In addition, the proposal would modify the reporting rules to require that payment of death benefits under such previously-sold contracts be reported to the IRS and to the payee. The proposal would be effective for sales of life insurance contracts and payments of death benefits after the date of enactment.

Modify rules that apply to tax-exempt property casualty insurance companies.—Under current law, an insurance company with up to $350,000 of premium income is tax-exempt, regardless of the amount of investment income it has. Another provision allows cer-

tain small insurance companies to elect to be taxed only on their net investment income. Premiums of companies in the same controlled group are combined for purposes of determining whether an entity is eligible for tax exemption. An excise tax is imposed on premiums paid to foreign companies with respect to policies insuring U.S. risks. Current law allows foreign insurance companies to elect to be taxed as domestic companies if they meet certain requirements. These rules have been used by U.S. persons to shift assets into tax-free or tax-preferred affiliated insurance companies, which often are located in tax havens and issue "insurance" that is generated directly or indirectly by the U.S. person. The proposal would modify current law, beginning the first taxable year after date of enactment, so that all items of gross income of all affiliated companies would be aggregated in determining whether an insurance company qualifies for tax-exempt status. Also, tax-exempt status would not be available to foreign insurance companies beginning the first taxable year after the date of enactment. Conforming amendments would be made to the current-law election to be taxed on investment income. The proposal also would modify current law so that the election to be taxed as a U.S. corporation would not be available to a foreign company formed after the date of first Committee action, and would not be available beginning in the second year after the date of enactment for any other foreign company that would otherwise qualify for a tax exemption under current law.

Exempt Organizations

Subject investment income of trade associations to tax.—Trade associations described in section 501(c)(6) are generally exempt from Federal income tax, but are subject to tax on their unrelated business income. To eliminate the current-law bias in favor of trade association members' making and deducting advance payments to fund future collective activities of the trade association, the proposal would subject trade associations to unrelated business income tax on their net investment income in excess of $10,000 for any taxable year. As under current-law rules for certain other tax-exempt organizations, investment income would not be subject to tax under the proposal to the extent that it is set aside for a specified charitable purpose. In addition, any gain from the sale of property used directly in the performance of the trade association's exempt function would not be subject to tax under the proposal to the extent that the sale proceeds are used to purchase replacement exempt-function property. The proposal would be effective for taxable years beginning after December 31, 2000.

Impose penalty for failure to file an annual information return.—To encourage voluntary compliance and assist the IRS in its enforcement efforts, the proposal would impose a penalty on split-interest trusts (such as charitable remainder trusts, charitable lead trusts, and pooled income funds) that fail to file an annual information return on Form 5227. Form 5227 contains information regarding the trust's financial activities and whether the trust is subject to certain excise taxes. Under the proposal, any failure to file Form 5227 would be subject to a penalty of $20 per day (up to a maximum of $10,000 per return) or, in the case of any trust with income in excess of $250,000, $100 per day (up to a maximum of $50,000 per return). In addition, any trustee who knowingly fails to file Form 5227, unless such failure is not willful and is due to reasonable cause, would be jointly and severally liable for the amount of the penalty. The proposal would be effective for any return the due date for which is after the date of enactment.

Estate and Gift

Restore phaseout of unified credit for large estates.—Prior to TRA97, the benefit of both the estate tax graduated rate brackets below fifty-five percent and the unified credit were phased out by imposing a five-percent surtax on estates with a value above $10 million. When TRA97 increased the unified credit amount, the phase out of the unified credit was inadvertently omitted. The Administration proposes to restore the surtax in order to phase out the benefits of the unified credit as well as the graduated estate tax brackets. The proposal would be effective for decedents dying after the date of enactment.

Require consistent valuation for estate and income tax purposes.—The basis of property acquired from a decedent generally is its fair market value on the date of death. Property included in the gross estate of a decedent is valued also at its fair market value on the date of death. Recipients of lifetime gifts generally take a carryover basis in the property received. The Administration proposes to impose a duty of consistency on heirs receiving property from a decedent, requiring such heirs to use the value as reported on the estate tax return as the basis for the property for income tax purposes. Estates would be required to notify heirs (and the IRS) of such values. In addition, donors making lifetime gifts would be required to notify the recipients of such gifts (and the IRS) of the donor's basis in the property at the time of the gift, as well as any gift tax paid with respect to the gift. This proposal would be effective for gifts made after, and decedents dying after, the date of enactment.

Require basis allocation for part sale, part gift transactions.—In a part gift, part sale transaction, the donee/purchaser takes a basis equal to the greater of the amount paid by the donee or the donor's adjusted basis at the time of the transfer. The donor/seller uses adjusted cost basis in computing the gain or loss on the sale portion of the transaction. The Administration proposes to rationalize basis allocation in a part gift, part sale transaction by requiring the basis of the property to be allocated ratably between the gift portion and the sale portion based on the fair market value

of the property on the date of transfer and the consideration paid. This proposal would be effective for transactions entered into on or after the date of enactment.

Conform treatment of surviving spouses in community property States.—If joint property is owned by spouses in a non-community property state, a surviving spouse receives a stepped-up basis only in the half of the property owned by the deceased spouse. In contrast, when a spouse dies owning community property, the surviving spouse is entitled to a stepped-up basis not only in the half of the property owned by the deceased spouse, but also in the half of the property already owned by the surviving spouse prior to the decedent's death. The Administration proposes to eliminate the stepped-up basis in the part of the community property owned by the surviving spouse prior to the deceased spouse's death. The half of the community property owned by the deceased spouse would continue to be entitled to a stepped-up basis upon death. This treatment will be consistent with the treatment of joint property owned by spouses in a non-community property State. This proposal would be effective for decedents dying 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.

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 non-business assets. The proposal would be effective for gifts made after, and decedents dying after, the date of enactment.

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 trust 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.

Modify requirements for annual exclusion for gifts.—Currently, annual gifts of present interests of up to $10,000 (in 2000) per donor per donee 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. Two recent cases expanded on the *Crummey* rule by holding that the annual exclusion is available, even where the person holding the withdrawal power is not a primary beneficiary of the trust. The Administration proposes to modify the annual exclusion rule as it applies to gifts and trusts so that a transfer to a trust would qualify only if: (1) during the life of the individual who is the beneficiary of the trust, no portion of the corpus or income of the trust may be distributed to or for the benefit of any person other than the beneficiary, and (2) the trust does not terminate before the beneficiary dies, the assets of the trust will be includible in the gross estate of the beneficiary. A withdrawal right would not be sufficient to create a present interest. This proposal would be effective for gifts completed after December 31, 2000. A grandfather rule would allow continued use of Crummey powers in existing irrevocable trusts, but only to the extent that the Crummey powers are held by primary noncontingent beneficiaries.

Pensions

Increase elective withholding rate for nonperiodic distributions from deferred compensation plans. —The Administration proposes increasing the current 10-percent elective withholding rate for nonperiodic distributions (such as certain lump sums) from pensions, IRAs and annuities to 15 percent, which more closely approximates the taxpayer's income tax liability for the distribution effective for distributions after 2001. The withholding would not apply to eligible rollover distributions.

Increase excise tax for excess IRA contributions.—Excess IRA contributions are currently subject to an annual 6-percent tax rate. With high investment returns, this annual 6-percent rate may be insufficient to discourage contributions in excess of the current limits for IRAs. The Administration proposes increasing from 6 percent to 10 percent the excise tax on excess contributions to IRAs for taxable years after the year the excess contribution is made. Thus, the 6-percent rate would continue to apply for the year of the excess contribution and the higher annual rate would only

apply if the excess amounts are not withdrawn from the IRA. This increase would be effective for taxable years beginning after 2000.

Limit pre-funding of welfare benefits for 10 or more employer plans.—Current law generally limits the ability of employers to claim a deduction for amounts used to prefund welfare benefits. An exception is provided for certain arrangements where 10 or more employers participate because it is believed that such relationships involve risk-sharing similar to insurance which will effectively eliminate any incentive for participating employers to prefund benefits . However, as a practical matter, it has proven difficult to enforce the risk-sharing requirements in the context of certain arrangements. The Administration proposes limiting the 10 or more employer plan funding exception to medical, disability, and group-term life insurance benefits because these benefits do not present the same risk of prefunding abuse. Thus, effective for contributions paid after the date of first committee action, the existing deduction rules of the Internal Revenue Code would apply to prevent an employer who contributes to a 10 or more employer plan from claiming a current deduction for supplemental unemployment benefits, severance pay or life insurance (other than group-term life insurance) benefits to be paid in future years.

Subject signing bonuses to employment taxes.—Bonuses paid to individuals for signing a first contract of employment are ordinary income in the year received. The Administration proposes to clarify that these amounts are treated as wages for purposes of income tax withholding and FICA taxes effective after date of enactment. No inference is intended with respect to the application of prior law withholding rules to signing bonuses.

Clarify employment tax treatment of choreworkers.—Choreworkers, individuals paid by State agencies to provide domestic services for disabled and elderly individuals, often provide services for more than one disabled or elderly individual. The Administration's proposal would clarify that State agencies, and not the disabled or elderly individual receiving the services, are responsible for withholding and employment taxes for choreworkers effective for wages paid after 2000. For this purpose, all wages paid by the State agency to a choreworker are treated as paid by a single employer.

Prohibit IRAs from investing in foreign sales corporations.—Foreign sales corporations (FSCs) are foreign corporations whose income is partially subject to US tax. IRAs were never intended to be able to invest in FSCs. The proposal would prohibit an IRA from investing in a FSC effective after the date of first committee action.

Compliance

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.

Require withholding on certain gambling winnings.—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.

Require information reporting for private separate accounts.—Direct investments generally result in taxable income each year of dividends and interest, plus taxable gain or loss for changes in the value of the securities in the year that such securities are sold. In contrast, investments held through insurance contracts—called separate accounts—generally give rise to tax-free or tax-deferred income unless the policyholder has too much control over the contract's investments. Insurance companies sometimes create private separate accounts through which only one or a small group of policyholders may invest their funds. These policyholders generally exercise investor control, and thus are liable for income tax each year on the investment income earned. However, the IRS has no efficient way to identify which insurance contracts' funds are invested through private separate accounts. The Administration proposal would require insurance companies to report each insurance contract with funds invested through private separate accounts, and the policyholder taxpayer identification number and earnings for such contract. The proposal would be 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 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.

Miscellaneous

Modify deposit requirement for Federal Unemployment Act (FUTA).—Beginning in 2005, 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.

Reinstate Oil Spill Liability Trust Fund 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 September 30, 2001 and before October 1, 2010. 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.

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.

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 40-percent excise tax on the difference between the amount paid by the purchaser to the injured person and the undiscounted value of the purchased payment stream 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 on or 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.

Require taxpayers to include rental income of residence in income without regard to the period of rental.—Under current law, rental income is generally includable in income and the deductibility of expenses attributable to the rental property is subject to certain limitations. An exception to this general treatment applies if a dwelling is used by the taxpayer as a residence and is rented for less than 15 days during the taxable year. The income from such a rental is not included in gross income and no expenses arising from the rental are deductible. The Administration proposes to repeal this 15-day exception. The proposal would apply to taxable years beginning after December 31, 2000.

Eliminate installment payment of heavy vehicle use tax.—An annual tax is imposed on the use of heavy (at least 55,000 pounds) highway vehicles. The tax year is July 1 through June 30 and the tax return is generally due on August 31 of the year to which it relates. A taxpayer may, however, elect to pay the tax in installments. The installment option generally permits payment of one quarter of the tax on each of the following dates: August 31, December 31, March 31, and

June 30. States are required to obtain evidence, before issuing tags for a vehicle, that the use tax return has been filed and any tax due with the return (generally only the first installment) has been paid. To foster compliance, the Administration proposes to eliminate the installment option for taxable years beginning after June 30, 2002. Thus, heavy vehicle owners would be required to pay the entire tax with their returns and would be unable to obtain State tags without providing proof of full payment.

Require recognition of gain on sale of principal residence if acquired in a tax-free exchange within five years of sale.—Gain of up to $250,000 ($500,000 in the case of a joint return) from the sale or exchange of property is excluded from income if, during the five-year period ending on the date of the sale or exchange, the property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating two years or more. No gain or loss is recognized if property held for use in a trade or business or for investment is exchanged solely for other like-kind property held for use in a trade or business or for investment. The current-law exclusion for principal residences, in combination with the tax-free like-kind exchange provision, allows planning opportunities for taxpayers who wish to liquidate real property held for use in a trade or business or for investment. Such planning opportunities are beyond the intended scope of the principal residence exclusion. The Administration proposes to require recognition of gain on the sale of property that has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating two years or more if the property was acquired in a tax-free like-kind exchange within five years of the sale. The proposal would be effective for sales after the date of enactment.

International

Identified Tax Havens

The Administration is concerned about the use of tax havens. Tax havens facilitate tax avoidance and evasion and many of them, through strict confidentiality rules, substandard regulatory regimes, and uncooperative information exchange practices, inhibit our law enforcement capabilities. The Administration proposes several remedies to reduce the attractiveness of, and increase access to information about activity in, certain tax havens identified by the Secretary of the Treasury ("Identified Tax Havens"). To identify tax havens that will be subject to these rules, the Secretary of the Treasury will use criteria including, but not limited to, whether a jurisdiction imposes no or nominal taxation, either generally or on specific classes of capital income, has strict confidentiality rules and practices, and has ineffective information exchange practices.

Require reporting of all payments to identified tax havens—The proposal would provide that all payments to entities, including corporations, partnerships and disregarded entities, branches, trusts, accounts or individuals resident or located in Identified Tax Havens must be reported on the taxpayer's annual return unless: (1) information regarding the payment would be available to the IRS upon request or otherwise, or (2) the payment is less than $10,000. Failure to report a covered payment would result in the imposition of a penalty equal to 20 percent of the amount of the payment. Special rules would apply to certain financial services businesses that would permit reporting certain payments on an aggregate basis. An anti-abuse rule would require aggregation of related payments for purposes of determining whether a payment is under $10,000. The proposal would be effective for payments made after the date of enactment.

Impose limitations on certain tax attributes and income flowing through Identified Tax Havens.—Current rules deny foreign tax credits for taxes paid to (1) countries whose governments the U.S. does not recognize, (2) countries with respect to which the U.S. has severed diplomatic relations, or (3) countries that the State Department cites as supporting international terrorism. In addition, the foreign tax credit limitation and other rules are applied separately to income attributable to such countries. The proposal would apply similar rules to Identified Tax Havens. In addition, the proposal would reduce by a factor (similar to the international boycott factor) a taxpayer's (1) otherwise allowable foreign tax credit or FSC benefit attributable to income from an Identified Tax Haven, and (2) the income, attributable to an Identified Tax Haven, that is otherwise eligible for deferral. This reduction of tax benefits would be based on a fraction the numerator of which is the sum of the taxpayer's income and gains from an Identified Tax Haven and the denominator of which is the taxpayer's total non-U.S. income and gains. The proposal would be effective for taxable years beginning after the date of enactment.

Mark-to-Market Proposals

Modify treatment of built-in losses and other attributes trafficking.—Under current law, a taxpayer that becomes subject to U.S. taxation may take the position that it determines its beginning bases in its assets under U.S. tax principles as if the taxpayer had historically been subject to U.S. tax. Other tax attributes are computed similarly. A taxpayer may thus "import" built-in losses or other favorable tax attributes incurred outside U.S. taxing jurisdiction to offset income or gain that would otherwise be subject to U.S. tax. To prevent this ability to import "built-in" losses or other favorable attributes, the proposal would eliminate tax attributes (including built-in items) and mark-to-market bases when an entity or an asset becomes relevant for U.S. tax purposes. The proposal would be effective for transactions in which assets or entities become relevant for U.S. tax purposes on or after the date of enactment.

Simplify taxation of property that no longer produces income effectively connected with a U.S. trade or business.—Under current law, a foreign person is subject to tax in the United States on net income that is effectively connected with a U.S. trade or business ("ECI"). If a foreign person transfers property from a U.S. trade or business to its foreign office, the United States retains the right to tax all of the gain realized from a subsequent disposition of the property if the disposition occurs within ten years of the time the property ceased to be used in the U.S. trade or business. The United States also retains, for ten years, the right to tax deferred income from an asset attributable to a U.S. trade or business. These rules are difficult to administer and may in some cases result in the United States taxing gain that economically accrued after the property was removed from U.S. taxing jurisdiction. The proposal would mark to market property (including rights to deferred income) at the time that the property ceases to be used in, or attributable to, a U.S. trade or business. The proposal would be effective for property that ceases to be used in, or attributable to, a U.S. trade or business after the date of enactment.

Prevent avoidance of tax on U.S.-accrued gains (expatriation).—-Under current rules, persons renouncing U.S. citizenship for tax-avoidance purposes are subject to U.S. taxation for ten years after renunciation. Although these rules were modified in 1996, they are still easily avoided and impose significant administrative burdens on both taxpayers and the Government. The proposal would simplify and toughen the taxation of expatriates by repealing the current regime and imposing a one-time tax on accrued gains at the time of expatriation. Also, if an expatriate subsequently makes a gift or bequest to a U.S. person, the proposal would treat the gift as gross income to the U.S. recipient, taxable at the highest marginal rate applicable to gifts and bequests. In addition, the proposal would amend a 1996 law (the "Reed Amendment"), which requires the Attorney General to deny re-entry to a tax-motivated expatriate, to coordinate it with the tax proposal, and improve the enforceability of both the tax proposal and the Reed Amendment. The proposal would apply for individuals expatriating on or after the date of first committee action.

Other International Provisions

Expand ECI rules to include certain foreign source income.—-Under current rules, only certain enumerated types of foreign source income of a nonresident (rents, royalties, interest, dividends and sales of inventory property) can be treated as effectively connected with a U.S. trade or business ("ECI") and thus subject to net basis taxation. Economic equivalents of such enumerated types of foreign source income, such as interest equivalents (including letter of credit fees) and dividend equivalents, cannot constitute ECI under any circumstances. Moreover, some excluded foreign source income can in large part be attributable to business activities that take place in the United States. For example, a foreign satellite corporation with an office, satellite ground station or other fixed place of business in the United States may earn income with respect to the leasing of a satellite. Under current rules, such foreign source income would not be subject to U.S. tax as ECI even if it is attributable to the foreign corporation's U.S. office. The proposal would expand the categories of foreign source income that could constitute ECI to include interest equivalents and dividend equivalents and to include other income that is attributable to an office or other fixed place of business in the U.S. The proposal would be effective for taxable years beginning after date of enactment.

Limit basis step-up for imported pensions.—Under current law, a nonresident alien individual who anticipates receiving a distribution from a foreign pension plan may, under certain circumstances, establish U.S. residency, receive the distribution, claim a high basis in the plan distribution, and pay little or no U.S. tax on the distribution. Moreover, as a result of certain existing U.S. tax treaties, the individual may pay no foreign tax on the distribution. The proposal would prevent individuals from utilizing internal law and U.S. tax treaties to produce double non-taxation on foreign pension plan distributions. The proposal would modify the Internal Revenue Code to give an individual basis in a foreign pension plan distribution only to the extent the individual previously has been subject to tax (either in the United States or the foreign jurisdiction) on the amounts being distributed. The proposal would be effective for distributions occurring on or after the date of enactment.

Replace sales-source rules.—If inventory is manufactured in the United States and sold abroad, Treasury regulations provide that 50 percent of the income from such sales is treated as earned in production activities and 50 percent in sales activities. The income from the production activities is sourced on the basis of the location of assets held or used to produce the income. The income from the sales activities (the remaining 50 percent) is sourced based on where title to the inventory transfers. If inventory is purchased in the United States and sold abroad, 100 percent of the sales income generally is deemed to be foreign source. These rules generally produce more foreign source income for United States tax purposes than is subject to foreign tax. This generally increases the U.S. exporters' foreign tax credit limitation and allows U.S. exporters that operate in high-tax foreign countries to credit against their U.S. tax liability foreign income taxes levied in excess of the U.S. income tax rate. The proposal would require that the allocation between production and sales 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. tax treaty obligations that allow a credit for taxes paid or accrued on certain oil or gas income.

Recapture overall foreign losses when controlled foreign corporation (CFC) stock is disposed.—Under the interest allocation rules of section 864(e), the value of stock in a CFC is added to the value of directly-owned foreign assets, and then compared to the value of domestic assets of a corporation (or a group of affiliated U.S. corporations) for purposes of determining how much of the corporation's interest deductions should be allocated against foreign income and how much against domestic income. If these deductions against foreign income result in (or increase) an overall foreign loss which is then applied against U.S. income, section 904(f) recapture rules require subsequent foreign income or gain to be recharacterized as domestic. Recapture can take place when a taxpayer disposes of directly-owned foreign assets, for example. However, there may be no recapture when a shareholder disposes of stock in a CFC. The proposal would correct that asymmetry by providing that property subject to the recapture rules upon disposition under section 904(f)(3) would include stock in a CFC. The proposal would be effective on or after 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 nonresident'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.

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, 1999 and before January 1, 2011.

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, 2010. These taxes expired on December 31, 1995.

Convert a portion of the excise taxes deposited in the Airport and Airway Trust Fund to cost-based user fees assessed for Federal Aviation Administration (FAA) services.—The excise taxes that are levied on domestic air passenger tickets and flight segments, international departures and arrivals, and domestic air cargo are proposed to be reduced over time as more efficient, cost-based user fees for air traffic services are phased in beginning in fiscal year 2001. The Administration proposes to phase in implementation of the new fees over two years and raise sufficient revenue (excise taxes plus new fees) to support expected FAA operational and capital needs in the subsequent year.

Increase excise tax on tobacco products and levy a youth smoking assessment on tobacco manufacturers. —Under current law, the 34-cents-per-pack excise tax on cigarettes is scheduled to increase by 5-cents-per-pack effective January 1, 2002. The Adminis-

tration proposes to accelerate the scheduled 5-cents-per-pack increase in the excise tax on cigarettes and to increase the tax by an additional 25-cents-per-pack effective October 1, 2000. Tax rates on other taxable tobacco products will increase proportionately. In addition, beginning after 2003, the Administration proposes to levy an assessment on tobacco manufacturers if the youth smoking rate is not reduced by 50 percent.

Recover State bank supervision and regulation expenses (receipt effect).—The Administration proposes to require the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve to recover their respective costs for supervision and regulation of State-chartered 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 recoveries.

Maintain Federal Reserve surplus transfer to the Treasury.—In FY 2000, the Federal Reserve System transferred $3.752 billion from its capital account surplus funds to the Treasury. The Administration proposes in FY 2001 that the Federal Reserve System maintain the capital account surplus fund at the post-transfer level.

Restore premiums for the United Mine Workers of America Combined Benefit Fund.—The Administration proposes legislation to restore the previous calculation of premiums charged to coal companies that employed the retired miners that have been assigned to them. By reversing the court decision of *National Coal v. Chater*, this legislation will restore a premium calculation that supports medical cost containment.

Extend abandoned mine reclamation fees.—The abandoned mine reclamation fees, which are scheduled to expire on September 30, 2004, are proposed to be extended through September 30, 2014. These fees, which are levied on coal operators, generally are the lesser of 15 cents per ton for coal produced by underground mining and 35 cents per ton for coal produced by surface mining, or 10 percent of the value of the coal at the mine. Amounts collected will be used to continue abandoned coal mine reclamation. The coal mining states and Indian Tribes have identified over $4.2 billion in remaining restoration needs. Each year, states, Indian Tribes and Federal agencies identify additional needs.

Replace Harbor Maintenance Tax with the Harbor Services User Fee (receipt effect).—The Administration proposes to replace the ad valorem Harbor Maintenance Tax with a cost-based user fee, the Harbor Services User Fee. The user fee will finance construction and operation and maintenance of harbor activities performed by the Army Corps of Engineers, the costs of operating and maintaining the Saint Lawrence Seaway, and the costs of administering the fee. Through appropriation acts, the fee will raise an average of $980 million annually through FY 2005, which is less than would have been raised by the Harbor Maintenance Tax before the Supreme Court decision that the ad valorem tax on exports was unconstitutional.

Revise Army Corps of Engineers regulatory program fees.—The Army Corps of Engineers has not changed the fee structure of its regulatory program since 1977. The Administration proposes to pursue reasonable changes that would reduce the fees paid from many applicants and increase recovery from commercial applicants.

Roll back Federal employee retirement contributions.—The Administration proposes to roll back to pre-1999 levels the higher retirement contributions required of Federal employees by the Balanced Budget Act of 1997. The rollback is proposed to take effect in January 2001.

Provide government-wide buyout authority (receipt effect).—The Administration proposes to provide government-wide buyout authority, which will lower employee contributions to the civil service retirement fund.

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS

(In millions of dollars)

	Estimate						
	2000	2001	2002	2003	2004	2005	2001–2005
Provide tax relief:							
Expand educational opportunities:							
Provide College Opportunity tax cut	.....	–395	–2,009	–2,323	–3,103	–3,262	–11,092
Provide incentives for public school construction and modernization	.....	–36	–174	–419	–739	–1,020	–2,388
Expand exclusion for employer-provided educational assistance to include graduate education	–66	–275	–90	.....	.....	.....	–365
Eliminate 60-month limit on student loan interest deduction	.....	–23	–80	–87	–89	–93	–372
Eliminate tax when forgiving student loans subject to income contingent repayment	.....	.....	.....	.....	.....	.....	.....
Provide tax relief for participants in certain Federal education programs	.....	–3	–7	–7	–7	–6	–30
Subtotal, expand educational opportunities	–66	–732	–2,360	–2,836	–3,938	–4,381	–14,247
Provide poverty relief and revitalize communities:							
Increase and simplify the Earned Income Tax Credit (EITC) [1]	.....	–2,293	–1,936	–1,967	–1,992	–2,001	–10,189
Increase and index low-income housing tax credit per-capita cap	.....	–6	–55	–168	–306	–448	–983
Provide New Markets Tax Credit	.....	–30	–222	–515	–743	–940	–2,450
Extend Empowerment Zone (EZ) tax incentives and authorize additional EZs	.....	–36	–167	–333	–452	–568	–1,556
Provide Better America Bonds to improve the environment	.....	–8	–41	–112	–214	–315	–690
Permanently extend the expensing of brownfields remediation costs	.....	.....	–98	–152	–146	–140	–536
Expand tax incentives for specialized small business investment companies (SSBICs)	–*	–*	–*	–*	–*	–*	–*
Bridge the Digital Divide	.....	–107	–272	–344	–289	–207	–1,219
Subtotal, provide poverty relief and revitalize communities	.....	–2,480	–2,791	–3,591	–4,142	–4,619	–17,623
Make health care more affordable:							
Assist taxpayers with long-term care needs [2]	.....	–109	–1,150	–1,681	–2,427	–3,028	–8,395
Encourage COBRA continuation coverage	.....	.....	–41	–858	–1,149	–1,286	–3,334
Provide tax credit for Medicare buy-in program	.....	.....	–5	–105	–140	–164	–414
Provide tax relief for workers with disabilities [2]	.....	–18	–128	–143	–158	–165	–612
Provide tax relief to encourage small business health plans	.....	–1	–9	–22	–35	–38	–105
Encourage development of vaccines for targeted diseases	.....	.....	.....	.....	.....	.....	.....
Subtotal, make health care more affordable [2]	.....	–128	–1,333	–2,809	–3,909	–4,681	–12,860
Strengthen families and improve work incentives:							
Provide marriage penalty relief and increase standard deduction	.....	–248	–843	–1,536	–2,130	–4,637	–9,394
Increase, expand, and simplify child and dependent care tax credit [2]	.....	–121	–589	–922	–1,288	–1,643	–4,563
Provide tax incentives for employer-provided child-care facilities	.....	–42	–88	–121	–140	–148	–539
Subtotal, strengthen families and improve work incentives [2]	.....	–411	–1,520	–2,579	–3,558	–6,428	–14,496
Promote expanded retirement savings, security, and portability:							
Establish Retirement Savings Accounts	.....	.....	–657	–2,185	–2,290	–4,034	–9,166
Provide small business tax credit for automatic contributions for non-highly compensated employees	.....	.....	–157	–648	–1,878	–3,074	–5,757
Provide tax credit for plan start up and administrative expenses; provide for payroll deduction IRAs	–1	–18	–35	–61	–92	–135	–341
Provide for the SMART plan	.....	–44	–65	–66	–68	–70	–313
Enhance the 401(k) SIMPLE plan	.....	–25	–61	–108	–161	–236	–591
Accelerate vesting for qualified plans	.....	214	137	104	66	29	550
Other changes affecting retirement savings, security and portability	.....	–53	–207	–288	–377	–450	–1,375
Subtotal, promote expanded retirement savings, security and portability	–1	74	–1,045	–3,252	–4,800	–7,970	–16,993
Provide AMT relief for families and simplify the tax laws:							
Provide adjustments for personal exemptions and the standard deduction in the individual alternative minimum tax (AMT)	–72	–377	–544	–996	–1,312	–1,650	–4,879
Simplify and increase standard deduction for dependent filers	–7	–42	–29	–33	–51	–37	–192
Replace support test with residency test (limited to children)	.....	–66	–97	–102	–107	–112	–484
Provide tax credit to encourage electronic filing of individual income tax returns [2]	.....	.....	–192	–207	–208	–209	–816
Simplify, retarget and expand expensing for small business	.....	–217	–206	–19	–86	–135	–663
Simplify the foreign tax credit limitation for dividends from 10/50 companies	–80	–168	–102	–46	10	27	–279
Other simplification	–1	–17	–23	–27	–30	–35	–132
Subtotal, provide AMT relief for families and simplify the tax laws [2]	–160	–887	–1,193	–1,430	–1,784	–2,151	–7,445
Encourage philanthropy:							
Allow deduction for charitable contributions by non-itemizing taxpayers	.....	–516	–1,062	–733	–765	–817	–3,893
Simplify and reduce the excise tax on foundation investment income	.....	–49	–70	–71	–73	–75	–338
Increase limit on charitable donations of appreciated property	.....	–7	–47	–29	–20	–12	–115

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

(In millions of dollars)

	Estimate						
	2000	2001	2002	2003	2004	2005	2001–2005
Clarify public charity status of donor advised funds	*	*	*	*	*	*	*
Subtotal, encourage philanthropy	.....	–572	–1,179	–833	–858	–904	–4,346
Promote energy efficiency and improve the environment:							
Provide tax credit for energy-efficient building equipment	.....	–18	–35	–49	–71	–28	–201
Provide tax credit for new energy-efficient homes	.....	–82	–150	–194	–134	–73	–633
Extend electric vehicle tax credit and provide tax credit for hybrid vehicles	.....	.....	–4	–182	–700	–1,192	–2,078
Provide 15-year depreciable life for distributed power property	.....	–1	–1	–2	–3	–3	–10
Extend and modify the tax credit for producing electricity from certain sources	.....	–91	–173	–220	–231	–261	–976
Provide tax credit for solar energy systems	.....	–9	–19	–25	–34	–45	–132
Subtotal, promote energy efficiency and improve the environment	.....	–201	–382	–672	–1,173	–1,602	–4,030
Electricity restructuring	.....	3	11	20	30	41	105
Modify international trade provisions:							
Extend and modify Puerto Rico economic-activity tax credit	.....	–35	–67	–101	–134	–166	–503
Extend GSP and modify other trade provisions [3]	–10	–454	–858	–940	–884	–248	–3,384
Levy tariff on certain textiles/apparel produced in the CNMI [3]	.....	.....	169	169	169	169	676
Subtotal, modify international trade provisions [3]	–10	–489	–756	–872	–849	–245	–3,211
Miscellaneous provisions:							
Make first $2,000 of severance pay exempt from income tax	.....	–43	–174	–180	–138	.....	–535
Exempt Holocaust reparations from Federal income tax	–4	–17	–18	–19	–15	.....	–69
Subtotal, miscellaneous provisions	–4	–60	–192	–199	–153	.....	–604
Subtotal, provide tax relief [2 3]	**–241**	**–5,883**	**–12,740**	**–19,053**	**–25,134**	**–32,940**	**–95,750**
Refundable credits	.....	**–23**	**–679**	**–736**	**–2,218**	**–2,343**	**–5,999**
Total gross tax relief including refundable credits [3]	**–241**	**–5,906**	**–13,419**	**–19,789**	**–27,352**	**–35,283**	**–101,749**
Eliminate unwarranted benefits and adopt other revenue measures:							
Limit benefits of corporate tax shelter transactions:							
Increase disclosure of certain transactions, modify substantial understatement penalty for corporate tax shelters, codify the economic substance doctrine, tax income from shelters involving tax-indifferent parties and impose a penalty excise tax on certain fees received by promotors and advisors	.....	1,872	1,392	1,357	1,351	1,374	7,346
Require accrual of income on forward sale of corporate stock	1	5	10	15	21	26	77
Modify treatment of ESOP as S corporation shareholder	.....	15	47	67	88	104	321
Limit dividend treatment for payments on certain self-amortizing stock	.....	22	37	39	40	42	180
Prevent serial liquidation of U.S. subsidiaries of foreign corporations	12	20	19	19	19	18	95
Prevent capital gains avoidance through basis shift transactions involving foreign shareholders	71	328	121	65	45	26	585
Prevent mismatching of deductions and income in transactions with related foreign persons	.....	62	108	112	117	122	521
Prevent duplication or acceleration of loss through assumption of certain liabilities	4	34	36	37	38	40	185
Amend 80/20 company rules	.....	21	46	53	54	56	230
Modify corporate-owned life insurance (COLI) rules	.....	176	340	417	489	548	1,970
Require lessors of tax-exempt-use property to include service contract options in lease term	.....	6	11	17	24	30	88
Interaction	–42	–239	–175	–157	–157	–160	–888
Subtotal, limit benefits of corporate tax shelter transactions	46	2,322	1,992	2,041	2,129	2,226	10,710
Other proposals:							
Require banks to accrue interest on short-term obligations	6	63	21	4	5	5	98
Require current accrual of market discount by accrual method taxpayers	1	7	13	19	25	31	95
Modify and clarify certain rules relating to debt-for-debt exchanges	9	73	74	71	70	70	358
Modify and clarify the straddle rules	14	30	34	33	34	35	166
Provide generalized rules for all stripping transactions	7	18	22	21	19	18	98
Require ordinary treatment for certain dealers of commodities and equity options	16	29	31	31	31	31	153
Prohibit tax deferral on contributions of appreciated property to swap funds	.....	2	5	8	10	11	36
Conform control test for tax-free incorporations, distributions, and reorganizations	13	34	41	39	38	39	191
Treat receipt of tracking stock in certain distributions and exchanges as the receipt of property	28	108	158	153	149	151	719
Require consistent treatment and provide basis allocation rules for transfers of intangibles in certain nonrecognition transactions	1	41	51	53	55	57	257
Modify tax treatment of certain reorganizations involving portfolio stock	17	49	66	71	77	83	346
Modify definition of nonqualified preferred stock	11	53	61	64	67	54	299

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

(In millions of dollars)

	Estimate						
	2000	2001	2002	2003	2004	2005	2001–2005
Modify estimated tax provision for deemed asset sales	.....	314	90	–23	–15	–8	358
Modify treatment of transfers to creditors in divisive reorganizations	3	15	18	19	20	21	93
Provide mandatory basis adjustments for partners that have a significant net built-in loss in partnership property	–41	50	52	55	60	58	275
Modify treatment of closely held REITs	.....	1	4	8	12	17	42
Apply RIC excise tax to undistributed profits of REITs	.....	.....	1	1	1	1	4
Allow RICs a dividends paid deduction for redemptions only in cases where the redemption represents a contraction in the RIC	.....	99	489	457	429	405	1,879
Require REMICs to be secondarily liable for the tax liability of REMIC residual interest holders	.....	5	17	29	42	55	148
Deny change in method treatment to tax-free formations	3	59	59	59	61	63	301
Deny deduction for punitive damages	16	92	130	137	144	151	654
Repeal lower-of-cost-or-market inventory accounting method	.....	459	447	371	372	154	1,803
Disallow interest on debt allocable to tax-exempt obligations	4	11	18	24	30	35	118
Require capitalization of mutual fund commissions	.....	23	111	98	83	64	379
Provide consistent amortization periods for intangibles	.....	–216	–220	34	259	445	302
Clarify recovery period of utility grading costs	12	40	65	82	91	99	377
Apply rules generally applicable to acquisitions of tangible assets to acquisitions of professional sports franchises	2	43	73	113	141	139	509
Require recapture of policyholder surplus accounts	.....	65	174	285	522	782	1,828
Modify rules for capitalizing policy acquisition costs of life insurance companies	.....	536	1,820	2,191	2,413	1,328	8,288
Increase the proration percentage for P&C insurance companies	.....	48	82	98	115	133	476
Modify rules that apply to sales of life insurance contracts	.....	13	35	39	43	48	178
Modify rules that apply to tax-exempt property casualty insurance companies	.....	12	22	23	24	25	106
Subject investment income of trade associations to tax	.....	180	309	325	341	358	1,513
Impose penalty for failure to file an annual information return	.....	.....	24	23	22	21	90
Restore phaseout of unified credit for large estates	.....	33	70	78	83	106	370
Require consistent valuation for estate and income tax purposes	1	5	10	14	18	21	68
Require basis allocation for part sale, part gift transactions	.....	2	3	4	5	5	19
Conform treatment of surviving spouses in community property States	3	19	42	59	75	92	287
Include QTIP trust assets in surviving spouse's estate	.....	.....	2	2	2	2	8
Eliminate non-business valuation discounts	.....	271	575	600	636	618	2,700
Eliminate gift tax exemption for personal residence trusts	.....	–1	–1	.....	5	14	17
Modify requirements for annual exclusion for gifts	.....	.....	20	20	22	20	82
Increase elective withholding rate for nonperiodic distributions from deferred compensation plans	.....	.....	47	3	3	3	56
Increase excise tax for excess IRA contributions	.....	1	12	13	14	14	54
Limit pre-funding of welfare benefits for 10 or more employer plans	.....	92	156	159	151	150	708
Subject signing bonuses to employment taxes	.....	5	3	3	3	2	16
Clarify employment tax treatment of choreworkers	.....	48	64	64	63	63	302
Prohibit IRAs from investing in foreign sales corporations	3	16	29	30	32	33	140
Tighten the substantial understatement penalty for large corporations	.....	26	44	45	41	37	193
Require withholding on certain gambling winnings	.....	20	1	1	1	1	24
Require information reporting for private separate accounts	.....	5	10	14	18	21	68
Increase penalties for failure to file correct information returns	.....	6	15	15	9	10	55
Modify deposit requirement for FUTA	.....	.....	.....	.....	.....	1,583	1,583
Reinstate Oil Spill Liability Trust Fund tax [3]	.....	.....	253	261	264	266	1,044
Repeal percentage depletion for non-fuel minerals mined on Federal and formerly Federal lands	.....	94	96	97	99	101	487
Impose excise tax on purchase of structured settlements	6	7	5	2	.....	–2	12
Require taxpayers to include rental income of residence in income without regard to the period of rental	.....	4	11	12	12	13	52
Eliminate installment payment of heavy vehicle use tax [3]	.....	.....	378	27	30	32	467
Require recognition of gain on sale of principal residence if acquired in a tax-free exchange within five years of the sale	.....	10	13	11	11	11	56
Limit benefits of transactions with "Identified Tax Havens"	.....	36	52	40	36	35	199
Modify treatment of built-in losses and other attributes trafficking	1	78	136	143	151	161	669
Simplify taxation of property that no longer produces income effectively connected with a U.S. trade or business	*	*	*	*	*	*	*
Prevent avoidance of tax on U.S.-accrued gains (expatriation)	3	28	58	107	155	212	560
Expand ECI rules to include certain foreign source income	.....	22	38	39	41	42	182
Limit basis step-up for imported pensions	2	26	33	34	36	38	167
Replace sales-source rules	.....	320	570	600	630	660	2,780
Modify rules relating to foreign oil and gas extraction income	.....	5	69	112	118	124	428
Recapture overall foreign losses when CFC stock is disposed	1	1	*	*	*	*	1
Modify foreign office material participation exception applicable to inventory sales attributable to nonresident's U.S. office	1	7	10	11	11	11	50

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

(In millions of dollars)

	Estimate						
	2000	2001	2002	2003	2004	2005	2001–2005
Subtotal, other proposals [3]	143	3,542	7,221	7,635	8,565	9,478	36,441
Subtotal, eliminate unwarranted benefits and adopt other revenue measures [3]	**189**	**5,864**	**9,213**	**9,676**	**10,694**	**11,704**	**47,151**
Net tax relief including refundable credits [3]	**–52**	**–42**	**–4,206**	**–10,113**	**–16,658**	**–23,579**	**–54,598**
Other provisions that affect receipts:							
Reinstate environmental tax on corporate taxable income [4]	.....	725	432	438	434	437	2,466
Reinstate Superfund excise taxes [3]	152	707	762	772	785	797	3,823
Convert Airport and Airway Trust Fund taxes to a cost-based user fee system [3]	.....	724	1,399	1,500	1,522	1,522	6,667
Increase excise tax on tobacco products and levy a youth smoking assessment on tobacco manufacturers [3]	446	4,084	3,738	3,532	10,140	9,700	31,194
Recover State bank supervision and regulation expenses (receipt effect) [3]	.....	78	82	86	90	95	431
Maintain Federal Reserve surplus transfer to the Treasury	.....	3,752	.....	.....	.....	.....	3,752
Restore premiums for United Mine Workers of America Combined Benefit Fund	.....	11	10	10	9	9	49
Extend abandoned mine reclamation fees [3]	.....	.....	.....	.....	.....	218	218
Replace Harbor Maintenance tax with the Harbor Services User Fee (receipt effect) [3]	.....	–549	–602	–647	–681	–718	–3,197
Revise Army Corps of Engineers regulatory program fees [3]	.....	5	5	5	5	5	25
Roll back Federal employee retirement contributions	.....	–427	–619	–160	.....	.....	–1,206
Provide Government-wide buyout authority (receipt effect)	.....	–9	–18	–9	.....	.....	–36
Total, other provisions [3 4]	**598**	**9,101**	**5,189**	**5,527**	**12,304**	**12,065**	**44,186**

* $500,000 or less

[1] The proposal to increase and simplify the Earned Income Tax Credit has both receipts and outlay effects. The receipts effect for the proposal is –$305 million, –$304 million, –$314 million, –$326 million and –$339 million for fiscal years 2001–2005, respectively. The outlay effect is $2,003 million, $1,936 million, $1,967 million, $1,992 million and $2,001 million for fiscal years 2001–2005, respectively.

[2] Amounts shown are the effect on receipts.

[3] Net of income offsets

[4] Net of deductibility for income tax purposes

Table 3–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	1999 Actual	Estimate					
		2000	2001	2002	2003	2004	2005
Individual income taxes (federal funds):							
Existing law	879,480	951,945	978,249	1,005,714	1,040,248	1,086,039	1,143,081
Proposed Legislation (PAYGO)	.....	–359	–5,634	–10,125	–14,215	–19,554	–25,821
Legislative proposal, discretionary offset	.....	.....	–205	–397	–424	–432	–432
Total individual income taxes	**879,480**	**951,586**	**972,410**	**995,192**	**1,025,609**	**1,066,053**	**1,116,828**
Corporation income taxes:							
Federal funds:							
Existing law	184,670	192,285	189,594	190,189	191,800	196,090	205,076
Proposed Legislation (PAYGO)	.....	110	3,942	4,405	3,105	3,150	.....
Legislative proposal, discretionary offset	.....	.....	119	102	110	119	131
Total Federal funds corporation income taxes	184,670	192,395	193,655	194,696	195,015	199,359	205,207
Trust funds:							
Hazardous substance superfund	10	.....	.....	.....	.....	.....	.....
Proposed Legislation (PAYGO)	.....	.....	1,115	664	674	668	673
Total corporation income taxes	**184,680**	**192,395**	**194,770**	**195,360**	**195,689**	**200,027**	**205,880**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old age and survivors insurance (Off-budget)	383,559	408,583	427,322	446,421	465,244	484,401	511,676
Disability insurance (Off-budget)	60,909	68,180	72,573	75,805	79,003	82,259	86,890
Hospital insurance	132,268	136,515	143,695	150,290	156,694	163,258	172,612
Railroad retirement:							
Social Security equivalent account	1,515	1,639	1,674	1,697	1,719	1,740	1,762
Rail pension and supplemental annuity	2,629	2,621	2,661	2,699	2,736	2,773	2,803
Total employment and general retirement	580,880	617,538	647,925	676,912	705,396	734,431	775,743
On-budget	136,412	140,775	148,030	154,686	161,149	167,771	177,177
Off-budget	444,468	476,763	499,895	522,226	544,247	566,660	598,566
Unemployment insurance:							
Deposits by States [1]	19,894	21,453	23,327	24,529	25,594	26,273	27,411
Proposed Legislation (PAYGO)	.....	.....	.....	.....	.....	.....	1,297
Federal unemployment receipts [1]	6,475	6,668	6,873	7,010	7,127	7,260	7,405
Proposed Legislation (PAYGO)	.....	.....	.....	.....	.....	.....	286
Railroad unemployment receipts [1]	111	67	54	97	123	124	102
Total unemployment insurance	26,480	28,188	30,254	31,636	32,844	33,657	36,501
Other retirement:							
Federal employees' retirement—employee share	4,400	4,221	4,269	4,194	3,547	3,197	3,028
Proposed Legislation (non-PAYGO)	.....	.....	–9	–18	–9	.....	.....
Proposed Legislation (PAYGO)	.....	.....	–427	–619	–160	.....	.....
Non-Federal employees retirement [2]	73	74	68	63	51	46	43
Total other retirement	4,473	4,295	3,901	3,620	3,429	3,243	3,071
Total social insurance and retirement receipts	**611,833**	**650,021**	**682,080**	**712,168**	**741,669**	**771,331**	**815,315**
On-budget	167,365	173,258	182,185	189,942	197,422	204,671	216,749
Off-budget	444,468	476,763	499,895	522,226	544,247	566,660	598,566
Excise taxes:							
Federal funds:							
Alcohol taxes	7,386	7,267	7,150	7,158	7,120	7,091	7,080
Proposed Legislation (PAYGO)	.....	–32	32	.....	.....	.....	.....
Tobacco taxes	5,400	6,742	7,158	7,844	8,013	7,938	7,869
Proposed Legislation (PAYGO)	.....	594	5,446	4,985	4,709	4,018	3,756
Transportation fuels tax	849	787	808	793	811	817	836
Telephone and teletype services	5,185	5,500	5,821	6,142	6,471	6,833	7,231
Ozone depleting chemicals and products	105	73	73	22	9	.....	.....
Other Federal fund excise taxes	368	2,174	2,200	2,114	1,997	1,987	2,030

Table 3–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	1999 Actual	Estimate					
		2000	2001	2002	2003	2004	2005
Proposed Legislation (PAYGO)	.....	38	–74	–65	–69	–73	–77
Total Federal fund excise taxes	19,293	23,143	28,614	28,993	29,061	28,611	28,725
Trust funds:							
Highway	39,299	34,311	35,148	35,597	36,229	36,870	37,622
Proposed Legislation (PAYGO)	.....	.....	.....	383	32	35	37
Airport and airway	10,391	9,222	9,645	10,173	10,630	11,333	12,115
Legislative proposal, discretionary offset	.....	.....	965	1,866	1,999	2,030	2,030
Aquatic resources	374	336	341	376	380	395	401
Black lung disability insurance	596	577	591	606	619	628	636
Inland waterway	104	104	107	109	111	114	116
Hazardous substance superfund	11	.....	.....	.....	.....	.....	.....
Proposed Legislation (PAYGO)	.....	204	942	1,016	1,031	1,046	1,063
Oil spill liability	.....	173	.....	.....	.....	.....	.....
Proposed Legislation (PAYGO)	.....	.....	.....	338	348	351	355
Vaccine injury compensation	130	131	134	137	139	141	110
Leaking underground storage tank	216	183	189	191	195	198	202
Total trust funds excise taxes	51,121	45,241	48,062	50,792	51,713	53,141	54,687
Total excise taxes	**70,414**	**68,384**	**76,676**	**79,785**	**80,774**	**81,752**	**83,412**
Estate and gift taxes:							
Federal funds	27,782	30,482	31,975	34,172	35,494	37,831	36,151
Proposed Legislation (PAYGO)	.....	4	329	721	777	846	878
Total estate and gift taxes	**27,782**	**30,486**	**32,304**	**34,893**	**36,271**	**38,677**	**37,029**
Customs duties:							
Federal funds	17,727	20,149	21,405	23,430	25,262	26,554	27,921
Proposed Legislation (PAYGO)	.....	–13	–569	–880	–990	–917	–71
Trust funds	609	739	797	870	932	978	1,030
Proposed Legislation (PAYGO)	.....	.....	–30	–30	–30	–30	–30
Legislative proposal, discretionary offset	.....	.....	–732	–803	–863	–908	–958
Total customs duties	**18,336**	**20,875**	**20,871**	**22,587**	**24,311**	**25,677**	**27,892**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	101	119	121	124	126	129	132
Proposed youth smoking assessment (PAYGO)	.....	.....	.....	.....	.....	7,379	7,280
United Mine Workers of America combined benefit fund	148	142	138	132	127	122	118
Proposed Legislation (PAYGO)	.....	.....	11	10	10	9	9
Deposit of earnings, Federal Reserve System	25,917	32,452	25,664	30,196	31,296	32,489	33,662
Legislative proposal, discretionary offset	.....	.....	3,856	109	115	120	126
Defense cooperation	.....	6	6	6	6	6	6
Fees for permits and regulatory and judicial services	6,572	7,509	7,965	8,726	9,549	10,378	10,972
Proposed Legislation (PAYGO)	.....	.....	–2	–7	–7	.....	290
Legislative proposal, discretionary offset	.....	.....	7	7	7	7	7
Fines, penalties, and forfeitures	2,738	2,188	2,157	1,966	1,977	1,977	1,979
Gifts and contributions	186	281	188	156	150	148	149
Refunds and recoveries	–733	–192	–191	–190	–190	–190	–190
Total miscellaneous receipts	**34,929**	**42,505**	**39,920**	**41,235**	**43,166**	**52,574**	**54,540**
Total budget receipts	**1,827,454**	**1,956,252**	**2,019,031**	**2,081,220**	**2,147,489**	**2,236,091**	**2,340,896**
On-budget	1,382,986	1,479,489	1,519,136	1,558,994	1,603,242	1,669,431	1,742,330
Off-budget	444,468	476,763	499,895	522,226	544,247	566,660	598,566

[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.

4. USER FEES AND OTHER COLLECTIONS

In addition to collecting taxes and other receipts by the exercise of its sovereign powers, which is discussed in the previous chapter, the Federal Government collects income from the public from market-oriented activities. Examples of these collections include the sale of postage stamps and electricity, 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.

Depending on the laws that authorize the collections, they can be credited directly to expenditure accounts as "offsetting collections," where they are usually available for expenditure without further action by Congress, or they are credited to receipt accounts as "offsetting receipts," which may be appropriated to expenditure accounts through action by the Congress. The budget refers to them as offsetting collections and offsetting receipts, because they are subtracted from gross outlays rather than added to taxes on the receipts side of the budget. 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. [1]

Offsetting collections and receipts include most user fees, which are discussed below, as well as some amounts that are not user fees. Table 4–1 summarizes these transactions. For 2001, total offsetting collections and receipts from the public are estimated to be $214.8 billion, and total user fees are estimated to be $148.6 billion.

The following section discusses user fees and the Administration's user fee proposals. The subsequent section displays more information on offsetting collections and receipts. The offsetting collections and receipts by agency are also displayed in Table 20–1, "Outlays to the Public, Net and Gross," which appears in Chapter 20 of this volume.

TABLE 4–1. GROSS OUTLAYS, USER FEES, OTHER OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, AND NET OUTLAYS

(In billions of dollars)

	Actual 1999	Estimate	
		2000	2001
Gross outlays	1,910.3	2,001.6	2,049.8
Offsetting collections and receipts from the public:			
User fees [1]	137.0	137.6	147.2
Other	70.3	74.4	67.6
Subtotal, offsetting collections and receipts from the public	207.3	212.0	214.8
Net outlays	1,703.0	1,789.6	1,835.0

[1] Total user fees are shown below. They include user fees that are classified on the receipts side of the budget in addition to the amounts shown on this line. For additional details of total user fees, see Table 4–2. "Total User Fee Collections."

Total user fees:			
Offsetting collections and receipts from the public	137.0	137.6	147.2
Receipts	1.0	1.1	1.5
Total user fees	138.0	138.7	148.6

USER FEES

I. Introduction and Background

The Federal Government may charge user fees to those who benefit directly from a particular activity or those subject to regulation. According to the definition of user fees used in this chapter, Table 4–2 shows that user fees were $138.0 billion in 1999, and are estimated to increase to $138.7 billion in 2000 and to $148.6 billion in 2001, growing to an estimated $176.4 billion in 2005, including the user fee proposals proposed in this budget, which are shown in Table 4–3. This table shows that the Administration is proposing to increase user fees by an estimated $3.8 billion in 2001, growing to an estimated $7.7 billion in 2005.

Definition. The term "user fee" as defined here is fees, charges, and assessments levied on a class directly benefiting from, or subject to regulation by, a government program or activity, and to be utilized solely to support the program or activity. In addition, the payers of the fee must be limited 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 it is charged, including directly associated agency functions, not for unrelated programs or activities and not for the broad purposes of the Government or an agency.

[1] Showing collections from business-type transactions as offsets on the spending side of the budget follows the concept recommended by the 1967 *Report of the President's Commission on Budget Concepts.* The concept is discussed in Chapter 24: "Budget System and Concepts and Glossary" in this volume.

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 federally-owned buildings and facilities
  —Flood insurance premiums
  —Sales of commemorative coins
- User fees are earmarked to fund 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 different from general revenue, because they are not collected from the general public or broad segments of the public (e.g., income taxes or customs duties) and they are not used for the general purposes of government (e.g., 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 depends on fees, instead of 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.

- Examples of business-type or market-oriented user fees include fees for the sale of postal services (the sale of stamps), electricity (e.g., sales by the Tennessee Valley Authority), payments for Medicare voluntary supplemental medical insurance, life insurance premiums for veterans, recreation fees for parks, NASA fees for shuttle services, the sale of weather maps and related information by the Department of Commerce, the sale of commemorative coins, and fees for the sale of books.
- Examples of regulatory and licensing user fees include fees for regulating the nuclear energy industry, bankruptcy filing fees, immigration fees, food inspection fees, passport fees, and patent and trademark fees.

User fees do not include all offsetting collections and receipts, such as the interest and repayments received from credit programs; proceeds from the sale of loans and other financial investments; interest, dividends, and other earnings; cost sharing contributions; the sale of timber, minerals, oil, commodities, and other natural resources; proceeds from asset sales (property, plant, and equipment); Outer Continental Shelf receipts; or spectrum auction proceeds. Neither do they include earmarked taxes (such as taxes paid to social insurance programs or excise taxes), or customs duties, fines, penalties, and forfeitures.

Alternative definitions. The definition used in this chapter is useful because it identifies goods, services, and regulations financed by earmarked collections and receipts.[2] Other definitions may be used for other purposes, such as establishing policy for charging prices to the public for goods and services regardless of whether the proceeds are earmarked.

Alternative definitions could, for example:

- be narrower than the one used here, by excluding regulatory fees and analyzing them as a separate category.
- be broader than the one used here, by:
  —eliminating the requirement that fees be earmarked. The definition would then include fees that go to the general fund in addition to those that are earmarked to finance the related activity.
  —including the sale of resources as well as goods and services, such as natural resources (e.g., timber, oil, or minerals) and property, plant, and equipment.
  —interpreting more broadly whether a program has private beneficiaries, or whether the proceeds are earmarked to benefit directly those paying the fee. A broader interpretation might include beneficiary- or liability-based excise taxes.[3]

What is the purpose of user fees? The purpose of user fees is to improve the efficiency and equity of certain Government activities, and to reduce the bur-

[2] The definition used here is similar to one the House of Representatives uses as a guide for purposes of committee jurisdiction. The definition helps differentiate between taxes, which are under the jurisdiction of the Ways and Means Committee, and fees, which can be under the jurisdiction of other committees. See the Congressional Record, January 3, 1991, p. H31, item 8.

[3] Beneficiary- and liability-based taxes are terms taken from the Congressional Budget Office, *The Growth of Federal User Charges,* August 1993, and updated in October 1995. Examples of beneficiary-based taxes include taxes on gasoline, which finance grants to States for highway construction, or taxes on airline tickets, which finance air traffic control activities and airports. An example of a liability-based tax is the excise tax that helps fund the hazardous substance superfund in the Environmental Protection Agency. This tax is paid by industry groups to finance environmental cleanup activities related to the industry activity but not necessarily caused by the payer of the fee.

den on the taxpayer to finance activities whose benefits accrue to a relatively limited number of people.

- User fees that are set to cover the costs of production of goods and services can provide *efficiency* in the allocation of resources within the economy. They allocate goods and services to those who value them the most, and they signal to the government how much of the goods or services it should provide. Prices in private, competitive markets serve the same purposes.
- User fees for goods and services that do not have special social benefits improve *equity,* or fairness, by requiring that those who benefit from an activity are the same people who pay for it. The public often perceives user fees as fair because those who benefit from the good or service pay for it in whole or in part, and those who do not benefit do not pay.

When should the Government charge a fee? Discussions of whether to finance spending with a tax or a fee often focus on whether the benefits of the activity are to the public in general or to a limited group of people. As a general rule, if the benefits accrue to the public in general, then the program should be financed by taxes paid by the public; in contrast, if the benefits accrue to a limited number of private individuals or groups, then the program should be financed by fees paid by the private beneficiaries. For Federal programs where the benefits are entirely public or entirely private, applying this rule is relatively easy. For example, according to this rule, the benefits from national defense accrue to the public in general and should be (and are) financed by taxes. In contrast, the benefits of electricity sold by the Tennessee Valley Authority accrue exclusively to those using the electricity, and should be (and are) financed by user fees.

In many cases, however, an activity has benefits that accrue to both public and to private groups, and it may be difficult to identify how much of the benefits accrue to each. Because of this, it can be difficult to know how much of the program should be financed by taxes and how much by fees. For example, the benefits from recreation areas are mixed. Fees for visitors to these areas are appropriate because the visitors benefit directly from their visit, but the public in general also benefits because these areas protect the Nation's natural and historical heritage now and for posterity.

As a further complication, where a fee may be appropriate to finance all or part of an activity, some consideration must be given to the ease of administering the fee.

What should be the amount of the fee? For programs that have private beneficiaries, the amount of the fee should depend on the costs of producing the goods or services and the portion of the program that is for private benefits. If the benefit is primarily private, and any public benefits are incidental, the Administration supports fees that cover the full cost to the Government, including both direct and indirect costs.[4]

The Administration is working to put cost accounting systems in place across the Government that would make the calculation of full cost more feasible. The difficulties in measuring full cost are associated in part with allocating to an activity the full costs of capital, retirement benefits, and insurance, as well as other Federal costs that may appear in other parts of the budget. Guidance in the Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* (July 31, 1995), should underlie cost accounting in the Federal Government.

Classification of user fees in the budget. As shown in Table 4–1, most user fees are classified as offsets to outlays on the spending side of the budget, but a few are classified on the receipts side of the budget. An estimated $1.5 billion in 2001 are classified this way and are included in the totals described in Chapter 3. "Federal Receipts." They are classified as receipts because they are regulatory fees collected by the Federal Government by the exercise of its sovereign powers.

The remaining user fees, an estimated $147.2 billion in 2001, are classified as offsetting collections and receipts on the spending side of the budget. Some of these are collected by the Federal Government by the exercise of its sovereign powers and would normally appear on the receipts side of the budget, but are required by law to be classified as offsetting collections or receipts.

- An estimated $107.0 billion of user fees for 2001 are credited directly to expenditure accounts, and are generally available for expenditure when they are collected, without further action by the Congress.
- An estimated $40.1 billion for 2001 are deposited in offsetting receipt accounts, and generally are not available to be spent unless appropriated by the Congress each year.

As a further classification, the following Tables 4–2 and 4–3 identify the fees as *discretionary* or *mandatory*. These classifications are terms from the Budget Enforcement Act of 1990 as amended and are used frequently in the analysis of the budget. "Discretionary" in this chapter refers to fees generally controlled through annual appropriations acts and under the jurisdiction of the appropriations committees in the Congress. These fees offset discretionary spending under the discretionary caps. "Mandatory" refers to fees controlled by permanent laws and under the jurisdiction of the authorizing committees. These fees are subject to rules of paygo, whereby changes in law affecting mandatory programs and receipts cannot result in a net cost. Mandatory spending is sometimes referred to as direct spending.

[4] Policies for setting user charges are promulgated in OMB Circular No. A–25: "User Charges" (July 8, 1993). These policies are required regardless of whether or not the proceeds are earmarked to finance the related activity.

These and other classifications are discussed further in this volume in Chapter 24, "Budget System and Concepts and Glossary."

II. Current User Fees

As shown in Table 4–2, "Total User Fee Collections," total user fee collections (including those proposed in this budget) are estimated to be $148.6 billion in 2001, increasing to $176.4 billion in 2005. User fee collections by the Postal Service, Medicare premiums, and foreign military sales are the largest and are estimated to be more than two-thirds of all existing user fee collections in 2001.

User fee collections are used to offset outlays in both the discretionary and mandatory parts of the budget. Discretionary user fee collections are estimated to be $16.6 billion in 2001. The Administration is proposing to make collections from Federal Aviation Administration (FAA) cost-based user fees, the new harbor services fee, and proposed fees for the Federal Deposit Insurance Corporation available to offset discretionary spending.

III. User Fee Proposals

The Administration is proposing the new or increased user fees shown in Table 4–3: "User Fee Proposals." These proposals would increase user fee collections by an estimated $3.8 billion in 2001, increasing to $7.7 billion in 2005.

A. User Fee Proposals to Offset Discretionary Spending

1. Proposals for Discretionary User Fees

a. Offsetting collections deposited in appropriation accounts

Department of Agriculture

Food Safety and Inspection Service meat, poultry, and egg inspection fees.—This budget proposes a new user fee for the Food Safety and Inspection Service. 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. 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.

Animal and Plant Health Inspection Service (APHIS).—The budget proposes to establish fees to cover the cost of providing animal welfare inspections to recipients of APHIS services such as animal research centers, humane societies, and kennels. Fees would also be established to cover the cost of issuing biotechnology certificates to firms that manufacture products derived through biotechnological innovation.

Grain Inspection, Packers and Stockyards Administration (GIPSA) licensing fees.—The budget proposes to charge the grain industry for GIPSA's costs to review and maintain standards (such as grain quality and classification) that are used by the 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.

Department of Commerce

National Oceanic and Atmospheric Administration (NOAA), navigational assistance fees.—The Administration proposes to levy 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.

Fisheries management fees.—The budget proposes to levy a fee to recover a portion of the costs of providing fisheries management and enforcement services.

Department of Health and Human Services

Food and Drug Administration (FDA) fees.—The budget seeks $19 million in new fees to finance FDA activities for the review of new medical devices and food additives, and for food export certifications. These fees will be used to augment current funding for these activities.

Health Care Financing Administration (HCFA).—These proposals would establish fees for a variety of activities associated with the Medicare program, including:

Managed care application and renewal fees.—The Administration proposes to charge managed care organizations a fee to cover the cost of reviewing initial applications and renewing annual contracts with Medicare. Proceeds from this fee would be used to offset funding for Federal administrative expenses related to managed care organization applications and renewals.

Provider initial certification fees.—The Administration proposes to levy a fee on providers (e.g., home health agencies and skilled nursing facilities) 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 funding.

Table 4–2. TOTAL USER FEE COLLECTIONS

(In millions of dollars)

	1999 actual	Estimates					
		2000	2001	2002	2003	2004	2005
Receipts							
Proposed FAA user fees to replace excise taxes [1]	.....	.....	965	1,866	1,999	2,030	2,030
Harbor maintenance and inland waterway fees [2]	553	675	.....	.....	.....	.....	.....
Agricultural quarantine inspection fees	172	188	215	217	220	223	225
Other governmental receipt user fees	248	255	281	286	287	293	298
Subtotal, governmental receipts	973	1,118	1,461	2,369	2,506	2,546	2,553
Offsetting Collections and Receipts from the Public							
Discretionary							
Department of Agriculture: Food safety inspection and other fees	167	186	735	735	737	741	746
Department of Commerce: Patent and trademark, fees for weather services, and other fees	1,021	1,123	1,304	1,304	1,319	1,352	1,382
Department of Defense: Commissary and other fees	7,345	6,438	6,366	6,347	6,347	6,347	6,347
Department of Energy: Federal Energy Regulation Commission and other fees	508	631	655	645	643	641	619
Department of Health and Human Services: Food and Drug Administration, Health Care Financing Administration, and other fees	316	338	657	657	664	681	696
Department of the Interior: Bureau of Land Management and other fees	235	260	250	250	252	260	264
Department of Justice: Antitrust and other fees	343	314	590	590	596	611	625
Department of State: Visa, passport, and other fees	365	411	451	451	456	468	478
Department of Transportation: Coast Guard and other fees	83	104	464	888	897	921	942
Department of the Treasury: Sale of commemorative coins and other fees	1,906	1,935	1,854	1,854	1,876	1,923	1,965
Department of Veterans Affairs: Medical care and other fees	577	603	496	496	501	515	525
National Aeronautics and Space Administration: Reimbursement for the use of NASA services	848	956	875	875	875	875	875
Federal Communications Commission: Regulatory and other fees	173	191	200	200	202	207	212
Federal Trade Commission: Regulatory and other fees	97	111	165	165	167	171	175
Legislative Branch: Library of Congress and copyright fees	85	119	114	114	114	114	114
National Credit Union Administration: Stock subscription fees	102	111	121	121	122	125	128
Nuclear Regulatory Commission: Regulatory fees	442	447	454	454	459	471	481
Panama Canal Commission: Fees for use of the canal	756	176	.....	.....	.....	.....	.....
Securities and Exchange Commission: Regulatory fees	591	634	650	650	658	674	689
All other agencies, discretionary user fees	144	150	199	187	188	191	195
Subtotal, discretionary offsetting collections and receipts	16,104	15,238	16,600	16,983	17,073	17,288	17,458
Mandatory							
Department of Agriculture: Federal crop insurance and other fees	883	1,111	1,586	1,557	1,633	1,697	1,727
Department of Defense: Commissary surcharge and other fees	257	276	275	275	275	275	275
Department of Energy: Proceeds from the sale of energy and other fees:	2,889	2,489	2,697	3,162	3,234	3,195	3,140
Department of Health and Human Services: Medicare Part B insurance premiums, and other fees	21,570	21,744	23,169	25,631	28,214	30,854	33,694
Department of the Interior: Recreation and other fees	610	575	586	604	621	629	637
Department of Justice: Immigration and other fees	1,300	1,498	1,483	1,488	1,516	1,524	1,531
Department of Labor: Insurance premiums to guarantee private pensions and other fees	460	824	1,083	1,013	1,087	1,160	1,233
Department of the Treasury: Customs, bank regulation, and other fees	1,813	1,871	1,922	2,001	2,074	2,150	2,229
Department of Veterans Affairs: Veterans life insurance and other fees	1,696	1,651	1,724	1,720	1,686	1,643	1,606
Corps of Engineers: Harbor services and other fees	40	41	1,007	1,004	1,002	1,038	1,056
Federal Emergency Management Agency: Flood insurance fees	1,416	1,545	1,756	1,868	1,986	2,121	2,266
International Assistance Programs: Foreign military sales	11,624	10,560	10,760	10,890	10,920	11,020	11,150
Office of Personnel Management: Federal employee health and life insurance fees	6,093	6,620	7,140	7,677	8,286	8,909	9,539
Federal Deposit Insurance Corporation: Deposit insurance fees	860	374	590	664	1,014	1,548	2,336
National Credit Union Administration: Credit union share insurance and other fees	350	308	326	300	321	347	388
Postal Service: Fees for postal services (e. g., sale of stamps)	61,957	63,998	67,421	70,000	72,750	74,100	75,650
Tennessee Valley Authority: Proceeds from the sale of energy	6,818	6,590	6,718	6,826	7,078	7,419	7,565
All other agencies, mandatory user fees	244	287	315	326	313	329	339
Subtotal, mandatory offsetting collections and receipts	120,880	122,362	130,558	137,006	144,010	149,958	156,361
Subtotal, offsetting collections and receipts	136,984	137,600	147,158	153,989	161,083	167,246	173,819
TOTAL, User fees	**137,957**	**138,718**	**148,619**	**156,358**	**163,589**	**169,792**	**176,372**

[1] Gross revenue increase from proposed fees. Current aviation excise taxes, which are not user fees, will gradually be converted to cost-based user fees. While considered governmental receipts, the following proceeds from the fees, net of income tax offsets, would be made available to offset discretionary spending:

	1999	2000	2001	2002	2003	2004	2005	2000–05
FAA collections available for spending	.....	.....	724	1,399	1,499	1,522	1,522	6,667

[2] The Budget proposes to convert proceeds to offsetting collections for the Corps of Engineers. While the fee collection will be mandatory, proceeds from the fee will be made available to offset discretionary spending.

Table 4–3. USER FEE PROPOSALS

(estimated collections in millions of dollars)

	2001	2002	2003	2004	2005	2001–2005
A. USER FEE PROPOSALS TO OFFSET DISCRETIONARY SPENDING						
1. Proposals for Discretionary User Fees						
a. Offsetting collections deposited in appropriation accounts						
Department of Agriculture						
Food Safety Inspection Service fees	534	641	641	641	641	3,098
Animal and Plant Health Inspection Service	11	11	11	11	11	55
Grain Inspection, Packers and Stockyards Administration	23	23	23	23	23	115
Department of Commerce						
National Oceanic and Atmospheric Administration, Navigational assistance fees	14	14	14	14	14	70
Fisheries management fees	20	20	20	20	20	100
Department of Health and Human Services						
Food and Drug Administration fees	19	19	19	19	19	95
Health Care Financing Administration fee proposals:						
Managed care application and renewal fees	21	21	21	21	21	105
Provider initial certification fees	13	13	13	13	13	65
Provider recertification fees	50	50	50	50	50	250
Paper claims submission fees	83	83	83	83	83	415
Duplicate and unprocessable claims fees	53	53	53	53	53	265
Increase Medicare+Choice fees	131	130	129	128	128	646
Nursing home criminal abuse registry fee	4	4	4	4	4	20
Department of the Interior						
User fees on Outer Continental Shelf lands	10	10	10	10	10	50
Department of Justice						
Hart-Scott Rodino pre-merger filing fees	38	38	38	38	38	190
Department of Transportation						
Coast Guard, navigational services fees	212	636	644	660	674	2,826
Federal Railroad Administration, rail safety inspection fees	103	103	103	103	103	515
Hazardous materials transportation safety fees	19	19	19	19	19	95
Surface Transportation Board fees	17	17	17	17	17	85
Department of the Treasury						
Customs, automation modernization fee	210	210	210	210	210	1,050
Federal Trade Commission						
Hart-Scott Rodino pre-merger filing fees	38	38	38	38	38	190
National Transportation Safety Board						
Commercial accident investigation fees	10	10	10	10	10	50
b. Offsetting collections deposited in receipt accounts						
Department of Justice						
Immigration premium processing fee	17	17	17	17	17	85
Increase inspection user fees	167	167	167	167	167	835
Department of Transportation						
Pipeline safety fees	11	12	12	12	12	59
Environmental Protection Agency						
Pesticide registration fees	16	.....	.....	.....	.....	16
Pre-manufacture notice (PMN) fees	4	8	8	8	8	36
Nuclear Regulatory Commission						
Extend Nuclear Regulatory Commission user fees	295	295	295	295	295	1,475
Subtotal, proposals for discretionary user fees	2,143	2,662	2,669	2,684	2,698	12,856
2. Proposals for Mandatory User Fees to Offset Discretionary Spending						
a. Offsetting collections deposited in appropriation accounts						
Federal Deposit Insurance Corporation						
State bank exam fees	92	96	102	106	111	507
b. Offsetting collections deposited in receipt accounts						
Corps of Engineers						
Harbor services user fee, replaces harbor maintenance tax [1]	417	361	313	315	296	1,702
c. Receipts						
Department of Transportation						
Federal Aviation Administration cost-based user fees (governmental receipt) [2]	965	1,866	1,999	2,030	2,030	8,890
Subtotal, proposals for mandatory user fees to offset discretionary spending	1,474	2,323	2,414	2,451	2,437	11,099
Subtotal, user fee proposals to offset discretionary spending	3,617	4,985	5,083	5,135	5,135	23,955

Table 4–3. USER FEE PROPOSALS—Continued

(estimated collections in millions of dollars)

	2001	2002	2003	2004	2005	2001–2005
B. USER FEE PROPOSALS TO OFFSET MANDATORY SPENDING						
a. Offsetting collections deposited in appropriation accounts						
Department of Agriculture						
Federal crop insurance	69	.....	.....	.....	.....	69
Department of Labor						
Implement alien labor certification fees	138	122	122	122	122	626
Federal Emergency Management Agency						
Flood map license fee for flood map modernization	104	107	109	112	114	546
b. Offsetting collections deposited in receipt accounts						
Department of Agriculture						
Recreation and entrance fees	.....	28	36	48	50	162
Concession, land use, right of way, and filming permits	6	7	13	13	13	52
Department of Health and Human Services						
Medicare premiums	–180	226	392	418	590	1,446
Department of the Interior						
Recreation and entrance fees	.....	73	74	76	74	297
Filming and special use permits fees	3	3	4	4	5	19
Hardrock mining production fees	.....	8	26	26	26	86
Department of the Treasury						
Customs, extend conveyance/passenger fee	.....	.....	.....	424	465	889
Customs, extend merchandise processing fee	.....	.....	.....	1,036	1,059	2,095
Subtotal user fee proposals to offset mandatory spending	140	574	776	2,279	2,518	6,287
Total user fee proposals	**3,757**	**5,559**	**5,859**	**7,414**	**7,653**	**30,242**

[1] The amounts shown here are the amounts available to offset discretionary spending. This is the total amount from the proposed harbor services user fee, less three-fourths (to account for the income tax offset) of the tax revenues that would be lost from repealing the existing harbor maintenance tax.

[2] Gross revenue increase from proposed fees. Current aviation excise taxes, which are not user fees, will gradually be converted to cost-based user fees. While considered governmental receipts, the following proceeds from the fees, net of income tax offsets, would be made to offset discretionary spending:

	2001	2002	2003	2004	2005	2001–05
FAA collections available for spending	724	1,399	1,499	1,522	1,522	6,667

Provider recertification fees.—The Administration proposes to levy a fee on providers who are recertified for the Medicare program. By statute, skilled nursing facilities must be surveyed every year, home health agencies 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 funding.

Paper claims submission fees.—The Administration proposes to charge providers $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 to offset Contractor funding related to claims processing.

Duplicate and unprocessable claims fees.—The Administration 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 to offset Contractor funding related to claims processing.

Increase in the Medicare+Choice fees.—The Administration proposes to increase the fee on Medicare+Choice plans by approximately $131 million in 2001. The fee was authorized at $100 million in the Balanced Budget Act of 1997 but reduced to approximately $19 million (for 2001) by the Balanced Budget Refinement Act of 1999. This increase would be used to maintain the current level of effort in providing information to Medicare beneficiaries regarding the Medicare+Choice program.

Nursing home criminal abuse registry fee.—The Administration proposes to charge nursing facilities a fee to query a nursing home criminal abuse registry. Proceeds from the fee would be used to fund the operation and maintenance of the registry.

Department of the Interior

User fees on Outer Continental Shelf lands.—The Administration proposes new and modifications to existing user fees on the Minerals Management Service program that supports energy and mineral exploration, development and production on the Outer Continental lands such as increasing rental rates, implementing a bidding fee, and charging for violation re-inspections. Collections would be available upon appropriation to fund royalty and offshore minerals management activities.

Department of Justice

Hart-Scott-Rodino pre-merger filing fees.—The Administration proposes to restructure the Hart- Scott-

Rodino fee, which is charged to acquiring firms in mergers. Fees are collected by the Federal Trade Commission (FTC) and divided evenly between the FTC and the Antitrust Division in the Department of Justice.

Department of Transportation

Coast Guard, navigational services fees.—The Administration proposes to levy a fee on U.S. and foreign commercial cargo and cruise vessels 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, ice breaking, and vessel traffic services. Fishing and recreational vessels would be exempt.

Federal Railroad Administration, rail safety inspection fees.—This proposed fee would offset the costs of the Federal Railroad Administration's safety inspection program. An estimated $103 million in fees would be collected from railroad carriers based upon a calculation of their rail usage.

Hazardous materials transportation safety fees.—Beginning late in 2001, hazardous materials transportation safety activities previously financed by general fund appropriations to the Research and Special Programs Administration are proposed to be financed instead by an increase in hazardous materials registration fees. Authorizing legislation will be proposed to increase the fees paid by shippers and carriers of hazardous materials by an estimated $19 million in 2001 to fund these safety activities.

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 the Treasury

Customs, automation modernization fee.—The Administration proposes to establish a fee to offset the costs of modernizing automated commercial operations of the U. S. Customs Service. Fees would finance the development of the Automated Commercial Environment (ACE), which is critical to maintain the ability of the U. S. Customs Service to process the increasing volume of trade. Subsequent to the budget, authorization legislation will be transmitted to allow the Secretary to establish the fee.

Federal Trade Commission (FTC)

Hart-Scott-Rodino pre-merger filing fees.—The Administration proposes to restructure the Hart- Scott-Rodino fee, which is charged to acquiring firms in mergers. Fees are collected by the Federal FTC and divided evenly between the FTC and the Antitrust Division in the Department of Justice.

National Transportation Safety Board (NTSB)

Commercial accident investigation fees.—To offset a portion of the growing cost of commercial accident investigations by the NTSB, a new aviation accident recovery and investigation fee is proposed. This fee, which would be paid by commercial air, motor, ocean, rail, and pipeline carriers based on an approximation of risk, would collect an estimated $10 million in 2001.

b. Offsetting collections deposited in receipt accounts

Department of Justice

Immigration premium processing fee.—This is a voluntary fee paid in addition to existing user fees charged for business visa processing that will guarantee expedited processing and direct liaison with the Immigration and Naturalization Service (INS). The INS estimates that $17 million of the projected $80 million in annual receipts will be used for expedited processing. The remainder will be earmarked for fraud investigations ($8 million), reduction of backlog, and infrastructure improvements ($55 million).

Increase inspection user fees.—Congress established the user fee account to cover the full cost of air and sea passenger inspections. The Administration is proposing to increase the per passenger inspection fee from $6 to $8 and eliminate an exemption from the inspection fee for cruise ship passengers. The increase will be used solely to defray inspection expenses.

Department of Transportation

Pipeline safety fees.—The Administration proposes to increase offsetting collections from the pipeline safety fund by an estimated $11 million in user fees in 2001. These fees would fund grants to States to inspect intrastate pipelines, damage prevention grants to implement best practices of damage prevention, and additional research, training and risk assessment.

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.

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 user fees.—Under current law, the NRC must recover approximately 100 percent of its budget (less appropriations from the Nuclear Waste Fund) from licensing, inspection, and annual fees charged to its applicants and licensees through 2000. Unless the law is extended, this requirement will revert to 33 percent of NRC's budget. Because of fairness and equity concerns related to charging NRC licensees for expenses that do not

provide a direct benefit to them, the Administration proposes to extend the requirement to collect fees at approximately 98 percent of the NRC's budget in 2001, 96 percent in 2002, 94 percent in 2003, 92 percent in 2004, and 90 percent in 2005.

2. Proposals for Mandatory User Fees to Offset Discretionary Spending

a. Offsetting collections deposited in appropriation accounts

Federal Deposit Insurance Corporation (FDIC)

Recovery of supervision and regulation expenses.—The Administration proposes to require the FDIC and the Federal Reserve to recover their respective costs for supervision and regulation of state-chartered banks and bank holding companies. Currently, supervision and regulation expenses are funded from deposit insurance premiums (FDIC) and interest earnings on Treasury securities (Federal Reserve). The FDIC's collections would finance its state bank supervision and regulation operations.

b. Offsetting collections deposited in receipt accounts

Corps of Engineers

Harbor services fee.—The Administration proposes to replace collection of the ad valorem harbor maintenance tax with a cost-based user fee, the harbor services user fee. The user fee will finance construction, operation, and maintenance of harbor activities performed by the Corps of Engineers, the costs of operating and maintaining the Saint Lawrence Seaway, and the costs of administering the fee. Through appropriations acts, the fee will raise an average of $980 million annually through 2005, which is less than would have been raised by the harbor maintenance tax before the Supreme Court decision that the ad valorem tax on exports was unconstitutional. While the collections from the harbor services fee would be mandatory, collections would be available to offset discretionary spending.

c. Receipts

Department of Transportation

Federal Aviation Administration (FAA), cost-based user fees.—The Budget proposes to reduce the existing aviation excise taxes over time as more efficient, cost-based user fees for air traffic services are phased in beginning in 2001. Under this proposal, the collections each year from the new cost-based user fees and the existing excise taxes combined would be equal to the total budget resources requested for the FAA in each succeeding year. In 2001, this proposal would result in the collection of $1.0 billion in additional aviation user charges. These charges will be deposited into a governmental receipt account and be made available for FAA discretionary spending.

B. User Fee Proposals to Offset Mandatory Spending

a. Offsetting collections deposited in appropriation accounts

Department of Agriculture

Federal crop insurance.—The President's Budget contains a proposal to strengthen the farm safety net that includes nearly $1 billion in crop insurance reforms. These reforms include a crop insurance premium discount which is expected to attract new participants to the crop insurance program and induce current participants to purchase higher coverage levels. Both of these expected outcomes will result in an increase in gross premiums, a portion of which are paid by producers. The estimated increase in producer-paid premiums as a result of the safety net proposal is $69 million, as shown in Table 4–3.

Department of Labor

Implement alien labor certification fees.—The proposal would establish a new fee, charged to businesses, for processing of alien labor certification applications by the Department of Labor. The fee proceeds would offset the costs of administering and enforcing the alien labor program, and provide reemployment and training assistance to U.S. workers who have been dislocated from their jobs.

Federal Emergency Management Agency (FEMA)

Flood map license fee.—The Administration proposes to establish a $12 license fee on the use of FEMA's flood hazard maps to support a multi-year program to update and modernize FEMA's inventory of flood-plain maps (100,000 maps). Accurate and easy to use flood hazard maps are essential in determining if a property is located in a flood plain. The maps allow lenders to meet their statutory obligation of requiring the risk-prone homes they insure to carry flood insurance, and allow homeowners to assess their risk of flood damage. The maps are the basis for developing appropriate risk-based flood insurance premium charges, and improved maps will result in a more actuarially sound insurance program.

b. Offsetting collections deposited in receipt accounts

Department of Agriculture

Recreation and entrance fees.—The Administration proposes to permanently extend the current pilot program which expires in 2001. The United States Forest Service would be allowed to collect increased recreation and entrance fees and use the receipts without further appropriation for facility improvements and new services. The Forest Service would also be authorized to use collections from existing fees for similar improvements and services.

Concession, land use, right of way, and filming permits. This budget proposes to collect fair market value from a variety of forest uses, including special use permits for rights-of-way on Forest Service lands (e.g., for oil and gas pipelines, phone lines, and optic cables), recreational concessions, marinas, and film, motion pic-

ture, and other similar uses. Funds would be available for spending one year after these collections.

Department of Health and Human Services

Medicare premiums for retirees under the age of 65 and displaced workers.—The Administration proposes, in the context of the President's Medicare Reform Plan, 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 offset by the reduction in premium collections due to the Medicare savings proposals.

Medicare premiums for prescription drug benefit.—The President's Medicare reform plan includes a prescription drug benefit which is financed through a 50 percent premium. After paying the premium, Medicare beneficiaries receive first-dollar coverage of prescription drugs up to a $5,000 limit once the benefit is fully implemented.

Department of the Interior

Recreation and entrance fees.—The Administration proposes to permanently extend the current pilot program which expires in 2001. The National Park Service, Fish and Wildlife Service, and the Bureau of Land Management would be allowed to collect increased recreation and entrance fees and use the receipts without further appropriation for facility improvements and new services.

Filming and special use permits fees.—The Administration proposes to authorize the National Park Service and other land management agencies, including the Department of Agriculture's Forest Service, to increase fees for permits to use land and facilities for the making of motion pictures, television productions, still photos, sound tracks and other similar purposes. Collections would be available without further appropriations to cover related Government costs (as currently authorized) and provide a fair return to the Government.

Hardrock mining production fees.—The Administration proposes to charge mining companies a 5% fee on net smelter production from hard rock mining on public domain or reserved public domain Federal lands.

Department of the Treasury

Extend Customs conveyance and passenger and merchandise processing fees.—Under existing legislation, the Customs Conveyance/Passenger Fee and the Merchandise Processing Fee will expire on September 30, 2003. The Administration proposes to extend both of these fees starting on October 1, 2003.

OTHER OFFSETTING COLLECTIONS AND RECEIPTS

Table 4–4 shows that total offsetting collections and receipts from the public are estimated to be $214.8 billion in 2001. Of these, an estimated $141.4 billion are offsetting collections credited to appropriation accounts and an estimated $73.4 billion are deposited in offsetting receipt accounts.

The user fees in Table 4–4 were discussed in the previous section. Major offsetting collections deposited in expenditure accounts that are not user fees are precredit reform loan repayments, collections from States to supplement payments in the supplemental security income program, and collections for the Federal Savings and Loan resolution fund. Major offsetting receipts that are not user fees include spectrum auction receipts, rents and royalties for oil and gas on the Outer Continental Shelf, and interest income.

Table 4–5 includes all offsetting receipts 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 to be $413.2 billion in 2001—$339.9 billion are intragovernmental transactions, and $73.4 billion are from the public, shown in the table as proprietary receipts and offsetting governmental receipts.

As noted above, offsetting collections and receipts by agency are also displayed in Table 20–1, "Outlays to the Public, Net and Gross," which appears in Chapter 20 of this volume.

Table 4–4. OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC

(In millions of dollars)

	1999 Actual	Estimate	
		2000	2001
Offsetting collections credited to expenditure accounts:			
User fees:			
Postal service stamps and other postal fees	61,957	63,998	67,421
Defense Commissary Agency	4,967	4,999	4,999
Employee contributions for employees and retired employees health benefits funds	4,853	5,249	5,622
Sale of energy:			
Tennessee Valley Authority	6,818	6,590	6,718
Bonneville Power Administration	2,539	2,309	2,345
All other user fees	17,904	17,290	19,929
Subtotal, user fees	99,038	100,435	107,034
Other collections credited to expenditure accounts:			
Pre-credit reform loan repayments	14,919	14,977	14,787
Supplemental security income (collections from the States)	3,219	3,310	3,410
Federal Savings and Loan Insurance Corporation resolution fund	3,784	2,188	624
All other collections	15,417	16,524	15,564
Subtotal, other collections	37,339	36,999	34,385
Subtotal, collections credited to expenditure accounts	136,377	137,434	141,419
Offsetting receipts:			
User fees:			
Medicare premiums	21,561	21,735	23,160
Foreign military sales program	11,624	10,560	10,760
Immigration fees	1,053	1,219	1,389
Customs fees	1,210	1,255	1,294
All other user fees	2,498	2,396	3,521
Subtotal, user fees deposited in receipt accounts	37,946	37,165	40,124
Other collections deposited in receipt accounts:			
Spectrum auction receipts	1,505	2,076	3,559
OCS rents, bonuses, and royalties	3,098	3,550	3,691
Interest income	9,441	10,971	13,564
All other collections deposited in receipt accounts	18,941	20,794	12,426
Subtotal, other collections deposited in receipt accounts	32,985	37,391	33,240
Subtotal, collections deposited in receipt accounts	70,931	74,556	73,364
Total, offsetting collections and receipts from the public	**207,308**	**211,990**	**214,783**
Total, offsetting collections and receipts excluding off-budget	145,331	147,976	147,346
ADDENDUM:			
User fees that are offsetting collections and receipts [1]	136,984	137,600	147,158
Other offsetting collections and receipts from the public	70,324	74,390	67,625
Total, offsetting collections and receipts from the public	**207,308**	**211,990**	**214,783**

[1] Excludes user fees that are classified on the receipts side of the budget. For total user fees, see Table 4.1 or Table 4.2.

Table 4–5. OFFSETTING RECEIPTS BY TYPE

(In millions of dollars)

Source	1999 Actual	Estimate					
		2000	2001	2002	2003	2004	2005
INTRAGOVERNMENTAL TRANSACTIONS							
On-budget receipts:							
Federal intrafund transactions:							
Distributed by agency:							
Interest from the Federal Financing Bank	2,503	2,412	2,159	1,988	1,853	2,205	2,472
Interest on Government capital in enterprises	1,473	1,634	1,633	1,400	1,269	1,138	1,059
Other	1,119	1,721	2,084	2,190	2,298	2,361	2,354
Proposed Legislation (non-PAYGO)	.....	.....	65	79	82	85	96
Total Federal intrafunds	5,095	5,767	5,941	5,657	5,502	5,789	5,981
Trust intrafund transactions:							
Distributed by agency:							
Payments to railroad retirement	3,816	3,760	3,637	3,749	3,763	3,786	3,810
Other	.....	1	1	1	1	1	1
Total trust intrafunds	3,816	3,761	3,638	3,750	3,764	3,787	3,811
Total intrafund transactions	8,911	9,528	9,579	9,407	9,266	9,576	9,792
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Contributions to insurance programs:							
Military retirement fund	15,250	15,302	15,914	16,551	17,213	17,901	18,618
Supplementary medical insurance	62,185	65,063	69,777	75,983	83,259	89,121	96,212
Proposed Legislation (non-PAYGO)	.....	.....	–280	–780	3,636	9,668	11,404
Hospital insurance	7,367	7,865	7,571	7,855	8,409	8,952	9,476
Proposed Legislation (non-PAYGO)	.....	.....	15,400	12,600	.....	.....	.....
Railroad social security equivalent fund	98	105	88	88	89	91	94
Rail industry pension fund	394	265	238	243	248	255	262
Civilian supplementary retirement contributions	21,706	21,496	21,760	22,074	22,491	22,860	23,250
Proposed Legislation (non-PAYGO)	.....	.....	1	1	1	2	3
Unemployment insurance	403	399	454	474	500	543	574
Other contributions	438	541	441	492	488	485	482
Proposed Legislation (non-PAYGO)	.....	.....	38	37	36	36	34
Miscellaneous payments	597	960	569	577	566	570	580
Proposed Legislation (non-PAYGO)	.....	.....	1,467	–1	–1	–1	–1
Subtotal	108,438	111,996	133,438	136,194	136,935	150,483	160,988
Trust fund payments to Federal funds:							
Quinquennial adjustment for military service credits	.....	.....	1,152	.....	.....	.....	.....
Other	1,082	1,051	1,076	1,103	1,130	1,160	1,188
Proposed Legislation (non-PAYGO)	.....	.....	3,226	.....	.....	.....	.....
Subtotal	1,082	1,051	5,454	1,103	1,130	1,160	1,188
Total interfunds distributed by agency	109,520	113,047	138,892	137,297	138,065	151,643	162,176
Undistributed by agency:							
Employer share, employee retirement (on-budget):							
Civil service retirement and disability insurance (CSRDI)	9,094	8,879	9,335	9,729	9,839	10,344	10,895
Proposed Legislation (non-PAYGO)	.....	.....	–34	22	–17	–24	–26
CSRDI from Postal Service	6,001	6,437	6,624	6,799	6,919	7,041	7,166
Hospital insurance (contribution as employer) [1]	1,965	2,043	2,093	2,211	2,292	2,384	2,499
Postal employer contributions to FHI	611	633	659	687	717	749	781
Military retirement fund	10,417	11,454	11,413	11,781	12,114	12,459	12,825
Other Federal employees retirement	121	129	135	141	144	150	157
Total employer share, employee retirement (on-budget)	28,209	29,575	30,225	31,370	32,008	33,103	34,297
Interest received by on-budget trust funds	66,561	71,291	73,735	76,779	79,629	82,210	84,782
Proposed Legislation (non-PAYGO)	.....	65	377	1,413	2,297	2,556	2,804
Total interfund transactions undistributed by agency	94,770	100,931	104,337	109,562	113,934	117,869	121,883

Table 4–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	1999 Actual	Estimate					
		2000	2001	2002	2003	2004	2005
Total interfund transactions	204,290	213,978	243,229	246,859	251,999	269,512	284,059
Total on-budget receipts	213,201	223,506	252,808	256,266	261,265	279,088	293,851
Off-budget receipts:							
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Old-age, survivors, and disability insurance	10,824	11,663	10,985	11,494	12,048	12,813	13,725
Undistributed by agency:							
Employer share, employee retirement (off-budget)	7,385	7,860	8,212	8,919	9,493	10,144	10,905
Proposed Legislation (non-PAYGO)	.....	.....	–271	–321	–285	–289	–291
Interest received by off-budget trust funds	52,070	59,656	68,138	77,622	87,895	98,812	110,493
Total off-budget receipts:	70,279	79,179	87,064	97,714	109,151	121,480	134,832
Total intragovernmental transactions	**283,480**	**302,685**	**339,872**	**353,980**	**370,416**	**400,568**	**428,683**
PROPRIETARY RECEIPTS FROM THE PUBLIC							
Distributed by agency:							
Interest:							
Interest on foreign loans and deferred foreign collections	888	753	749	758	823	812	806
Interest on deposits in tax and loan accounts	935	1,152	1,104	1,052	1,052	1,052	1,052
Other interest (domestic—civil) [2]	7,617	9,066	10,369	11,372	12,368	13,324	14,216
Total interest	9,440	10,971	12,222	13,182	14,243	15,188	16,074
Royalties and rents	1,097	1,510	1,318	1,355	1,339	1,354	1,401
Proposed Legislation (PAYGO)	.....	.....	.....	9	33	33	33
Sale of products:							
Sale of timber and other natural land products	366	618	453	438	423	446	425
Proposed Legislation (non-PAYGO)	.....	.....	–1	–1	–1	–1	–1
Proposed Legislation (PAYGO)	.....	.....	219	262	288	286	293
Sale of minerals and mineral products	38	27	21	21	14	20	17
Sale of power and other utilities	731	737	776	758	753	750	690
Other	65	61	59	64	64	65	66
Total sale of products	1,200	1,443	1,527	1,542	1,541	1,566	1,490
Fees and other charges for services and special benefits:							
Medicare premiums and other charges (trust funds)	21,561	21,735	23,340	25,396	27,813	30,427	33,095
Proposed Legislation (PAYGO)	.....	.....	–180	226	8,052	10,921	13,703
Nuclear waste disposal revenues	662	663	550	550	550	545	535
Veterans life insurance (trust funds)	204	189	179	168	157	145	133
Other [2]	1,860	1,892	2,565	2,520	2,543	2,578	2,619
Proposed Legislation (non-PAYGO)	.....	.....	–3	–3	–3	–3	–3
Proposed Legislation (PAYGO)	.....	.....	–157	–66	–56	–42	–41
Legislative proposal, discretionary offset	.....	.....	966	963	960	996	1,015
Total fees and other charges	24,287	24,479	27,260	29,754	40,016	45,567	51,056
Sale of Government property:							
Sale of land and other real property	58	59	114	419	79	77	77
Proposed Legislation (PAYGO)	.....	.....	3	5	13	14	14
Military assistance program sales (trust funds)	11,624	10,560	10,760	10,890	10,920	11,020	11,150
Other	172	170	220	224	188	73	88
Total sale of Government property	11,854	10,789	11,097	11,538	11,200	11,184	11,329
Realization upon loans and investments:							
Foreign military credit sales	367	.....	.....	.....	.....	.....	.....
Negative subsidies and downward reestimates	5,914	10,606	894	5,176	5,424	5,690	6,323
Repayment of loans to foreign nations	175	253	254	67	80	81	87
Other	96	84	88	136	116	113	111
Total realization upon loans and investments	6,552	10,943	1,236	5,379	5,620	5,884	6,521

Table 4–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	1999 Actual	Estimate					
		2000	2001	2002	2003	2004	2005
Recoveries and refunds [2]	3,831	4,028	3,406	4,440	3,436	3,514	3,688
Proposed Legislation (PAYGO)	.....	.....	22	–180	–16	–24	–21
Legislative proposal, discretionary offset	.....	.....	1,309	.....	.....	.....	.....
Miscellaneous receipt accounts [2]	4,724	1,426	1,436	1,437	1,442	1,449	1,452
Total proprietary receipts from the public distributed by agency	62,985	65,589	60,833	68,456	78,854	85,715	93,023
Undistributed by agency:							
Other interest: Interest received from Outer Continental Shelf escrow account	1	.....	1,342	.....	.....	.....	.....
Rents and royalties on the Outer Continental Shelf:							
Rents and bonuses	791	365	809	401	277	249	236
Royalties	2,307	3,185	2,882	2,881	2,705	2,604	2,469
Sale of major assets	.....	.....	.....	.....	323	.....	.....
Total proprietary receipts from the public undistributed by agency	3,099	3,550	5,033	3,282	3,305	2,853	2,705
Total proprietary receipts from the public [3]	**66,084**	**69,139**	**65,866**	**71,738**	**82,159**	**88,568**	**95,728**
OFFSETTING GOVERNMENTAL RECEIPTS							
Distributed by agency:							
Regulatory fees	3,020	3,264	3,640	3,603	3,692	2,318	2,342
Proposed Legislation (non-PAYGO)	.....	.....	20	8	8	8	8
Proposed Legislation (PAYGO)	.....	.....	.....	.....	.....	1,460	1,524
Other	74	77	79	81	6	6	6
Undistributed by agency:							
Spectrum auction proceeds	1,753	2,076	3,559	5,535	2,480	770	675
Proposed Legislation (non-PAYGO)	.....	.....	200	200	200	200	200
Total offsetting governmental receipts	**4,847**	**5,417**	**7,498**	**9,427**	**6,386**	**4,762**	**4,755**
Total offsetting receipts	**354,411**	**377,241**	**413,236**	**435,145**	**458,961**	**493,898**	**529,166**

[1] Includes provision for covered Federal civilian employees and military personnel.
[2] Includes both Federal funds and trust funds.
[3] Consists of:

	1999 Actual	*Estimate*					
		2000	*2001*	*2002*	*2003*	*2004*	*2005*
Federal funds	27,796	35,402	30,725	34,052	34,218	35,065	36,661
Trust funds	38,267	33,708	35,099	37,644	47,899	53,461	59,025
Off-budget	21	29	42	42	42	42	42

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: 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, sizeable tax preferences are provided for pension contributions and earnings, employer contributions for medical insurance, mortgage interest payments on owner-occupied homes, capital gains, and payments of State and local individual income and property 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 for the revenue loss estimated from 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 1999–2005 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 of the chapter on performance measures and economic effects presents information related to assessment of the effect of tax expenditures on the achievement of program performance goals. This section is a complement to the government-wide performance plan required by the Government Performance and Results Act of 1993. Tax expenditures are also discussed in Section V 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, 1999. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 1999. 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 1999–2005 are displayed according to 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 tables.

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 could be stock-

holders, employees, customers, or others, depending on economic forces.

Table 5–3 ranks the major tax expenditures by fiscal year 2001 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

The revenue loss estimates shown for individual tax expenditures in Tables 5–1, 5–2, and 5–3 do not necessarily equal the increase in Federal revenues (or the change in the budget balance) that would result from repealing these 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, because 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 estimates 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 could yield their full potential revenue gains relatively quickly, whereas changes to other provisions would only gradually yield their full revenue potential, especially if certain deductions or exemptions were 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. Although 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 on major tax provisions may have some impact on overall levels of income and rates of economic growth and, thus, on the budget economic assumptions. In practice, 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 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 1999 which cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 1999 would cause a deferral of tax payments on wages in 1999 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 1999 pension contribution and accrued earnings would be paid out and taxes would 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							
		1999	2000	2001	2002	2003	2004	2005	2001–2005
	National Defense								
1	Exclusion of benefits and allowances to armed forces personnel	2,120	2,140	2,160	2,180	2,200	2,220	2,240	11,000
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	2,330	2,550	2,790	3,040	3,285	3,545	3,825	16,485
3	Exclusion of certain allowances for Federal employees abroad	635	665	695	725	760	795	830	3,805
4	Exclusion of income of foreign sales corporations	3,640	3,890	4,160	4,460	4,770	5,100	5,460	23,950
5	Inventory property sales source rules exception	1,050	1,100	1,150	1,250	1,350	1,450	1,550	6,750
6	Deferral of income from controlled foreign corporations (normal tax method)	5,800	6,200	6,600	7,000	7,450	7,900	8,400	37,350
7	Deferred taxes for financial firms on certain income earned overseas	960	1,190	1,290	540	0	0	0	1,830
	General science, space, and technology:								
8	Expensing of research and experimentation expenditures (normal tax method)	1,890	1,865	1,885	1,965	2,090	2,245	2,410	10,595
9	Credit for increasing research activities	1,705	1,010	3,360	3,710	2,970	2,605	1,505	14,150
	Energy:								
10	Expensing of exploration and development costs, fuels	–80	–15	–30	–10	15	15	15	5
11	Excess of percentage over cost depletion, fuels	265	275	280	280	285	290	290	1,425
12	Alternative fuel production credit	1,025	960	905	845	125	125	125	2,125
13	Exception from passive loss limitation for working interests in oil and gas properties	30	25	25	25	25	25	25	125
14	Capital gains treatment of royalties on coal	65	65	70	70	75	80	85	380
15	Exclusion of interest on energy facility bonds	115	115	115	120	120	120	120	595
16	Enhanced oil recovery credit	225	260	295	340	390	450	515	1,990
17	New technology credit	50	60	80	90	90	90	85	435
18	Alcohol fuel credits [1]	15	15	15	15	15	15	15	75
19	Tax credit and deduction for clean-fuel burning vehicles	85	90	105	100	80	55	20	360
20	Exclusion from income of conservation subsidies provided by public utilities	85	80	80	80	85	85	85	415
	Natural resources and environment:								
21	Expensing of exploration and development costs, nonfuel minerals	15	15	20	20	20	20	20	100
22	Excess of percentage over cost depletion, nonfuel minerals	225	230	245	250	265	275	285	1,320
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	460	460	470	475	480	480	490	2,395
24	Capital gains treatment of certain timber income	65	65	70	70	75	80	85	380
25	Expensing of multiperiod timber growing costs	495	500	530	565	590	605	630	2,920
26	Investment credit and seven-year amortization for reforestation expenditures	10	10	10	15	15	15	15	70
27	Tax incentives for preservation of historic structures	210	220	240	250	265	280	295	1,330
	Agriculture:								
28	Expensing of certain capital outlays	70	70	75	75	80	85	90	405
29	Expensing of certain multiperiod production costs	85	85	90	95	105	110	110	510
30	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
31	Capital gains treatment of certain income	635	665	695	725	760	795	830	3,805
32	Income averaging for farmers	75	75	80	80	80	85	85	410
33	Deferral of gain on sale of farm refiners	10	10	10	10	15	15	15	65
	Commerce and housing:								
	Financial institutions and insurance:								
34	Exemption of credit union income	1,470	1,550	1,650	1,765	1,890	2,020	2,155	9,480
35	Excess bad debt reserves of financial institutions	60	65	55	45	35	20	5	160
36	Exclusion of interest on life insurance savings	13,920	14,985	16,130	17,365	18,870	20,130	21,680	94,175
37	Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25
38	Tax exemption of certain insurance companies owned by tax-exempt organizations	220	225	235	240	250	255	265	1,245
39	Small life insurance company deduction	100	100	100	100	100	105	105	510
	Housing:								
40	Exclusion of interest on owner-occupied mortgage subsidy bonds	905	915	920	930	940	950	955	4,695
41	Exclusion of interest on rental housing bonds	155	155	160	160	160	160	160	800
42	Deductibility of mortgage interest on owner-occupied homes	56,920	58,815	60,925	63,240	65,955	68,965	72,160	331,245
43	Deductibility of State and local property tax on owner-occupied homes	21,215	22,185	23,075	24,000	24,980	25,915	26,840	124,810
44	Deferral of income from post-1987 installment sales	995	1,015	1,035	1,055	1,075	1,095	1,115	5,375
45	Capital gains exclusion on home sales	18,000	18,540	19,095	19,670	20,260	20,870	21,495	101,390
46	Exception from passive loss rules for $25,000 of rental loss	5,315	5,035	4,790	4,555	4,330	4,100	3,885	21,660
47	Credit for low-income housing investments	2,820	3,055	3,195	3,300	3,405	3,485	3,540	16,925
48	Accelerated depreciation on rental housing (normal tax method)	3,710	3,985	4,225	4,500	4,765	4,975	5,145	23,610
	Commerce:								
49	Cancellation of indebtedness	40	25	15	15	20	20	25	95
50	Exceptions from imputed interest rules	160	160	160	165	165	165	165	820
51	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	39,405	40,575	41,780	43,025	44,300	45,615	46,965	221,685
52	Capital gains exclusion of small corporation stock	5	5	5	5	5	5	5	25
53	Step-up basis of capital gains at death	25,800	27,090	28,240	29,370	30,545	31,765	33,035	152,955
54	Carryover basis of capital gains on gifts	175	185	195	205	210	220	230	1,060
55	Ordinary income treatment of loss from small business corporation stock sale	35	35	40	40	40	40	40	200

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							
		1999	2000	2001	2002	2003	2004	2005	2001–2005
56	Accelerated depreciation of buildings other than rental housing (normal tax method)	1,660	710	–435	–755	–1,115	–1,695	–2,145	–6,145
57	Accelerated depreciation of machinery and equipment (normal tax method)	26,445	27,740	32,830	33,345	34,265	36,390	37,330	174,160
58	Expensing of certain small investments (normal tax method)	1,465	1,590	1,925	1,965	1,920	1,895	1,905	9,610
59	Amortization of start-up costs (normal tax method)	200	205	205	215	215	220	225	1,080
60	Graduated corporation income tax rate (normal tax method)	6,360	6,300	6,275	6,460	6,490	6,710	6,815	32,750
61	Exclusion of interest on small issue bonds	310	315	315	320	320	325	330	1,610
	Transportation:								
62	Deferral of tax on shipping companies	15	15	15	15	15	15	15	75
63	Exclusion of reimbursed employee parking expenses	1,725	1,805	1,895	1,995	2,100	2,210	2,330	10,530
64	Exclusion for employer-provided transit passes	130	150	170	190	215	235	260	1,070
	Community and regional development:								
65	Investment credit for rehabilitation of structures (other than historic)	25	25	30	30	30	30	30	150
66	Exclusion of interest for airport, dock, and similar bonds	730	735	740	750	755	765	770	3,780
67	Exemption of certain mutuals' and cooperatives' income	60	60	60	65	65	65	70	325
68	Empowerment zones and enterprise communities	330	445	500	465	330	300	260	1,855
69	Expensing of environmental remediation costs	115	150	175	60	–30	–35	–30	140
	Education, training, employment, and social services:								
	Education:								
70	Exclusion of scholarship and fellowship income (normal tax method)	1,085	1,110	1,120	1,130	1,140	1,150	1,165	5,705
71	HOPE tax credit	4,595	4,925	5,125	5,145	4,745	4,615	5,335	24,965
72	Lifetime Learning tax credit	2,170	2,375	2,420	2,465	4,405	4,430	4,630	18,350
73	Education Individual Retirement Accounts	0	10	25	40	60	80	105	310
74	Deductibility of student-loan interest	240	265	310	350	375	395	430	1,860
75	Deferral for State prepaid tuition plans	120	175	225	275	320	350	385	1,555
76	Exclusion of interest on student-loan bonds	245	250	255	255	255	260	260	1,285
77	Exclusion of interest on bonds for private nonprofit educational facilities	590	595	600	600	610	615	620	3,045
78	Credit for holders of zone academy bonds	5	10	20	35	50	65	70	240
79	Exclusion of interest on savings bonds redeemed to finance educational expenses	10	15	15	15	15	20	20	85
80	Parental personal exemption for students age 19 or over	915	965	1,015	1,055	1,105	1,155	1,185	5,515
81	Child credit [2]	19,435	19,575	19,480	18,970	18,155	17,535	16,855	90,995
82	Deductibility of charitable contributions (education)	2,525	2,650	2,765	2,910	3,035	3,140	3,300	15,150
83	Exclusion of employer-provided educational assistance	220	235	250	175	0	0	0	425
	Training, employment, and social services:								
84	Work opportunity tax credit	270	455	465	350	215	95	35	1,160
85	Welfare-to-work tax credit	35	60	80	80	60	25	10	255
86	Exclusion of employer-provided child care	645	670	700	725	765	805	850	3,845
87	Adoption assistance	125	140	140	125	40	15	10	330
88	Exclusion of employee meals and lodging (other than military)	650	680	710	740	775	810	845	3,880
89	Credit for child and dependent care expenses	2,420	2,390	2,360	2,330	2,305	2,275	2,250	11,520
90	Credit for disabled access expenditures	50	50	55	55	55	60	60	285
91	Expensing of costs of removing certain architectural barriers to the handicapped	0	0	5	5	5	5	5	25
92	Deductibility of charitable contributions, other than education and health	19,220	20,015	20,860	21,780	22,750	23,765	24,895	114,050
93	Exclusion of certain foster care payments	35	40	40	45	45	50	50	230
94	Exclusion of parsonage allowances	320	340	365	390	415	445	475	2,090
	Health:								
95	Exclusion of employer contributions for medical insurance premiums and medical care	69,610	75,095	80,570	86,175	90,655	95,960	102,725	456,085
96	Self-employed medical insurance premiums	935	1,250	1,380	1,545	2,070	2,905	3,210	11,110
97	Workers' compensation insurance premiums	4,420	4,585	4,555	4,935	5,120	5,315	5,515	25,440
98	Medical Savings Accounts	20	30	30	30	30	30	25	145
99	Deductibility of medical expenses	3,695	3,910	4,160	4,440	4,720	5,005	5,305	23,630
100	Exclusion of interest on hospital construction bonds	1,210	1,225	1,235	1,250	1,265	1,275	1,290	6,315
101	Deductibility of charitable contributions (health)	2,675	2,800	2,930	3,080	3,210	3,315	3,490	16,025
102	Tax credit for orphan drug research	70	80	90	100	115	130	140	575
103	Special Blue Cross/Blue Shield deduction	245	315	200	135	180	245	315	1,075
	Income security:								
104	Exclusion of railroad retirement system benefits	395	405	410	415	420	430	430	2,105
105	Exclusion of workers' compensation benefits	5,185	5,330	5,785	6,040	6,310	6,575	6,865	31,575
106	Exclusion of public assistance benefits (normal tax method)	345	360	375	390	405	420	435	2,025
107	Exclusion of special benefits for disabled coal miners	75	75	70	70	65	60	55	320
108	Exclusion of military disability pensions	130	130	135	140	140	145	150	710
	Net exclusion of pension contributions and earnings:								
109	Employer plans	83,780	88,830	92,390	97,085	102,575	108,020	113,705	513,775
110	Individual Retirement Accounts	13,350	15,050	15,975	17,030	17,630	18,250	18,750	87,635
111	Keogh plans	5,230	5,550	5,895	6,255	6,635	7,040	7,465	33,290
	Exclusion of other employee benefits:								

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							
		1999	2000	2001	2002	2003	2004	2005	2001–2005
112	Premiums on group term life insurance	1,700	1,740	1,780	1,820	1,860	1,915	1,970	9,345
13	Premiums on accident and disability insurance	185	195	205	215	225	235	245	1,125
114	Income of trusts to finance supplementary unemployment benefits	0	0	0	5	5	5	5	20
115	Special ESOP rules	1,130	1,175	1,205	1,250	1,300	1,360	1,425	6,540
116	Additional deduction for the blind	30	30	30	30	35	35	35	165
117	Additional deduction for the elderly	1,785	1,830	1,890	1,955	1,985	2,030	2,110	9,970
118	Tax credit for the elderly and disabled	35	35	35	35	35	35	35	175
119	Deductibility of casualty losses	255	265	275	285	295	310	325	1,490
120	Earned income tax credit [3]	4,825	4,700	4,790	4,985	5,205	5,440	5,740	26,160
	Social Security:								
	Exclusion of social security benefits:								
121	Social Security benefits for retired workers	17,135	18,010	18,885	19,995	21,230	22,505	16,515	99,130
122	Social Security benefits for disabled	2,390	2,595	2,830	3,090	3,375	3,700	3,150	16,145
123	Social Security benefits for dependents and survivors	3,775	3,900	4,050	4,210	4,385	4,555	3,625	20,825
	Veterans benefits and services:								
124	Exclusion of veterans death benefits and disability compensation	2,940	3,070	3,200	3,335	3,490	3,655	3,830	17,510
125	Exclusion of veterans pensions	65	70	75	80	85	85	90	415
126	Exclusion of GI bill benefits	75	85	90	90	95	100	105	480
127	Exclusion of interest on veterans housing bonds	40	40	40	40	40	40	40	200
	General purpose fiscal assistance:								
128	Exclusion of interest on public purpose bonds	22,750	22,975	23,205	23,440	23,670	23,905	24,145	118,365
129	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	37,740	40,240	42,390	44,735	47,610	50,530	53,480	238,745
130	Tax credit for corporations receiving income from doing business in U.S. possessions	2,515	2,590	2,670	2,600	2,550	2,600	2,650	13,070
	Interest:								
131	Deferral of interest on U.S. savings bonds	1,015	1,065	1,115	1,175	1,235	1,295	1,355	6,175
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	21,215	22,185	23,075	24,000	24,980	25,915	26,840	124,810
	Nonbusiness State and local taxes other than on owner-occupied homes	37,740	40,240	42,390	44,735	47,610	50,530	53,480	238,745
	Exclusion of interest on State and local bonds for:								
	Public purposes	22,750	22,975	23,205	23,440	23,670	23,905	24,145	118,365
	Energy facilities	115	115	115	120	120	120	120	595
	Water, sewage, and hazardous waste disposal facilities	460	460	470	475	480	480	490	2,395
	Small-issues	310	315	315	320	320	325	330	1,610
	Owner-occupied mortgage subsidies	905	915	920	930	940	950	955	4,695
	Rental housing	155	155	160	160	160	160	160	800
	Airports, docks, and similar facilities	730	735	740	750	755	765	770	3,780
	Student loans	245	250	255	255	255	260	260	1,285
	Private nonprofit educational facilities	590	595	600	600	610	615	620	3,045
	Hospital construction	1,210	1,225	1,235	1,250	1,265	1,275	1,290	6,315
	Veterans' housing	40	40	40	40	40	40	40	200
	Credit for holders of zone academy bonds	5	10	20	35	50	65	70	240

[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: 1999 $760; 2000 $800; 2001 $805; 2002 $810; 2003 $815; 2004 $825; and 2005 $830.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1999 $445; 2000 $550; 2001 $520; 2002 $505; 2003 $460; 2004 $450; and 2005 $420.

[3] 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: 1999 $25,632; 2000 $25,676; 2001 $25,799; 2002 $26,876; 2003 $27,638; 2004 $28,701; and 2005 $29,722.

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. Provisions with estimates that rounded to zero in each year are not included in the table.

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

(In millions of dollars)

		Revenue Loss															
		Corporations								Individuals							
		1999	2000	2001	2002	2003	2004	2005	2001–2005	1999	2000	2001	2002	2003	2004	2005	2001–2005
	National Defense																
1	Exclusion of benefits and allowances to armed forces personnel	.....	.....	.....	.....	.....	.....	.....	.....	2,120	2,140	2,160	2,180	2,200	2,220	2,240	11,000
	International affairs:																
2	Exclusion of income earned abroad by U.S. citizens	.....	.....	.....	.....	.....	.....	.....	.....	2,330	2,550	2,790	3,040	3,285	3,545	3,825	16,485
3	Exclusion of certain allowances for Federal employees abroad	.....	.....	.....	.....	.....	.....	.....	.....	635	665	695	725	760	795	830	3,805
4	Exclusion of income of foreign sales corporations	3,640	3,890	4,160	4,460	4,770	5,100	5,460	23,950	.....	.....	.....	.....	.....	.....	.....	.....
5	Inventory property sales source rules exception	1,050	1,100	1,150	1,250	1,350	1,450	1,550	6,750	.....	.....	.....	.....	.....	.....	.....	.....
6	Deferral of income from controlled foreign corporations (normal tax method)	5,800	6,200	6,600	7,000	7,450	7,900	8,400	37,350	.....	.....	.....	.....	.....	.....	.....	.....
7	Deferred taxes for financial firms on certain income earned overseas	960	1,190	1,290	540	0	0	0	1,830	.....	.....	.....	.....	.....	.....	.....	.....
	General science, space, and technology:																
8	Expensing of research and experimentation expenditures (normal tax method)	1,855	1,830	1,850	1,925	2,050	2,200	2,365	10,390	35	35	35	40	40	45	45	205
9	Credit for increasing research activities	1,675	995	3,300	3,650	2,925	2,565	1,490	13,930	30	15	60	60	45	40	15	220
	Energy:																
10	Expensing of exploration and development costs, fuels	–70	–15	–30	–10	15	15	15	5	–10	0	0	0	0	0	0	0
11	Excess of percentage over cost depletion, fuels	220	225	230	230	235	240	240	1,175	45	50	50	50	50	50	50	250
12	Alternative fuel production credit	975	915	860	805	125	125	125	2,040	50	45	45	40	0	0	0	85
13	Exception from passive loss limitation for working interests in oil and gas properties	.....	.....	.....	.....	.....	.....	.....	.....	30	25	25	25	25	25	25	125
14	Capital gains treatment of royalties on coal	.....	.....	.....	.....	.....	.....	.....	.....	65	65	70	70	75	80	85	380
15	Exclusion of interest on energy facility bonds	30	30	30	30	30	30	30	150	85	85	85	90	90	90	90	445
16	Enhanced oil recovery credit	205	235	270	310	355	410	470	1,815	20	25	25	30	35	40	45	175
17	New technology credit	45	50	60	70	70	70	65	335	5	10	20	20	20	20	20	100
18	Alcohol fuel credits [1]	10	10	10	10	10	10	10	50	5	5	5	5	5	5	5	25
19	Tax credit and deduction for clean-fuel burning vehicles	70	75	85	80	65	45	15	290	15	15	20	20	15	10	5	70
20	Exclusion from income of conservation subsidies provided by public utilities	–5	–5	–5	–5	0	0	0	–10	90	85	85	85	85	85	85	425
	Natural resources and environment:																
21	Expensing of exploration and development costs, nonfuel minerals	10	10	15	15	15	15	15	75	5	5	5	5	5	5	5	25
22	Excess of percentage over cost depletion, nonfuel minerals	180	185	195	200	210	220	230	1,055	45	45	50	50	55	55	55	265
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	115	115	120	120	120	120	125	605	345	345	350	355	360	360	365	1,790
24	Capital gains treatment of certain timber income	.....	.....	.....	.....	.....	.....	.....	.....	65	65	70	70	75	80	85	380
25	Expensing of multiperiod timber growing costs	305	310	330	350	365	375	390	1,810	190	190	200	215	225	230	240	1,110
26	Investment credit and seven-year amortization for reforestation expenditures	.....	.....	.....	.....	.....	.....	.....	.....	10	10	10	15	15	15	15	70
27	Tax incentives for preservation of historic structures	170	180	195	205	215	230	240	1,085	40	40	45	45	50	50	55	245
	Agriculture:																
28	Expensing of certain capital outlays	10	10	10	10	10	10	10	50	60	60	65	65	70	75	80	355
29	Expensing of certain multiperiod production costs	10	10	10	10	15	15	15	65	75	75	80	85	90	95	95	445
30	Treatment of loans forgiven for solvent farmers	.....	.....	.....	.....	.....	.....	.....	.....	10	10	10	10	10	10	10	50
31	Capital gains treatment of certain income	.....	.....	.....	.....	.....	.....	.....	.....	635	665	695	725	760	795	830	3,805
32	Income averaging for farmers	.....	.....	.....	.....	.....	.....	.....	.....	75	75	80	80	80	85	85	410
33	Deferral of gain on sale of farm refiners	10	10	10	10	15	15	15	65								
	Commerce and housing:																
	Financial institutions and insurance:																
34	Exemption of credit union income	1,470	1,550	1,650	1,765	1,890	2,020	2,155	9,480	.....	.....	.....	.....	.....	.....	.....	.....
35	Excess bad debt reserves of financial institutions	60	65	55	45	35	20	5	160	.....	.....	.....	.....	.....	.....	.....	.....

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

(In millions of dollars)

		Revenue Loss															
		Corporations								Individuals							
		1999	2000	2001	2002	2003	2004	2005	2001–2005	1999	2000	2001	2002	2003	2004	2005	2001–2005
36	Exclusion of interest on life insurance savings	420	450	485	520	565	605	650	2,825	13,500	14,535	15,645	16,845	18,305	19,525	21,030	91,350
37	Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25	...	...	...	...	...	...	...	...
38	Tax exemption of certain insurance companies owned by tax-exempt organizations	220	225	235	240	250	255	265	1,245	...	...	...	...	...	...	...	...
39	Small life insurance company deduction	100	100	100	100	100	105	105	510	...	...	...	...	...	...	...	...
	Housing:																
40	Exclusion of interest on owner-occupied mortgage subsidy bonds	230	230	230	235	235	240	240	1,180	675	685	690	695	705	710	715	3,515
41	Exclusion of interest on rental housing bonds	40	40	40	40	40	40	40	200	115	115	120	120	120	120	120	600
42	Deductibility of mortgage interest on owner-occupied homes	...	...	...	...	...	...	...	...	56,920	58,815	60,925	63,240	65,955	68,965	72,160	331,245
43	Deductibility of State and local property tax on owner-occupied homes	...	...	...	...	...	...	...	...	21,215	22,185	23,075	24,000	24,980	25,915	26,840	124,810
44	Deferral of income from post-1987 installment sales	260	265	270	275	280	285	290	1,400	735	750	765	780	795	810	825	3,975
45	Capital gains exclusion on home sales	...	...	...	...	...	...	...	...	18,000	18,540	19,095	19,670	20,260	20,870	21,495	101,390
46	Exception from passive loss rules for $25,000 of rental loss	...	...	...	...	...	...	...	...	5,315	5,035	4,790	4,555	4,330	4,100	3,885	21,660
47	Credit for low-income housing investments	2,115	2,290	2,395	2,475	2,555	2,615	2,655	12,695	705	765	800	825	850	870	885	4,230
48	Accelerated depreciation on rental housing (normal tax method)	110	120	135	160	180	200	230	905	3,600	3,865	4,090	4,340	4,585	4,775	4,915	22,705
	Commerce:																
49	Cancellation of indebtedness	...	...	...	...	...	...	...	...	40	25	15	15	20	20	25	95
50	Exceptions from imputed interest rules	...	...	...	...	...	...	...	...	160	160	160	165	165	165	165	820
51	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	...	...	...	...	...	...	...	...	39,405	40,575	41,780	43,025	44,300	45,615	46,965	221,685
52	Capital gains exclusion of small corporation stock	...	...	...	...	...	...	...	...	5	5	5	5	5	5	5	25
53	Step-up basis of capital gains at death	...	...	...	...	...	...	...	...	25,800	27,090	28,240	29,370	30,545	31,765	33,035	152,955
54	Carryover basis of capital gains on gifts	...	...	...	...	...	...	...	...	175	185	195	205	210	220	230	1,060
55	Ordinary income treatment of loss from small business corporation stock sale	...	...	...	...	...	...	...	...	35	35	40	40	40	40	40	200
56	Accelerated depreciation of buildings other than rental housing (normal tax method)	1,195	655	230	15	–260	–625	–905	–1,545	465	55	–665	–770	–855	–1,070	–1,240	–4,600
57	Accelerated depreciation of machinery and equipment (normal tax method)	21,100	22,085	26,970	27,265	27,965	29,825	30,465	142,490	5,345	5,655	5,860	6,080	6,300	6,565	6,865	31,670
58	Expensing of certain small investments (normal tax method)	395	490	630	665	630	625	645	3,195	1,070	1,100	1,295	1,300	1,290	1,270	1,260	6,415
59	Amortization of start-up costs (normal tax method)	120	125	125	130	130	135	135	655	80	80	80	85	85	85	90	425
60	Graduated corporation income tax rate (normal tax method)	6,360	6,300	6,275	6,460	6,490	6,710	6,815	32,750	...	...	...	...	...	...	...	...
61	Exclusion of interest on small issue bonds	80	80	80	80	80	80	85	405	230	235	235	240	240	245	245	1,205
	Transportation:																
62	Deferral of tax on shipping companies	15	15	15	15	15	15	15	75	...	...	...	...	...	...	...	...
63	Exclusion of reimbursed employee parking expenses	...	...	...	...	...	...	...	...	1,725	1,805	1,895	1,995	2,100	2,210	2,330	10,530
64	Exclusion for employer-provided transit passes	...	...	...	...	...	...	...	...	130	150	170	190	215	235	260	1,070
	Community and regional development:																
65	Investment credit for rehabilitation of structures (other than historic)	15	15	15	15	15	15	15	75	10	10	15	15	15	15	15	75
66	Exclusion of interest for airport, dock, and similar bonds	185	185	185	190	190	195	195	955	545	550	555	560	565	570	575	2,825
67	Exemption of certain mutuals' and cooperatives' income	60	60	60	65	65	65	70	325	...	...	...	...	...	...	...	...
68	Empowerment zones and enterprise communities	150	205	220	185	130	110	90	735	180	240	280	280	200	190	170	1,120
69	Expensing of environmental remediation costs	95	125	145	50	–25	–30	–25	115	20	25	30	10	–5	–5	–5	25

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

(In millions of dollars)

		Revenue Loss															
		Corporations								Individuals							
		1999	2000	2001	2002	2003	2004	2005	2001–2005	1999	2000	2001	2002	2003	2004	2005	2001–2005
	Education, training, employment, and social services:																
	Education:																
70	Exclusion of scholarship and fellowship income (normal tax method)	...	...	...	...	...	...	...	...	1,085	1,110	1,120	1,130	1,140	1,150	1,165	5,705
71	HOPE tax credit	...	...	...	...	...	...	...	...	4,595	4,925	5,125	5,145	4,745	4,615	5,335	24,965
72	Lifetime Learning tax credit	...	...	...	...	...	...	...	...	2,170	2,375	2,420	2,465	4,405	4,430	4,630	18,350
73	Education Individual Retirement Accounts	...	...	...	...	...	...	...	...	0	10	25	40	60	80	105	310
74	Deductibility of student-loan interest	...	...	...	...	...	...	...	...	240	265	310	350	375	395	430	1,860
75	Deferral for State prepaid tuition plans	...	...	...	...	...	...	...	...	120	175	225	275	320	350	385	1,555
76	Exclusion of interest on student-loan bonds	60	65	65	65	65	65	65	325	185	185	190	190	190	195	195	960
77	Exclusion of interest on bonds for private nonprofit educational facilities	150	150	150	150	155	155	155	765	440	445	450	450	455	460	465	2,280
78	Credit for holders of zone academy bonds	5	10	20	35	50	65	70	240	...	...	...	...	...	...	...	...
79	Exclusion of interest on savings bonds redeemed to finance educational expenses	...	...	...	...	...	...	...	...	10	15	15	15	15	20	20	85
80	Parental personal exemption for students age 19 or over	...	...	...	...	...	...	...	...	915	965	1,015	1,055	1,105	1,155	1,185	5,515
81	Child credit [2]	...	...	...	...	...	...	...	...	19,435	19,575	19,480	18,970	18,155	17,535	16,855	90,995
82	Deductibility of charitable contributions (education)	485	515	545	595	615	610	650	3,015	2,040	2,135	2,220	2,315	2,420	2,530	2,650	12,135
83	Exclusion of employer-provided educational assistance	...	...	...	...	...	...	...	...	220	235	250	175	0	0	0	425
	Training, employment, and social services:																
84	Work opportunity tax credit	230	385	395	300	185	80	30	990	40	70	70	50	30	15	5	170
85	Welfare-to-work tax credit	30	50	65	70	50	20	10	215	5	10	15	10	10	5	0	40
86	Exclusion of employer-provided child care	...	...	...	...	...	...	...	...	645	670	700	725	765	805	850	3,845
87	Adoption assistance	...	...	...	...	...	...	...	...	125	140	140	125	40	15	10	330
88	Exclusion of employee meals and lodging (other than military)	...	...	...	...	...	...	...	...	650	680	710	740	775	810	845	3,880
89	Credit for child and dependent care expenses	...	...	...	...	...	...	...	...	2,420	2,390	2,360	2,330	2,305	2,275	2,250	11,520
90	Credit for disabled access expenditures	15	15	15	15	15	15	15	75	35	35	40	40	40	45	45	210
91	Expensing of costs of removing certain architectural barriers to the handicapped	0	0	5	5	5	5	5	25								
92	Deductibility of charitable contributions, other than education and health	600	635	680	740	760	755	805	3,740	18,620	19,380	20,180	21,040	21,990	23,010	24,090	110,310
93	Exclusion of certain foster care payments	...	...	...	...	...	...	...	...	35	40	40	45	45	50	50	230
94	Exclusion of parsonage allowances	...	...	...	...	...	...	...	...	320	340	365	390	415	445	475	2,090
	Health:																
95	Exclusion of employer contributions for medical insurance premiums and medical care	...	...	...	...	...	...	...	...	69,610	75,095	80,570	86,175	90,655	95,960	102,725	456,085
96	Self-employed medical insurance premiums	...	...	...	...	...	...	...	...	935	1,250	1,380	1,545	2,070	2,905	3,210	11,110
97	Workers' compensation insurance premiums	...	...	...	...	...	...	...	...	4,420	4,585	4,555	4,935	5,120	5,315	5,515	25,440
98	Medical Savings Accounts	...	...	...	...	...	...	...	...	20	30	30	30	30	30	25	145
99	Deductibility of medical expenses	...	...	...	...	...	...	...	...	3,695	3,910	4,160	4,440	4,720	5,005	5,305	23,630
00	Exclusion of interest on hospital construction bonds	305	310	310	315	320	320	325	1,590	905	915	925	935	945	955	965	4,725
101	Deductibility of charitable contributions (health)	585	620	660	720	740	735	780	3,635	2,090	2,180	2,270	2,360	2,470	2,580	2,710	12,390
102	Tax credit for orphan drug research	70	80	90	100	115	130	140	575	...	...	...	...	...	...	...	...
103	Special Blue Cross/Blue Shield deduction	245	315	200	135	180	245	315	1,075	...	...	...	...	...	...	...	...
	Income security:																
104	Exclusion of railroad retirement system benefits	...	...	...	...	...	...	...	...	395	405	410	415	420	430	430	2,105
105	Exclusion of workers' compensation benefits	...	...	...	...	...	...	...	...	5,185	5,330	5,785	6,040	6,310	6,575	6,865	31,575
106	Exclusion of public assistance benefits (normal tax method)	...	...	...	...	...	...	...	...	345	360	375	390	405	420	435	2,025

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

(In millions of dollars)

		Revenue Loss															
		Corporations								Individuals							
		1999	2000	2001	2002	2003	2004	2005	2001–2005	1999	2000	2001	2002	2003	2004	2005	2001–2005
107	Exclusion of special benefits for disabled coal miners	...	...	...	...	...	...	...	...	75	75	70	70	65	60	55	320
108	Exclusion of military disability pensions	...	...	...	...	...	...	...	...	130	130	135	140	140	145	150	710
	Net exclusion of pension contributions and earnings:																
109	Employer plans	...	...	...	...	...	...	...	...	83,780	88,830	92,390	97,085	102,575	108,020	113,705	513,775
110	Individual Retirement Accounts	...	...	...	...	...	...	...	...	13,350	15,050	15,975	17,030	17,630	18,250	18,750	87,635
111	Keogh plans	...	...	...	...	...	...	...	...	5,230	5,550	5,895	6,255	6,635	7,040	7,465	33,290
	Exclusion of other employee benefits:																
112	Premiums on group term life insurance	...	...	...	...	...	...	...	...	1,700	1,740	1,780	1,820	1,860	1,915	1,970	9,345
113	Premiums on accident and disability insurance	...	...	...	...	...	...	...	...	185	195	205	215	225	235	245	1,125
114	Income of trusts to finance supplementary unemployment benefits	0	0	0	5	5	5	5	20	...	...	...	...	...	...	...	...
115	Special ESOP rules	860	890	915	950	990	1,040	1,090	4,985	270	285	290	300	310	320	335	1,555
116	Additional deduction for the blind	...	...	...	...	...	...	...	...	30	30	30	30	35	35	35	165
117	Additional deduction for the elderly	...	...	...	...	...	...	...	...	1,785	1,830	1,890	1,955	1,985	2,030	2,110	9,970
118	Tax credit for the elderly and disabled	...	...	...	...	...	...	...	...	35	35	35	35	35	35	35	175
119	Deductibility of casualty losses	...	...	...	...	...	...	...	...	255	265	275	285	295	310	325	1,490
120	Earned income tax credit [3]	...	...	...	...	...	...	...	...	4,825	4,700	4,790	4,985	5,205	5,440	5,740	26,160
	Social Security:																
	Exclusion of social security benefits:																
121	Social Security benefits for retired workers	...	...	...	...	...	...	...	...	17,135	18,010	18,885	19,995	21,230	22,505	16,515	99,130
122	Social Security benefits for disabled	...	...	...	...	...	...	...	...	2,390	2,595	2,830	3,090	3,375	3,700	3,150	16,145
123	Social Security benefits for dependents and survivors	...	...	...	...	...	...	...	...	3,775	3,900	4,050	4,210	4,385	4,555	3,625	20,825
	Veterans benefits and services:																
124	Exclusion of veterans death benefits and disability compensation	...	...	...	...	...	...	...	...	2,940	3,070	3,200	3,335	3,490	3,655	3,830	17,510
125	Exclusion of veterans pensions	...	...	...	...	...	...	...	...	65	70	75	80	85	85	90	415
126	Exclusion of GI bill benefits	...	...	...	...	...	...	...	...	75	85	90	90	95	100	105	480
127	Exclusion of interest on veterans housing bonds	10	10	10	10	10	10	10	50	30	30	30	30	30	30	30	150
	General purpose fiscal assistance:																
128	Exclusion of interest on public purpose bonds	5,735	5,790	5,850	5,910	5,965	6,025	6,085	29,835	17,015	17,185	17,355	17,530	17,705	17,880	18,060	88,530
129	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	...	...	...	...	...	...	...	...	37,740	40,240	42,390	44,735	47,610	50,530	53,480	238,745
130	Tax credit for corporations receiving income from doing business in U.S. possessions	2,515	2,590	2,670	2,600	2,550	2,600	2,650	13,070	...	...	...	...	...	...	...	...
	Interest:																
131	Deferral of interest on U.S. savings bonds	...	...	...	...	...	...	...	...	1,015	1,065	1,115	1,175	1,235	1,295	1,355	6,175
	Addendum: Aid to State and local governments:																
	Deductibility of:																
	Property taxes on owner-occupied homes	...	...	...	...	...	...	...	...	21,215	22,185	23,075	24,000	24,980	25,915	26,840	124,810
	Nonbusiness State and local taxes other than on owner-occupied homes	...	...	...	...	...	...	...	...	37,740	40,240	42,390	44,735	47,610	50,530	53,480	238,745
	Exclusion of interest on State and local bonds for:																
	Public purposes	5,735	5,790	5,850	5,910	5,965	6,025	6,085	29,835	17,015	17,185	17,355	17,530	17,705	17,880	18,060	88,530
	Energy facilities	30	30	30	30	30	30	30	150	85	85	85	90	90	90	90	445
	Water, sewage, and hazardous waste disposal facilities	115	115	120	120	120	120	125	605	345	345	350	355	360	360	365	1,790
	Small-issues	80	80	80	80	80	80	85	405	230	235	235	240	240	245	245	1,205
	Owner-occupied mortgage subsidies	230	230	230	235	235	240	240	1,180	675	685	690	695	705	710	715	3,515
	Rental housing	40	40	40	40	40	40	40	200	115	115	120	120	120	120	120	600
	Airports, docks, and similar facilities	185	185	185	190	190	195	195	955	545	550	555	560	565	570	575	2,825
	Student loans	60	65	65	65	65	65	65	325	185	185	190	190	190	195	195	960
	Private nonprofit educational facilities	150	150	150	150	155	155	155	765	440	445	450	450	455	460	465	2,280
	Hospital construction	305	310	310	315	320	320	325	1,590	905	915	925	935	945	955	965	4,725
	Veterans' housing	10	10	10	10	10	10	10	50	30	30	30	30	30	30	30	150

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

(In millions of dollars)

		Revenue Loss															
		Corporations								Individuals							
		1999	2000	2001	2002	2003	2004	2005	2001–2005	1999	2000	2001	2002	2003	2004	2005	2001–2005
	Credit for holders of zone academy bonds	5	10	20	35	50	65	70	240	.....	.....	.....	.....	.....	.....	.....	.....

[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: 1999 $760; 2000 $800; 2001 $805; 2002 $810; 2003 $815; 2004 $825; and 2005 $830.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1999 $445; 2000 $550; 2001 $520; 2002 $505; 2003 $460; 2004 $450; and 2005 $420.

[3] 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: 1999 $25,632; 2000 $25,676; 2001 $25,799; 2002 $26,876; 2003 $27,638; 2004 $28,701; and 2005 $29,722.

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. Provisions with estimates that rounded to zero in each year are not included in the table.

Table 5–3. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 2001 REVENUE LOSS

(In millions of dollars)

Provision	2001	2001–2005
Net exclusion of pension contributions and earnings: Employer plans	92,390	513,775
Exclusion of employer contributions for medical insurance premiums and medical care	80,570	456,085
Deductibility of mortgage interest on owner-occupied homes	60,925	331,245
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	42,390	238,745
Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	41,780	221,685
Accelerated depreciation of machinery and equipment (normal tax method)	32,830	174,160
Step-up basis of capital gains at death	28,240	152,955
Deductibility of charitable contributions, total	26,555	145,225
Exclusion of interest on public purpose bonds	23,205	118,365
Deductibility of State and local property tax on owner-occupied homes	23,075	124,810
Child credit [2]	19,480	90,995
Capital gains exclusion on home sales	19,095	101,390
Exclusion of Social Security benefits for retired workers	18,885	99,130
Exclusion of interest on life insurance savings	16,130	94,175
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	15,975	87,635
Deferral of income from controlled foreign corporations (normal tax method)	6,600	37,350
Graduated corporation income tax rate (normal tax method)	6,275	32,750
Net exclusion of pension contributions and earnings: Keogh plans	5,895	33,290
Exclusion of workers' compensation benefits	5,785	31,575
HOPE tax credit	5,125	24,965
Exclusion of interest on non-public purpose State and local debt	4,850	24,720
Earned income tax credit [3]	4,790	26,160
Exception from passive loss rules for $25,000 of rental loss	4,790	21,660
Workers' compensation insurance premiums	4,555	25,440
Accelerated depreciation on rental housing (normal tax method)	4,225	23,610
Exclusion of income of foreign sales corporations	4,160	23,950
Deductibility of medical expenses	4,160	23,630
Exclusion of Social Security benefits for dependents and survivors	4,050	20,825
Credit for increasing research activities	3,360	14,150
Exclusion of veterans death benefits and disability compensation	3,200	17,510
Credit for low-income housing investments	3,195	16,925
Exclusion of Social Security benefits for disabled	2,830	16,145
Exclusion of income earned abroad by U.S. citizens	2,790	16,485
Tax credit for corporations receiving income from doing business in U.S. possessions	2,670	13,070
Lifetime Learning tax credit	2,420	18,350
Credit for child and dependent care expenses	2,360	11,520
Exclusion of benefits and allowances to armed forces personnel	2,160	11,000
Expensing of certain small investments (normal tax method)	1,925	9,610
Exclusion of reimbursed employee parking expenses	1,895	10,530
Additional deduction for the elderly	1,890	9,970
Expensing of research and experimentation expenditures (normal tax method)	1,885	10,595
Exclusion of other employee benefits: Premiums on group term life insurance	1,780	9,345
Exemption of credit union income	1,650	9,480
Self-employed medical insurance premiums	1,380	11,110
Deferred taxes for financial firms on certain income earned overseas	1,290	1,830
Special ESOP rules	1,205	6,540
Inventory property sales source rules exception	1,150	6,750
Exclusion of scholarship and fellowship income (normal tax method)	1,120	5,705
Deferral of interest on U.S. savings bonds	1,115	6,175
Deferral of income from post-1987 installment sales	1,035	5,375
Parental personal exemption for students age 19 or over	1,015	5,515
Alternative fuel production credit	905	2,125
Exclusion of employee meals and lodging (other than military)	710	3,880
Exclusion of employer-provided child care	700	3,845
Capital gains treatment of certain income from agriculture	695	3,805
Exclusion of certain allowances for Federal employees abroad	695	3,805
Expensing of multiperiod timber growing costs	530	2,920
Excess of percentage over cost depletion, fuels and nonfuel minerals	525	2,745
Empowerment zones and enterprise communities	500	1,855
Work opportunity tax credit	465	1,160
Exclusion of railroad retirement system benefits	410	2,105
Exclusion of public assistance benefits (normal tax method)	375	2,025
Exclusion of parsonage allowances	365	2,090
Deductibility of student-loan interest	310	1,860
Enhanced oil recovery credit	295	1,990
Deductibility of casualty losses	275	1,490
Exclusion of employer-provided educational assistance	250	425
Tax incentives for preservation of historic structures	240	1,330
Tax exemption of certain insurance companies owned by tax-exempt organizations	235	1,245

Table 5–3. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 2001 REVENUE LOSS—Continued

(In millions of dollars)

Provision	2001	2001–2005
Deferral for State prepaid tuition plans	225	1,555
Amortization of start-up costs (normal tax method)	205	1,080
Exclusion of other employee benefits: Premiums on accident and disability insurance	205	1,125
Special Blue Cross/Blue Shield deduction	200	1,075
Carryover basis of capital gains on gifts	195	1,060
Expensing of environmental remediation costs	175	140
Exclusion for employer-provided transit passes	170	1,070
Exceptions from imputed interest rules	160	820
Adoption assistance	140	330
Exclusion of military disability pensions	135	710
Tax credit and deduction for clean-fuel burning vehicles	105	360
Small life insurance company deduction	100	510
Expensing of certain multiperiod production costs	90	510
Exclusion of GI bill benefits	90	480
Tax credit for orphan drug research	90	575
Welfare-to-work tax credit	80	255
Income averaging for farmers	80	410
New technology credit	80	435
Exclusion from income of conservation subsidies provided by public utilities	80	415
Exclusion of veterans pensions	75	415
Expensing of certain capital outlays	75	405
Capital gains treatment of royalties on coal	70	380
Exclusion of special benefits for disabled coal miners	70	320
Capital gains treatment of certain timber income	70	380
Exemption of certain mutuals' and cooperatives' income	60	325
Credit for disabled access expenditures	55	285
Excess bad debt reserves of financial institutions	55	160
Ordinary income treatment of loss from small business corporation stock sale	40	200
Exclusion of certain foster care payments	40	230
Tax credit for the elderly and disabled	35	175
Medical Savings Accounts	30	145
Additional deduction for the blind	30	165
Investment credit for rehabilitation of structures (other than historic)	30	150
Education Individual Retirement Accounts	25	310
Exception from passive loss limitation for working interests in oil and gas properties	25	125
Credit for holders of zone academy bonds	20	240
Expensing of exploration and development costs, nonfuel minerals	20	100
Cancellation of indebtedness	15	95
Alcohol fuel credits [1]	15	75
Exclusion of interest on savings bonds redeemed to finance educational expenses	15	85
Deferral of tax on shipping companies	15	75
Deferral of gain on sale of farm refiners	10	65
Investment credit and seven-year amortization for reforestation expenditures	10	70
Treatment of loans forgiven for solvent farmers	10	50
Capital gains exclusion of small corporation stock	5	25
Special alternative tax on small property and casualty insurance companies	5	25
Expensing of costs of removing certain architectural barriers to the handicapped	5	25
Income of trusts to finance supplementary unemployment benefits	0	20
Expensing of exploration and development costs, fuels	–30	5
Accelerated depreciation of buildings other than rental housing (normal tax method)	–435	–6,145

[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: 1999 $760; 2000 $800; 2001 $805; 2002 $810; 2003 $815; 2004 $825; and 2005 $830.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1999 $445; 2000 $550; 2001 $520; 2002 $505; 2003 $460; 2004 $450; and 2005 $420.

[3] 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: 1999 $25,630; 2000 $25,675; 2001 $25,800; 2002 $26,875; 2003 $27,640; 2004 $28,700; and 2005 $29,720.

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. Provisions with estimates that rounded to zero in each year are not included in the table.

Note: Three categories in the table are aggregated: Deductibility of charitable contributions, exclusion of interest for non-public purpose State and local debt, and excess of percentage over cost depletion for fuels and nonfuel minerals.

Table 5–4. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 1999

(In millions of dollars)

	Provision	Present Value of Revenue Loss
1	Deferral of income from controlled foreign corporations (normal tax method)	5,960
2	Deferred taxes for financial firms on income earned overseas	965
3	Expensing of research and experimentation expenditures (normal tax method)	2,570
4	Expensing of exploration and development costs—fuels	110
5	Expensing of exploration and development costs—nonfuels	10
6	Expensing of multiperiod timber growing costs	240
7	Expensing of certain multiperiod production costs—agriculture	90
8	Expensing of certain capital outlays—agriculture	75
9	Deferral of income on life insurance and annuity contracts	22,100
10	Accelerated depreciation of rental housing (normal tax method)	2,845
11	Accelerated depreciation of buildings other than rental housing (normal tax method)	335
12	Accelerated depreciation of machinery and equipment (normal tax method)	32,780
13	Expensing of certain small investments (normal tax method)	1,030
14	Amortization of start-up costs (normal tax method)	170
15	Deferral of tax on shipping companies	15
16	Deferral for state prepaid tuition plans	170
17	Credit for holders of zone academy bonds	220
18	Credit for low-income housing investments	2,730
19	Exclusion of pension contributions—employer plans	95,620
20	Exclusion of IRA contributions and earnings	6,005
21	Exclusion of contributions and earnings for Keogh plans	3,510
22	Exclusion of interest on public-purpose bonds	26,995
23	Exclusion of interest on non-public purpose bonds	3,950
24	Deferral of interest on U.S. savings bonds	405

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 outlay-equivalent 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							
		1999	2000	2001	2002	2003	2004	2005	2001–2005
	National Defense								
1	Exclusion of benefits and allowances to armed forces personnel	2,470	2,495	2,520	2,545	2,570	2,600	2,630	12,865
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	3,940	4,270	4,625	5,000	5,370	5,760	6,185	26,940
3	Exclusion of income of foreign sales corporations	5,600	5,980	6,400	6,860	7,340	7,850	8,400	36,850
4	Inventory property sales source rules exception	1,620	1,690	1,770	1,920	2,080	2,230	2,380	10,380
5	Deferral of income from controlled foreign corporations (normal tax method)	5,800	6,200	6,600	7,000	7,450	7,900	8,400	37,350
6	Deferred taxes for financial firms on income earned overseas	960	1,190	1,290	540	0	0	0	1,830
	General science, space, and technology:								
7	Expensing of research and experimentation expenditures (normal tax method)	1,890	1,865	1,875	1,960	2,090	2,245	2,415	10,585
8	Credit for increasing research activities	2,625	1,550	5,175	5,710	4,570	4,010	2,320	21,785
	Energy:								
9	Expensing of exploration and development costs, fuels	–80	–20	–30	–10	15	15	15	5
10	Excess of percentage over cost depletion, fuels	325	330	335	340	345	350	355	1,725
11	Alternative fuel production credit	1,495	1,400	1,315	1,235	775	180	180	3,685
12	Exception from passive loss limitation for working interests in oil and gas properties	30	25	25	25	25	25	25	125
13	Capital gains treatment of royalties on coal	85	85	95	95	100	105	115	510
14	Exclusion of interest on energy facility bonds	165	165	165	170	170	170	170	845
15	Enhanced oil recovery credit	315	360	415	480	550	635	730	2,810
16	New technology credit	70	85	120	130	125	125	125	625
17	Alcohol fuel credits [1]	15	15	15	15	15	15	15	75
18	Tax credit and deduction for clean-fuel burning vehicles	110	125	135	125	105	70	25	460
19	Exclusion from income of conservation subsidies provided by public utilities	115	110	105	110	115	115	115	560
	Natural resources and environment:								
20	Expensing of exploration and development costs, nonfuel minerals	15	15	15	15	15	20	20	85
21	Excess of percentage over cost depletion, nonfuel minerals	275	285	295	310	320	335	350	1,610
22	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	660	660	670	680	685	685	705	3,425
23	Capital gains treatment of certain timber income	85	85	95	95	100	105	115	510
24	Expensing of multiperiod timber growing costs	495	500	530	565	585	610	630	2,920
25	Investment credit and seven-year amortization for reforestation expenditures	15	15	15	15	15	15	15	75
26	Tax incentives for preservation of historic structures	205	225	240	255	265	280	295	1,335
	Agriculture:								
27	Expensing of certain capital outlays	65	70	75	75	80	85	85	400
28	Expensing of certain multiperiod production costs	85	85	90	95	100	105	110	500
29	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	845	885	925	965	1,015	1,060	1,105	5,070
31	Income averaging for farmers	75	75	80	80	80	85	85	410
32	Deferral of gain on sale of farm refiners	10	10	10	10	15	15	15	65
	Commerce and housing:								
	Financial institutions and insurance:								
33	Exemption of credit union income	1,910	2,015	2,160	2,320	2,490	2,675	2,865	12,510
34	Excess bad debt reserves of financial institutions	75	85	70	55	40	25	5	195
35	Exclusion of interest on life insurance savings	13,920	14,985	16,130	17,365	18,870	20,130	21,680	94,175
36	Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	295	300	315	320	335	340	355	1,665
38	Small life insurance company deduction	135	135	135	135	135	140	140	685
	Housing:								
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	1,300	1,310	1,320	1,330	1,345	1,365	1,370	6,730
40	Exclusion of interest on rental housing bonds	220	220	230	230	230	230	230	1,150
41	Deductibility of mortgage interest on owner-occupied homes	56,920	58,815	60,925	63,240	65,955	68,965	72,160	331,245
42	Deductibility of State and local property tax on owner-occupied homes	21,215	22,185	23,075	24,000	24,980	25,915	26,840	124,810
43	Deferral of income from post-1987 installment sales	995	1,015	1,035	1,055	1,075	1,095	1,115	5,375
44	Capital gains exclusion on home sales	22,500	23,175	23,870	24,590	25,325	26,090	26,870	126,745
45	Exception from passive loss rules for $25,000 of rental loss	5,315	5,035	4,790	4,555	4,330	4,100	3,885	21,660
46	Credit for low-income housing investments	0	0	0	5	5	5	5	20
47	Accelerated depreciation on rental housing (normal tax method)	3,710	3,985	4,225	4,495	4,760	4,975	5,145	23,600
	Commerce:								
48	Cancellation of indebtedness	40	25	15	15	20	20	25	95
49	Exceptions from imputed interest rules	160	160	160	165	165	165	165	820
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	52,540	54,100	55,705	57,365	59,065	60,820	62,620	295,575
51	Capital gains exclusion of small corporation stock	5	5	5	5	5	5	5	25
52	Step-up basis of capital gains at death	34,400	36,120	37,655	39,160	40,725	42,355	44,045	203,940
53	Carryover basis of capital gains on gifts	175	185	195	205	210	220	230	1,060
54	Ordinary income treatment of loss from small business corporation stock sale	45	45	55	55	55	55	55	275
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	1,655	705	–435	–755	–1,110	–1,695	–2,140	–6,135

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

(In millions of dollars)

		Outlay Equivalents							
		1999	2000	2001	2002	2003	2004	2005	2001–2005
56	Accelerated depreciation of machinery and equipment (normal tax method)	26,440	27,735	32,825	33,340	34,260	36,380	37,325	174,130
57	Expensing of certain small investments (normal tax method)	1,465	1,590	1,920	1,965	1,915	1,890	1,900	9,590
58	Amortization of start-up costs (normal tax method)	200	205	205	215	215	220	225	1,080
59	Graduated corporation income tax rate (normal tax method)	9,790	9,690	9,655	9,940	9,985	10,325	10,485	50,390
60	Exclusion of interest on small issue bonds	445	450	450	460	460	465	475	2,310
	Transportation:								
61	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
62	Exclusion of reimbursed employee parking expenses	2,225	2,330	2,450	2,575	2,710	2,855	3,005	13,595
63	Exclusion for employer-provided transit passes	180	205	235	265	295	330	360	1,485
	Community and regional development:								
64	Investment credit for rehabilitation of structures (other than historic)	25	25	25	25	25	25	30	130
65	Exclusion of interest for airport, dock, and similar bonds	1,045	1,050	1,060	1,075	1,085	1,095	1,105	5,420
66	Exemption of certain mutuals' and cooperatives' income	60	60	60	65	65	65	70	325
67	Empowerment zones and enterprise communities	325	445	500	470	325	300	265	1,860
68	Expensing of environmental remediation costs	150	200	235	80	–40	–50	–40	185
	Education, training, employment, and social services:								
	Education:								
69	Exclusion of scholarship and fellowship income (normal tax method)	1,190	1,220	1,235	1,240	1,255	1,265	1,280	6,275
70	HOPE tax credit	5,890	6,310	6,570	6,595	6,080	5,915	6,845	32,005
71	Lifetime Learning tax credit	2,780	3,045	3,100	3,160	5,645	5,675	5,935	23,515
72	Education Individual Retirement Accounts	0	10	25	40	60	80	105	310
73	Deductibility of student-loan interest	300	335	390	440	470	495	535	2,330
74	Deferral for State prepaid tuition plans	120	175	225	275	320	355	385	1,560
75	Exclusion of interest on student-loan bonds	355	360	365	365	365	370	370	1,835
76	Exclusion of interest on bonds for private nonprofit educational facilities	845	855	860	860	875	880	890	4,365
77	Credit for holders of zone academy bonds	5	15	30	50	75	90	100	345
78	Exclusion of interest on savings bonds redeemed to finance educational expenses	15	20	20	20	20	30	30	120
79	Parental personal exemption for students age 19 or over	1,010	1,070	1,125	1,165	1,225	1,280	1,310	6,105
80	Child credit [2]	25,915	26,100	25,975	25,290	24,205	23,385	22,475	121,330
81	Deductibility of charitable contributions (education)	3,435	3,685	3,850	4,040	4,250	4,395	4,610	21,145
82	Exclusion of employer-provided educational assistance	275	290	310	215	0	0	0	525
	Training, employment, and social services:								
83	Work opportunity tax credit	270	455	465	350	215	95	35	1,160
84	Welfare-to-work tax credit	35	60	80	80	60	25	10	255
85	Exclusion of employer provided child care	860	890	930	970	1,020	1,075	1,135	5,130
86	Adoption assistance	160	175	180	160	55	20	10	425
87	Exclusion of employee meals and lodging (other than military)	795	830	865	905	945	990	1,030	4,735
88	Credit for child and dependent care expenses	3,225	3,185	3,145	3,110	3,075	3,035	3,000	15,365
89	Credit for disabled access expenditures	65	65	75	75	75	80	80	385
90	Expensing of costs of removing certain architectural barriers to the handicapped	0	0	5	5	5	5	5	25
91	Deductibility of charitable contributions, other than education and health	25,750	26,955	28,115	29,380	30,790	32,200	33,755	154,240
92	Exclusion of certain foster care payments	45	50	50	55	55	60	60	280
93	Exclusion of parsonage allowances	395	420	450	480	515	550	585	2,580
	Health:								
94	Exclusion of employer contributions for medical insurance premiums and medical care	88,730	95,950	103,085	110,390	115,840	122,545	131,495	583,355
95	Self-employed medical insurance premiums	1,145	1,535	1,700	1,900	2,550	3,580	3,955	13,685
96	Workers' compensation insurance premiums	5,520	5,730	5,945	6,170	6,400	6,645	3,895	29,055
97	Medical Savings Accounts	30	40	45	45	45	40	35	210
98	Deductibility of medical expenses	3,695	3,910	4,160	4,440	4,720	5,005	5,305	23,630
99	Exclusion of interest on hospital construction bonds	1,735	1,755	1,770	1,790	1,815	1,830	1,850	9,055
100	Deductibility of charitable contributions (health)	3,640	3,910	4,095	4,300	4,525	4,665	4,900	22,485
101	Tax credit for orphan drug research	70	80	90	100	115	130	140	575
102	Special Blue Cross/Blue Shield deduction	325	420	270	180	240	325	420	1,435
	Income security:								
103	Exclusion of railroad retirement system benefits	395	405	410	415	420	430	430	2,105
104	Exclusion of workers' compensation benefits	5,185	5,330	5,785	6,040	6,310	6,575	6,865	31,575
105	Exclusion of public assistance benefits (normal tax method)	345	360	375	390	405	420	435	2,025
106	Exclusion of special benefits for disabled coal miners	75	75	70	70	65	60	55	320
107	Exclusion of military disability pensions	130	130	135	140	140	145	150	710
	Net exclusion of pension contributions and earnings:								
108	Employer plans	97,960	104,060	108,190	113,770	120,275	126,700	133,400	602,335
109	Individual Retirement Accounts	18,290	20,025	21,360	22,770	23,695	24,645	25,445	117,915
110	Keogh plans	6,630	7,040	7,475	7,930	8,415	8,925	9,465	42,210
	Exclusion of other employee benefits:								
111	Premiums on group term life insurance	2,240	2,290	2,340	2,395	2,445	2,520	2,590	12,290

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

(In millions of dollars)

		Outlay Equivalents							
		1999	2000	2001	2002	2003	2004	2005	2001–2005
112	Premiums on accident and disability insurance	235	250	260	275	290	305	315	1,445
113	Income of trusts to finance supplementary unemployment benefits	0	0	0	5	5	5	5	20
114	Special ESOP rules	1,565	1,630	1,670	1,730	1,800	1,885	1,975	9,060
115	Additional deduction for the blind	35	35	40	40	40	45	45	210
116	Additional deduction for the elderly	2,155	2,215	2,285	2,360	2,400	2,455	2,555	12,055
117	Tax credit for the elderly and disabled	45	45	45	45	45	45	45	225
118	Deductibility of casualty losses	280	290	300	315	325	340	355	1,635
119	Earned income tax credit [3]	5,360	5,220	5,320	5,540	5,785	6,045	6,380	29,070
	Social Security:								
	Exclusion of social security benefits:								
120	Social Security benefits for retired workers	17,135	18,010	18,885	19,995	21,230	22,505	16,515	99,130
121	Social Security benefits for disabled	2,390	2,595	2,830	3,090	3,375	3,700	3,150	16,145
122	Social Security benefits for dependents and survivors	3,775	3,900	4,050	4,210	4,385	4,555	3,625	20,825
	Veterans benefits and services:								
123	Exclusion of veterans death benefits and disability compensation	2,940	3,070	3,200	3,335	3,490	3,655	3,830	17,510
124	Exclusion of veterans pensions	65	70	75	80	85	85	90	415
125	Exclusion of GI bill benefits	75	85	90	90	95	100	105	480
126	Exclusion of interest on veterans housing bonds	60	60	60	60	60	60	60	300
	General purpose fiscal assistance:								
127	Exclusion of interest on public purpose bonds	32,600	32,925	33,250	33,590	33,920	34,255	34,600	169,615
128	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	37,740	40,240	42,390	44,735	47,610	50,530	53,480	238,745
129	Tax credit for corporations receiving income from doing business in U.S. possessions	3,590	3,700	3,815	3,715	3,640	3,715	3,785	18,670
	Interest:								
130	Deferral of interest on U.S. savings bonds	1,015	1,065	1,115	1,175	1,235	1,295	1,355	6,175
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	21,215	22,185	23,075	24,000	24,980	25,915	26,840	124,810
	Nonbusiness State and local taxes other than on owner-occupied homes	37,740	40,240	42,390	44,735	47,610	50,530	53,480	238,745
	Exclusion of interest on State and local bonds for:								
	Public purposes	32,600	32,925	33,250	33,590	33,920	34,255	34,600	169,615
	Energy facilities	165	165	165	170	170	170	170	845
	Water, sewage, and hazardous waste disposal facilities	660	660	670	680	685	685	705	3,425
	Small-issues	445	450	450	460	460	465	475	2,310
	Owner-occupied mortgage subsidies	1,300	1,310	1,320	1,330	1,345	1,365	1,370	6,730
	Rental housing	220	220	230	230	230	230	230	1,150
	Airports, docks, and similar facilities	1,045	1,050	1,060	1,075	1,085	1,095	1,105	5,420
	Student loans	355	360	365	365	365	370	370	1,835
	Private nonprofit educational facilities	845	855	860	860	875	880	890	4,365
	Hospital construction	1,735	1,755	1,770	1,790	1,815	1,830	1,850	9,055
	Veterans' housing	60	60	60	60	60	60	60	300
	Credit for holders of zone academy bonds	5	15	30	50	75	90	100	345

[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: 1999 $760; 2000 $800; 2001 $805; 2002 $810; 2003 $815; 2004 $825; and 2005 $830.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1999 $445; 2000 $550; 2001 $520; 2002 $505; 2003 $460; 2004 $450; and 2005 $420.

[3] 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: 1999 $25,632; 2000 $25,676; 2001 $25,799; 2002 $26,876; 2003 $27,638; 2004 $28,701; and 2005 $29,722.

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. Provisions with estimates that rounded to zero in each year are not included in the table.

Tax Expenditure Baselines

A tax expenditure is a preferential exception to the baseline provisions of the tax structure. The 1974 Congressional Budget Act did not, however, specify the baseline provisions of the tax law. Deciding whether provisions are preferential exceptions, therefore, is a matter of judgment. 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 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. Tax expenditures under the reference law baseline are generally tax expenditures under the normal tax baseline, but 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 only when it is 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).

Although 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.

[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.

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.

Beyond these examples, there are still more areas of difference where the Joint Committee on Taxation considers a somewhat broader set of tax expenditures under its normal tax baseline than under the reference baseline considered here.

Performance Measures and the Economic Effects of Tax Expenditures

The Government Performance and Results Act of 1993 (GPRA) directs Federal agencies to develop annual and strategic plans for their programs and activities. These plans set out performance objectives to be achieved over a specific time period. Most of these objectives will be achieved through direct expenditure programs. However, tax expenditures may also contribute to achieving these goals. The report of the Senate Governmental Affairs Committee on GPRA[4] calls on the Executive branch to undertake a series of analyses to assess the effect of specific tax expenditures on the achievement of agencies' performance objectives.

One finding of pilot studies on selected tax expenditures undertaken by Treasury's Office of Tax Analysis is that much of the data needed for thorough analysis are not currently available. Hence, assessment of data needs and availability from Federal statistical agencies, program-agency studies, or private-sector sources, should prove valuable to broader efforts to assess the effects of tax expenditures and to compare their effectiveness with other policy means of achieving important public objectives. This effort will complement information published by the Joint Committee on Taxation and the Senate Budget Committee on tax expenditures.[5]

Over the next few years, the Executive Branch's focus will be on the availability of the data needed to assess the effects of the tax expenditures designed to increase savings. As one part of this effort, Treasury's Office of Tax Analysis and its Statistics of Income Division (IRS) are developing the specifications for a new data sample which will follow the same individual income tax filers over an extended period of time. Such a sample is called a "panel" sample. Current economic analyses of the effect of Federal tax laws are generally based on data from "cross-section" samples, which capture the demographic and economic circumstances of individuals and the provisions of Federal tax law only at a single point in time. However, over time, the demographic and economic status of individuals changes in ways that can significantly change how they are affected by current (or proposed) Federal tax laws. In addition, some provisions of the tax law have effects over multiple years, and the effects of some tax provisions change over time due to phase-ins, phase-outs, and other factors. The new panel sample will capture the changing demographic and economic circumstances of individuals and the effects of changes in tax law over an extended period of time. Data from the panel sample will therefore permit more extensive, and better, analyses of many tax provisions than can be performed using only cross-section data. In particular, data from the panel sample will enhance our ability to analyze the effect of tax expenditures designed to increase savings. Other efforts to improve data available for the analysis of savings tax expenditures will be undertaken over the next several years by OMB, Treasury and other agencies.

Comparison 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.[6] 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 some cases. In addition, some tax expenditures actually simplify the tax system (for example, the exclusion for up to $500,000 of capital gains on home sales). Tax expenditures also implicitly subsidize certain activities. Spending, regulatory or tax-disincentive policies, can also modify behavior, but may have different economic effects. 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 economic effects.

Tax expenditures also have limitations. In many cases they add to the complexity of the tax system, which raises both administrative and compliance costs. For example, various holding periods and tax rates for capital gains can complicate filing and decisionmaking. The income tax system may have little or no contact with persons who have no or very low incomes, and does not inquire into certain characteristics of individ-

[4] Committee on Government Affairs, United States Senate, "Government Performance and Results Act of 1993" (Report 103–58, 1993).

[5] Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 1999–1993," JCS–7–98, December 14, 1998; 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).

[6] Although 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 bases of those taxes, such as an excise tax exemption for certain types of consumption that are deemed meritorious.

uals used in some spending programs, such as wealth. 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 outlay programs. 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 may not receive the same frequency or level of scrutiny afforded to other programs.

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, the availability of many different 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—provides flexibility for policy design. On the other hand, 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 more direct and immediate effects than outlay and tax-expenditure programs because regulations apply directly and immediately to the regulated party (i.e., the intended actor)—generally in the private sector. Regulations can also be fine-tuned more quickly than tax expenditures, because they can generally be changed by the executive branch without legislation. Like tax expenditures, regulations often rely largely 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. This reliance can diminish their economic efficiency, although this feature can also promote full compliance where (as in certain safety-related cases) policymakers believe that trade-offs with economic considerations are not of paramount importance. Also, regulations generally do not directly affect Federal outlays or receipts. 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 outlays and tax-expenditures. To some extent, the GPRA requirement for performance evaluation will address this lack of formal analysis.

Some policy objectives are achieved using multiple approaches. For example, minimum wage legislation, the earned income tax credit, and the food stamp program are regulatory, tax expenditure, and direct outlay programs, respectively, all having the objective of improving the economic welfare of low-wage workers.

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., the exclusion for up to $500,000 of capital gains on home sales); 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, accelerated depreciation may encourage investment. 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). Effects on the incomes of members of particular groups 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 devel-

oped. In practice, data availability is likely to be a major challenge, and data constraints may limit the assessment of the effectiveness of many provisions. In addition, such assessments can raise significant challenges in economic modeling.

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—might 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 producers) 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 grants 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 pooling of risks. 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.

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). 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 provided at the firm level to individuals.

Other provisions principally affect the incomes of members of certain groups, rather than affecting incentives. 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 earned-income tax credit, in contrast, should be evaluated for its effects on labor force participation as well as the income it provides lower-income workers.

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, although 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. As indicated above, over the next few years the Executive Branch's focus will be on the availability of the data needed to assess the effects of the tax expenditures designed to increase savings.

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.***—U.S. citizens who lived abroad, worked in the private sector, and satisfyied a foreign residency requirement in 1999 may exclude up to $74,000 in foreign earned income from U.S. taxes. The exclusion increases in 2000, 2001, and 2002 to $76,000, $78,000, and $80,000, respectively. In addition, if these taxpayers receive a specific allowance for foreign housing from their employers, they may also exclude the value of that allowance. If they do not receive a specific allowance for housing expenses, they may deduct against their U.S. taxes that portion of such expenses that exceeds one-sixth the salary of a civil servant at grade GS-14, step 1 ($63,567 in 1999). Beginning this year, the value of U.S. tax benefits provided to employees of the U.S. government who live and work overseas is not included under this heading. Those tax benefits now are included under their own heading, Exclusion of Certain Allowances for Federal Employees Abroad (#3).

3. ***Exclusion of Certain Allowances for Federal Employees Abroad.***—U.S. Federal civilian employees and Peace Corps members who work outside the continental United States are allowed to exclude from U.S. taxable income certain special allowances they receive to compensate them for the relatively high costs associated with living overseas. The allowances supplement wage income and cover expenses like rent, education, and the cost of travel to and from the United States.

4. ***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.

5. ***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.

6. ***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 considered to be 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.

7. ***Exceptions under subpart F for active financing income.***—Financial firms can defer taxes on income earned overseas in an active business. Taxes on income earned through December 31, 2001 can be deferred. The Tax Relief Extension Act of 1999 extended the expiration date from December 31, 1999 to December 31, 2001.

General Science, Space, and Technology

8. ***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.

9. ***R&E credit.***—The research and experimentation (R&E) credit, which expired on June 30, 1999, was reinstated (retroactively) in the Tax Relief Extension Act of 1999 for five years (through June 30, 2004). The Act also increased the credit rates for the alternative credit by one percentage point and extended the research credit to include research conducted in Puerto Rico and the U.S. possessions. 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" by the average amount of the company's gross receipts for the prior four years. The taxpayer's fixed base percentage generally is the ratio of its research expenses to gross receipts for 1984 through 1988. Taxpayers may also elect an alternative credit regime. Under the alternative credit regime the taxpayer is assigned a three-tiered fixed-base percentage that is lower than the fixed-base percentage that would otherwise apply, and the credit rate is reduced (the rates range from 2.65 percent to 3.75 percent). A 20-percent credit with a separate threshold is provided for a taxpayer's payments to universities for basic research.

Energy

10. ***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.

11. ***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.

12. ***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.

13. ***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.

14. ***Capital gains treatment of royalties on coal.***—Sales of certain coal under royalty contracts can be treated as capital gains rather than ordinary income.

15. ***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.

16. ***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.

17. ***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 on or before December 31, 2001. The Tax Relief Extension Act of 1999 extended the expiration date from June 30, 1999 to December 31, 2001 and expanded the credit to apply to electricity produced from poultry waste facilities (placed in service after December 31, 1999).

18. ***Alcohol fuel credits.***—An income tax credit is provided for ethanol that is derived from renewable sources and used as fuel. The credit equals 54 cents per gallon in 1998, 1999, and 2000; 53 cents per gallon in 2001 and 2002; 52 cents per gallon in 2003 and 2004; and 51 cents per gallon in 2005, 2006, and 2007. To the extent that ethanol is mixed with taxable motor fuel to create gasohol, taxpayers may claim an exemption of the Federal excise tax rather than the income tax credit. In addition, small ethanol producers are eligible for a separate 10 cents per gallon credit.

19. ***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.

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

Natural Resources and Environment

21. **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.

22. ***Percentage depletion.***—Most nonfuel mineral extractors may use percentage depletion rather than cost depletion, with percentage depletion rates ranging from 22 percent for sulfur to 5 percent for sand and gravel.

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 a capital gain 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 may be amortized 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, a 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 reduces carryover losses, then unused credits, and then basis; any remainder of the forgiven debt is excluded from tax. 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.***—Taxpayers can lower their tax liability by averaging, over the prior three-year period, their taxable income from farming.

33. ***Deferral of gain on sales of farm refiners.***—A taxpayer who sells stock in a farm refiner to a farmers' cooperative can defer recognition of gain if the taxpayer reinvests the proceeds in qualified replacement property.

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.

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

35. ***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.

36. ***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.

37. ***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 $2.1 million of net premium incomes may elect to pay tax only on the income earned by their investment portfolio.

38. ***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.

39. ***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.

40. ***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. The volume cap increases to $55 per capita ($165 million minimum) in 2003 and ratably annually thereafter until the cap reaches $75 per capita ($225 million minimum) in 2007. States may issue mortgage credit certificates (MCCs) in lieu of mortgage revenue 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.

41. ***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.

42. ***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.

43. ***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.

44. ***Installment sales.***—Dealers in real and personal property (i.e., sellers who 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 pay-

ment 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.

45. ***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 may not be used more than once every two years.

46. ***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.

47. ***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. State agencies determine who receives the credit; States are limited in the amount of credit they may authorize annually to $1.25 per resident.

48. ***Accelerated depreciation of rental property.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to 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, a 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.

49. ***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.

50. ***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. 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.

51. ***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, the top tax rate is 20 percent (10 percent for taxpayers who would otherwise pay capital gains tax at the 15-percent rate).

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.

52. ***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.

53. ***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.

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

55. ***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.

56. ***Accelerated depreciation of non-rental-housing buildings.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to 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.

57. ***Accelerated depreciation of machinery and equipment.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to 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.

58. ***Expensing of certain small investments.***—In 1999, qualifying investments in tangible property up to $19,000 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 1999, the amount expensed is completely phased out when qualifying investments exceed $219,000.

59. ***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.

60. ***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.

61. ***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

62. ***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.

63. ***Exclusion of employee parking expenses.***—Employee parking expenses that are paid for by the employer or that are received in lieu of wages are excludable from the income of the employee. In 1999, the maximum amount of the parking exclusion was $175 (indexed, except in 1999) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

64. ***Exclusion of employee transit pass expenses.***—Transit passes, tokens, fare cards, and vanpool expenses paid for by an employer or provided in lieu of wages to defray an employee's commuting costs are excludable from the employee's income. In 1999, the maximum amount of the exclusion wasis $65 (indexed, except in 1999) per month.

Community and Regional Development

65. ***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.

66. ***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.

67. ***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.

68. ***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 on homes purchased on or before December 31, 2001, and investors in certain D.C. property can receive a capital gains break.

69. ***Expensing of environmental remediation costs.***—Taxpayers who clean up hazardous substances at a qualified site may 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 on or before December 31, 2001. Tax Relief Extension Act of 1999 extended the expiration date from December 31, 2000 to December 31, 2001.

Education, Training, Employment, and Social Services

70. ***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).

71. ***HOPE tax credit.***—The non-refundable HOPE tax credit 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).

72. ***Lifetime Learning tax credit.***—The non-refundable Lifetime Learning tax credit allows a credit for 20 percent of an eligible student's tuition and fees. For tuition and fees paid before January 1, 2003, 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.

73. ***Education Individual Retirement Accounts.***—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. 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.

74. ***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).

75. ***State prepaid tuition plans.***—Some States have adopted prepaid tuition plans and prepaid room and board plans, which allow persons to pay in advance for college expenses for designated beneficiaries. Taxes on the earnings from these plans are paid by the beneficiaries and are deferred until the tuition is actually paid.

76. ***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.

77. ***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.

78. ***Credit for holders of zone academy bonds.***—Financial institutions that own zone academy bonds receive a non-refundable tax credit (set by the Treasury Department) rather than interest. The credit is included in gross income. Proceeds from zone academy bonds may only be used to improve impoverished schools. The total amount of zone academy bonds that may be issued is limited to $1.6 billion—$400 million in each year between 1998 and 2001. The Tax Relief Extension Act of 1999 allowed bonds to be issued in 2000 and 2001.

79. ***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 $79,650 and $109,650 ($53,100 and $68,100 for singles) in 1999.

80. ***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.

81. ***Child credit.***—Taxpayers with children under age 17 can qualify for a $500 child credit. 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.

82. ***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.

83. ***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 on or before December 31, 2001. The Tax Relief Extension Act of 1999 extended the expiration date from May 31, 2000 to December 31, 2001.

84. ***Work opportunity tax credit.***—Employers can claim a tax credit for qualified wages paid to individuals who begin work on or before December 31, 2000 and who are certified as members of various targeted groups. The Tax Relief Extension Act of 1999 extended the expiration date from June 30, 1999 to December 31, 2000. The amount of the credit that can be claimed is 25 percent for employment of less than 400 hours and 40 percent for employment of 400 hours or more. The maximum credit per employee is $2,400 and can only be claimed on the first year of wages an individual earns from an employer. Employers must reduce their deduction for wages paid by the amount of the credit claimed.

85. ***Welfare-to-work tax credit.***—An employer is eligible for a 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 on or before December 31, 2001. The Tax Relief Extension Act of 1999 extended the expiration date from June 30, 1999 to December 31, 2001.

86. ***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.

87. ***Adoption credit and exclusion.***—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.

88. ***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.

89. ***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.

90. ***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.

91. ***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.

92. ***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.

93. ***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.

94. ***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

95. ***Employer-paid medical insurance and expenses.***—Employer-paid health insurance premiums and other medical expenses (including long-term care) are deducted as a business expense by employers, but they are not included in employee gross income. The self-employed also may deduct part of their family health insurance premiums.

96. ***Self-employed medical insurance premiums.***—Self-employed taxpayers may deduct a percentage of their family health insurance premiums. Taxpayers without self-employment income are not eligible for the special percentage deduction. The deductible percentage is 60 percent in 1999 through 2001, 70 percent in 2002, and 100 percent in 2003 and thereafter.

97. ***Workers compensation insurance premiums.***—Workers compensation insurance premiums are paid by employers and deducted as a business expense, but the premiums are not included in employee gross income.

98. ***Medical savings accounts.***—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.

99. ***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.

100. ***Hospital construction bonds.***—Interest earned on State and local government debt issued to finance hospital construction is excluded from income subject to tax.

101. ***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.

102. ***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.

103. ***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

104. ***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.

105. ***Workers' compensation benefits.***—Workers compensation provides payments to disabled workers. These benefits, although income to the recipients, are not subject to the income tax.

106. ***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.

107. ***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.

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

109. ***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.

110. ***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 1999, an employee could exclude up to $10,000 (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 taxpayers with AGI between $50,000 and $60,000 ($30,000 and $40,000 for singles). The phase-out range increases annually until it reaches $80,000 to $100,000 in 2007 ($50,000 to $60,000 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.

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).

111. ***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.

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 corporations 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 $6,800 of earned income in 1999. The credit is 40 percent of the first $9,540 of income for a family with two or more qualifying children. When the taxpayer's income exceeds $12,460, 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 $26,928 of modified adjusted gross income ($30,580 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 1999, the credit is 7.65 percent of the first $4,530 of earned income. When the taxpayer's income exceeds $5,670, the credit is phased out at the rate of 7.65 percent. It is completely phased out at $10,200 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 (indexed) 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 1999, this credit allows each taxpayer to make a $650,000 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.[7]
- *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 1999–2005 are dis-

[7] 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 lease 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.

played 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. Up to 40 percent of the value of land subject to certain conservation easements may be excluded from taxable estates; the maximum amount of the exclusion is $200,000 in 1999 and increases by $100,000 in each year through 2002.

Agriculture

2. ***Special-use valuation of farms.***—Up to $750,000 (indexed) 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.

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.

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.***—Certain family-owned businesses that are bequeathed to qualified heirs can be excluded from taxable estates. The exclusion generally cannot exceed $1.3 million less the exemption value of the unified credit. The exclusion is recaptured if certain conditions are not maintained for 10 years.

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	1999	2000	2001	2002	2003	2004	2005	2001–2005
	Natural Resources and Environment:								
1	Donations of conservation easements	10	25	40	55	75	95	105	370
	Agriculture:								
2	Special use valuation of farm real property	95	100	105	110	115	125	120	575
3	Tax deferral of closely held farms	5	15	20	20	20	25	30	115
	Commerce:								
4	Special use valuation of real property used in closely held businesses	10	10	10	10	15	15	15	65
5	Tax deferral of closely held business	35	100	110	110	120	130	180	650
6	Exclusion for family owned businesses	505	520	535	550	495	440	395	2,415
	Education, training, employment, and social services:								
7	Deduction for charitable contributions (education)	682	760	830	855	910	930	1,020	4,545
8	Deduction for charitable contributions (other than education and health)	2,015	2,240	2,450	2,525	2,680	2,750	3,015	13,420
	Health:								
9	Deduction for charitable contributions (health)	615	685	750	775	820	840	925	4,110
	General government:								
10	Credit for State death taxes	5,825	6,070	6,345	6,640	6,945	7,265	7,595	34,790

3. FEDERAL RECEIPTS

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

The Federal Government also collects income from the public from market-oriented activities. Collections from these activities, which are subtracted from gross outlays, rather than added to taxes and other governmental receipts, are discussed in the following chapter.

Growth in receipts.—Total receipts in 2002 are estimated to be $2,191.7 billion, an increase of $54.8 billion or 2.6 percent relative to 2001. Receipts are projected to grow at an average annual rate of 3.6 percent between 2002 and 2006, rising to $2,528.7 billion. This growth in receipts is largely due to assumed increases in incomes resulting from both real economic growth and inflation, partially offset by the effects of the President's proposed tax reductions. In the absence of the President's proposed tax reductions, receipts are projected to grow at an average annual rate of 5.0 percent between 2002 and 2006.

As a share of GDP, receipts are projected to decline from 20.7 percent in 2001 to 20.2 percent in 2002. As the President's proposed tax plan phases in, the receipts share of GDP is projected to decline annually, falling to 18.9 percent in 2006; this is 1.3 percentage points below the share of 20.2 percent that would be attained in the absence of the proposed reductions.

Table 3–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	2000 actual	Estimate					
		2001	2002	2003	2004	2005	2006
Individual income taxes	1,004.5	1,072.9	1,078.8	1,092.3	1,117.9	1,157.0	1,196.6
Corporation income taxes	207.3	213.1	218.8	227.3	235.5	244.2	252.2
Social insurance and retirement receipts	652.9	689.7	725.8	766.0	806.0	855.8	896.4
(On-budget)	(172.3)	(185.8)	(194.9)	(205.2)	(215.8)	(226.8)	(237.9)
(Off-budget)	(480.6)	(503.9)	(530.9)	(560.8)	(590.3)	(629.0)	(658.5)
Excise taxes	68.9	71.1	74.0	76.3	78.3	80.5	82.3
Estate and gift taxes	29.0	31.1	28.7	26.6	28.3	24.9	22.5
Customs duties	19.9	21.4	22.5	24.3	25.0	26.0	27.7
Miscellaneous receipts	42.8	37.6	43.1	45.4	47.8	49.3	51.0
Total receipts	**2,025.2**	**2,136.9**	**2,191.7**	**2,258.2**	**2,338.8**	**2,437.8**	**2,528.7**
(On-budget)	*(1,544.6)*	*(1,633.1)*	*(1,660.8)*	*(1,697.4)*	*(1,748.5)*	*(1,808.8)*	*(1,870.2)*
(Off-budget)	*(480.6)*	*(503.9)*	*(530.9)*	*(560.8)*	*(590.3)*	*(629.0)*	*(658.5)*

Table 3–2. EFFECT ON RECEIPTS OF CHANGES IN THE SOCIAL SECURITY TAXABLE EARNINGS BASE

(In billions of dollars)

	Estimate				
	2002	2003	2004	2005	2006
Social security (OASDI) taxable earnings base increases:.					
$80,400 to $84,600 on Jan. 1, 2002	1.9	5.2	5.8	6.5	7.2
$84,600 to $88,800 on Jan. 1, 2003	.....	1.9	5.2	5.9	6.5
$88,800 to $93,600 on Jan. 1, 2004	.....	.....	2.2	6.0	6.6
$93,600 to $98,100 on Jan. 1, 2005	.....	.....	.....	2.1	5.6
$98,100 to $102,600 on Jan. 1, 2006	.....	.....	.....	.....	2.1

ENACTED LEGISLATION

Several laws were enacted in 2000 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

Community Renewal Tax Relief Act of 2000.—This Act contains a package of tax incentives designed to encourage investment in economically distressed communities, a provision that extends the availability of tax-favored Medical Savings Accounts (MSAs), and several administrative and technical provisions. The major incentives and changes provided in this Act include the following:

Designate "renewal communities".—The Secretary of HUD is authorized to designate up to 40 "renewal communities" (12 of which must be rural), which will be eligible for the following tax incentives: (1) a zero-percent capital gains tax rate on the sale of qualifying assets held more than five years; (2) a 15-percent wage credit to employers for the first $10,000 of qualified wages; (3) a "commercial revitalization deduction;" (4) an additional $35,000 of section 179 expensing for qualified property; and (5) an expansion of the work opportunity tax credit with respect to individuals who live in a renewal community. These communities must be designated before January 1, 2002 and the tax benefits will be available for the period beginning on January 1, 2002 and ending December 31, 2009.

Extend and expand empowerment zones.—The Omnibus Budget Reconciliation Act of 1993 (OBRA93) authorized the designation of 9 empowerment zones (Round I empowerment zones). Two additional Round I empowerment zones were authorized under the Taxpayer Relief Act of 1997; the designation of 20 Round II empowerment zones was also authorized. The tax incentives with respect to the original 9 Round I empowerment zones, which differ from those provided the two additional Round I zones and the Round II zones, generally would have expired after 2004. The tax incentives with respect to the Round II empowerment zones generally are available through 2008. The Community Renewal Tax Relief Act of 2000 extends Round I and Round II empowerment zone designations through December 31, 2009. In addition, the tax incentives provided Round I and Round II empowerment zones are equalized and in some cases (the wage credit, tax-exempt bond financing and section 179 expensing) enhanced. The Secretaries of HUD and Agriculture are authorized to designate nine additional empowerment zones (seven in urban areas and two in rural areas) before January 1, 2002. Businesses in these new zones are eligible for the same tax incentives provided to existing zones (as modified by this Act), which will be available through December 31, 2009. In addition, this Act (1) permits taxpayers to rollover gain from the sale or exchange of any qualified empowerment zone asset held for more than one year if the proceeds are used to purchase other qualifying empowerment zone assets, and (2) increases from 50 percent to 60 percent the exclusion of gain from the sale of qualifying small business stock held more than five years if such stock satisfies the requirements of a qualifying business under the empowerment zone rules.

Provide New Markets Tax Credit.—A new tax credit is provided for qualified equity investments made after December 31, 2000 to acquire stock in a selected community development entity (CDE). A credit of five percent is provided to the investor for the first three years of investment. The credit increases to six percent for the following four years. The maximum amount of annual qualifying equity investment is capped at $1.0 billion for 2001, $1.5 billion for 2002 and 2003, $2.0 billion for 2004 and 2005, and $3.5 billion for 2006 and 2007. A CDE is any domestic corporation or partnership (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons, (2) that maintains accountability to residents, and (3) is certified by the Department of Treasury as an eligible CDE.

Increase and modify the low-income housing tax credit.—The low-income housing tax credit may be claimed over a 10-year period for the cost of rental housing occupied by tenants having incomes below specified levels. The aggregate first-year credit authority provided annually to each State under prior law was $1.25 per resident. This Act increases the per-capita housing credit cap to $1.50 per capita in calendar year 2001, to $1.75 in 2002, and provides for annual indexation for inflation beginning in 2003. A minimum annual cap of $2 million (to be adjusted annually for inflation beginning in 2003) is provided for small States beginning in calendar year 2001.

Accelerate scheduled increase in State volume limits on tax-exempt private activity bonds.—Interest on bonds issued by State and local governments to finance activities carried out and paid for by private persons (private activity bonds) is taxable unless the activities are specified in the Internal Revenue code. The volume of certain tax-exempt private activity bonds that State and local governments may issue in each calendar year is limited by State-wide volume limits. Under prior law the annual volume limits were the greater of $50 per resident of the State or $150 million, increasing to the greater of $55 per resident or $165 million in 2003, and increasing ratably each succeeding year, reaching the greater of $75 per resident or $225 million in 2007. This Act accelerates the scheduled increase in the volume limits to the greater of $62.50 per resident or $187.5 million in 2001 and to the greater of $75 per resident or $225 million in 2002. Beginning in 2003, the volume limits are increased annually for inflation.

Extend the expensing of brownfields remediation costs.—Taxpayers can elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital accounts as deductible in the year paid or incurred. This Act extends the expensing of these costs, which was scheduled to expire with re-

spect to expenditures paid or incurred after December 31, 2001, through December 31, 2003 and removes the geographic targeting of this provision.

Extend District of Columbia homebuyer tax credit.—The $5,000 tax credit provided for the first-time purchase of a principal residence in the District of Columbia, which was scheduled to expire after December 31, 2001, is extended through December 31, 2003.

Extend District of Columbia Enterprise Zone designation.—The Taxpayer Relief Act of 1997 designated certain economically depressed census tracts within the District of Columbia as the District of Columbia Enterprise Zone, within which businesses and individual residents are eligible for special tax incentives through December 31, 2002. This Act extends the D.C. enterprise zone designation through December 31, 2003.

Extend and modify deduction for corporate donations of computer technology.—The charitable contribution deduction that may be claimed by a corporation for donations of inventory property generally is limited to the lesser of fair market value or the corporation's basis in the property. However, corporations are provided augmented deductions, not subject to this limitation, for certain contributions. These augmented deductions equal the lesser of (1) the basis of the property plus one-half of the amount of ordinary income that would have been realized if the property had been sold, or (2) twice the basis of the donated property. Under prior law, an augmented deduction was provided for contributions of computer technology and equipment to U.S. schools for educational purposes in grades K-12, provided the contribution was made before January 1, 2001. This Act extends this augmented deduction to apply to donations made before January 1, 2004. In addition, the deduction is expanded to apply to donations to public libraries, to apply to property donated no later than three years (instead of two years as required under prior law) after the date the taxpayer acquires the property, and to apply to property donated after reacquisition by a computer manufacturer.

Treat Indian Tribal Governments as non-profit organizations or State or local governments for purposes of the Federal unemployment tax (FUTA).—Non-profit organizations and State and local governments are not required to pay FUTA taxes. Instead, they may elect to reimburse the unemployment compensation system for unemployment compensation benefits actually paid to their former employees. This Act provides that an Indian tribal government be treated like a non-profit organization or State or local government for FUTA tax purposes.

Extend the Medical Savings Account (MSA) program.—Within limits, contributions to an MSA are deductible in determining adjusted gross income if made by an eligible individual and are excludable from gross income and wages for employment tax purposes if made by the employer of an eligible individual. Earnings on amounts in an MSA are not currently taxable. Distributions from an MSA for medical expenses are not taxable. Distributions not used for medical expenses are taxable and subject to an additional 15-percent tax unless the distribution is made after age 65, death, or disability. MSAs are available to self-employed individuals and to employees covered under a high-deductible plan sponsored by a small employer. This Act extends the MSA program through December 31, 2002 and renames MSAs as Archer MSAs. Under prior law, no new contributions could be made to MSAs after December 31, 2000, except by and on behalf of self-employed individuals and employees who had participated in the program before that date or were employed by a participating employer.

Make administrative and technical changes.—Several administrative and technical provisions are provided in this Act, including the following: (1) clarification of the allowance of certain tax benefits with respect to kidnaped children, (2) authorization of agencies to use corrected levels of the consumer price index (CPI) for purposes of determining benefits and taxes, (3) prevention of the duplication or acceleration of loss through assumption of certain liabilities, and (4) disclosure of return information to the Congressional Budget Office.

FSC Repeal and Extraterritorial Income Exclusion Act of 2000.—This Act repeals the foreign sales corporation (FSC) tax provisions of the Internal Revenue Code that the World Trade Organization (WTO) found to be a prohibited export subsidy in violation of international tax standards. In the absence of the repeal, the United States would have faced WTO-approved sanctions. The repealed rules are replaced with an exclusion from U.S. tax for extraterritorial income. Because the exclusion of such income is a means of avoiding double taxation, no foreign tax credit is allowed for foreign income taxes paid with respect to such excluded income. Extraterritorial income is eligible for the exclusion to the extent that it is "qualifying foreign trade income."

Installment Tax Correction Act of 2000.—Generally, an accrual method of accounting requires a taxpayer to recognize income when all events have occurred that fix the right to its receipt and its amount can be determined with reasonable accuracy. The installment method of accounting provides an exception to these general recognition principles by allowing a taxpayer to defer recognition of income from the disposition of certain property until payment is received. This Act repeals provisions of law provided in the Ticket to Work and Work Incentives Improvement Act of 1999 that generally prohibited the use of the installment method of accounting for dispositions of property entered into on or after December 17, 1999 that would otherwise have been reported for Federal income tax purposes using an accrual method of accounting.

Trade and Development Act of 2000.—This Act provides eligibility for expanded trade benefits to 48 sub-Saharan African and 27 Caribbean Basin countries, reduces tariffs for certain worsted wool fabric, and shifts $32 million in rum excise tax cover over pay-

ments to Puerto Rico and the Virgin Islands from 2001 to 2000.

Tariff Suspension and Trade Act of 2000.—Technical corrections and miscellaneous amendments are made to certain trade laws, including the temporary suspension or refund of duties on approximately 200 categories of imported items and the alteration of the treatment of certain imported goods. The items affected by these changes include a wide variety of chemicals, some of which are used to develop cancer and AIDS-fighting drugs, environmentally-friendly herbicides and insecticides, and a number of pigments and dyes.

Department of Transportation Appropriations Act for Fiscal Year 2001.—Under prior law, the required retirement contribution of Federal employees participating in the Civil Service Retirement System (CSRS) was to increase to 7.5 percent of salary for calendar years 2001 and 2002 and to decline to 7 percent of salary effective January 1, 2003. This Act amends Federal civil service retirement law by reducing the required retirement contribution of Federal employees participating in CSRS to 7 percent of salary effective January 1, 2001. Similar reductions (from 1.3 to 0.8 percent) are made for participants in the Federal Employees' Retirement System (FERS).

Federal Employee Thrift Savings Plan Amendments.—Under prior law, contributions of employees to the Federal Thrift Savings Plan (TSP) could not begin until the second open season following an employee's date of commencing service. This Act allows employees to elect to contribute to the TSP on the date of commencing service. Matching and automatic contributions by agencies will continue to begin during the second open season after an employee's date of commencing service. This Act also allows Federal employees to contribute eligible rollover distributions from a qualified trust to the TSP.

National Defense Authorization Act for Fiscal Year 2001.—Participation in the Federal Thrift Savings Plan (TSP) is extended to members of the uniformed services on active duty and to members of the Ready Reserve in any pay status.

Miscellaneous Appropriations Act, 2001.—The maximum percentage contribution limitations to the TSP (5 percent for CSRS and 10 percent for FERS) are increased by one percentage point in each year, 2001 through 2005. The maximum percentage is eliminated beginning in 2006, thus allowing for a 100 percent contribution, subject to the annual dollar contribution limitation provided under prior law.

ADMINISTRATION PROPOSALS

The President's plan provides tax relief to individuals who pay income taxes, reduces the marriage penalty, permanently extends the research and experimentation (R&E) tax credit, phases out the death tax, and provides tax incentives for education, farmers, the disabled, health care, the environment, and charitable purposes. These proposed reductions will allow taxpayers to keep roughly one-fourth of the surplus that would be produced under existing tax law.

PRESIDENT'S TAX PLAN PRESENTED TO CONGRESS ON FEBRUARY 8TH

Create new 10-percent individual income tax bracket.—Under current law, there are five statutory individual income tax rate brackets ranging from 15 to 39.6 percent. The 15-percent bracket covers the first $27,050 of taxable income (for calendar year 2001) for single taxpayers, the first $36,250 for taxpayers who file as heads of household, and the first $45,200 for married taxpayers filing joint returns ($22,600 for married taxpayers filing separate returns). The Administration proposes to split the existing 15-percent tax rate bracket into two tax rate brackets of 10 and 15 percent. The 10-percent tax rate would apply to the first $6,000 of taxable income for single taxpayers (and married taxpayers filing separate returns), the first $10,000 of taxable income for unmarried heads of household, and the first $12,000 of taxable income for married taxpayers filing jointly. Taxable income above these thresholds that is currently taxed at the 15-percent rate would continue to be taxed at that rate. The new 10-percent rate would be phased in over 5 years, beginning in 2002. The tax rate for the new bracket would be 14 percent in 2002, 13 percent in 2003, 12 percent in 2004, 11 percent in 2005 and 10 percent in 2006 and subsequent years. The income thresholds for the new tax rate bracket would be adjusted annually for inflation beginning in 2007.

Reduce individual income tax rates.—The Administration proposes to replace the five statutory individual income tax rate brackets of current law (15, 28, 31, 36, and 39.6) with a simplified rate structure of 10, 15, 25 and 33 percent. In addition to splitting the existing 15-percent tax rate bracket into two rate brackets (see preceding discussion), the Administration proposes to reduce the tax rates in the existing 28-percent and 31-percent tax rate brackets to 25 percent, and to reduce the tax rates in the existing 36-percent and 39.6-percent tax rate brackets to 33 percent. The new, lower tax rates would be phased in over 5 years, beginning in 2002. The income thresholds for these tax rate brackets would be adjusted annually for inflation as provided under current law.

The current 31-percent tax rate would be reduced to 30 percent in 2002, 29 percent in 2003, 28 percent in 2004, 27 percent in 2005 and 25 percent in 2006 and subsequent years. The current 28-percent tax rate would be reduced to 27 percent in 2002 and 2003, 26

percent in 2004 and 2005, and 25 percent in 2006 and subsequent years.

The current 39.6-percent tax rate would be reduced to 38 percent in 2002, 37 percent in 2003, 36 percent in 2004, 35 percent in 2005, and 33 percent in 2006. The current 36-percent tax rate would be reduced to 35 percent in 2002 and 2003, 34 percent in 2004 and 2005, and 33 percent in 2006 and subsequent years.

Increase the child tax credit.—Current law provides taxpayers a tax credit of up to $500 for each qualifying child under the age of 17. The credit is reduced by $50 for each $1,000 (or fraction thereof) by which the taxpayer's modified adjusted gross income (AGI) exceeds $110,000 ($75,000 if the taxpayer is not married and $55,000 if the taxpayer is married but filing a separate return). These income thresholds are not adjusted for inflation. Generally, the credit is nonrefundable; however, taxpayers with three or more qualifying children may be eligible for an additional refundable child tax credit if they have little or no individual income tax liability. The additional credit may be offset against social security payroll tax liability, provided that liability exceeds the refundable portion of the earned income tax credit (EITC). Beginning in taxable year 2002, the child tax credit (as well as other nonrefundable personal tax credits) will be allowed only to the extent that an individual's regular individual income tax liability exceeds his or her tentative minimum tax. In addition, beginning in taxable year 2002, the refundable child tax credit and the EITC will be reduced by the amount of the individual's alternative minimum tax.

To assist families with the costs of raising children, the Administration proposes to double the amount of the child tax credit to $1,000 per child, and to phase out the credit more slowly and at higher levels of income. The increase in the amount of the credit would be phased in over 5 years, rising to $600 in 2002, $700 in 2003, $800 in 2004, $900 in 2005, and $1,000 in 2006 and subsequent years. Beginning in 2006, the credit would be reduced by $20 for each $1,000 (or fraction thereof) by which the taxpayer's modified AGI exceeds $200,000 ($100,000 if the taxpayer is married but filing a separate return). The increase in the modified AGI threshold would be gradually implemented in $18,000 annual increments ($25,000 if the taxpayer is not married and $9,000 if the taxpayer is married and filing a separate return) between 2002 and 2006. Under the Administration's proposal the credit could offset both the regular tax and the alternative minimum tax; in addition, refundable credits would no longer be reduced by the amount of the alternative minimum tax.

Reduce the marriage penalty.—A couple has a marriage penalty if they file a joint return and their individual income tax liability is greater than what it would be if they were not married and each filed a separate return. The Administration proposes to reduce the marriage penalty by restoring the two-earner deduction that was in effect between 1982 and 1986, effective for taxable years beginning after December 31, 2001. Joint filers would be allowed to deduct 10 percent of the first $30,000 of the earned income of the lower paid spouse. The limitation on eligible earnings would be phased in over 5 years, increasing from $6,000 in 2002 to $12,000 in 2003, $18,000 in 2004, $24,000 in 2005 and $30,000 in 2006 and subsequent years.

Provide charitable contribution deduction for nonitemizers.—Under current law, individual taxpayers who do not itemize their deductions (nonitemizers) are not able to deduct contributions to qualified charitable organizations. The Administration proposes to allow nonitemizers to deduct charitable contributions in addition to claiming the standard deduction, effective for taxable years beginning after December 31, 2001. The deduction would be phased in between 2002 and 2006 by allowing deductible amounts to increase as a percentage of contributions from 20 percent in 2002 to 40 percent in 2003, 60 percent in 2004, 80 percent in 2005, and 100 percent in 2006 and subsequent years. Deductible contributions would be limited to the amount of the taxpayer's standard deduction and would be subject to existing rules governing itemized charitable contributions, such as the substantiation requirements and the percentage-of-AGI limitations.

Permit tax-free withdrawals from Individual Retirement Accounts (IRAs) for charitable contributions.—Under current law, eligible individuals may make deductible or non-deductible contributions to a traditional IRA. Pre-tax amounts (including earnings) in a traditional IRA are included in income when withdrawn. Effective for distributions after December 31, 2001, the Administration proposes to allow individuals who have attained age 59½ to exclude from gross income IRA distributions made directly to a charitable organization. The exclusion would apply without regard to the percentage-of-AGI limitations that apply to deductible charitable contributions. The exclusion would apply only to the extent the individual receives no return benefit in exchange for the transfer, and no charitable deduction would be allowed with respect to any amount that is excludable from income under this provision.

Raise the cap on corporate charitable contributions.—Current law limits deductible charitable contributions by corporations to 10 percent of net income (calculated before the deduction of the charitable contributions and certain other deductions). The Administration proposes to increase the limit on deductible charitable contributions by corporations from 10 percent to 15 percent of net income, effective for taxable years beginning after December 31, 2001.

Increase and expand education savings accounts.—Under current law, taxpayers may elect to contribute up to $500 per year to an education savings account (an "education IRA") for beneficiaries under age

18. The contribution limit is phased out for taxpayers with modified AGI between $95,000 and $110,000 ($150,000 and $160,000 for married couples filing a joint return). Contributions are not deductible, but earnings on contributions accumulate tax-free. Distributions are excludable from gross income to the extent they do not exceed qualified higher education expenses incurred during the year the distributions are made. The earnings portion of a distribution not used to cover qualified education expenses is included in the gross income of the beneficiary and is generally subject to an additional 10-percent tax. If any portion of a distribution from an education savings account is excluded from gross income, an education tax credit may not be claimed with respect to the same student in the same taxable year.

The Administration proposes to increase the annual contribution limit to education savings accounts to $5,000. The higher contribution limit would be phased in over 5 years, increasing to $1,000 in 2002, $2,000 in 2003, $3,000 in 2004, $4,000 in 2005, and $5,000 in 2006 and subsequent years. The Administration also proposes to expand education savings accounts to allow tax-free and penalty-free distributions for certain elementary, secondary, and after-school program expenses. Eligible expenses generally would include tuition, fees, academic tutoring, special needs services, books, supplies, computer equipment, and certain expenses for room and board, uniforms, and transportation. Expenses for both public and private educational institutions would qualify. Under the proposal, both an education tax credit and a tax-free distribution from an education savings account would be allowed with respect to the same student in the same taxable year, provided the credit and the distribution were not used for the same expenses. These changes are proposed to be effective for contributions and distributions made after December 31, 2001.

Permanently extend the research and experimentation (R&E) tax credit.—The Administration proposes to permanently extend the 20-percent tax credit for qualified research and experimentation expenditures above a base amount and the alternative incremental credit, which are scheduled to expire on June 30, 2004.

Phase out death tax.—The Administration proposes to reduce estate tax rates between 2002 and 2008, and to repeal the estate, gift and generation-skipping transfer tax completely in 2009. The tax rate reductions would begin in 2002, with a 5-percentage-point reduction in each existing tax rate bracket. The 5-percentage-point surtax, which currently phases out the benefit of the graduated rate schedule, would be repealed in 2002. State death tax credit rates would be reduced to maintain the current relationship between the credit rates and the Federal estate tax rates. After repeal of the estate, gift and generation-skipping transfer taxes, inherited assets generally would carry the decedent's tax basis. However, there would be an adjustment to basis, so that in general, to the extent that taxpayers are not currently subject to estate tax, they would not be subject to capital gains tax on inherited assets. There would also be provisions to discourage transfers made for the purpose of avoiding income or capital gains tax.

ADDITIONAL TAX INCENTIVES

Strengthen and Reform Education

Allow teachers to deduct out-of-pocket classroom expenses.—Under current law, teachers who incur unreimbursed, job-related expenses may deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceed 2 percent of AGI. Effective for expenses incurred in taxable years beginning after December 31, 2001, the Administration proposes to allow teachers and other elementary and secondary school professionals to treat up to $400 in qualified out-of-pocket classroom expenses as a non-itemized deduction (above-the-line deduction). Unreimbursed expenditures for certain books, supplies and equipment related to classroom instruction and for certain professional training programs would qualify for the deduction.

Allow tax-free distributions from Qualified State Tuition Plans (QSTPs) for certain higher education expenses and allow private colleges to offer prepaid tuition plans.—Current law provides two basic tax benefits to contributions to, and beneficiaries of, QSTPs: (1) earnings on amounts invested in a QSTP are not subject to tax until a distribution is made (or educational benefits are provided), and (2) distributions made on behalf of a beneficiary are taxed at the beneficiary's (rather than the contributor's) individual income tax rate. These programs generally take two forms - prepaid tuition plans and savings plans. Under a prepaid tuition plan, an individual may purchase tuition credits or certificates on behalf of a designated beneficiary, which entitle the beneficiary to the waiver or payment of qualified higher education expenses at participating educational institutions. Under a savings plan, an individual may make contributions to an account, which is established for the purpose of meeting the qualified higher education expenses of a designated beneficiary. Distributions from QSTPs for nonqualified expenses generally are subject to a more than de minimus penalty (typically 10 percent of the earnings portion of the distribution). There is no specific dollar cap on annual contributions to a QSTP; in addition, there is no limit on contributions to a QSTP based on the contributor's income. Contributions to a QSTP are permitted at any time during the beneficiary's lifetime and the account can remain open after the beneficiary reaches age 30. However, a QSTP must provide adequate safeguards to prevent contributions on behalf of a designated beneficiary in excess of amounts necessary to provide for qualified education expenses.

Effective for taxable years beginning after December 31, 2001, the Administration proposes to allow tax-free withdrawals from QSTPs for qualified higher education

expenses, including room and board, tuition and fees, and certain expenses for books, supplies, and equipment. An education tax credit, a tax-free distribution from an education savings account, and a tax-free distribution from a QSTP would be allowed with respect to the same student in the same taxable year, provided the credit and the distributions were not used for the same expenses. The Administration also proposes to allow private educational institutions to establish qualified prepaid tuition plans (but not savings plans), provided the institution is eligible to participate in Federal financial aid programs under Title IV of the Higher Education Act of 1965.

Allow States to issue tax-exempt private activity bonds for school construction.—Current law does not exclude from income the interest on private activity bonds used to finance school construction or equipment. The Administration proposes to provide States with annual authority of $10 per resident (a minimum of $5 million is provided for small States) to issue tax-exempt, private activity bonds for constructing and equipping public elementary and secondary schools. Private entities would construct the schools and own the schools while the bonds are outstanding; ownership would revert to the school district when the bonds are retired. The proposal would be effective for bonds issued after December 31, 2001.

Invest in Health Care

Provide refundable tax credit for the purchase of health insurance.—Current law provides a tax preference for employer-provided group health insurance plans, but not for individually purchased health insurance coverage except to the extent that deductible medical expenses exceed 7.5 percent of AGI or the individual has self-employment income. The Administration proposes to make health insurance more affordable for individuals not covered by an employer plan nor eligible for public programs. Effective for taxable years beginning after December 31, 2001, a new refundable tax credit would be provided for the cost of health insurance purchased by individuals under age 65. The credit, which would equal 90 percent of health insurance premiums, would be capped at $750 for single policies and $1,500 for family policies in 2002 and 2003, and $1,000 for single policies and $2,000 for family policies in 2004 and subsequent years. The credit would be phased out for single taxpayers with AGI between $15,000 and $30,000 ($30,000 and $60,000 for married couples filing a joint return and purchasing a family policy). The maximum credit amounts and the income phase-out thresholds would be indexed annually for inflation beginning in 2003. The Administration is looking at ways to implement the credit so it is available to potential beneficiaries when they need it. To qualify for the credit, the purchased health insurance would be required to include coverage for catastrophic medical expenses. Individuals would not be allowed to claim the credit and make a contribution to an MSA for the same taxable year.

Provide an above-the-line deduction for long-term care insurance premiums.—Current law provides a tax preference for employer-paid long-term care insurance, but not for individually-purchased long-term case insurance except to the extent that deductible medical expenses exceed 7.5 percent of AGI or the individual has self-employment income. Premiums on qualified long-term care insurance are deductible as a medical expense, subject to annual dollar limitations that increase with age. The Administration proposes to make individually-purchased long-term care insurance (the vast majority of the long-term care insurance market) more affordable by creating an above-the-line deduction for qualified long-term care insurance premiums. To qualify for the deduction, the long-term care insurance would be required to meet certain standards providing consumer protections. The deduction would be available to taxpayers who individually purchase qualified long-term care insurance and to those who pay at least 50 percent of the cost of employer-provided coverage (the employer-paid share of the cost is less than 50 percent). The deduction would be effective for taxable years beginning after December 31, 2001 but would be phased in over six years. The deduction would be subject to current law annual dollar limitations on qualified long-term care insurance premiums.

Allow up to $500 in unused benefits in a health flexible spending arrangement to be carried forward to the next year.—Under current law, unused benefits in a health flexible spending arrangement under a cafeteria plan for a particular year revert to the employer at the end of the year. Effective for plan years beginning after December 31, 2001, the Administration proposes to allow up to $500 in unused benefits in a health flexible spending arrangement at the end of a particular year to be carried forward to the next plan year.

Provide additional choice with regard to unused benefits in a health flexible spending arrangement.—In addition to the proposed carryforward of unused benefits (see preceding discussion), the Administration proposes to allow up to $500 in unused benefits in a health flexible spending arrangement at the end of a particular year to be distributed to the participant as taxable income, contributed to an Archer MSA, or contributed to the employer's 401(k), 403(b), or governmental 457(b) retirement plan. Amounts distributed to the participant would be subject to income tax withholding and employment taxes. Amounts contributed to an Archer MSA or retirement plan would be subject to the normal rules applicable to elective contributions to the receiving plan or account. The proposal would be effective for plan years beginning after December 31, 2001.

Permanently extend and reform Archer MSAs.—Current law allows only self-employed individuals and employees of small firms to establish Archer MSAs, and caps the number of accounts at 750,000. In addition to other requirements, (1) individuals who establish MSAs must be covered by a high-deductible health plan (and no other plan) with a deductible of at least $1,600 but not greater than $2,400 for policies covering a single person and a deductible of at least $3,200 but not greater than $4,800 in all other cases, (2) tax-preferred contributions are limited to 65 percent of the deductible for single policies and 75 percent of the deductible for other policies, and (3) either an individual or an employer, but not both, may make a tax-preferred contribution to an MSA for a particular year. The Administration proposes to permanently extend the MSA program, which is scheduled to expire on December 31, 2002. Effective after December 31, 2001, the Administration proposes to remove the 750,000 cap on the number of accounts. In addition, the program would be reformed by (1) expanding eligibility to include all individuals and employees of firms of all sizes covered by a high-deductible health plan, (2) modifying the definition of high deductible to permit a deductible as low as $1,000 for policies covering a single person and $2,000 in all other cases, (3) increasing tax-preferred contributions to 100 percent of the deductible, (4) allowing tax-preferred contributions by both employers and employees for a particular year, up to the applicable maximum, and (5) allowing contributions to MSAs under cafeteria plans. Individuals would not be allowed to make a contribution to an MSA and claim the proposed refundable tax credit for health insurance premiums for the same taxable year.

Provide an additional personal exemption to home caretakers of family members.—Current law provides a tax deduction for certain long-term care expenses. In addition, taxpayers are allowed to claim exemptions for themselves (and their spouses, if married) and dependents who they support. However, neither provision may meet the needs of taxpayers who provide long-term care in their own home for close family members. Effective for taxable years beginning after December 31, 2001, the Administration proposes to provide an additional personal exemption to taxpayers who care for certain qualified spouses or ancestors with long-term care needs. The spouse or ancestor must be a member of the taxpayer's household for the entire year. There would be no support requirement for the additional exemption. An individual would be considered to have long-term care needs if he or she were certified by a licensed physician as being unable for at least 180 consecutive days to perform at least two activities of daily living without substantial assistance from another individual due to a loss of functional capacity. Alternatively, an individual would be considered to have long-term care needs if he or she were certified by a licensed physician (1) as requiring substantial supervision for at least 180 consecutive days to be protected from threats to his or her own health and safety due to severe cognitive impairment and (2) being unable for at least six months to perform at least one activity of daily living or being unable to engage in age appropriate activities.

Provide tax relief for awards under certain health education programs.—Current law provides tax-free treatment for certain scholarship and fellowship grants used to pay qualified tuition and related expenses, but not to the extent that any grant represents compensation for services. The Administration proposes to provide that any amounts received by an individual under the National Health Service Corps Scholarship Program or the Armed Forces Health Professions Scholarship and Financial Assistance Program are "qualified scholarships" excludable from income, without regard to the recipient's future service obligation. The proposal would be effective for awards received after December 31, 2001.

Assist Americans With Disabilities

Exclude from income the value of employer-provided computers, software and peripherals.—The Administration proposes to allow individuals with disabilities to exclude from income the value of employer-provided computers, software or other office equipment that are necessary for the individual to perform work for the employer at home. To qualify for the exclusion, the employee would be required to make substantial use of the equipment (relative to overall use) performing work for his or her employer. However, unlike current law, which limits the exclusion to the extent that the equipment is used to perform work for the employer, the proposed exclusion would apply to all use of such equipment, including use by the employee for personal or non-employer-related trade or business purposes. Employees would be required to provide their employer with a certification from a licensed physician that they meet eligibility criteria. The proposal would be effective for taxable years beginning after December 31, 2001.

Strengthen Families

Permanently extend and increase the adoption tax credit.—Current law provides a permanent nonrefundable 100-percent tax credit for the first $6,000 of qualified expenses incurred in the adoption of a child with special needs. A nonrefundable 100-percent tax credit is provided for the first $5,000 of qualified expenses incurred before January 1, 2002 in the adoption of a child without special needs. The dollar limits are cumulative per adoption but may be used over more than one calendar year. Qualified expenses do not include any expenses that are paid or reimbursed under any other government or non-government program. The credit is phased out ratably for taxpayers with incomes between $75,000 and $115,000; in addition, it is not available for adoptions by stepparents. The Administration proposes to make the tax credit for the adoption of children without special needs permanent. In addi-

tion, effective for expenses incurred after December 31, 2001, the Administration proposes to increase the credit to $8,500 for the adoption of a child with special needs and to $7,500 for the adoption of a child without special needs.

Help Farmers and Fishermen Manage Economic Downturns

Establish Farm, Fish and Ranch Risk Management (FFARRM) savings accounts.—Current law does not provide for the elective deferral of farm or fishing income. However, farmers can elect to average their farming income over a three-year period, and farmers may carry back net operating losses over the five previous years. In addition, taxes can be deferred on certain forms of income, including disaster payments, crop insurance and proceeds from emergency livestock sales. The Administration proposes to allow up to 20 percent of taxable income attributable to an eligible farming or fishing business to be contributed to a FFARRM savings account each year and deducted from income. Earnings on contributions would be taxable as earned and distributions from the account (except those attributable to earnings on contributions) would be included in gross income. Any amount not distributed within five years of deposit would be deemed to have been distributed and included in gross income; in addition, such distributions would be subject to a 10-percent surtax. The proposal would be effective for taxable years beginning after December 31, 2001.

Increase Housing Opportunities

Provide tax credit for developers of affordable single-family housing.—The Administration proposes to provide annual tax credit authority to States (including U.S. possessions) designed to promote the development of affordable single-family housing in low-income urban and rural neighborhoods. Beginning in calendar year 2002, first-year credit authority of $1.75 per capita (indexed annually for inflation thereafter) would be made available to each State. State housing agencies would award first-year credits to single-family housing units comprising a project located in a census tract with median income equal to 80 percent or less of area median income. Units in condominiums and cooperatives could qualify as single-family housing. Credits would be awarded as a fixed amount for individual units comprising a project. The present value of the credits, determined on the date of a qualifying sale, could not exceed 50 percent of the cost of constructing a new home or rehabilitating an existing property. The taxpayer (developer or investor partnership) owning the housing unit immediately prior to the sale to a qualified buyer would be eligible to claim credits over a 5-year period beginning on the date of sale. Eligible homebuyers would be required to have incomes equal to 80 per cent or less of area median income. Technical features of the provision would follow similar features of current law with respect to the low-income housing tax credit and mortgage revenue bonds.

Encourage Saving

Establish Individual Development Accounts (IDAs).—The Administration proposes to allow eligible individuals to make contributions to a new savings vehicle, the Individual Development Account, which would be set up and administered by financial institutions. Financial institutions would be allowed a tax credit for a portion of their matching contributions to an IDA. Matching contributions and the earnings on those contributions would be deposited in a separate "parallel account." Contributions to an IDA by an eligible individual would not be deductible, and earnings on those contributions would be included in income. Matching contributions by financial institutions and the earnings on those contributions would be tax free, provided they are withdrawn for qualified purposes (higher education, the first-time purchase of a home, business start-up, and qualified rollovers). Withdrawals for other than qualified purposes would result in the forfeiture of matching contributions and the earnings on those contributions. Individuals eligible to contribute to an IDA would be required to be at least 18 years of age, a citizen or legal resident of the United States, and meet certain income limitations. The proposal would be effective for contributions to IDAs and matching contributions made with respect to such IDAs after December 31, 2001.

Promote Trade

Extend and expand Andean trade preferences.—The Administration proposes to renew and enhance the Andean Trade Preference Program (ATPA) when it expires on December 4, 2001. The current ATPA program was enacted in 1991 to augment beneficiary countries' efforts to diversify their economies away from narcotics production and drug trafficking. The current program provides duty-free treatment on most, but not all, imports from Bolivia, Columbia, Peru and Ecuador. The Administration is seeking to work with Congress to expand the list of products eligible for duty free treatment under a renewed ATPA. It supports extending ATPA benefits for the period until the entry into force of the Free Trade Area of the Americas (FTAA). The Administration is seeking to conclude the FTAA negotiations in time for entry into force of the agreement by January 1, 2005.

Protect the Environment

Permanently extend expensing of brownfields remediation costs.—Taxpayers may elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred. Under current law, the ability to deduct such expenditures expires with respect to expenditures paid or incurred after December 31, 2003. The Administration proposes to permanently extend this provision, facilitating its use by businesses to undertake projects that may extend beyond the cur-

rent expiration date and be uncertain in overall duration.

Exclude 50 percent of gains from the sale of property for conservation purposes.—The Administration proposes to create a new incentive for private, voluntary land protection. This incentive is a cost-effective, non-regulatory approach to conservation. Under the proposal, when land (or an interest in land or water) is sold for conservation purposes, only 50 percent of any gain would be included in the seller's income. To be eligible for the exclusion, the sale may be either to a government agency or to a qualified conservation organization, and the buyer must supply a letter of intent that the acquisition will serve conservation purposes. In addition, the taxpayer or a member of the taxpayer's family must have owned the property for the three years immediately preceding the sale. The provision would be effective for sales taking place on or after the date of first committee action.

Energy Policy Proposals

Extend and modify the tax credit for producing electricity from certain sources.—Taxpayers are provided a 1.5-cent-per-kilowatt-hour tax credit, adjusted for inflation after 1992, for electricity produced from wind, closed-loop biomass (organic material from a plant grown exclusively for use at a qualified facility to produce electricity), and poultry waste. To qualify for the credit, the electricity must be sold to an unrelated third party and must be produced during the first 10 years of production at a facility placed in service before January 1, 2002. The Administration proposes to extend the credit for electricity produced from wind and biomass to facilities placed in service before January 1, 2005. In addition, eligible biomass sources would be expanded to include certain biomass from forest-related resources, agricultural sources, and other specified sources. Special rules would apply to biomass facilities placed in service before January 1, 2002. Electricity produced at such facilities from newly eligible sources would be eligible for the credit only from January 1, 2002 through December 31, 2004, and at a rate equal to 60 percent of the generally applicable rate. Electricity produced from newly eligible biomass cofired in coal plants would also be eligible for the credit only from January 1, 2002 through December 31, 2004, and at a rate equal to 30 percent of the generally applicable rate.

Provide tax credit for residential solar energy systems.—Current law provides a 10-percent investment tax credit to businesses for qualifying equipment that uses solar energy to generate electricity; to heat, cool or provide hot water for use in a structure; or to provide solar process heat. A credit currently is not provided for nonbusiness purchases of solar energy equipment. The Administration proposes a new tax credit for individuals who purchase solar energy equipment to generate electricity (photovoltaic equipment) or heat water (solar water heating equipment used exclusively for purposes other than heating swimming pools) for use in a dwelling unit that the individual uses as a residence. The proposed nonrefundable credit would be equal to 15 percent of the cost of the equipment and its installation; each individual taxpayer would be allowed a maximum credit of $2,000 for photovoltaic equipment and $2,000 for solar water heating equipment. The credit would apply to photovoltaic equipment placed in service after December 31, 2001 and before January 1, 2008 and to solar water heating equipment placed in service after December 31, 2001 and before January 1, 2006.

Modify treatment of nuclear decommissioning funds.—Under current law, deductible contributions to nuclear decommissioning funds are limited to the amount included in the taxpayer's cost of service for ratemaking purposes. For deregulated utilities, this limitation may result in the denial of any deduction for contributions to a nuclear decommissioning fund. The Administration proposes to repeal this limitation.

Also under current law, deductible contributions are not permitted to exceed the amount the IRS determines to be necessary to provide for level funding of an amount equal to the taxpayer's post-1983 decommissioning costs. The Administration proposes to permit funding of all decommissioning costs through deductible contributions. Any portion of these additional contributions relating to pre-1983 costs that exceeds the amount previously deducted (other than under the nuclear decommissioning fund rules) or excluded from the taxpayer's gross income on account of the taxpayer's liability for decommissioning costs, would be allowed as a deduction ratably over the remaining useful life of the nuclear power plant.

The Administration's proposal would also permit taxpayers to make deductible contributions to a qualified fund after the end of the nuclear power plant's estimated useful life and would provide that nuclear decommissioning costs are deductible when paid. These changes in the treatment of nuclear decommissioning funds are proposed to be effective for taxable years beginning after December 31, 2001.

ONE-YEAR EXTENSION OF PROVISIONS EXPIRING IN 2001

Extend the work opportunity tax credit.—The work opportunity tax credit provides an incentive for employers to expand the number of entry level positions for individuals from certain targeted groups. The credit generally applies to the first $6,000 of wages paid to several categories of economically disadvantaged or handicapped workers. The credit rate is 25 percent of qualified wages for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. The Administration proposes to extend the credit for one year, making the credit available for workers hired after December 31, 2001 and before January 1, 2003.

Extend the welfare-to-work tax credit.—The welfare-to-work tax credit entitles employers to claim a tax credit for hiring certain recipients of long-term family assistance. The purpose of the credit is to expand job opportunities for persons making the transition from welfare to work. 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. Eligible wages include cash wages plus the cash value of certain employer-paid health, dependent care, and educational fringe benefits. The minimum employment period that employees must work before employers can claim the credit is 400 hours. The Administration proposes to extend the credit for one year, to apply to individuals who begin work after December 31, 2001 and before January 1, 2003.

Extend exclusion for employer-provided educational assistance.—Certain amounts paid or incurred by an employer for educational assistance provided to an employee 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 Administration proposes to extend the exclusion, which is limited to undergraduate courses, to apply to courses beginning after December 31, 2001 and before January 1, 2003.

Extend minimum tax relief for individuals.—A temporary provision of prior law permits nonrefundable personal tax credits to be offset against both the regular tax and the alternative minimum tax; in addition, refundable credits are not reduced by the amount of the alternative minimum tax. The temporary provision expires after taxable year 2001. The Administration is concerned that the AMT may limit the benefit of personal tax credits and impose financial and compliance burdens on taxpayers who have few, if any, tax preference items and who were not the originally intended targets of the AMT. The Administration proposes to extend minimum tax relief for nonrefundable personal tax credits (other than the child credit) one year, to apply to taxable year 2002. The Administration's proposal to double the child credit (see earlier discussion) includes a provision providing permanent minimum tax relief for the child credit and refundable personal credits.

Extend exceptions provided under subpart F for certain active financing income.—Under the Subpart F rules, certain U.S. shareholders of a controlled foreign corporation (CFC) are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, "foreign personal holding company income" and insurance income. Foreign personal holding company income generally includes many types of income derived by a financial service company, such as dividends; interest; royalties; rents; annuities; net gains from the sale of certain property, including securities, commodities and foreign currency; and income from notional principal contracts and securities lending activities. For taxable years beginning before 2002, certain income derived in the active conduct of a banking, financing, insurance, or similar business is excepted from Subpart F. The Administration proposes to extend the exception for one year, to apply to taxable years beginning in 2002.

Extend suspension of net income limitation on percentage depletion from marginal oil and gas wells.—Taxpayers are allowed to recover their investment in oil and gas wells through depletion deductions. For certain properties, deductions may be determined using the percentage depletion method; however, in any year, the amount deducted generally may not exceed 100 percent of the net income from the property. For taxable years beginning after December 31, 1997 and before January 1, 2002, domestic oil and gas production from "marginal" properties is exempt from the 100-percent of net income limitation. The Administration proposes to extend the exemption to apply to taxable years beginning after December 31, 2001 and before January 1, 2003.

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. The Administration proposes to extend this program, which is scheduled to expire after September 30, 2001, through September 30, 2002.

Extend authority to issue Qualified Zone Academy Bonds.—Prior law allows State and local governments 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 must be used for teacher training, purchases of equipment, curricular development, or rehabilitation and repairs at certain public school facilities. A nationwide total of $400 million of qualified zone academy bonds was authorized to be issued in each of calendar years 1998 through 2001. In addition, unused authority arising in 1998 and 1999 may be carried forward for up to three years and unused authority arising in 2000 and 2001 may be carried forward for up to two years. The Administration proposes to authorize the issuance of an additional $400 million of qualified zone academy bonds in calendar year 2002.

OTHER PROVISIONS THAT AFFECT RECEIPTS

Recover State bank supervision and regulation expenses (receipt effect).—The Administration proposes to require the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve to recover their

respective costs for supervision and regulation of State-chartered 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 recoveries.

Table 3–3. EFFECT OF PROPOSALS ON RECEIPTS

(In millions of dollars)

	Estimate							
	2001	2002	2003	2004	2005	2006	2002–2006	2002–2011
President's Tax Plan presented to Congress on February 8th:								
Create new 10-percent individual income tax bracket	.....	–5,678	–13,847	–21,932	–29,849	–37,407	–108,713	–310,618
Reduce individual income tax rates	.....	–11,793	–21,047	–33,493	–42,306	–57,299	–165,938	–500,666
Increase the child tax credit [1]	.....	–1,238	–7,505	–11,455	–16,347	–20,963	–57,508	–192,657
Reduce the marriage penalty	.....	–1,435	–4,844	–7,773	–10,343	–12,675	–37,070	–112,834
Provide charitable contribution deduction for nonitemizers	.....	–482	–1,690	–2,963	–4,448	–6,065	–15,648	–52,171
Permit tax-free withdrawals from IRAs for charitable contributions	.....	–53	–181	–195	–210	–225	–864	–2,261
Raise the cap on corporate charitable contributions	.....	–85	–136	–136	–143	–149	–649	–1,579
Increase and expand education savings accounts	.....	–3	–25	–88	–204	–373	–693	–5,645
Permanently extend the R&E tax credit	.....	.....	.....	–1,055	–3,431	–5,415	–9,901	–49,576
Phase out death tax	–154	–4,930	–10,435	–11,442	–13,411	–16,263	–56,481	–261,257
Total, President's Tax Plan presented to Congress on February 8th [1]	**–154**	**–25,697**	**–59,710**	**–90,532**	**–120,692**	**–156,834**	**–453,465**	**–1,489,264**
Provide refundable tax credit for the purchase of health insurance [1]	.....	–219	–1,513	–3,966	–5,796	–6,143	–17,637	–52,858
Additional tax incentives [2]	–18	–1,812	–3,602	–4,322	–5,090	–6,001	–20,827	–66,531
One-year extension of provisions expiring in 2001 [2]	.....	–1,614	–1,355	–170	–94	–66	–3,299	–3,410
Total tax reduction [1, 2]	**–172**	**–29,342**	**–66,180**	**–98,990**	**–131,672**	**–169,044**	**–495,228**	**–1,612,063**
Other provisions that affect receipts:								
Recover State bank supervision and regulation expenses [1, 2]	.....	70	74	76	80	84	384	866

[1] Affects both receipts and outlays. Only the receipt effect is shown here; the outlay effect is shown in Table S–9 of the *Budget of the United States Government, Fiscal Year 2002.*

[2] Net of income offsets

Table 3–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	2000 Actual	Estimate					
		2001	2002	2003	2004	2005	2006
Individual income taxes (federal funds):							
Existing law	1,004,462	1,073,088	1,102,871	1,148,882	1,205,565	1,273,084	1,345,297
Proposed Legislation (PAYGO)	.....	–161	–24,082	–56,592	–87,684	–116,040	–148,690
Total individual income taxes	**1,004,462**	**1,072,927**	**1,078,789**	**1,092,290**	**1,117,881**	**1,157,044**	**1,196,607**
Corporation income taxes:							
Federal funds:							
Existing law	207,286	213,080	219,984	228,800	237,816	249,059	259,360
Proposed Legislation (PAYGO)	.....	–11	–1,198	–1,507	–2,319	–4,907	–7,201
Total Federal funds corporation income taxes	207,286	213,069	218,786	227,293	235,497	244,152	252,159
Trust funds:							
Hazardous substance superfund	3	.....	.....	.....	.....	.....	.....
Total corporation income taxes	**207,289**	**213,069**	**218,786**	**227,293**	**235,497**	**244,152**	**252,159**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	411,677	430,916	453,853	479,405	504,598	537,690	562,913
Disability insurance (Off-budget)	68,907	72,954	77,067	81,407	85,689	91,307	95,594
Hospital insurance	135,529	147,228	154,098	162,932	171,656	182,952	191,783
Railroad retirement:							
Social Security equivalent account	1,650	1,713	1,755	1,801	1,836	1,877	1,916
Rail pension and supplemental annuity	2,688	2,694	2,758	2,826	2,881	2,932	2,981
Total employment and general retirement	620,451	655,505	689,531	728,371	766,660	816,758	855,187
On-budget	139,867	151,635	158,611	167,559	176,373	187,761	196,680
Off-budget	480,584	503,870	530,920	560,812	590,287	628,997	658,507
Unemployment insurance:							
Deposits by States [1]	20,701	22,405	24,601	25,944	27,623	27,362	29,485
Federal unemployment receipts [1]	6,871	7,105	7,257	7,437	7,619	7,805	7,998
Railroad unemployment receipts [1]	68	50	88	134	149	105	74
Total unemployment insurance	27,640	29,560	31,946	33,515	35,391	35,272	37,557
Other retirement:							
Federal employees' retirement—employee share	4,691	4,523	4,259	4,106	3,948	3,767	3,582
Non-Federal employees retirement [2]	70	68	62	53	50	45	41
Total other retirement	4,761	4,591	4,321	4,159	3,998	3,812	3,623
Total social insurance and retirement receipts	**652,852**	**689,656**	**725,798**	**766,045**	**806,049**	**855,842**	**896,367**
On-budget	172,268	185,786	194,878	205,233	215,762	226,845	237,860
Off-budget	480,584	503,870	530,920	560,812	590,287	628,997	658,507
Excise taxes:							
Federal funds:							
Alcohol taxes	8,140	7,688	7,810	7,885	7,946	8,011	8,074
Tobacco taxes	7,221	7,548	8,140	8,175	7,941	7,778	7,643
Transportation fuels tax	819	779	743	759	766	784	306
Telephone and teletype services	5,670	5,914	6,295	6,687	7,097	7,526	7,976
Ozone depleting chemicals and products	125	94	65	39	20	.....	.....
Other Federal fund excise taxes	717	1,961	1,863	1,774	1,772	1,826	1,885
Total Federal funds excise taxes	22,692	23,984	24,916	25,319	25,542	25,925	25,884
Trust funds:							
Highway	34,972	35,431	36,539	37,646	38,727	39,823	40,867
Airport and airway	9,739	10,414	11,183	11,875	12,578	13,311	14,085
Aquatic resources	342	352	392	401	420	429	440
Black lung disability insurance	518	555	570	583	596	609	618
Inland waterway	101	93	93	94	95	96	97
Hazardous substance superfund	2	.....	.....	.....	.....	.....	.....
Oil spill liability	182	.....	.....	.....	.....	.....	.....

Table 3–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	2000 Actual	Estimate					
		2001	2002	2003	2004	2005	2006
Vaccine injury compensation	133	134	137	140	142	143	145
Leaking underground storage tank	184	185	190	196	200	207	210
Total trust funds excise taxes	46,173	47,164	49,104	50,935	52,758	54,618	56,462
Total excise taxes	**68,865**	**71,148**	**74,020**	**76,254**	**78,300**	**80,543**	**82,346**
Estate and gift taxes:							
Federal funds	29,010	31,072	32,068	34,480	37,036	35,364	35,605
Proposed Legislation (PAYGO)	.....	.....	–3,369	–7,841	–8,739	–10,467	–13,107
Total estate and gift taxes	**29,010**	**31,072**	**28,699**	**26,639**	**28,297**	**24,897**	**22,498**
Customs duties:							
Federal funds	19,172	20,635	22,403	23,650	24,299	25,302	26,775
Proposed Legislation (PAYGO)	.....	.....	–716	–264	–274	–285	–74
Trust funds	742	807	850	895	936	972	1,023
Total customs duties	**19,914**	**21,442**	**22,537**	**24,281**	**24,961**	**25,989**	**27,724**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	99	104	109	111	113	115	118
United Mine Workers of America combined benefit fund	155	149	143	135	129	125	121
Deposit of earnings, Federal Reserve System	32,293	26,599	31,800	33,345	34,944	35,881	36,693
Proposed Legislation (PAYGO)	.....	.....	93	98	102	107	112
Defense cooperation	12	6	6	6	6	6	6
Fees for permits and regulatory and judicial services	7,664	8,919	9,189	9,969	10,771	11,314	12,189
Fines, penalties, and forfeitures	2,422	1,923	1,880	1,907	1,915	1,923	1,932
Gifts and contributions	260	286	183	172	168	170	166
Refunds and recoveries	–79	–354	–298	–305	–317	–325	–327
Total miscellaneous receipts	**42,826**	**37,632**	**43,105**	**45,438**	**47,831**	**49,316**	**51,010**
Total budget receipts	**2,025,218**	**2,136,946**	**2,191,734**	**2,258,240**	**2,338,816**	**2,437,783**	**2,528,711**
On-budget	1,544,634	1,633,076	1,660,814	1,697,428	1,748,529	1,808,786	1,870,204
Off-budget	480,584	503,870	530,920	560,812	590,287	628,997	658,507
MEMORANDUM							
Federal funds	1,325,755	1,401,028	1,416,473	1,440,883	1,479,627	1,526,937	1,575,483
Trust funds	426,651	450,829	478,176	504,047	527,620	557,380	586,271
Interfund transactions	–207,772	–218,781	–233,835	–247,502	–258,718	–275,531	–291,550
Total on-budget	**1,544,634**	**1,633,076**	**1,660,814**	**1,697,428**	**1,748,529**	**1,808,786**	**1,870,204**
Off-budget (trust funds)	**480,584**	**503,870**	**530,920**	**560,812**	**590,287**	**628,997**	**658,507**
Total	**2,025,218**	**2,136,946**	**2,191,734**	**2,258,240**	**2,338,816**	**2,437,783**	**2,528,711**

[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.

4. USER FEES AND OTHER COLLECTIONS

In addition to collecting taxes and other receipts by the exercise of its sovereign powers, which is discussed in the previous chapter, the Federal Government collects income from the public from market-oriented activities and the financing of regulatory expenses. Some of these collections are classified as user fees, which include the sale of postage stamps and electricity, fees for admittance to national parks, and premiums for deposit insurance; and some are other offsetting collections or receipts, such as rents and royalties for the right to extract oil from the Outer Continental Shelf.

Depending on the laws that authorize the collections, the collections can be credited directly to expenditure accounts as "offsetting collections," or to receipt accounts as "offsetting receipts." Usually offsetting collections are authorized to be spent for the purposes of the account without further action by the Congress. Offsetting receipts may or may not be earmarked for a specific purpose, depending on the legislation that authorizes them, and the authorizing legislation may either authorize them to be spent without further action by the Congress, or require them to be appropriated in annual appropriations acts before they can be spent.

The budget refers to them as offsetting collections and offsetting receipts, because they are subtracted from gross outlays rather than added to taxes on the receipts side of the budget. 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.[1]

Offsetting collections and receipts include most user fees, which are discussed below, as well as some amounts that are not user fees. Table 4–1 summarizes these transactions. For 2002, total offsetting collections and receipts from the public are estimated to be $222.1 billion, and total user fees are estimated to be $143.8 billion.

The following section discusses user fees and the Administration's user fee proposals. The subsequent section displays more information on offsetting collections and receipts. The offsetting collections and receipts by agency are also displayed in Table 20–1, "Outlays to the Public, Net and Gross," which appears in Chapter 20 of this volume.

Table 4–1. GROSS OUTLAYS, USER FEES, OTHER OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, AND NET OUTLAYS

(In billions of dollars)

	2000 Actual	Estimate	
		2001	2002
Gross outlays	2,002.9	2,079.2	2,182.7
Offsetting collections and receipts from the public:			
User fees [1]	129.5	134.0	142.3
Other	84.6	88.9	79.8
Subtotal, offsetting collections and receipts from the public	214.1	223.0	222.1
Net outlays	1,788.8	1,856.2	1,960.6

[1] Total user fees are shown below. They include user fees that are classified on the receipts side of the budget in addition to the amounts shown on this line. For additional details of total user fees, see Table 4–2. "Total User Fee Collections."

Total user fees:			
Offsetting collections and receipts from the public	129.5	134.0	142.3
Receipts	1.3	1.4	1.5
Total user fees	130.8	135.5	143.8

[1] Showing collections from business-type transactions as offsets on the spending side of the budget follows the concept recommended by the 1967 *Report of the President's Commission on Budget Concepts*. The concept is discussed in Chapter 25: "Budget System and Concepts and Glossary" in this volume.

USER FEES

I. Introduction and Background

The Federal Government may charge user fees to those who benefit directly from a particular activity or those subject to regulation. According to the definition of user fees used in this chapter, Table 4–2 shows that user fees were $130.8 billion in 2000, and are estimated to increase to $135.5 billion in 2001 and to $143.8 billion in 2002, growing to an estimated $171.3 billion in 2006, including the user fee proposals that are shown in Table 4–3. This table shows that the Administration is proposing to increase user fees by an estimated $0.6 billion in 2002, growing to an estimated $1.5 billion in 2006.

Definition. The term "user fee" as defined here is fees, charges, and assessments levied on a class directly benefitting from, or subject to regulation by, a government program or activity, and to be utilized solely to support the program or activity. In addition, the payers of the fee must be limited to those benefitting 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 it is charged, including directly associated agency functions, not for unrelated programs or activities and not for the broad purposes of the Government or an agency.

- Examples of business-type or market-oriented user fees include fees for the sale of postal services (the sale of stamps), electricity (e.g., sales by the Tennessee Valley Authority), payments for Medicare voluntary supplemental medical insurance, life insurance premiums for veterans, recreation fees for parks, NASA fees for shuttle services, the sale of weather maps and related information by the Department of Commerce, the sale of commemorative coins, and fees for the sale of books.
- Examples of regulatory and licensing user fees include fees for regulating the nuclear energy industry, bankruptcy filing fees, immigration fees, food inspection fees, passport fees, and patent and trademark fees.

User fees do not include all offsetting collections and receipts, such as the interest and repayments received from credit programs; proceeds from the sale of loans and other financial investments; interest, dividends, and other earnings; cost sharing contributions; the sale of timber, minerals, oil, commodities, and other natural resources; proceeds from asset sales (property, plant, and equipment); Outer Continental Shelf receipts; or spectrum auction proceeds. Neither do they include earmarked taxes (such as taxes paid to social insurance programs or excise taxes), or customs duties, fines, penalties, and forfeitures.

There has been a growth in user fees, and some have been classified by law as offsetting collections when they more appropriately should have been classified as governmental receipts. The classification of some user fees as an offset to budget authority and outlays do not meet the guidelines established by the 1967 President's Commission on Budget Concepts that only business-type transactions should be classified as offsetting collections. To the extent these collections are inappropriately classified as an offset to Federal spending, they reduce the size of Federal spending and governmental receipts. The Administration plans to monitor and review the classification of user fees and other types of collections.

Alternative definitions. The definition used in this chapter is useful because it identifies goods, services, and regulations financed by earmarked collections and receipts.[2] Other definitions may be used for other purposes, such as establishing policy for charging prices to the public for goods and services regardless of whether the proceeds are earmarked.

One alternative definition could be the broader concept of user charges, as defined in OMB Circular A–25, "User Charges," (July 8, 1993). User charges are fees assessed for the provision of Government services and for the sale or use of Government goods or resources. The payers of the user charge must be limited in the authorizing legislation to those receiving special benefits from, or subject to regulation by, the program or activity beyond the benefits received by the general public or broad segments of the public (such as those who pay income taxes or customs duties). The term is broader than user fees as defined in this chapter because user charges encompass proceeds, whether or not earmarked, from the sale or use of government goods and services, including the sale of natural resources (such as timber, oil, and minerals) and proceeds from asset sales (such as property, plant, and equipment).

Other alternative definitions of user fees could, for example:

- be narrower than the one used here, by excluding regulatory fees and analyzing them as a separate category.
- be broader than the one used here, by selecting one or more of the following:
  - —eliminating the requirement that fees be earmarked. The definition would then include fees that go to the general fund in addition to those that are earmarked to finance the related activity.
  - —including the sale of resources as well as goods and services, such as natural resources (e.g., timber, oil, or minerals) and property, plant, and equipment.

[2] The definition used here is similar to one the House of Representatives uses as a guide for purposes of committee jurisdiction. The definition helps differentiate between taxes, which are under the jurisdiction of the Ways and Means Committee, and fees, which can be under the jurisdiction of other committees. See the *Congressional Record*, January 3, 1991, p. H31, item 8.

—interpreting more broadly whether a program has private beneficiaries, or whether the proceeds are earmarked to benefit directly those paying the fee. A broader interpretation might include beneficiary- or liability-based excise taxes.[3]

What is the purpose of user fees? The purpose of user fees is to improve the efficiency and equity of certain Government activities, and to reduce the burden on the taxpayer to finance activities whose benefits accrue to a relatively limited number of people.

User fees that are set to cover the costs of production of goods and services can provide efficiency in the allocation of resources within the economy. They allocate goods and services to those who value them the most, and they signal to the Government how much of the goods or services it should provide. Prices in private, competitive markets serve the same purposes.

User fees for goods and services that do not have special social benefits improve equity, or fairness, by requiring that those who benefit from an activity are the same people who pay for it. The public often perceives user fees as fair because those who benefit from the good or service pay for it in whole or in part, and those who do not benefit do not pay.

When should the Government charge a fee? Discussions of whether to finance spending with a tax or a fee often focus on whether the benefits of the activity are to the public in general or to a limited group of people. In general, if the benefits accrue broadly to the public, then the program should be financed by taxes paid by the public; in contrast, if the benefits accrue to a limited number of private individuals or groups, then the program should be financed by fees paid by the private beneficiaries. For Federal programs where the benefits are entirely public or entirely private, applying this principle is relatively easy. For example, according to this principle, the benefits from national defense accrue to the public in general and should be (and are) financed by taxes. In contrast, the benefits of electricity sold by the Tennessee Valley Authority accrue exclusively to those using the electricity, and should be (and are) financed by user fees.

In many cases, however, an activity has benefits that accrue to both public and to private groups, and it may be difficult to identify how much of the benefits accrue to each. Because of this, it can be difficult to know how much of the program should be financed by taxes and how much by fees. For example, the benefits from recreation areas are mixed. Fees for visitors to these areas are appropriate because the visitors benefit directly from their visit, but the public in general also benefits because these areas protect the Nation's natural and historical heritage now and for posterity.

As a further complication, where a fee may be appropriate to finance all or part of an activity, some consideration must be given to the ease of administering the fee.

What should be the amount of the fee? For programs that have private beneficiaries, the amount of the fee should depend on the costs of producing the goods or services and the portion of the program that is for private benefits. If the benefit is primarily private, and any public benefits are incidental, current policies support fees that cover the full cost to the Government, including both direct and indirect costs.[4]

The Executive Branch is working to put cost accounting systems in place across the Government that would make the calculation of full cost more feasible. The difficulties in measuring full cost are associated in part with allocating to an activity the full costs of capital, retirement benefits, and insurance, as well as other Federal costs that may appear in other parts of the budget. Guidance in the Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* (July 31, 1995), should underlie cost accounting in the Federal Government.

Classification of user fees in the budget. As shown in Table 4–1, most user fees are classified as offsets to outlays on the spending side of the budget, but a few are classified on the receipts side of the budget. An estimated $1.5 billion in 2002 are classified this way and are included in the totals described in Chapter 3. "Federal Receipts." They are classified as receipts because they are regulatory fees collected by the Federal Government by the exercise of its sovereign powers.

The remaining user fees, an estimated $142.3 billion in 2002, are classified as offsetting collections and receipts on the spending side of the budget. Some of these are collected by the Federal Government by the exercise of its sovereign powers and would normally appear on the receipts side of the budget, but are required by law to be classified as offsetting collections or receipts.

An estimated $108.7 billion of user fees for 2002 are credited directly to expenditure accounts, and are generally available for expenditure when they are collected, without further action by the Congress.

An estimated $33.7 billion of user fees for 2002 are deposited in offsetting receipt accounts, and are available to be spent only according to the legislation that established the fees.

As a further classification, the following Tables 4–2 and 4–3 identify the fees as discretionary or mandatory. These classifications are terms from the Budget Enforcement Act of 1990 as amended and are used frequently in the analysis of the budget. "Discretionary"

[3] Beneficiary- and liability-based taxes are terms taken from the Congressional Budget Office, *The Growth of Federal User Charges*, August 1993, and updated in October 1995. Examples of beneficiary-based taxes include taxes on gasoline, which finance grants to States for highway construction, or taxes on airline tickets, which finance air traffic control activities and airports. An example of a liability-based tax is the excise tax that helps fund the hazardous substance superfund in the Environmental Protection Agency. This tax is paid by industry groups to finance environmental cleanup activities related to the industry activity but not necessarily caused by the payer of the fee.

[4] Policies for setting user charges are promulgated in OMB Circular No. A-25: "User Charges" (July 8, 1993). These policies are required regardless of whether or not the proceeds are earmarked to finance the related activity.

in this chapter refers to fees generally controlled through annual appropriations acts and under the jurisdiction of the appropriations committees in the Congress. These fees offset discretionary spending under the discretionary caps. "Mandatory" refers to fees controlled by permanent laws and under the jurisdiction of the authorizing committees. These fees are subject to rules of paygo, whereby changes in law affecting mandatory programs and receipts cannot result in a net cost. Mandatory spending is sometimes referred to as direct spending.

These and other classifications are discussed further in this volume in Chapter 25, "Budget System and Concepts and Glossary."

II. Current User Fees

As shown in Table 4–2, total user fee collections (including those proposed in this budget) are estimated to be $143.8 billion in 2002, increasing to $171.3 billion in 2006. User fee collections by the Postal Service and Medicare premiums are the largest and are estimated to be almost two-thirds of total user fee collections in 2002.

User fee collections are used to offset outlays in both the discretionary and mandatory parts of the budget. User fee collections classified in the discretionary part of the budget are estimated to be $17.2 billion in 2002, and those in the mandatory part are estimated to be $125.1 billion in 2002.

III. User Fee Proposals

As shown in Table 4–3, the Administration is proposing new or increased user fees that would increase collections by an estimated $0.6 billion in 2002, increasing to $1.5 billion in 2006.

A. User Fee Proposals to Offset Discretionary Spending

1. Offsetting collections

Department of Agriculture

Animal and Plant Health Inspection Service (APHIS).—The Administration proposes to establish fees to cover the cost of providing animal welfare inspections to recipients of APHIS services such as animal research centers, humane societies, and kennels.

Grain Inspection, Packers and Stockyards Administration (GIPSA) licensing fees.—The budget proposes to charge the grain industry for GIPSA's costs to review and maintain standards (such as grain quality and classification) that are used by the industry.

Department of Health and Human Services

User fees for Medicare providers for processing paper claims and duplicate or unprocessable claims.—The Administration is proposing new user fees for providers for submitting paper claims and duplicate or unprocessable claims. Under this proposal, providers would be charged $1.50 for every paper claim submitted for payment. The fee is necessary because processing paper claims is more costly than processing electronic claims. Paper claim fees could be waived for rural and poor providers.

The Health Care Financing Administration and its contractors go to great lengths to ensure that providers are aware of billing requirements and the need to submit accurate claims. Charging a $1.50 fee for duplicate or unprocessable claims would heighten provider awareness of these issues and increase efficiency by deterring this action.

Fees for export certification of foods and for import program operations.—The Administration is proposing new user fees for export certification of foods and for import program operations. Spending financed by these fees would be in addition to regular appropriations. The Food and Drug Administration currently assesses user fees for non-food regulated products when export certifications are requested by industry.

2. Offsetting receipts

Department of Housing and Urban Development

User fees to finance inspection of manufactured housing.—The Administration is proposing inspection fees that would finance Federal formulation and enforcement of standards in manufactured housing. These fees are authorized by the Manufactured Housing Improvement Act of 2000 and replace fees previously authorized by the National Manufactured Housing Construction and Safety Standards Act of 1974.

Department of Justice

Increase immigration inspection user fees.—Congress established this user fee to cover the full cost of air and sea passenger inspections. The Administration proposes to increase the per passenger inspection fee from $6 to $7 and phase out the exemption from the inspection fee for cruise ship passengers—establishing a $3 fee in 2002. The increase will be used to defray inspection expenses of the Immigration and Naturalization Service.

Department of Transportation

Hazardous materials transportation safety fees.—Beginning in 2002, hazardous materials transportation safety activities previously financed by general fund appropriations to the Research and Special Programs Administration are proposed to be financed instead by an increase in hazardous materials registration fees. Appropriation legislation is proposed to increase the fees paid by shippers and carriers of hazardous materials in 2002 to fund these safety activities.

Table 4–2. TOTAL USER FEE COLLECTIONS

(In millions of dollars)

	2000 Actual	Estimates					
		2001	2002	2003	2004	2005	2006
Receipts							
Agricultural quarantine inspection fees	234	240	246	252	259	266	272
Corps of Engineers, Harbor maintenance trust fund	678	741	781	825	865	900	946
Other governmental receipts user fees	413	469	455	457	464	474	477
Subtotal, governmental receipts	1,325	1,450	1,482	1,534	1,588	1,640	1,695
Offsetting Collections and Receipts from the Public							
Discretionary							
Department of Agriculture: Food safety inspection and other fees	177	189	200	197	197	197	198
Department of Commerce: Patent and trademark, fees for weather services, and other fees	1,156	1,315	1,500	1,616	1,765	1,926	2,137
Department of Defense: Commissary and other fees	7,376	7,353	7,248	7,155	7,155	7,155	7,155
Department of Energy: Federal Energy Regulation Commission, power marketing, and other fees	594	787	1,223	632	621	590	597
Department of Health and Human Services: Food and Drug Administration, Health Care Financing Administration, and other fees	337	276	413	418	428	438	448
Department of the Interior: Bureau of Land Management and other fees	215	231	219	219	219	219	219
Department of Justice: Antitrust and other fees	328	361	548	585	585	585	585
Department of State: Passport and other fees	478	485	490	490	490	490	490
Department of Transportation: Railroad safety and other fees	131	139	216	282	286	292	297
Department of the Treasury: Sale of commemorative coins and other fees	1,833	1,513	1,619	1,697	1,721	1,746	1,772
Department of Veterans Affairs: Medical care and other fees	576	611	623	633	643	653	663
National Aeronautics and Space Administration: Reimbursement for the use of NASA services	846	839	881	881	881	881	881
Federal Communications Commission: Regulatory fees	192	200	219	219	219	219	219
Federal Trade Commission: Regulatory fees	106	159	207	207	207	207	207
Nuclear Regulatory Commission: Regulatory fees	447	453	469	475	482	488	506
Panama Canal Commission: Fees for use of the canal	220	.....	.....	.....	.....	.....	.....
Securities and Exchange Commission: Regulatory fees	862	974	983	1,054	1,079	1,200	1,337
All other agencies, discretionary user fees	133	134	175	179	180	185	187
Subtotal, discretionary user fees	16,007	16,019	17,233	16,939	17,158	17,471	17,898
Mandatory							
Department of Agriculture: Federal crop insurance and other fees	895	1,339	1,338	1,402	1,440	1,502	1,563
Department of Defense: Commissary surcharge and other fees	279	277	283	293	277	277	277
Department of Energy: Proceeds from the sale of energy, nuclear regulatory fees, and other fees	4,078	3,703	3,831	3,960	3,907	3,921	3,984
Department of Health and Human Services: Medicare Part B insurance premiums, and other fees	21,916	23,442	27,044	29,905	31,503	35,029	37,951
Department of the Interior: Recreation and other fees	583	630	619	648	652	657	658
Department of Justice: Immigration and other fees	1,480	2,036	1,972	1,906	1,814	1,818	1,823
Department of Labor: Insurance premiums to guarantee private pensions	922	951	845	835	845	843	839
Department of the Treasury: Customs, bank regulation, and other fees	1,881	1,929	1,985	2,046	666	681	693
Department of Veterans Affairs: Veterans life insurance, medical collections, and other fees	1,629	1,674	1,823	1,932	1,883	1,842	1,802
Corps of Engineers: Recreation and other fees	37	36	51	57	62	67	67
Federal Emergency Management Agency: Flood insurance fees	1,475	1,553	1,640	1,808	1,936	2,118	2,343
Office of Personnel Management: Federal employee health and life insurance fees	6,694	7,278	7,974	8,612	9,308	9,987	10,684
Federal Communications Commission: Analog spectrum lease fee	.....	.....	200	200	200	200	200
Federal Deposit Insurance Corporation: Deposit insurance fees	759	559	963	1,748	2,552	3,543	5,573
Postal Service: Fees for postal services	63,529	65,498	67,095	69,350	71,500	73,350	75,100
Tennessee Valley Authority: Proceeds from the sale of energy	6,928	6,795	7,127	7,341	7,424	7,675	7,811
All other agencies, mandatory user fees	363	324	312	328	336	347	354
Subtotal, mandatory user fees	113,448	118,024	125,102	132,371	136,305	143,857	151,722
Subtotal, offsetting collections and receipts from the public	129,455	134,043	142,335	149,310	153,463	161,328	169,620
Total, User fees	**130,780**	**135,493**	**143,817**	**150,844**	**155,051**	**162,968**	**171,315**

Pipeline safety fees.—This proposal would increase the existing pipeline safety user fees to support increased activities in the Pipeline Integrity Management and the Oil Spill Prevention and Response programs.

Railroad safety user fees.—This proposal would fund Federal Railroad Administration safety inspections and the safety component of the railroad research and development program. The fees would be collected from the primary beneficiaries of these services, the railroad carriers, and be based upon a calculation of their usage as established through regulations. The estimated 2002 collections are 50 percent of the anticipated cost of safety services. In subsequent years these services would be fully funded with user fees.

Environmental Protection Agency

Abolish cap on pre-manufacturing notification fees.—EPA collects fees from chemical manufacturers seeking to bring new chemicals into commerce. These fees are authorized by the Toxic Substances Control Act and are now subject to an outdated statutory cap. The Administration is proposing authorizing and appropriations language to modify the cap so that EPA can increase fees to fully cover the cost of the program.

Nuclear Regulatory Commission

Extend NRC fees at their 2005 level for 2006 and later.—The Omnibus Budget Reconciliation Act (OBRA) of 1990, as amended, required that the NRC assess license and annual fees that recover approximately 98 percent of its budget authority in 2001, less the appropriation from the nuclear waste fund. Licensees are required to reimburse NRC for its services because licensees benefit from such services.

Under recent amendments to OBRA, the budget authority recovery requirement decreases by 2 percentage points per year until it reaches 90 percent in 2005. After 2005, the requirement reverts to 33 percent per

Table 4–3. USER FEE PROPOSALS

(Estimated collections in millions of dollars)

	2002	2003	2004	2005	2006	2002–2006
A. USER FEE PROPOSALS TO OFFSET DISCRETIONARY SPENDING						
1. Offsetting collections						
Department of Agriculture						
Animal and Plant Health Inspection Service	5	5	5	5	6	26
Grain Inspection, Packers and Stockyards Administration	4	4	4	4	4	20
Department of Health and Human Services						
User fees for Medicare providers for processing paper claims and duplicate or unprocessable claims	95	90	90	90	90	455
Fees for export certification of foods and for import program operations	20	21	22	23	24	110
2. Offsetting receipts						
Department of Housing and Urban Development						
User fees to finance inspection of manufactured housing	17	17	17	18	18	87
Department of Justice						
Increase immigration inspection user fees	109	109	109	109	109	545
Department of Transportation						
Hazardous materials transportation safety fees	12	22	22	23	24	103
Pipeline safety fees	9	9	9	9	7	43
Railroad safety user fees	55	110	113	116	119	513
Environmental Protection Agency						
Abolish cap on pre-manufacturing notification fees	4	8	8	8	8	36
Nuclear Regulatory Commission						
Extend NRC fees at their 2005 level for 2006 and later	.....	.....	.....	.....	321	321
Subtotal, user fee proposals to offset discretionary spending	330	395	399	405	730	2,259
B. USER FEE PROPOSALS TO OFFSET MANDATORY SPENDING						
1. Offsetting collections						
Federal Emergency Management Agency						
Phase out subsidized premiums for certain flood insurance coverage and remove repetitive loss properties from the flood insurance program	7	26	71	167	302	573
Federal Deposit Insurance Corporation						
State bank examination fees	92	97	101	106	112	508
2. Offsetting receipts						
Department of Agriculture						
Forest Service recreation and entrance fees	.....	38	40	42	44	164
Department of the Interior						
Recreation entrance fees	.....	75	76	74	75	300
Corps of Engineers						
Recreation user fee increases	10	15	20	25	25	95
Federal Communications Commission						
Analog spectrum lease fee	200	200	200	200	200	1,000
Subtotal, user fee proposals to offset mandatory spending	309	451	508	614	758	2,640
Total, user fee proposals	639	846	907	1,019	1,488	4,899

year. If the 90 percent requirement is not extended beyond 2005, fees would drop from an estimated $488 million in 2005 to $185 million in 2006; with the proposed extension at 90 percent, fees would be an estimated $506 million in 2006, a proposed increase of $321 million.

B. User Fee Proposals to Offset Mandatory Spending

1. Offsetting collections

Federal Emergency Management Agency

Phase out subsidized premiums for certain flood insurance coverage.—The Administration proposes phasing out subsidized premium rates for vacation homes, rental properties, and other non-primary residences and businesses starting in 2002. FEMA charges many of these policy holders less than actuarial rates, which undermines the financial stability of the insurance program. Rates for primary residences, which represent a majority of policies in the program, would not change under this proposal.

Remove repetitive loss properties from the flood insurance program.—The Administration proposes to remove several thousand properties from the program. These properties have been flooded repeatedly but nevertheless still benefit from subsidized premiums. Starting in 2002, owners of targeted properties may make one more claim for a flood loss. Subsequently, those properties will be ineligible to receive coverage. While net savings from avoided claims are estimated to be significant, the proposal will also generate a PAYGO cost from lost premium revenue as properties are removed from the program.

Federal Deposit Insurance Corporation

State bank examination fees.—The Administration proposes to require the Federal Deposit Insurance Corporation and the Federal Reserve to recover their respective costs for supervision and regulation of State-chartered banks and bank holding companies. The proposal would eliminate the subsidization of State banks by national banks and taxpayers, treat State and federally chartered financial institutions the same, and reduce the incentive for federally-chartered banks to convert to State charters solely to avoid assessments.

Currently, the FDIC pays for its supervision and regulatory expenses with the deposit insurance premiums that all banks pay, including national banks. Additional income from the proposal would be realized as offsetting collections. The Federal Reserve uses its interest earnings to pay its supervision and regulatory costs, consequently transferring less money to the Treasury. Therefore, deposits of earnings by the Federal Reserve, which are classified as governmental receipts, would increase under this proposal. This estimated increase in recoveries is in addition to the amounts shown on Table 4–3.

2. Offsetting receipts

Department of Agriculture

Forest Service recreation and entrance fees.—The Administration proposes to extend for four years, for 2003 through 2006, the current pilot program that allows the Forest Service to collect increased recreation and entrance fees. These receipts would be available for use without further appropriation and are necessary to maintain and improve recreation facilities and services. A similar proposal affects recreation fees for the National Park Service, the Bureau of Land Management, and the Fish and Wildlife Service in the Department of the Interior.

Department of the Interior

Recreation entrance fees.—The Administration proposes to extend for four years, for 2003 through 2006, the current pilot program that allows the National Park Service, the Bureau of Land Management, and the Fish and Wildlife Service to collect increased recreation and entrance fees. These receipts would be available for use without further appropriation, and approximately 60 percent of National Park Service receipts would be used to reduce its deferred maintenance backlog. A related proposal affects recreation fees for the Forest Service in the Department of Agriculture.

Corps of Engineers

Recreation user fee increases.—The Administration proposes to phase in recreation user fee increases with the entire increase available without further legislative action for spending on operation, maintenance, and improvement of the recreation facilities of the Corps of Engineers. Some increases in fee receipts can be accomplished without changes to existing legislation. Other increases will require legislation to increase limits on existing recreation user fees, authorize new fees, or reclassify existing fees. In addition, the Administration recommends extending the recreation demonstration program, which allows recreation fee revenues above a baseline of $34 million per year to be used by the Corps for operation and maintenance of recreation facilities. The Corps spends about $250 million per year on these activities.

Recreation fee increases to boost agency expenditures on recreation and maintenance of facilities have been enacted in recent years for other agencies such as the National Park Service in the Department of the Interior and the Forest Service in the Department of Agriculture. A similar proposal affects recreation fees for these programs.

Federal Communications Commission

Analog spectrum lease fee.—The Administration supports establishing a lease fee on commercial television broadcasters' use of the analog spectrum until broadcasters complete the transition to digital broadcasting and return their analog spectrum licenses to the FCC. The proposal would encourage a timely transition to

digital broadcasting and have television broadcasters reimburse the public for use of this scarce resource.

OTHER OFFSETTING COLLECTIONS AND RECEIPTS

Table 4–4 shows that total offsetting collections and receipts from the public are estimated to be $222.1 billion in 2002. Of these, an estimated $143.7 billion are offsetting collections credited to appropriation accounts and an estimated $78.4 billion are deposited in offsetting receipt accounts.

The user fees in Table 4–4 were discussed in the previous section. Major offsetting collections deposited in expenditure accounts that are not user fees are pre-credit reform loan repayments, collections from States to supplement payments in the supplemental security income program, and collections for the Federal Savings and Loan resolution fund. Major offsetting receipts that are not user fees include spectrum auction receipts, military assistance program sales, rents and royalties for oil and gas on the Outer Continental Shelf, and interest income.

Table 4–5 includes all offsetting receipts 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 to be $428.3 billion in 2002—$349.9 billion are intragovernmental transactions, and $78.4 billion are from the public, shown in the table as proprietary receipts and offsetting governmental receipts.

As noted above, offsetting collections and receipts by agency are also displayed in Table 20–1, “Outlays to the Public, Net and Gross,” which appears in Chapter 20 of this volume.

Table 4–4. OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC

(In millions of dollars)

	2000 Actual	Estimate	
		2001	2002
Offsetting collections:			
User fees:			
Postal service stamps and other postal fees	63,529	65,498	67,095
Defense Commissary Agency	5,087	5,282	5,209
Federal employee contributions for employees and retired employees health benefits funds	5,263	5,817	6,436
Sale of energy:			
Tennessee Valley Authority	6,928	6,795	7,127
Bonneville Power Administration	2,995	2,732	2,929
All other user fees	17,989	18,229	19,864
Subtotal, user fees	101,791	104,353	108,660
Other offsetting collections:			
Pre-credit reform loan repayments	15,864	15,563	14,847
Supplemental security income (collections from the States)	3,399	3,570	3,665
Federal Savings and Loan Insurance Corporation resolution fund	2,638	1,670	1,102
Other collections	17,672	15,935	15,423
Subtotal, other offsetting collections	39,573	36,738	35,037
Subtotal, offsetting collections	141,364	141,091	143,697
Offsetting receipts:			
User fees:			
Medicare premiums and other charges	21,907	23,433	27,014
All other user fees	5,757	6,257	6,661
Subtotal, user fees	27,664	29,690	33,675
Other offsetting receipts:			
Spectrum auction receipts	150	1,572	1,760
Military assistance program sales	11,362	11,340	11,450
OCS rents, bonuses, and royalties	4,580	6,931	5,884
Interest income	13,207	13,091	13,837
All other offsetting receipts	15,743	19,266	11,800
Subtotal, other offsetting receipts	45,042	52,200	44,731
Subtotal, offsetting receipts	72,706	81,890	78,406
Total, offsetting collections and receipts from the public	214,070	222,981	222,103
Total, offsetting collections and receipts excluding off-budget	150,497	157,439	154,964
ADDENDUM:			
User fees that are offsetting collections and receipts[1]	129,455	134,043	142,335
Other offsetting collections and receipts from the public	84,615	88,938	79,768
Total, offsetting collections and receipts from the public	214,070	222,981	222,103

[1] Excludes user fees that are classified on the receipts side of the budget. For total user fees, see Table 4.1 or Table 4.2.

Table 4–5. OFFSETTING RECEIPTS BY TYPE

(In millions of dollars)

Source	2000 Actual	Estimate					
		2001	2002	2003	2004	2005	2006
INTRAGOVERNMENTAL TRANSACTIONS							
On-budget receipts:							
Federal intrafund transactions:							
Distributed by agency:							
Interest from the Federal Financing Bank	1,974	2,035	2,136	1,830	2,160	2,387	2,535
Interest on Government capital in enterprises	1,867	1,339	1,524	1,187	1,073	1,010	948
DoD retiree health care fund	.....	.....	.....	9,036	9,397	9,773	10,164
Credit subsidy balance transfers	.....	10,637	439	482	667	861	1,059
Other	2,383	1,974	1,988	2,077	2,183	2,280	2,362
Undistributed by agency:							
DoD retiree health care fund	.....	.....	.....	2,943	3,072	3,211	3,355
Total Federal intrafunds	6,224	15,985	6,087	17,555	18,552	19,522	20,423
Trust intrafund transactions:							
Distributed by agency:							
Payments to railroad retirement	3,697	3,215	3,812	3,838	3,838	3,853	3,679
Other	1	1	1	1	1	1	1
Total trust intrafunds	3,698	3,216	3,813	3,839	3,839	3,854	3,680
Total intrafund transactions	9,922	19,201	9,900	21,394	22,391	23,376	24,103
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Contributions to insurance programs:							
Military retirement fund	15,302	16,089	16,653	17,235	17,839	18,463	19,110
Supplementary medical insurance	65,561	69,777	81,332	88,779	92,549	102,042	110,380
Proposed legislation (non-PAYGO)	.....	.....	–70	–75	–70	–70	–70
Hospital insurance	9,450	8,030	8,596	9,107	9,839	10,560	11,358
Proposed legislation (non-PAYGO)	.....	.....	–106	–304	–461	–662	–821
Railroad social security equivalent fund	141	106	113	124	134	145	152
Proposed legislation (non-PAYGO)	.....	.....	–1	–3	–6	–8	–11
Rail industry pension fund	318	229	234	241	247	254	262
Proposed legislation (non-PAYGO)	.....	.....	–5	–12	–15	–23	–27
Civilian supplementary retirement contributions	21,808	22,056	22,724	23,183	23,869	24,563	25,042
Unemployment insurance	397	466	483	478	478	482	495
Other contributions	518	574	466	443	444	444	474
Subtotal	113,495	117,327	130,419	139,196	144,847	156,190	166,344
Miscellaneous payments	956	1,443	819	864	876	893	912
Proposed legislation (non-PAYGO)	.....	.....	–11	–11	–12	–12	–12
Subtotal	114,451	118,770	131,227	140,049	145,711	157,071	167,244
Trust fund payments to Federal funds:							
Quinquennial adjustment for military service credits	.....	836	.....	.....	.....	.....	.....
Other	1,078	2,496	1,186	1,214	1,241	1,271	1,303
Subtotal	1,078	3,332	1,186	1,214	1,241	1,271	1,303
Total interfunds distributed by agency	115,529	122,102	132,413	141,263	146,952	158,342	168,547
Undistributed by agency:							
Employer share, employee retirement (on-budget):							
Civil service retirement and disability insurance (CSRDI)	9,611	10,316	10,679	10,585	11,174	11,843	12,547
Proposed legislation (non-PAYGO)	.....	.....	.....	469	482	449	415
CSRDI from Postal Service	6,445	6,768	6,854	6,975	7,111	7,249	7,327
Hospital insurance (contribution as employer) [1]	1,991	2,038	2,127	2,229	2,337	2,470	2,574
Postal employer contributions to FHI	639	655	682	711	742	774	807
Military retirement fund	11,402	11,369	12,166	12,622	13,098	13,567	14,040
Other Federal employees retirement	126	130	134	138	142	147	152
Total employer share, employee retirement (on-budget)	30,214	31,276	32,642	33,729	35,086	36,499	37,862

Table 4–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2000 Actual	Estimate					
		2001	2002	2003	2004	2005	2006
Interest received by on-budget trust funds	69,113	73,662	76,317	80,272	84,695	88,974	93,634
Proposed legislation (non-PAYGO)	.....	.....	–1	–76	–162	–261	–359
Total interfund transactions undistributed by agency	99,327	104,938	108,958	113,925	119,619	125,212	131,137
Total interfund transactions	214,856	227,040	241,371	255,188	266,571	283,554	299,684
Total on-budget receipts	224,778	246,241	251,271	276,582	288,962	306,930	323,787
Off-budget receipts:							
Trust intrafund transactions:							
Distributed by agency:							
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Old-age, survivors, and disability insurance	13,252	12,541	13,734	14,876	16,076	17,230	18,428
Proposed legislation (non-PAYGO)	.....	.....	–140	–418	–645	–921	–1,169
Undistributed by agency:							
Employer share, employee retirement (off-budget)	7,637	7,877	8,917	9,161	9,868	10,706	11,443
Interest received by off-budget trust funds	59,796	68,886	76,086	85,421	95,855	107,348	120,111
Total off-budget receipts:	80,685	89,304	98,597	109,040	121,154	134,363	148,813
Total intragovernmental transactions	**305,463**	**335,545**	**349,868**	**385,622**	**410,116**	**441,293**	**472,600**
PROPRIETARY RECEIPTS FROM THE PUBLIC							
Distributed by agency:							
Interest:							
Interest on foreign loans and deferred foreign collections	472	771	706	694	688	680	663
Interest on deposits in tax and loan accounts	1,785	1,455	1,340	1,340	1,340	1,340	1,340
Other interest (domestic—civil) [2]	9,598	10,865	11,791	12,445	13,323	14,062	14,561
Total interest	11,855	13,091	13,837	14,479	15,351	16,082	16,564
Royalties and rents	1,639	2,298	2,093	2,074	2,096	2,113	2,096
Sale of products:							
Sale of timber and other natural land products	293	445	440	449	439	440	440
Sale of minerals and mineral products	23	32	31	21	27	25	24
Sale of power and other utilities	735	775	690	722	699	681	707
Other	64	58	79	74	64	82	77
Total sale of products	1,115	1,310	1,240	1,266	1,229	1,228	1,248
Fees and other charges for services and special benefits:							
Medicare premiums and other charges (trust funds)	21,907	23,433	27,034	29,896	31,494	35,020	37,942
Proposed legislation (non-PAYGO)	.....	.....	–20	–25	–25	–25	–25
Nuclear waste disposal revenues	702	620	640	625	612	637	621
Veterans life insurance (trust funds)	201	190	179	168	156	142	128
Other [2]	2,349	2,750	2,757	2,875	2,926	3,001	3,056
Proposed legislation (PAYGO)	.....	.....	10	128	136	141	144
Total fees and other charges	25,159	26,993	30,600	33,667	35,299	38,916	41,866
Sale of Government property:							
Sale of land and other real property	45	149	458	117	114	114	113
Military assistance program sales (trust funds)	11,362	11,340	11,450	11,470	11,230	11,020	10,940
Other	94	332	192	183	142	171	129
Total sale of Government property	11,501	11,821	12,100	11,770	11,486	11,305	11,182
Realization upon loans and investments:							
Negative subsidies and downward reestimates of credit subsidies	5,007	8,054	818	3,449	3,717	3,749	3,686
Repayment of loans to foreign nations	138	291	70	85	88	94	108
Other	95	67	114	94	90	86	82
Total realization upon loans and investments	5,240	8,412	1,002	3,628	3,895	3,929	3,876

Table 4–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2000 Actual	Estimate					
		2001	2002	2003	2004	2005	2006
Recoveries and refunds [2]	3,854	3,296	3,352	3,381	3,498	3,680	3,485
Miscellaneous receipt accounts [2]	2,876	1,955	1,878	1,884	1,893	1,896	1,906
Total proprietary receipts from the public distributed by agency	63,239	69,176	66,102	72,149	74,747	79,149	82,223
Undistributed by agency:							
Other interest: Interest received from Outer Continental Shelf escrow account	1,352	.....	.....	.....	.....	.....	.....
Rents, bonuses, and royalties:							
Outer Continental Shelf rents and bonuses	894	505	637	383	322	270	229
Outer Continental Shelf royalties	3,686	6,426	5,247	4,975	4,863	4,701	4,607
Arctic National Wildlife Refuge:							
Proposed legislation (PAYGO)	.....	.....	.....	.....	2,402	2	2
Sale of major assets	.....	.....	.....	323	.....	.....	.....
Total proprietary receipts from the public undistributed by agency	5,932	6,931	5,884	5,681	7,587	4,973	4,838
Total proprietary receipts from the public	**69,171**	**76,107**	**71,986**	**77,830**	**82,334**	**84,122**	**87,061**
OFFSETTING GOVERNMENTAL RECEIPTS							
Distributed by agency:							
Regulatory fees [2]	3,310	4,134	4,310	4,306	2,432	2,439	2,454
Proposed legislation (non-PAYGO)	.....	.....	71	140	143	147	151
Other	75	77	79	81	84	86	88
Undistributed by agency:							
Spectrum auction proceeds	150	1,572	4,360	9,665	9,670	1,275	680
Proposed legislation (PAYGO)	.....	.....	–2,400	–800	5,300	2,200	4,200
Total offsetting governmental receipts	3,535	5,783	6,420	13,392	17,629	6,147	7,573
Total offsetting receipts	**378,169**	**417,435**	**428,274**	**476,844**	**510,079**	**531,562**	**567,234**
MEMORANDUM							
Composition of proprietary receipts from the public							
On-budget:							
Federal funds	34.468	39,908	32,162	35,149	38,316	36,805	36,935
Trust funds	34,651	36,115	39,740	42,594	43,928	47,223	50,029
Off-budget	52	84	84	87	90	94	97

[1] Includes provision for covered Federal civilian employees and military personnel.
[2] Includes both Federal funds and trust funds.

5. TAX EXPENDITURES

The Congressional Budget Act of 1974 (Public Law 93–344) requires that a list of "tax expenditures" be included in the budget. So-called tax expenditures may be defined as provisions of the Federal tax laws with exclusions, exemptions, deductions, credits deferrals, or special tax rates. Underlying the "tax expenditure" concept is the notion that the Federal Government would otherwise collect additional revenues but for these provisions. It assumes an arbitrary tax base is available to the Government in its entirety as a resource to be spent. Because of the breadth of this arbitrary tax base, the Administration believes that the concept of "tax expenditure" is of questionable analytic value. The discussion below is based on materials and formats developed and included in previous budgets. The Administration intends to reconsider this presentation in the future.

The largest tax expenditures tend to be associated with the individual income tax. For example, sizeable deductions and exclusions are provided for pension contributions and earnings, employer contributions for medical insurance, mortgage interest payments on owner-occupied homes, capital gains, and payments of State and local individual income and property 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 for the estimated 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.

Tax expenditures relating to the individual and corporate income taxes are considered first in this chapter. They are estimated for fiscal years 2000–2006 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 of the chapter on performance measures and economic effects presents information related to assessment of the effect of tax expenditures on the achievement of program performance goals. This section is a complement to the government-wide performance plan required by the Government Performance and Results Act of 1993 (see the Budget volume, which considers the Federal Government's spending, regulatory, and tax policies across functional areas).

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

All tax expenditure estimates presented here are based upon tax law enacted as of December 31, 2000. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 2000. 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 2000–2006 are displayed according to 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 tables.

Table 5–2 reports the respective portions of the total revenue effects that arise under the individual and corporate income taxes. Listing the 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 pro-

visions are cleared. The ultimate beneficiaries of corporate tax expenditures could be stockholders, employees, customers, or others, depending on economic forces.

Table 5–3 ranks the major tax expenditures by fiscal year 2002 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

The estimates shown for individual tax expenditures in Tables 5–1, 5–2, and 5–3 do not necessarily equal the increase in Federal revenues (or the change in the budget balance) that would result from repealing these 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 activity or of other tax provisions 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 tax revenues associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the revenue costs from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the revenue cost 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, because 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 effects reported in Table 5–2 and do not reflect any possible interactions between the individual and corporate income tax receipts. For this reason, the estimates 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, because 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. Although 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.

Present-Value Estimates

Discounted present-value estimates of revenue effects 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 effects, net of future tax payments, that follow from activities undertaken during calendar year 2000 which cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 2000 would cause a deferral of tax payments on wages in 2000 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 2000 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. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES [1]

(In millions of dollars)

		Total from corporations and individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006
	National Defense								
1	Exclusion of benefits, allowances, and certain pays to armed forces personnel	2,140	2,160	2,190	2,210	2,240	2,260	2,290	11,190
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	2,500	2,680	2,850	3,010	3,180	3,350	3,550	15,940
3	Exclusion of certain allowances for Federal employees abroad	680	720	750	790	830	870	920	4,160
4	Exclusion of income of foreign sales corporations	3,890	0	0	0	0	0	0	0
5	Extraterritorial income exclusion	0	4,490	4,810	5,150	5,500	5,880	6,290	27,630
6	Inventory property sales source rules exception	2,170	2,280	2,390	2,510	2,630	2,760	2,900	13,190
7	Deferral of income from controlled foreign corporations (normal tax method)	6,200	6,600	7,000	7,450	7,900	8,400	8,930	39,680
8	Deferred taxes for financial firms on certain income earned overseas	1,190	1,290	540	0	0	0	0	540
	General science, space, and technology:								
9	Expensing of research and experimentation expenditures (normal tax method)	1,680	1,650	1,680	1,770	1,880	1,980	2,100	9,410
10	Credit for increasing research activities	1,630	6,050	6,760	5,390	4,710	2,720	1,160	20,740
	Energy:								
11	Expensing of exploration and development costs, fuels	20	70	70	100	110	110	100	490
12	Excess of percentage over cost depletion, fuels	340	340	340	340	340	350	350	1,720
13	Alternative fuel production credit	970	920	860	540	130	130	130	1,790
14	Exception from passive loss limitation for working interests in oil and gas properties	20	20	20	20	20	20	20	100
15	Capital gains treatment of royalties on coal	70	70	80	80	80	90	90	420
16	Exclusion of interest on energy facility bonds	90	90	90	100	110	130	140	570
17	Enhanced oil recovery credit	310	370	440	530	630	770	910	3,280
18	New technology credit	40	60	70	90	90	90	90	430
19	Alcohol fuel credits [2]	20	20	20	20	20	20	20	100
20	Tax credit and deduction for clean-fuel burning vehicles	60	60	50	30	0	–30	–50	0
21	Exclusion from income of conservation subsidies provided by public utilities	90	80	80	80	90	90	90	430
	Natural resources and environment:								
22	Expensing of exploration and development costs, nonfuel minerals	20	20	20	20	20	20	20	100
23	Excess of percentage over cost depletion, nonfuel minerals	270	280	300	310	320	330	350	1,610
24	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	400	400	410	450	510	560	610	2,540
25	Capital gains treatment of certain timber income	70	70	80	80	80	90	90	420
26	Expensing of multiperiod timber growing costs	570	580	610	630	640	660	680	3,220
27	Investment credit and seven-year amortization for reforestation expenditures	0	0	0	0	10	10	10	30
28	Tax incentives for preservation of historic structures	190	200	210	220	240	250	260	1,180
	Agriculture:								
29	Expensing of certain capital outlays	160	160	160	170	170	180	180	860
30	Expensing of certain multiperiod production costs	110	110	120	120	120	130	130	620
31	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
32	Capital gains treatment of certain income	700	740	780	820	860	900	950	4,310
33	Income averaging for farmers	50	50	50	50	60	60	60	280
34	Deferral of gain on sale of farm refiners	10	10	10	10	10	10	10	50
	Commerce and housing:								
	Financial institutions and insurance:								
35	Exemption of credit union income	1,550	1,650	1,770	1,890	2,020	2,160	2,280	10,120
36	Excess bad debt reserves of financial institutions	70	60	50	30	20	10	0	110
37	Exclusion of interest on life insurance savings	13,950	15,170	16,520	17,990	19,610	21,370	23,330	98,820
38	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50
39	Tax exemption of certain insurance companies owned by tax-exempt organizations	230	240	250	270	280	300	310	1,410
40	Small life insurance company deduction	100	100	100	100	100	100	100	500
	Housing:								
41	Exclusion of interest on owner-occupied mortgage subsidy bonds	790	800	820	870	990	1,090	1,200	4,970
42	Exclusion of interest on rental housing bonds	160	160	170	170	200	230	260	1,030
43	Deductibility of mortgage interest on owner-occupied homes	60,270	63,190	65,750	68,050	70,470	73,100	76,150	353,520
44	Deductibility of State and local property tax on owner-occupied homes	22,140	23,920	25,570	27,220	29,080	30,980	33,220	146,070
45	Deferral of income from post 1987 installment sales	1,010	1,035	1,050	1,070	1,090	1,110	1,130	5,450
46	Capital gains exclusion on home sales	18,540	19,095	19,670	20,260	20,870	21,490	22,140	104,430
47	Exception from passive loss rules for $25,000 of rental loss	4,720	4,450	4,220	4,000	3,790	3,600	3,410	19,020
48	Credit for low-income housing investments	3,210	3,310	3,460	3,600	3,790	3,940	4,080	18,870
49	Accelerated depreciation on rental housing (normal tax method)	4,740	5,140	5,520	5,830	6,040	6,140	6,210	29,740
	Commerce:								
50	Cancellation of indebtedness	30	20	10	10	10	20	20	70
51	Exceptions from imputed interest rules	80	80	80	80	80	80	80	400
52	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	40,520	41,720	42,950	44,220	45,530	46,870	48,260	227,830
53	Capital gains exclusion of small corporation stock	40	70	90	120	160	200	250	820
54	Step-up basis of capital gains at death	27,090	28,240	29,370	30,540	31,760	33,030	34,360	159,060
55	Carryover basis of capital gains on gifts	180	190	200	210	220	230	240	1,100

Table 5–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES [1]—Continued

(In millions of dollars)

		Total from corporations and individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006
56	Ordinary income treatment of loss from small business corporation stock sale	35	40	40	40	40	40	40	200
57	Accelerated depreciation of buildings other than rental housing (normal tax method)	3,260	3,170	3,290	2,880	2,860	2,730	3,220	14,980
58	Accelerated depreciation of machinery and equipment (normal tax method)	30,660	33,050	35,400	37,680	39,760	41,530	43,330	197,700
59	Expensing of certain small investments (normal tax method)	2,100	2,570	2,690	2,670	2,570	2,480	2,510	12,920
60	Amortization of start-up costs (normal tax method)	200	200	200	210	220	220	220	1,070
61	Graduated corporation income tax rate (normal tax method)	6,480	6,700	7,140	7,460	7,540	7,760	7,960	37,860
62	Exclusion of interest on small issue bonds	290	300	310	330	360	410	450	1,860
	Transportation:								
63	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
64	Exclusion of reimbursed employee parking expenses	1,880	1,980	2,090	2,190	2,300	2,420	2,550	11,550
65	Exclusion for employer-provided transit passes	190	220	260	310	350	400	440	1,760
	Community and regional development:								
66	Investment credit for rehabilitation of structures (other than historic)	30	30	30	30	30	30	30	150
67	Exclusion of interest for airport, dock, and similar bonds	620	630	640	690	780	850	950	3,910
68	Exemption of certain mutuals' and cooperatives' income	60	60	60	60	60	70	70	320
69	Empowerment zones and enterprise communities	310	320	660	1,140	1,210	1,340	1,480	5,830
70	New markets tax credit	0	10	90	200	310	440	640	1,680
71	Expensing of environmental remediation costs	160	350	410	330	30	–130	–80	560
	Education, training, employment, and social services:								
	Education:								
72	Exclusion of scholarship and fellowship income (normal tax method)	1,110	1,120	1,130	1,140	1,150	1,160	1,180	5,760
73	HOPE tax credit	4,210	4,480	4,610	4,280	4,110	4,360	4,630	21,990
74	Lifetime Learning tax credit	2,420	2,570	2,580	2,960	4,490	4,460	4,660	19,150
75	Education Individual Retirement Accounts	20	30	50	60	80	100	120	410
76	Deductibility of student-loan interest	360	370	380	380	390	400	410	1,960
77	Deferral for state prepaid tuition plans	100	130	180	230	250	290	330	1,280
78	Exclusion of interest on student-loan bonds	210	230	230	240	270	290	330	1,360
79	Exclusion of interest on bonds for private nonprofit educational facilities	520	540	550	580	650	740	810	3,330
80	Credit for holders of zone academy bonds	10	20	40	50	60	70	70	290
81	Exclusion of interest on savings bonds redeemed to finance educational expenses	10	10	10	10	10	10	10	50
82	Parental personal exemption for students age 19 or over	950	1,010	1,070	1,110	1,170	1,220	1,270	5,840
83	Deductibility of charitable contributions (education)	2,730	2,830	2,930	3,090	3,200	3,300	3,540	16,060
84	Exclusion of employer-provided educational assistance	240	260	90	0	0	0	0	90
	Training, employment, and social services:								
85	Work opportunity tax credit	390	400	300	180	80	30	10	600
86	Welfare-to-work tax credit	50	70	70	50	20	10	0	150
87	Exclusion of employer provided child care	670	700	730	760	810	850	900	4,050
88	Adoption assistance	120	130	120	30	30	20	20	220
89	Assistance for adopted foster children	160	190	210	240	250	260	270	1,230
90	Exclusion of employee meals and lodging (other than military)	680	710	740	780	810	850	890	4,070
91	Child credit [3]	19,330	19,310	18,980	18,410	18,000	17,430	16,790	89,610
92	Credit for child and dependent care expenses	2,390	2,360	2,330	2,300	2,280	2,250	2,220	11,380
93	Credit for disabled access expenditures	40	40	50	50	50	50	50	250
94	Deductibility of charitable contributions, other than education and health	20,150	21,020	22,030	23,160	24,240	25,380	26,780	121,590
95	Exclusion of certain foster care payments	550	570	300	630	660	700	730	3,020
96	Exclusion of parsonage allowances	330	350	370	400	430	460	490	2,150
	Health:								
97	Exclusion of employer contributions for medical insurance premiums and medical care	76,530	84,350	92,230	99,800	107,620	115,770	124,690	540,110
98	Self-employed medical insurance premiums	1,340	1,510	1,760	2,470	3,580	3,900	4,220	15,930
99	Workers' compensation insurance premiums	4,620	4,850	5,090	5,350	5,620	5,900	6,190	28,150
100	Medical Savings Accounts	20	20	30	20	20	20	20	110
101	Deductibility of medical expenses	4,250	4,560	4,870	5,170	5,480	5,790	6,110	27,420
102	Exclusion of interest on hospital construction bonds	1,080	1,100	1,130	1,210	1,350	1,490	1,660	6,840
103	Deductibility of charitable contributions (health)	2,910	3,000	3,100	3,270	3,380	3,480	3,740	16,970
104	Tax credit for orphan drug research	100	110	130	140	160	180	200	810
105	Special Blue Cross/Blue Shield deduction	230	250	280	320	290	280	250	1,420
	Income security:								
106	Exclusion of railroad retirement system benefits	360	360	360	360	360	360	360	1,800
107	Exclusion of workers' compensation benefits	5,120	5,560	5,810	6,070	6,320	6,600	6,900	31,700
108	Exclusion of public assistance benefits (normal tax method)	360	370	390	400	420	430	450	2,090
109	Exclusion of special benefits for disabled coal miners	80	70	70	60	60	60	50	300
110	Exclusion of military disability pensions	120	120	130	130	130	140	140	670
	Net exclusion of pension contributions and earnings:								
111	Employer plans	89,120	93,220	97,510	103,010	108,480	114,220	121,990	545,210
112	Individual Retirement Accounts	15,200	15,920	16,600	17,230	17,770	18,220	18,520	88,340

Table 5–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES [1]—Continued

(In millions of dollars)

		Total from corporations and individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006
113	Keogh plans	5,500	5,830	6,180	6,540	6,930	7,330	7,750	34,730
	Exclusion of other employee benefits:								
114	Premiums on group term life insurance	1,720	1,750	1,780	1,830	1,860	1,900	1,930	9,300
115	Premiums on accident and disability insurance	200	210	220	230	240	250	260	1,200
116	Income of trusts to finance supplementary unemployment benefits	10	10	10	10	10	10	10	50
	Special ESOP rules	1,240	1,290	1,340	1,400	1,460	1,540	1,610	7,350
118	Additional deduction for the blind	30	30	30	30	40	40	40	180
119	Additional deduction for the elderly	1,920	1,990	2,060	2,130	2,210	2,260	2,350	11,010
120	Tax credit for the elderly and disabled	30	30	30	30	30	30	30	150
121	Deductibility of casualty losses	230	250	260	280	290	300	320	1,450
122	Earned income tax credit [4]	4,644	4,692	4,693	5,225	5,456	5,688	5,965	27,297
	Social Security:								
	Exclusion of social security benefits:								
123	Social Security benefits for retired workers	18,250	19,070	19,930	20,520	21,050	21,840	22,780	106,120
124	Social Security benefits for disabled	2,640	2,880	3,160	3,490	3,910	4,360	4,840	19,760
125	Social Security benefits for dependents and survivors	3,910	4,030	4,210	4,440	4,730	5,070	5,380	23,830
	Veterans benefits and services:								
126	Exclusion of veterans death benefits and disability compensation	3,090	3,290	3,460	3,640	3,820	4,010	4,210	19,140
127	Exclusion of veterans pensions	70	70	80	80	90	90	100	440
128	Exclusion of GI bill benefits	80	90	90	100	100	110	110	510
129	Exclusion of interest on veterans housing bonds	40	40	40	40	40	50	50	220
	General purpose fiscal assistance:								
130	Exclusion of interest on public purpose State and local bonds	22,600	23,050	23,510	23,980	24,460	24,950	25,450	122,350
131	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	42,650	45,730	48,730	51,780	55,030	58,390	62,160	276,090
132	Tax credit for corporations receiving income from doing business in U.S. possessions	2,470	2,520	2,560	2,580	2,610	2,630	1,060	11,440
	Interest:								
133	Deferral of interest on U.S. savings bonds	470	490	520	540	570	600	630	2,860
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	22,140	23,920	25,570	27,220	29,080	30,980	33,220	146,070
	Nonbusiness State and local taxes other than on owner-occupied homes	42,650	45,730	48,730	51,780	55,030	58,390	62,160	276,090
	Exclusion of interest on State and local bonds for:								
	Public purposes	22,600	23,050	23,510	23,980	24,460	24,950	25,450	122,350
	Energy facilities	90	90	90	100	110	130	140	570
	Water, sewage, and hazardous waste disposal facilities	400	400	410	450	510	560	610	2,540
	Small-issues	290	300	310	330	360	410	450	1,860
	Owner-occupied mortgage subsidies	790	800	820	870	990	1,090	1,200	4,970
	Rental housing	160	160	170	170	200	230	260	1,030
	Airports, docks, and similar facilities	620	630	640	690	780	850	950	3,910
	Student loans	210	230	230	240	270	290	330	1,360
	Private nonprofit educational facilities	520	540	550	580	650	740	810	3,330
	Hospital construction	1,080	1,100	1,130	1,210	1,350	1,490	1,660	6,840
	Veterans' housing	40	40	40	40	40	50	50	220
	Credit for holders of zone academy bonds	10	20	40	50	60	70	70	290

[1] The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of "income" that is larger in scope than is "income" as defined under general U.S. income tax principles. For that reason, the tax expenditure estimates include, for example, estimates related to the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation.

[2] 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: 2000 $840; 2001 $880; 2002 $930; 2003 $950; 2004 $960; 2005 $960; and in 2006 $960.

[3] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2000 $810; 2001 $790; 2002 $760; 2003 $720; 2004 $660; 2005 $630; and in 2006 $590.

[4] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2000 $26,099; 2001 $25,923; 2002 $26,983; 2003 $27,875; 2004 $28,545; 2005 $29,373; and in 2006 $30,165.

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 $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES [1]

(In millions of dollars)

		Corporations								Individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006	2000	2001	2002	2003	2004	2005	2006	2002–2006
	National Defense																
1	Exclusion of benefits, allowances, and certain pays to armed forces personnel	.....	.....	.....	.....	.....	.....	.....	.....	2,140	2,160	2,190	2,210	2,240	2,260	2,290	11,190
	International affairs:																
2	Exclusion of income earned abroad by U.S. citizens	.....	.....	.....	.....	.....	.....	.....	.....	2,500	2,680	2,850	3,010	3,180	3,350	3,550	15,940
3	Exclusion of certain allowances for Federal employees abroad	.....	.....	.....	.....	.....	.....	.....	.....	680	720	750	790	830	870	920	4,160
4	Exclusion of income of foreign sales corporations	3,890	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
5	Extraterritorial income exclusion	.....	4,490	4,810	5,150	5,500	5,880	6,290	27,630	.....	.....	.....	.....	.....	.....	.....	.....
6	Inventory property sales source rules exception	2,170	2,280	2,390	2,510	2,630	2,760	2,900	13,190	.....	.....	.....	.....	.....	.....	.....	.....
7	Deferral of income from controlled foreign corporations (normal tax method)	6,200	6,600	7,000	7,450	7,900	8,400	8,930	39,680	.....	.....	.....	.....	.....	.....	.....	.....
8	Deferred taxes for financial firms on certain income earned overseas	1,190	1,290	540	.....	.....	.....	.....	540	.....	.....	.....	.....	.....	.....	.....	.....
	General science, space, and technology:																
9	Expensing of research and experimentation expenditures (normal tax method)	1,650	1,620	1,650	1,740	1,840	1,940	2,060	9,230	30	30	30	30	40	40	40	180
10	Credit for increasing research activities	1,620	5,990	6,700	5,340	4,670	2,700	1,160	20,570	10	60	60	50	40	20	.....	170
	Energy:																
11	Expensing of exploration and development costs, fuels	20	60	60	80	90	90	80	400	.....	10	10	20	20	20	20	90
12	Excess of percentage over cost depletion, fuels	290	290	290	290	290	300	300	1,470	50	50	50	50	50	50	50	250
13	Alternative fuel production credit	930	880	820	520	120	120	120	1,700	40	40	40	20	10	10	10	90
14	Exception from passive loss limitation for working interests in oil and gas properties	.....	.....	.....	.....	.....	.....	.....	.....	20	20	20	20	20	20	20	100
15	Capital gains treatment of royalties on coal	.....	.....	.....	.....	.....	.....	.....	.....	70	70	80	80	80	90	90	420
16	Exclusion of interest on energy facility bonds	20	20	20	20	30	40	40	150	70	70	70	80	80	90	100	420
17	Enhanced oil recovery credit	280	340	400	480	580	700	830	2,990	30	30	40	50	50	70	80	290
18	New technology credit	40	60	70	90	90	90	90	430	.....	.....	.....	.....	.....	.....	.....	.....
19	Alcohol fuel credits [2]	10	10	10	10	10	10	10	50	10	10	10	10	10	10	10	50
20	Tax credit and deduction for clean-fuel burning vehicles	50	50	40	20	.....	–30	–40	–10	10	10	10	10	.....	.....	–10	10
21	Exclusion from income of conservation subsidies provided by public utilities	.....	.....	.....	.....	.....	.....	.....	.....	90	80	80	80	90	90	90	430
	Natural resources and environment:																
22	Expensing of exploration and development costs, nonfuel minerals	20	20	20	20	20	20	20	100	.....	.....	.....	.....	.....	.....	.....	.....
23	Excess of percentage over cost depletion, nonfuel minerals	250	260	280	290	300	310	330	1,510	20	20	20	20	20	20	20	100
24	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	100	100	100	120	130	140	150	640	300	300	310	330	380	420	460	1,900
25	Capital gains treatment of certain timber income	.....	.....	.....	.....	.....	.....	.....	.....	70	70	80	80	80	90	90	420
26	Expensing of multiperiod timber growing costs	280	290	310	320	330	340	360	1,660	290	290	300	310	310	320	320	1,560
27	Investment credit and seven-year amortization for reforestation expenditures	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	10	10	10	30
28	Tax incentives for preservation of historic structures	170	180	190	200	210	220	230	1,050	20	20	20	20	30	30	30	130
	Agriculture:																
29	Expensing of certain capital outlays	20	20	20	20	20	20	20	100	140	140	140	150	150	160	160	760
30	Expensing of certain multiperiod production costs	10	10	20	20	20	20	20	100	100	100	100	100	100	110	110	520
31	Treatment of loans forgiven for solvent farmers	.....	.....	.....	.....	.....	.....	.....	.....	10	10	10	10	10	10	10	50

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES [1]—Continued

(In millions of dollars)

		Corporations								Individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006	2000	2001	2002	2003	2004	2005	2006	2002–2006
32	Capital gains treatment of certain income	...	...	...	...	...	...	...	...	700	740	780	820	860	900	950	4,310
33	Income averaging for farmers	...	...	...	...	...	...	...	...	50	50	50	50	60	60	60	280
34	Deferral of gain on sale of farm refiners	10	10	10	10	10	10	10	50	...	...	...	...	...	...	...	...
	Commerce and housing:																
	Financial institutions and insurance:																
35	Exemption of credit union income	1,550	1,650	1,770	1,890	2,020	2,160	2,280	10,120	...	...	...	...	...	...	...	...
36	Excess bad debt reserves of financial institutions	70	60	50	30	20	10	...	110	...	...	...	...	...	...	...	...
37	Exclusion of interest on life insurance savings	490	530	580	630	690	750	820	3,470	13,460	14,640	15,940	17,360	18,920	20,620	22,510	95,350
38	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50	...	...	...	...	...	...	...	...
39	Tax exemption of certain insurance companies owned by tax-exempt organizations	230	240	250	270	280	300	310	1,410	...	...	...	...	...	...	...	...
40	Small life insurance company deduction	100	100	100	100	100	100	100	500	...	...	...	...	...	...	...	...
	Housing:																
41	Exclusion of interest on owner-occupied mortgage subsidy bonds	200	200	210	220	250	270	290	1,240	590	600	610	650	740	820	910	3,730
42	Exclusion of interest on rental housing bonds	40	40	40	40	50	60	70	260	120	120	130	130	150	170	190	770
43	Deductibility of mortgage interest on owner-occupied homes	...	...	...	...	...	...	...	...	60,270	63,190	65,750	68,050	70,470	73,100	76,150	353,520
44	Deductibility of State and local property tax on owner-occupied homes	...	...	...	...	...	...	...	...	22,140	23,920	25,570	27,220	29,080	30,980	33,220	146,070
45	Deferral of income from post 1987 installment sales	260	270	270	280	280	290	290	1,410	750	765	780	790	810	820	840	4,040
46	Capital gains exclusion on home sales	...	...	...	...	...	...	...	...	18,540	19,095	19,670	20,260	20,870	21,490	22,140	104,430
47	Exception from passive loss rules for $25,000 of rental loss	...	...	...	...	...	...	...	...	4,720	4,450	4,220	4,000	3,790	3,600	3,410	19,020
48	Credit for low-income housing investments	2,410	2,490	2,600	2,710	2,850	2,960	3,070	14,190	800	820	860	890	940	980	1,010	4,680
49	Accelerated depreciation on rental housing (normal tax method)	340	370	400	420	430	440	450	2,140	4,400	4,770	5,120	5,410	5,610	5,700	5,760	27,600
	Commerce:																
50	Cancellation of indebtedness	...	...	...	...	...	...	...	...	30	20	10	10	10	20	20	70
51	Exceptions from imputed interest rules	...	...	...	...	...	...	...	...	80	80	80	80	80	80	80	400
52	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	...	...	...	...	...	...	...	...	40,520	41,720	42,950	44,220	45,530	46,870	48,260	227,830
53	Capital gains exclusion of small corporation stock	...	...	...	...	...	...	...	...	40	70	90	120	160	200	250	820
54	Step-up basis of capital gains at death	...	...	...	...	...	...	...	...	27,090	28,240	29,370	30,540	31,760	33,030	34,360	159,060
55	Carryover basis of capital gains on gifts	...	...	...	...	...	...	...	...	180	190	200	210	220	230	240	1,100
56	Ordinary income treatment of loss from small business corporation stock sale	...	...	...	...	...	...	...	...	35	40	40	40	40	40	40	200
57	Accelerated depreciation of buildings other than rental housing (normal tax method)	1,650	1,530	1,540	1,360	1,210	1,130	1,230	6,470	1,610	1,640	1,750	1,520	1,650	1,600	1,990	8,510
58	Accelerated depreciation of machinery and equipment (normal tax method)	28,020	30,230	32,400	34,530	36,470	38,110	39,770	181,280	2,640	2,820	3,000	3,150	3,290	3,420	3,560	16,420
59	Expensing of certain small investments (normal tax method)	630	810	880	870	840	810	820	4,220	1,470	1,760	1,810	1,800	1,730	1,670	1,690	8,700
60	Amortization of start-up costs (normal tax method)	120	120	120	130	130	130	130	640	80	80	80	80	90	90	90	430
61	Graduated corporation income tax rate (normal tax method)	6,480	6,700	7,140	7,460	7,540	7,760	7,960	37,860	...	...	...	...	...	...	...	...
62	Exclusion of interest on small issue bonds	70	80	80	90	90	100	110	470	220	220	230	240	270	310	340	1,390

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES [1]—Continued

(In millions of dollars)

		Corporations								Individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006	2000	2001	2002	2003	2004	2005	2006	2002–2006
	Transportation:																
63	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100	...	...	...	...	...	...	...	...
64	Exclusion of reimbursed employee parking expenses	...	...	...	...	...	...	...	...	1,880	1,980	2,090	2,190	2,300	2,420	2,550	11,550
65	Exclusion for employer-provided transit passes	...	...	...	...	...	...	...	...	190	220	260	310	350	400	440	1,760
	Community and regional development:																
66	Investment credit for rehabilitation of structures (other than historic)	20	20	20	20	20	20	20	100	10	10	10	10	10	10	10	50
67	Exclusion of interest for airport, dock, and similar bonds	160	160	160	180	200	210	240	990	460	470	480	510	580	640	710	2,920
68	Exemption of certain mutuals' and cooperatives' income	60	60	60	60	60	70	70	320	...	...	...	...	...	...	...	...
69	Empowerment zones and enterprise communities	80	80	210	300	310	350	370	1,540	230	240	450	840	900	990	1,110	4,290
70	New markets tax credit	...	...	20	50	80	110	160	420	...	10	70	150	230	330	480	1,260
71	Expensing of environmental remediation costs	130	290	340	280	40	–110	–70	480	30	60	70	50	–10	–20	–10	80
	Education, training, employment, and social services:																
	Education:																
72	Exclusion of scholarship and fellowship income (normal tax method)	...	...	...	...	...	...	...	...	1,110	1,120	1,130	1,140	1,150	1,160	1,180	5,760
73	HOPE tax credit	...	...	...	...	...	...	...	...	4,210	4,480	4,610	4,280	4,110	4,360	4,630	21,990
74	Lifetime Learning tax credit	...	...	...	...	...	...	...	...	2,420	2,570	2,580	2,960	4,490	4,460	4,660	19,150
75	Education Individual Retirement Accounts	...	...	...	...	...	...	...	...	20	30	50	60	80	100	120	410
76	Deductibility of student-loan interest	...	...	...	...	...	...	...	...	360	370	380	380	390	400	410	1,960
77	Deferral for state prepaid tuition plans	...	...	...	...	...	...	...	...	100	130	180	230	250	290	330	1,280
78	Exclusion of interest on student-loan bonds	50	60	60	60	70	70	80	340	160	170	170	180	200	220	250	1,020
79	Exclusion of interest on bonds for private nonprofit educational facilities	130	140	140	150	160	190	200	840	390	400	410	430	490	550	610	2,490
80	Credit for holders of zone academy bonds	10	20	40	50	60	70	70	290	...	...	...	...	...	...	...	...
81	Exclusion of interest on savings bonds redeemed to finance educational expenses	...	...	...	...	...	...	...	...	10	10	10	10	10	10	10	50
82	Parental personal exemption for students age 19 or over	...	...	...	...	...	...	...	...	950	1,010	1,070	1,110	1,170	1,220	1,270	5,840
83	Deductibility of charitable contributions (education)	600	600	590	630	620	590	690	3,120	2,130	2,230	2,340	2,460	2,580	2,710	2,850	12,940
84	Exclusion of employer-provided educational assistance	...	...	...	...	...	...	...	...	240	260	90	...	...	...	...	90
	Training, employment, and social services:																
85	Work opportunity tax credit	350	360	270	160	70	30	10	540	40	40	30	20	10	...	...	60
86	Welfare-to-work tax credit	40	60	60	40	20	10	...	130	10	10	10	10	...	...	...	20
87	Exclusion of employer provided child care	...	...	...	...	...	...	...	...	670	700	730	760	810	850	900	4,050
88	Adoption assistance	...	...	...	...	...	...	...	...	120	130	120	30	30	20	20	220
89	Assistance for adopted foster children	...	...	...	...	...	...	...	...	160	190	210	240	250	260	270	1,230
90	Exclusion of employee meals and lodging (other than military)	...	...	...	...	...	...	...	...	680	710	740	780	810	850	890	4,070
91	Child credit [3]	...	...	...	...	...	...	...	...	19,330	19,310	18,980	18,410	18,000	17,430	16,790	89,610
92	Credit for child and dependent care expenses	...	...	...	...	...	...	...	...	2,390	2,360	2,330	2,300	2,280	2,250	2,220	11,380
93	Credit for disabled access expenditures	10	10	10	10	10	10	10	50	30	30	40	40	40	40	40	200
94	Deductibility of charitable contributions, other than education and health	750	740	730	790	760	730	860	3,870	19,400	20,280	21,300	22,370	23,480	24,650	25,920	117,720
95	Exclusion of certain foster care payments	...	...	...	...	...	...	...	...	550	570	300	630	660	700	730	3,020
96	Exclusion of parsonage allowances	...	...	...	...	...	...	...	...	330	350	370	400	430	460	490	2,150

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES [1]—Continued

(In millions of dollars)

		Corporations								Individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006	2000	2001	2002	2003	2004	2005	2006	2002–2006
	Health:																
97	Exclusion of employer contributions for medical insurance premiums and medical care	...	...	...	...	...	...	...	...	76,530	84,350	92,230	99,800	107,620	115,770	124,690	540,110
98	Self-employed medical insurance premiums	...	...	...	...	...	...	...	...	1,340	1,510	1,760	2,470	3,580	3,900	4,220	15,930
99	Workers' compensation insurance premiums	...	...	...	...	...	...	...	...	4,620	4,850	5,090	5,350	5,620	5,900	6,190	28,150
100	Medical Savings Accounts	...	...	...	...	...	...	...	...	20	20	30	20	20	20	20	110
101	Deductibility of medical expenses	...	...	...	...	...	...	...	...	4,250	4,560	4,870	5,170	5,480	5,790	6,110	27,420
102	Exclusion of interest on hospital construction bonds	270	280	290	310	340	370	410	1,720	810	820	840	900	1,010	1,120	1,250	5,120
103	Deductibility of charitable contributions (health)	730	720	710	760	740	710	830	3,750	2,180	2,280	2,390	2,510	2,640	2,770	2,910	13,220
104	Tax credit for orphan drug research	100	110	130	140	160	180	200	810	...	...	...	...	...	...	...	...
105	Special Blue Cross/Blue Shield deduction	230	250	280	320	290	280	250	1,420	...	...	...	...	...	...	...	...
	Income security:																
106	Exclusion of railroad retirement system benefits	...	...	...	...	...	...	...	...	360	360	360	360	360	360	360	1,800
107	Exclusion of workers' compensation benefits	...	...	...	...	...	...	...	...	5,120	5,560	5,810	6,070	6,320	6,600	6,900	31,700
108	Exclusion of public assistance benefits (normal tax method)	...	...	...	...	...	...	...	...	360	370	390	400	420	430	450	2,090
109	Exclusion of special benefits for disabled coal miners	...	...	...	...	...	...	...	...	80	70	70	60	60	60	50	300
110	Exclusion of military disability pensions	...	...	...	...	...	...	...	...	120	120	130	130	130	140	140	670
	Net exclusion of pension contributions and earnings:																
111	Employer plans	...	...	...	...	...	...	...	...	89,120	93,220	97,510	103,010	108,480	114,220	121,990	545,210
112	Individual Retirement Accounts	...	...	...	...	...	...	...	...	15,200	15,920	16,600	17,230	17,770	18,220	18,520	88,340
113	Keogh plans	...	...	...	...	...	...	...	...	5,500	5,830	6,180	6,540	6,930	7,330	7,750	34,730
	Exclusion of other employee benefits:																
114	Premiums on group term life insurance	...	...	...	...	...	...	...	...	1,720	1,750	1,780	1,830	1,860	1,900	1,930	9,300
115	Premiums on accident and disability insurance	...	...	...	...	...	...	...	...	200	210	220	230	240	250	260	1,200
116	Income of trusts to finance supplementary unemployment benefits	10	10	10	10	10	10	10	50	...	...	...	...	...	...	...	...
117	Special ESOP rules	940	980	1,020	1,070	1,120	1,180	1,240	5,630	300	310	320	330	340	360	370	1,720
118	Additional deduction for the blind	...	...	...	...	...	...	...	...	30	30	30	30	40	40	40	180
119	Additional deduction for the elderly	...	...	...	...	...	...	...	...	1,920	1,990	2,060	2,130	2,210	2,260	2,350	11,010
120	Tax credit for the elderly and disabled	...	...	...	...	...	...	...	...	30	30	30	30	30	30	30	150
121	Deductibility of casualty losses	...	...	...	...	...	...	...	...	230	250	260	280	290	300	320	1,450
122	Earned income tax credit [4]	...	...	...	...	...	...	...	...	4,644	4,692	4,963	5,225	5,436	5,688	5,965	27,297
	Social Security:																
	Exclusion of social security benefits:																
123	Social Security benefits for retired workers	...	...	...	...	...	...	...	...	18,250	19,070	19,930	20,520	21,050	21,840	22,780	106,120
124	Social Security benefits for disabled	...	...	...	...	...	...	...	...	2,640	2,880	3,160	3,490	3,910	4,360	4,840	19,760
125	Social Security benefits for dependents and survivors	...	...	...	...	...	...	...	...	3,910	4,030	4,210	4,440	4,730	5,070	5,380	23,830
	Veterans benefits and services:																
126	Exclusion of veterans death benefits and disability compensation	...	...	...	...	...	...	...	...	3,090	3,290	3,460	3,640	3,820	4,010	4,210	19,140
127	Exclusion of veterans pensions	...	...	...	...	...	...	...	...	70	70	80	80	90	90	100	440
128	Exclusion of GI bill benefits	...	...	...	...	...	...	...	...	80	90	90	100	100	110	110	510
129	Exclusion of interest on veterans housing bonds	10	10	10	10	10	10	10	50	30	30	30	30	30	40	40	170
	General purpose fiscal assistance:																
130	Exclusion of interest on public purpose State and local bonds	5,730	5,840	5,960	6,080	6,200	6,320	6,450	31,010	16,870	17,210	17,550	17,900	18,260	18,630	19,000	91,340
131	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	...	...	...	...	...	...	...	...	42,650	45,730	48,730	51,780	55,030	58,390	62,160	276,090

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES [1]—Continued

(In millions of dollars)

		Corporations								Individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006	2000	2001	2002	2003	2004	2005	2006	2002–2006
132	Tax credit for corporations receiving income from doing business in U.S. possessions	2,470	2,520	2,560	2,580	2,610	2,630	1,060	11,440	.....	.....	.....	.....	.....	.....	.....	.....
	Interest:																
133	Deferral of interest on U.S. savings bonds	.....	.....	.....	.....	.....	.....	.....	.....	470	490	520	540	570	600	630	2,860
	Addendum: Aid to State and local governments:																
	Deductibility of:																
	Property taxes on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	.....	22,140	23,920	25,570	27,220	29,080	30,980	33,220	146,070
	Nonbusiness State and local taxes other than on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	.....	42,650	45,730	48,730	51,780	55,030	58,390	62,160	276,090
	Exclusion of interest on State and local bonds for:																
	Public purposes	5,730	5,840	5,960	6,080	6,200	6,320	6,450	31,010	16,870	17,210	17,550	17,900	18,260	18,630	19,000	91,340
	Energy facilities	20	20	20	20	30	40	40	150	70	70	70	80	80	90	100	420
	Water, sewage, and hazardous waste disposal facilities	100	100	100	120	130	140	150	640	300	300	310	330	380	420	460	1,900
	Small-issues	70	80	80	90	90	100	110	470	220	220	230	240	270	310	340	1,390
	Owner-occupied mortgage subsidies	200	200	210	220	250	270	290	1,240	590	600	610	650	740	820	910	3,730
	Rental housing	40	40	40	40	50	60	70	260	120	120	130	130	150	170	190	770
	Airports, docks, and similar facilities	160	160	160	180	200	210	240	990	460	470	480	510	580	640	710	2,920
	Student loans	50	60	60	60	70	70	80	340	160	170	170	180	200	220	250	1,020
	Private nonprofit educational facilities	130	140	140	150	160	190	200	840	390	400	410	430	490	550	610	2,490
	Hospital construction	270	280	290	310	340	370	410	1,720	810	820	840	900	1,010	1,120	1,250	5,120
	Veterans' housing	10	10	10	10	10	10	10	50	30	30	30	30	30	40	40	170
	Credit for holders of zone academy bonds	10	20	40	50	60	70	70	290	.....	.....	.....	.....	.....	.....	.....	.....

[1] The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of "income" that is larger in scope than is "income" as defined under general U.S. income tax principles. For that reason, the tax expenditure estimates include, for example, estimates related to the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation.

[2] 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: 2000 $840; 2001 $880; 2002 $930; 2003 $950; 2004 $960; 2005 $960; and in 2006 $960.

[3] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2000 $810; 2001 $790; 2002 $760; 2003 $720; 2004 $660; 2005 $630; and in 2006 $590.

[4] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2000 $26,099; 2001 $25,923; 2002 $26,983; 2003 $27,875; 2004 $28,545; 2005 $29,373; and in 2006 $30,165.

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 $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Table 5–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2002 PROJECTED REVENUE EFFECT

(In millions of dollars)

Provision	2002	2002–2006
Net exclusion of pension contributions and earnings: Employer Plans	97,510	545,210
Exclusion of employer contributions for medical insurance premiums and medical care	92,230	540,110
Deductibility of mortgage interest on owner-occupied homes	65,750	353,520
Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	48,730	276,090
Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	42,950	227,830
Accelerated depreciation of machinery and equipment (normal tax method)	35,400	197,700
Step-up basis of capital gains at death	29,370	159,060
Deductibility of State and local property tax on owner-occupied homes	25,570	146,070
Exclusion of interest on public purpose State and local bonds	23,510	122,350
Deductibility of charitable contributions, other than education and health	22,030	121,590
Exclusion of Social Security benefits for retired workers	19,930	106,120
Capital gains exclusion on home sales	19,670	104,430
Child credit	18,980	89,610
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	16,600	88,340
Exclusion of interest on life insurance savings	16,520	98,820
Graduated corporation income tax rate (normal tax method)	7,140	37,860
Deferral of income from controlled foreign corporations (normal tax method)	7,000	39,680
Credit for increasing research activities	6,760	20,740
Net exclusion of pension contributions and earnings: Keough Plans	6,180	34,730
Exclusion of workers' compensation benefits	5,810	31,700
Accelerated depreciation on rental housing (normal tax method)	5,520	29,740
Workers' compensation insurance premiums	5,090	28,150
Earned income tax credit	4,963	27,297
Deductibility of medical expenses	4,870	27,420
Extraterritorial income exclusion	4,810	27,630
HOPE tax credit	4,610	21,990
Exception from passive loss rules for $25,000 of rental loss	4,220	19,020
Exclusion of Social Security benefits for dependents and survivors	4,210	23,830
Credit for low-income housing investments	3,460	18,870
Exclusion of veterans death benefits and disability compensation	3,460	19,140
Accelerated depreciation of buildings other than rental housing (normal tax method)	3,290	14,980
Exclusion of Social Security benefits for disabled	3,160	19,760
Deductibility of charitable contributions (health)	3,100	16,970
Deductibility of charitable contributions (education)	2,930	16,060
Exclusion of income earned abroad by U.S. citizens	2,850	15,940
Expensing of certain small investments (normal tax method)	2,690	12,920
Lifetime Learning tax credit	2,580	19,150
Tax credit for corporations receiving income from doing business in U.S. possessions	2,560	11,440
Inventory property sales source rules exception	2,390	13,190
Credit for child and dependent care expenses	2,330	11,380
Exclusion of benefits, allowances, and certain pays to armed forces personnel	2,190	11,190
Exclusion of reimbursed employee parking expenses	2,090	11,550
Additional deduction for the elderly	2,060	11,010
Exclusion of premiums on group term life insurance	1,780	9,300
Exemption of credit union income	1,770	10,120
Self-employed medical insurance premiums	1,760	15,930
Expensing of research and experimentation expenditures (normal tax method)	1,680	9,410
Special ESOP rules	1,340	7,350
Exclusion of scholarship and fellowship income (normal tax method)	1,130	5,760
Exclusion of interest on hospital construction bonds	1,130	6,840
Parental personal exemption for students age 19 or over	1,070	5,840
Deferral of income from post 1987 installment sales	1,050	5,450
Alternative fuel production credit	860	1,790
Exclusion of interest on owner-occupied mortgage subsidy bonds	820	4,970
Capital gains treatment of certain income	780	4,310
Exclusion of certain allowances for Federal employees abroad	750	4,160
Exclusion of employee meals and lodging (other than military)	740	4,070
Exclusion of employer provided child care	730	4,050
Empowerment zones and enterprise communities	660	5,830
Exclusion of interest for airport, dock, and similar bonds	640	3,910
Expensing of multiperiod timber growing costs	610	3,220
Exclusion of interest on bonds for private nonprofit educational facilities	550	3,330
Deferred taxes for financial firms on certain income earned overseas	540	540
Deferral of interest on U.S. savings bonds	520	2,860
Enhanced oil recovery credit	440	3,280
Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	410	2,540
Expensing of environmental remediation costs	410	560
Exclusion of public assistance benefits (normal tax method)	390	2,090
Deductibility of student-loan interest	380	1,960

Table 5–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2002 PROJECTED REVENUE EFFECT—Continued

(In millions of dollars)

Provision	2002	2002–2006
Exclusion of parsonage allowances	370	2,150
Exclusion of railroad retirement system benefits	360	1,800
Excess of percentage over cost depletion, fuels	340	1,720
Exclusion of interest on small issue bonds	310	1,860
Excess of percentage over cost depletion, nonfuel minerals	300	1,610
Work opportunity tax credit	300	600
Exclusion of certain foster care payments	300	3,020
Special Blue Cross/Blue Shield deduction	280	1,420
Exclusion for employer-provided transit passes	260	1,760
Deductibility of casualty losses	260	1,450
Tax exemption of certain insurance companies owned by tax-exempt organizations	250	1,410
Exclusion of interest on student-loan bonds	230	1,360
Exclusion of premiums on accident and disability insurance	220	1,200
Tax incentives for preservation of historic structures	210	1,180
Assistance for adopted foster children	210	1,230
Carryover basis of capital gains on gifts	200	1,100
Amortization of start-up costs (normal tax method)	200	1,070
Deferral for state prepaid tuition plans	180	1,280
Exclusion of interest on rental housing bonds	170	1,030
Expensing of certain capital outlays	160	860
Tax credit for orphan drug research	130	810
Exclusion of military disability pensions	130	670
Expensing of certain multiperiod production costs	120	620
Adoption assistance	120	220
Small life insurance company deduction	100	500
Exclusion of interest on energy facility bonds	90	570
Capital gains exclusion of small corporation stock	90	820
New markets tax credit	90	1,680
Exclusion of employer-provided educational assistance	90	90
Exclusion of GI bill benefits	90	510
Capital gains treatment of royalties on coal	80	420
Exclusion from income of conservation subsidies provided by public utilities	80	430
Capital gains treatment of certain timber income	80	420
Exceptions from imputed interest rules	80	400
Exclusion of veterans pensions	80	440
Expensing of exploration and development costs, fuels	70	490
New technology credit	70	430
Welfare-to-work tax credit	70	150
Exclusion of special benefits for disabled coal miners	70	300
Exemption of certain mutuals' and cooperatives' income	60	320
Tax credit and deduction for clean-fuel burning vehicles	50	.....
Income averaging for farmers	50	280
Excess bad debt reserves of financial institutions	50	110
Education Individual Retirement Accounts	50	410
Credit for disabled access expenditures	50	250
Ordinary income treatment of loss from small business corporation stock sale	40	200
Credit for holders of zone academy bonds	40	290
Exclusion of interest on veterans housing bonds	40	220
Investment credit for rehabilitation of structures (other than historic)	30	150
Medical Savings Accounts	30	110
Additional deduction for the blind	30	180
Tax credit for the elderly and disabled	30	150
Exception from passive loss limitation for working interests in oil and gas properties	20	100
Alcohol fuel credits	20	100
Expensing of exploration and development costs, nonfuel minerals	20	100
Deferral of tax on shipping companies	20	100
Treatment of loans forgiven for solvent farmers	10	50
Deferral of gain on sale of farm refiners	10	50
Special alternative tax on small property and casualty insurance companies	10	50
Cancellation of indebtedness	10	70
Exclusion of interest on savings bonds redeemed to finance educational expenses	10	50
Income of trusts to finance supplementary unemployment benefits	10	50
Exclusion of income of foreign sales corporations	.....	.....
Investment credit and seven-year amortization for reforestation expenditures	.....	30

Table 5–4. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 2000

(In millions of dollars)

	Provision	Present Value of Revenue Loss
1	Deferral of income from controlled foreign corporations (normal tax method)	6,360
2	Deferred taxes for financial firms on income earned overseas	1,130
3	Expensing of research and experimentation expenditures (normal tax method)	1,650
4	Expensing of exploration and development costs—fuels	140
5	Expensing of exploration and development costs—nonfuels	10
6	Expensing of multiperiod timber growing costs	340
7	Expensing of certain multiperiod production costs—agriculture	250
8	Expensing of certain capital outlays—agriculture	280
9	Deferral of income on life insurance and annuity contracts	21,220
10	Accelerated depreciation of rental housing (normal tax method)	4,470
11	Accelerated depreciation of buildings other than rental housing (normal tax method)	460
12	Accelerated depreciation of machinery and equipment (normal tax method)	35,760
13	Expensing of certain small investments (normal tax method)	1,140
14	Amortization of start-up costs (normal tax method)	180
15	Deferral of tax on shipping companies	20
16	Deferral for state prepaid tuition plans	110
17	Credit for holders of zone academy bonds	160
18	Credit for low-income housing investments	2,490
19	Exclusion of pension contributions—employer plans	121,100
20	Exclusion of IRA contributions and earnings	5,930
21	Exclusion of contributions and earnings for Keogh plans	4,320
22	Exclusion of interest on public-purpose bonds	19,670
23	Exclusion of interest on non-public purpose bonds	5,170
24	Deferral of interest on U.S. savings bonds	410

Outlay Equivalents

The concept of "outlay equivalents" is another theoretical 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 provision. The outlay-equivalent measure allows the cost of the tax expenditure to be compared with a direct Federal outlay. Outlay equivalents are reported in Table 5–5.

Table 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX [1]

(In millions of dollars)

		Outlay Equivalents							
		2000	2001	2002	2003	2004	2005	2006	2002–2006
	National Defense								
1	Exclusion of benefits, allowances, and certain pays to armed forces personnel	2,490	2,510	2,540	2,570	2,600	2,620	2,650	12,980
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	3,460	3,700	3,950	4,170	4,400	4,640	4,910	22,070
3	Exclusion of certain allowances for Federal employees abroad	920	970	1,020	1,070	1,120	1,180	1,240	5,630
4	Exclusion of income of foreign sales corporations	5,990	...	...	...	...	...	...	...
5	Extraterritorial income exclusion	...	6,910	7,410	7,920	8,470	9,050	9,670	42,520
6	Inventory property sales source rules exception	3,340	3,500	3,670	3,860	4,050	4,250	4,460	20,290
7	Deferral of income from controlled foreign corporations (normal tax method)	6,200	6,600	7,000	7,450	7,900	8,400	8,930	39,680
8	Deferred taxes for financial firms on certain income earned overseas	1,190	1,290	540	...	...	...	...	540
	General science, space, and technology:								
9	Expensing of research and experimentation expenditures (normal tax method)	1,680	1,650	1,680	1,770	1,880	1,980	2,100	9,410
10	Credit for increasing research activities	2,510	9,320	10,390	8,300	7,240	4,190	1,790	31,910
	Energy:								
11	Expensing of exploration and development costs, fuels	30	90	90	130	150	140	130	640
12	Excess of percentage over cost depletion, fuels	450	450	460	460	460	470	470	2,320
13	Alternative fuel production credit	1,310	1,230	1,150	730	170	170	170	2,390
14	Exception from passive loss limitation for working interests in oil and gas properties	20	20	20	20	20	20	20	100
15	Capital gains treatment of royalties on coal	90	100	100	110	110	120	120	560
16	Exclusion of interest on energy facility bonds	130	130	130	140	160	190	210	1,090
17	Enhanced oil recovery credit	410	500	590	710	860	1,030	1,230	4,420
18	New technology credit	50	80	100	120	130	120	120	590

Table 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX [1]—Continued

(In millions of dollars)

		Outlay Equivalents							
		2000	2001	2002	2003	2004	2005	2006	2002–2006
19	Alcohol fuel credits [2]	20	20	20	20	20	20	20	100
20	Tax credit and deduction for clean-fuel burning vehicles	80	90	70	40	10	–40	–60	20
21	Exclusion from income of conservation subsidies provided by public utilities	110	110	110	110	120	120	120	580
	Natural resources and environment:								
22	Expensing of exploration and development costs, nonfuel minerals	30	30	30	30	30	30	30	150
23	Excess of percentage over cost depletion, nonfuel minerals	340	350	370	380	400	420	430	2,000
24	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	570	570	590	650	750	830	900	3,720
25	Capital gains treatment of certain timber income	90	100	100	110	110	120	120	560
26	Expensing of multiperiod timber growing costs	740	770	800	820	840	870	890	4,220
27	Investment credit and seven-year amortization for reforestation expenditures	.....	.....	.....	10	10	10	10	40
28	Tax incentives for preservation of historic structures	190	200	210	220	240	250	260	1,180
	Agriculture:								
29	Expensing of certain capital outlays	200	200	200	210	210	220	220	1,060
30	Expensing of certain multiperiod production costs	140	140	150	150	150	150	150	750
31	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
32	Capital gains treatment of certain income	940	990	1,040	1,100	1,150	1,210	1,270	5,770
33	Income averaging for farmers	60	60	60	70	70	70	70	340
34	Deferral of gain on sale of farm refiners	10	10	10	10	10	10	10	50
	Commerce and housing:								
	Financial institutions and insurance:								
35	Exemption of credit union income	2,310	2,460	2,640	2,820	3,010	3,220	3,400	15,090
36	Excess bad debt reserves of financial institutions	80	70	60	40	20	10	.....	130
37	Exclusion of interest on life insurance savings	13,950	15,170	16,520	17,990	19,610	21,370	23,330	98,820
38	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50
39	Tax exemption of certain insurance companies owned by tax-exempt organizations	300	310	320	340	360	380	400	1,800
40	Small life insurance company deduction	130	130	130	130	130	130	130	650
	Housing:								
41	Exclusion of interest on owner-occupied mortgage subsidy bonds	1,130	1,140	1,170	1,270	1,440	1,600	1,790	7,270
42	Exclusion of interest on rental housing bonds	230	230	240	240	290	340	390	1,500
43	Deductibility of mortgage interest on owner-occupied homes	60,270	63,190	65,750	68,050	70,470	73,100	76,150	353,520
44	Deductibility of State and local property tax on owner-occupied homes	22,140	23,920	25,570	27,220	29,080	30,980	33,220	146,070
45	Deferral of income from post 1987 installment sales	1,000	1,020	1,040	1,060	1,080	1,100	1,120	5,400
46	Capital gains exclusion on home sales	23,170	23,870	24,590	25,320	26,090	26,870	27,670	130,540
47	Exception from passive loss rules for $25,000 of rental loss	4,720	4,450	4,220	4,000	3,790	3,600	3,410	19,020
48	Credit for low-income housing investments	4,350	4,500	4,690	4,900	5,150	5,360	5,540	25,640
49	Accelerated depreciation on rental housing (normal tax method)	4,740	5,140	5,520	5,830	6,040	6,140	6,210	29,740
	Commerce:								
50	Cancellation of indebtedness	30	20	10	10	10	20	20	70
51	Exceptions from imputed interest rules	80	80	80	80	80	80	80	400
52	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	54,030	55,630	57,270	58,960	60,700	62,500	64,340	303,770
53	Capital gains exclusion of small corporation stock	50	90	120	170	220	270	330	1,110
54	Step-up basis of capital gains at death	36,120	37,650	39,160	40,720	42,350	44,040	45,810	212,080
55	Carryover basis of capital gains on gifts	180	190	200	210	220	230	240	1,100
56	Ordinary income treatment of loss from small business corporation stock sale	40	50	50	50	60	60	60	280
57	Accelerated depreciation of buildings other than rental housing (normal tax method)	3,260	3,170	3,290	2,880	2,860	2,730	3,220	14,980
58	Accelerated depreciation of machinery and equipment (normal tax method)	30,660	33,050	35,400	37,680	39,760	41,530	43,330	197,700
59	Expensing of certain small investments (normal tax method)	2,100	2,570	2,690	2,670	2,570	2,480	2,510	12,920
60	Amortization of start-up costs (normal tax method)	200	200	200	210	220	220	220	1,070
61	Graduated corporation income tax rate (normal tax method)	9,960	10,300	10,980	11,470	11,600	11,940	12,250	58,240
62	Exclusion of interest on small issue bonds	410	430	440	480	520	600	670	2,710
	Transportation:								
63	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
64	Exclusion of reimbursed employee parking expenses	2,420	2,560	2,690	2,830	2,970	3,130	3,280	14,900
65	Exclusion for employer-provided transit passes	260	300	360	430	490	550	610	2,440
	Community and regional development:								
66	Investment credit for rehabilitation of structures (other than historic)	30	30	30	30	30	30	30	150
67	Exclusion of interest for airport, dock, and similar bonds	890	900	920	990	1,140	1,250	1,410	5,710
68	Exemption of certain mutuals' and cooperatives' income	60	60	60	60	60	70	70	320
69	Empowerment zones and enterprise communities	310	320	660	1,140	1,210	1,340	1,480	5,830
70	New markets tax credit	.....	10	120	250	390	560	810	2,130
71	Expensing of environmental remediation costs	200	440	510	410	40	–160	–100	700
	Education, training, employment, and social services:								
	Education:								
72	Exclusion of scholarship and fellowship income (normal tax method)	1,220	1,230	1,240	1,250	1,270	1,280	1,290	6,330
73	HOPE tax credit	5,400	5,750	5,910	5,490	5,260	5,590	5,930	28,180

Table 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX [1]—Continued

(In millions of dollars)

		Outlay Equivalents							
		2000	2001	2002	2003	2004	2005	2006	2002–2006
74	Lifetime Learning tax credit	3,110	3,290	3,310	3,800	5,750	5,720	5,980	24,560
75	Education Individual Retirement Accounts	20	30	50	60	80	100	120	410
76	Deductibility of student-loan interest	430	440	450	460	470	480	490	2,350
77	Deferral for state prepaid tuition plans	100	130	180	230	250	290	330	1,280
78	Exclusion of interest on student-loan bonds	300	330	330	340	390	420	490	1,970
79	Exclusion of interest on bonds for private nonprofit educational facilities	740	770	790	840	950	1,090	1,200	4,870
80	Credit for holders of zone academy bonds	10	30	50	70	90	100	100	410
81	Exclusion of interest on savings bonds redeemed to finance educational expenses	10	20	20	20	20	20	20	100
82	Parental personal exemption for students age 19 or over	1,060	1,120	1,180	1,230	1,290	1,350	1,410	6,460
83	Deductibility of charitable contributions (education)	3,770	3,890	4,110	4,310	4,450	4,650	4,970	22,490
84	Exclusion of employer-provided educational assistance	300	320	110	.....	.....	.....	.....	110
	Training, employment, and social services:								
85	Work opportunity tax credit	390	400	300	180	80	30	10	600
86	Welfare-to-work tax credit	50	70	70	50	20	10	.....	150
87	Exclusion of employer provided child care	890	930	970	1,020	1,080	1,140	1,200	5,410
88	Adoption assistance	150	160	150	40	40	30	20	280
89	Assistance for adopted foster children	180	210	240	270	280	290	300	1,380
90	Exclusion of employee meals and lodging (other than military)	830	870	910	950	990	1,030	1,080	4,960
91	Child credit [3]	25,770	25,750	25,310	24,550	24,000	23,240	23,240	120,340
92	Credit for child and dependent care expenses	3,190	3,150	3,110	3,080	3,340	3,000	2,970	15,500
93	Credit for disabled access expenditures	60	60	70	70	70	70	80	360
94	Deductibility of charitable contributions, other than education and health	27,070	28,280	29,760	31,300	32,810	34,460	36,340	164,670
95	Exclusion of certain foster care payments	630	660	690	730	760	800	840	3,820
96	Exclusion of parsonage allowances	410	440	470	500	530	570	610	2,680
	Health:								
97	Exclusion of employer contributions for medical insurance premiums and medical care	98,640	108,840	119,110	129,040	139,290	150,010	161,800	699,250
98	Self-employed medical insurance premiums	1,660	1,870	2,200	3,080	4,480	4,880	5,290	19,930
99	Workers' compensation insurance premiums	5,780	6,060	6,370	6,690	7,020	7,370	7,740	35,190
100	Medical Savings Accounts	30	30	30	30	30	30	20	140
101	Deductibility of medical expenses	4,250	4,560	4,870	5,170	5,480	5,790	6,110	27,420
102	Exclusion of interest on hospital construction bonds	1,540	1,570	1,620	1,750	1,980	2,190	2,470	10,010
103	Deductibility of charitable contributions (health)	4,000	4,140	4,380	4,520	4,650	4,860	5,210	23,620
104	Tax credit for orphan drug research	100	110	130	140	160	180	200	810
105	Special Blue Cross/Blue Shield deduction	320	250	390	460	410	390	350	2,000
	Income security:								
106	Exclusion of railroad retirement system benefits	360	360	360	360	360	360	360	1,800
107	Exclusion of workers' compensation benefits	5,120	5,560	5,810	6,070	6,320	6,600	6,900	31,700
108	Exclusion of public assistance benefits (normal tax method)	360	370	390	400	420	430	450	2,090
109	Exclusion of special benefits for disabled coal miners	80	70	70	60	60	60	50	300
110	Exclusion of military disability pensions	120	120	130	130	130	140	140	670
	Net exclusion of pension contributions and earnings:								
111	Employer plans	104,170	109,010	114,010	120,710	127,260	134,160	143,530	639,670
112	Individual Retirement Accounts	20,310	21,350	22,370	23,320	24,200	24,960	25,560	120,410
113	Keogh plans	6,980	7,400	7,840	8,300	8,780	9,290	9,830	44,040
	Exclusion of other employee benefits:								
114	Premiums on group term life insurance	2,070	2,110	2,150	2,200	2,240	2,290	2,330	11,210
115	Premiums on accident and disability insurance	250	260	270	290	300	320	330	1,510
116	Income of trusts to finance supplementary unemployment benefits	10	10	10	10	10	10	10	50
117	Special ESOP rules	1,340	1,400	1,460	1,530	1,600	1,690	1,770	8,050
118	Additional deduction for the blind	40	40	40	40	40	40	50	210
119	Additional deduction for the elderly	2,320	2,410	2,490	2,570	2,680	2,730	2,840	13,310
120	Tax credit for the elderly and disabled	40	40	40	40	40	40	40	200
121	Deductibility of casualty losses	260	270	290	310	320	330	350	1,600
122	Earned income tax credit [4]	5,160	5,214	5,515	5,806	6,062	6,320	6,628	30,331
	Social Security:								
	Exclusion of social security benefits:.								
123	Social Security benefits for retired workers	18,250	19,070	19,930	20,520	21,050	21,840	22,780	106,120
124	Social Security benefits for disabled	2,640	2,880	3,160	3,490	3,910	4,360	4,840	19,760
125	Social Security benefits for dependents and survivors	3,910	4,030	4,210	4,440	4,730	5,070	5,380	23,830
	Veterans benefits and services:								
126	Exclusion of veterans death benefits and disability compensation	3,090	3,290	3,460	3,640	3,820	4,010	4,210	19,140
127	Exclusion of veterans pensions	70	70	80	80	90	90	100	440
128	Exclusion of GI bill benefits	80	90	90	100	100	110	100	500
129	Exclusion of interest on veterans housing bonds	60	60	60	60	60	70	70	320
	General purpose fiscal assistance:								

Table 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX [1]—Continued

(In millions of dollars)

		Outlay Equivalents							
		2000	2001	2002	2003	2004	2005	2006	2002–2006
130	Exclusion of interest on public purpose State and local bonds	32,380	33,030	33,690	34,370	35,050	35,750	36,470	175,330
131	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	42,650	45,730	48,730	51,780	55,030	58,390	62,160	276,090
132	Tax credit for corporations receiving income from doing business in U.S. possessions	3,530	3,600	3,650	3,690	3,720	3,760	1,510	16,330
	Interest:								
133	Deferral of interest on U.S. savings bonds	470	490	520	540	570	600	630	2,860
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	22,140	23,920	25,570	27,220	29,080	30,980	33,220	146,070
	Nonbusiness State and local taxes other than on owner-occupied homes	42,650	45,730	48,730	51,780	55,030	58,390	62,160	276,090
	Exclusion of interest on State and local bonds for:								
	Public purposes	32,380	33,030	33,690	34,370	35,050	35,750	36,470	175,330
	Energy facilities	130	130	130	140	160	190	210	1,090
	Water, sewage, and hazardous waste disposal facilities	570	570	590	650	750	830	900	3,720
	Small-issues	410	430	440	480	520	600	670	2,710
	Owner-occupied mortgage subsidies	1,130	1,140	1,170	1,270	1,440	1,600	1,790	7,270
	Rental housing	230	230	240	240	290	340	390	1,500
	Airports, docks, and similar facilities	890	900	920	990	1,140	1,250	1,410	5,710
	Student loans	300	330	330	340	390	420	490	1,970
	Private nonprofit educational facilities	740	770	790	840	950	1,090	1,200	4,870
	Hospital construction	1,540	1,570	1,620	1,750	1,980	2,190	2,470	10,010
	Veterans' housing	60	60	60	60	60	70	70	320
	Credit for holders of zone academy bonds	10	30	50	70	90	100	100	410

[1] The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of "income" that is larger in scope than is "income" as defined under general U.S. income tax principles. For that reason, the tax expenditure estimates include, for example, estimates related to the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation.

[2] 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: 2000 $840; 2001 $880; 2002 $930; 2003 $950; 2004 $960; 2005 $960; and in 2006 $960.

[3] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2000 $810; 2001 $790; 2002 $760; 2003 $720; 2004 $660; 2005 $630; and in 2006 $590.

[4] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2000 $26,099; 2001 $25,923; 2002 $26,983; 2003 $27,875; 2004 $28,545; 2005 $29,373; and in 2006 $30,165.

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 $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Tax Expenditure Baselines

A tax expenditure is an exception to the baseline provisions of the tax structure. The 1974 Congressional Budget Act did not specify the baseline provisions of the tax law. Deciding whether provisions are 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 is closer to existing law. Tax expenditures under the reference law baseline are generally tax expenditures under the normal tax baseline, but 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 only when it is 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 meas-

uring interest costs would be regarded as a positive tax expenditure (i.e., a tax subsidy).

Although 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.[1] 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.[2]
- *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

The Government Performance and Results Act of 1993 (GPRA) directs Federal agencies to develop annual and strategic plans for their programs and activities. These plans set out performance objectives to be achieved over a specific time period. Most of these objectives will be achieved through direct expenditure programs. However, tax expenditures may also contribute to achieving these goals. The report of the Senate Governmental Affairs Committee on GPRA[3] calls on the Executive branch to undertake a series of analyses to assess the effect of specific tax expenditures on the achievement of agencies' performance objectives.

The Executive Branch is continuing to focus on the availability of data needed to assess the effects of the tax expenditures designed to increase savings. Treasury's Office of Tax Analysis and Statistics of Income Division (IRS) have developed the specifications for a new sample of individual income tax filers as one part of this effort. This new "panel" sample will follow the same taxpayers over a period of at least ten years. The first year of this panel sample will be drawn from tax returns filed in 2000 for tax year 1999. The sample will capture the changing demographic and economic circumstances of individuals and the effects of changes in tax law over an extended period of time. Data from the sample will therefore permit more extensive, and better, analyses of many tax provisions than can be performed using only annual ("cross-section") data. In particular, data from this panel sample will enhance our ability to analyze the effect of tax expenditures

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

[2] 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. In addition, costs of earning income may be limited under the alternative minimum tax.

[3] Committee on Government Affairs, United States Senate, A Government Performance and Results Act of 1993 (Report 103–58, 1993).

designed to increase savings. Other efforts by OMB, Treasury, and other agencies to improve data available for the analysis of savings tax expenditures will continue over the next several years.

Comparison 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.[4] 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 cases. In addition, some tax expenditures actually simplify the tax system, (for example, the exclusion for up to $500,000 of capital gains on home sales). Tax expenditures also implicitly subsidize certain activities. Spending, regulatory or tax-disincentive policies can also modify behavior, but may have different economic effects. Finally, a variety of tax expenditure tools can be used—e.g., deductions; credits; exemptions; deferrals; floors; ceilings; phase-ins; 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 economic effects.

Tax expenditures also have limitations. In many cases they add to the complexity of the tax system, which raises both administrative and compliance costs. For example, targeting personal exemptions and credits can complicate filing and decisionmaking. The income tax system may have little or no contact with persons who have no or very low incomes, and does not require information on certain characteristics of individuals used in some spending programs, such as wealth. 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 may not receive the same level of scrutiny afforded to other programs.

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, many different 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—provide flexibility for policy design. On the other hand, 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 more direct and immediate effects than outlay and tax-expenditure programs because regulations apply directly and immediately to the regulated party (i.e., the intended actor)—generally in the private sector. Regulations can also be fine-tuned more quickly than tax expenditures, because they can generally be changed by the executive branch without legislation. Like tax expenditures, regulations often rely largely 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. This reliance can diminish their economic efficiency, although this feature can also promote full compliance where (as in certain safety-related cases) policymakers believe that trade-offs with economic considerations are not of paramount importance. Also, regulations generally do not directly affect Federal outlays or receipts. Thus, like tax expenditures, they may escape the type of scrutiny that outlay programs receive. However, most regulations are subjected to a formal benefit-cost analysis that goes well beyond the analysis required for outlays and tax-expenditures. To some extent, the GPRA requirement for performance evaluation will address this lack of formal analysis.

Some policy objectives are achieved using multiple approaches. For example, minimum wage legislation, the earned income tax credit, and the food stamp program are regulatory, tax expenditure, and direct outlay programs, respectively, all having the objective of improving the economic welfare of low-wage workers.

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., the exclusion for up to $500,000 of capital gains on home sales); 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

[4] Although this section focuses upon tax expenditures under the income tax, tax expenditures also arise under the unified transfer, payroll, and excise tax systems. Such provisions can be useful when they relate to the base of those taxes, such as an excise tax exemption for certain types of consumption deemed meritorious.

above, may have more than one objective. For example, accelerated depreciation may encourage investment. 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). Effects on the incomes of members of particular groups 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 provisions. In addition, such assessments can raise significant challenges in economic modeling.

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 service in a combat zone or qualified hazardous duty area 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 goals such as promoting tax neutrality. These include the exclusion for income earned abroad by nongovernmental employees and exclusions for income of U.S.-controlled foreign corporations. Measuring the effectiveness of these provisions raises challenging issues.

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 (e.g., research spending, exploration activity, equipment) might 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 size of tax expenditure. Measures could also indicate the 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 tax expenditures 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 exclusion for 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 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 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 grants 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 pooling of risks. 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.

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). 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 provided at the firm level to individuals.

Other provisions principally affect the incomes of members of certain groups, rather than affecting incentives. 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 earned-income tax credit, in contrast, should be evaluated for its effects on labor force participation as well as the income it provides lower-income workers.

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, although 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. As indicated above, over the next few years the Executive Branch's focus will be on the availability of the data needed to assess the effects of the tax expenditures designed to increase savings.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported upon in this chapter follow. These descriptions relate to current law and do not reflect proposals made elsewhere in the Budget.

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 service in a combat zone or qualified hazardous duty area are excluded from income subject to tax.

International Affairs

2. ***Income earned abroad.***—U.S. citizens who lived abroad, worked in the private sector, and satisfied a foreign residency requirement in 2000 may exclude up to $76,000 in foreign earned income from U.S. taxes. The exclusion increases to $78,000 in 2001 and to $80,000 in 2002. In addition, if these taxpayers receive a specific allowance for foreign housing from their employers, they may also exclude the value of that allowance. If they do not receive a specific allowance for housing expenses, they may deduct against their U.S. taxes that portion of such expenses that exceeds one-sixth the salary of a civil servant at grade GS-14, step 1 ($65,983 in 2000).

3. ***Exclusion of certain allowances for federal employees abroad.***—U.S. Federal civilian employees and Peace Corps members who work outside the continental United States are allowed to exclude from U.S. taxable income certain special allowances they receive to compensate them for the relatively high costs associated with living overseas. The allowances supplement wage income and cover expenses like rent, education, and the cost of travel to and from the United States.

4. ***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. The FSC provisions were generally repealed by the FSC Repeal and Extraterritorial Income Exclusion Act of 2000, effective for transactions after September 30, 2000.

5. ***Extraterritorial income exclusion*** [5].—For purposes of calculating U.S. tax liability, a taxpayer may exclude from gross income the qualifying foreign trade income attributable to foreign trading gross receipts. The exclusion generally applies to income from the sale or lease of qualifying foreign trade property and certain types of services income. The exclusion is generally available for transactions entered into after September 30, 2000.

6. ***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 allocates earnings between the United States and abroad equally, which may increase foreign source income use of foreign tax credits.

7. ***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 considered to be 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.

8. ***Exceptions under subpart F for active financing income.***—Consistent with the rules applicable to U.S.-controlled foreign corporations, financial firms can defer taxes on income earned overseas in an active business. Taxes on income earned through December 31, 2001 can be deferred.

General Science, Space, and Technology

9. ***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.

10. ***R&E credit.***—The research and experimentation (R&E) 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" by the average amount of the company's gross receipts for the prior four years. The taxpayer's fixed base percentage generally is the ratio of its research expenses to gross receipts for 1984 through 1988. Taxpayers may also elect an alternative credit regime. Under the alternative credit regime the taxpayer is assigned a three-tiered fixed-base percentage that is lower than the fixed-base percentage that would otherwise apply, and the credit rate is reduced (the rates range from 2.65 percent to 3.75 percent). A 20-percent credit with a separate threshold is provided for a taxpayer's payments to universities for basic research. The credit applies to research conducted before July 1, 2004 and extends to research conducted in Puerto Rico and the U.S. possessions.

Energy

11. ***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

[5] The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of "income" that is larger in scope than is "income" as defined under general U.S. income tax principles. For that reason, the tax expenditure estimates include, for example, estimates related to the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation.

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.

12. ***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.

13. ***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.

14. ***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.

15. ***Capital gains treatment of royalties on coal.***—Sales of certain coal under royalty contracts can be treated as capital gains rather than ordinary income.

16. ***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.

17. ***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.

18. ***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, biomass, and poultry waste facilities. The renewable resources credit applies only to electricity produced by a facility placed in service on or before December 31, 2001.

19. ***Alcohol fuel credits.***—An income tax credit is provided for ethanol that is derived from renewable sources and used as fuel. The credit equals 54 cents per gallon in 2000; 53 cents per gallon in 2001 and 2002; 52 cents per gallon in 2003 and 2004; and 51 cents per gallon in 2005, 2006, and 2007. To the extent that ethanol is mixed with taxable motor fuel to create gasohol, taxpayers may claim an exemption of the Federal excise tax rather than the income tax credit. In addition, small ethanol producers are eligible for a separate 10 cents per gallon credit.

20. ***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.

21. ***Exclusion of utility conservation subsidies.***—Non-business customers can exclude from gross income subsidies received from public utilities for expenditures on energy conservation measures.

Natural Resources and Environment

22. ***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.

23. ***Percentage depletion.***—Most nonfuel mineral extractors may use percentage depletion rather than cost depletion, with percentage depletion rates ranging from 22 percent for sulfur to 5 percent for sand and gravel.

24. ***Sewage, water, solid and hazardous waste facility 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.

25. ***Capital gains treatment of certain timber.***—Certain timber sold under a royalty contract can be treated as a capital gain rather than ordinary income.

26. ***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.

27. ***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 may be amortized is not reduced by any of the allowable investment credit.

28. ***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

29. ***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.

30. ***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.

31. ***Loans forgiven solvent farmers.***—Farmers are forgiven the tax liability on certain forgiven debt. Normally, a 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 reduces carryover losses, then unused credits, and then basis; any remainder of the forgiven debt is excluded from tax. Farmers with forgiven debt are considered insolvent for tax purposes, and thus qualify for income tax forgiveness.

32. ***Capital gains treatment of certain income.***—Certain agricultural income, such as unharvested crops, can be treated as capital gains rather than ordinary income.

33. ***Income averaging for farmers.***—Taxpayers can lower their tax liability by averaging, over the prior three-year period, their taxable income from farming.

34. ***Deferral of gain on sales of farm refiners.***—A taxpayer who sells stock in a farm refiner to a farmers' cooperative can defer recognition of gain if the taxpayer reinvests the proceeds in qualified replacement property.

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.

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

36. ***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.

37. ***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.

38. ***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 $2.1 million of net premium incomes may elect to pay tax only on the income earned by their investment portfolio.

39. ***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.

40. ***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.

41. ***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 these and other private activity is limited. The combined volume cap for private activity bonds, including mortgage housing bonds, rental housing bonds, student loan bonds, and industrial development bonds, is $50 per capita ($150 million minimum) per State in 2000, $62.50 per capita ($187.5 million minimum) in 2001, and $75 per capita ($225 million minimum) in 2002. The Community Renewal Tax Relief Act of 2000 accelerated the scheduled increase in the state volume cap and indexed the cap for inflation, beginning in 2003. States may issue mortgage credit certificates (MCCs) in lieu of mortgage revenue bonds. MCCs entitle homebuyers 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.

42. ***Rental housing bonds.***—Interest earned on State and local government bonds used to finance mul-

tifamily 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.

43. ***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.

44. ***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.

45. ***Installment sales.***—Dealers in real and personal property (i.e., sellers who 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 million is, therefore, a tax expenditure.

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 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. State agencies determine who receives the credit; States are limited in the amount of credit they may authorize annually to $1.25 per resident in 2000. The Community Renewal Tax Relief Act of 2000 increased the per-resident limit to $1.50 in 2001 and to $1.75 in 2002 and indexed the limit for inflation, beginning in 2003. The Act also created a $2 million minimum annual cap for small States beginning in 2002; the cap is indexed for inflation, beginning in 2003.

49. ***Accelerated depreciation of rental property.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to 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, a 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. 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 most assets held for more than 1 year, the top capital gains tax rate is 20 percent. For assets acquired after December 31, 2000, the top capital gains tax rate for assets held for more than 5 years is 18 percent. On January 1, 2001, taxpayers may mark-to-market existing assets to start the 5-year holding period. Losses from the mark-to-market are not recognized.

For assets held for more than 1 year by taxpayers in the 15-percent ordinary tax bracket, the top capital gains tax rate is 10 percent. After December 31, 2000,

the top capital gains tax rate for assets held by these taxpayers for more than 5 years is 8 percent.

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 donor's basis in the transferred property (the cost that was incurred when the transferred property was first acquired) carries-over to the donee. The carryover of the donor's basis allows a continued deferral of unrealized capital gains.

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 give rise to 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 give rise to 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 2000, qualifying investments in tangible property up to $20,000 can be expensed rather than depreciated over time. The expensing limit increases to $24,000 in 2001 and to $25,000 in 2003. To the extent that qualifying investment during the year exceeds $200,000, the amount eligible for expensing is decreased. In 2000, the amount expensed is completely phased out when qualifying investments exceed $220,000.

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 $75,000. 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 employee parking expenses.***—Employee parking expenses that are paid for by the employer or that are received in lieu of wages are excludable from the income of the employee. In 2000, the maximum amount of the parking exclusion is $175 (indexed) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

65. ***Exclusion of employee transit pass expenses.***—Transit passes, tokens, fare cards, and vanpool expenses paid for by an employer or provided in

lieu of wages to defray an employee's commuting costs are excludable from the employee's income. In 2000, the maximum amount of the exclusion is $65 (indexed) per month. In 2002, the maximum amount of the exclusion increases to $100 (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, enterprise communities, and renewal 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, accelerated depreciation, and certain capital gains incentives. In addition, certain first-time buyers of a principal residence in the District of Columbia can receive a tax credit on homes purchased on or before December 31, 2003, and investors in certain D.C. property can receive a capital gains break. The Community Renewal Tax Relief Act of 2000 created the renewal communities tax benefits, which begin on January 1, 2002 and expire on December 31, 2009. The Act also created additional empowerment zones, increased the tax benefits for empowerment zones, and extended the expiration date of (1) empowerment zones from December 31, 2004 to December 31, 2009, and (2) the D.C. homebuyer credit from December 31, 2001 to December 31, 2003.

70. ***New markets tax credit.***—Taxpayers who invest in a community development entity (CDE) after December 31, 2000 are eligible for a tax credit. The total equity investment available for the credit across all CDEs is $1.0 billion in 2001, $1.5 billion in 2002 and 2003, $2.0 billion in 2004 and 2005, and $3.5 billion in 2006 and 2007. The amount of the credit equals (1) 5 percent in the year of purchase and the following 2 years, and (2) 6 percent in the following 4 years. A CDE is any domestic firm whose primary mission is to serve or provide investment capital for low-income communities/individuals; a CDE must be accountable to residents of low-income communities. The Community Renewal Tax Relief Act of 2000 created the new markets tax credit.

71. ***Expensing of environmental remediation costs.***—Taxpayers who clean up certain hazardous substances at a qualified site may expense the clean-up costs, rather than capitalize the costs, even though the expenses may increase the value of the property significantly. The expensing only applies to clean-up costs incurred on or before December 31, 2003. The Community Renewal Tax Relief Act of 2000 extended the expiration date from December 31, 2001 to December 31, 2003. The Act also expanded the number of qualified sites.

Education, Training, Employment, and Social Services

72. ***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).

73. ***HOPE tax credit.***—The non-refundable HOPE tax credit 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).

74. ***Lifetime Learning tax credit.***—The non-refundable Lifetime Learning tax credit allows a credit for 20 percent of an eligible student's tuition and fees. For tuition and fees paid before January 1, 2003, 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.

75. ***Education Individual Retirement Accounts.***—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. The maximum contribution is phased down ratably for taxpayers with modified AGI between $150,000 and $160,000 ($95,000 and $110,000 for sin-

gles). 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.

76. ***Student-loan interest.***—In 2000, taxpayers may claim an above-the-line deduction of up to $2,000 on interest paid on an education loan. The maximum deduction increases to $2,500 in 2001. 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).

77. ***State prepaid tuition plans.***—Some States have adopted prepaid tuition plans and prepaid room and board plans, which allow persons to pay in advance for college expenses for designated beneficiaries. Taxes on the earnings from these plans are paid by the beneficiaries and are deferred until the tuition is actually paid.

78. ***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.

79. ***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.

80. ***Credit for holders of zone academy bonds.***—Financial institutions that own zone academy bonds receive a non-refundable tax credit (at a rate set by the Treasury Department) rather than interest. The credit is included in gross income. Proceeds from zone academy bonds may only be used to renovate, but not construct, qualifying schools and for certain other school purposes. The total amount of zone academy bonds that may be issued is limited to $1.6 billion—$400 million in each year from 1998 to 2001.

81. ***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 $81,100 and $111,100 ($54,100 and $69,100 for singles) in 2000.

82. ***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.

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 on or before December 31, 2001.

85. ***Work opportunity tax credit.***—Employers can claim a tax credit for qualified wages paid to individuals who begin work on or before December 31, 2001 and who are certified as members of various targeted groups. The amount of the credit that can be claimed is 25 percent for employment of less than 400 hours and 40 percent for employment of 400 hours or more. The maximum credit per employee is $2,400 and can only be claimed on the first year of wages an individual earns from an employer. Employers must reduce their deduction for wages paid by the amount of the credit claimed.

86. ***Welfare-to-work tax credit.***—An employer is eligible for a 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 on or before December 31, 2001.

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. ***Assistance for adopted foster children.***—Taxpayers who adopt eligible children from the public foster care system can receive monthly payments for the children's significant and varied needs and a reimbursement of up to $2,000 for nonrecurring adoption expenses. These payments are excluded from gross income.

89. ***Adoption credit and exclusion.***—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). The credit is phased-out ratably for taxpayers with modified AGI between $75,000 and $115,000. Unused credits may be carried forward and used during the five subsequent years. Taxpayers may also exclude qualified adoption expenses from income, subject to the same maximum amounts and phase-out as the credit. The same expenses cannot qualify for tax benefits under both programs; however, a taxpayer may use the benefits of the exclusion and the tax credit for different expenses. Stepchild adoptions are not eligible for either benefit. Both of the current tax benefits expire at the end of 2001, except for the tax credit for expenses associated with special needs adoptions, which is permanent.

90. ***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.

91. ***Child credit.***—Taxpayers with children under age 17 can qualify for a $500 child credit. 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.

92. ***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 single parents and by divorced or separated parents who have custody of children. 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.

93. ***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.

94. ***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.

95. ***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.

96. ***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

97. ***Employer-paid medical insurance and expenses.***—Employer-paid health insurance premiums and other medical expenses (including long-term care) are deducted as a business expense by employers, but they are not included in employee gross income. The self-employed also may deduct part of their family health insurance premiums.

98. ***Self-employed medical insurance premiums.***—Self-employed taxpayers may deduct a percentage of their family health insurance premiums. Taxpayers without self-employment income are not eligible for the special percentage deduction. The deductible percentage is 60 percent in 2000 and 2001, 70 percent in 2002, and 100 percent in 2003 and thereafter.

99. ***Workers compensation insurance premiums.***—Workers compensation insurance premiums are paid by employers and deducted as a business expense, but the premiums are not included in employee gross income.

100. ***Medical savings accounts.***—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, 2002. The Community Renewal Tax Relief Act of 2000 extended the expiration date from December 31, 2000 to December 31, 2002.

101. ***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.

102. ***Hospital construction bonds.***—Interest earned on State and local government debt issued to finance hospital construction is excluded from income subject to tax.

103. ***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.

104. ***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.

105. ***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

106. ***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.

107. ***Workers' compensation benefits.***—Workers compensation provides payments to disabled workers. These benefits, although income to the recipients, are not subject to the income tax.

108. ***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.

109. ***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.

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

111. ***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.

112. ***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 federal government's Thrift Savings Plan).

In 2000, an employee could exclude up to $10,500 (indexed) of wages from AGI under a qualified arrangement with an employer's 401(k). In 2000, 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 $52,000 ($32,000 for singles). The AGI limit increases annually until it reaches $80,000 in 2007 ($50,000 in 2005 for singles). In 2000, the IRA deduction is phased out for taxpayers with AGI between $52,000 and $62,000 ($32,000 and $42,000 for singles). The phase-out range increases annually until it reaches $80,000 to $100,000 in 2007 ($50,000 to $60,000 in 2005 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.

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 59½, (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).

113. ***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.

114. ***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.

115. ***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.

116. ***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.

117. ***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 corporations 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.

118. ***Additional deduction for the blind.***—Taxpayers who are blind may take an additional $1,000 standard deduction if single, or $800 if married.

119. ***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.

120. ***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.

121. ***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.

122. ***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 $6,920 of earned income in 2000. The credit is 40 percent of the first $9,720 of income for a family with two or more qualifying children. When the taxpayer's income exceeds $12,690, 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 $27,413 of modified adjusted gross income ($31,152 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 2000, the credit is 7.65 percent of the first $4,610 of earned income. When the taxpayer's income exceeds $5,770, the credit is phased out at the rate of 7.65 percent. It is completely phased out at $10,380 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

123. ***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.

124. ***Social Security benefits for the disabled.***—Benefit payments from the Social Security Trust Fund, for disability and for dependents and survivors, are excluded from a beneficiary's gross incomes.

125. ***Social Security benefits for dependents and survivors.***—Benefit payments from the Social Security Trust Fund for dependents and survivors are excluded from a beneficiary's gross income.

Veterans Benefits and Services

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

127. ***Veterans pension payments.***—Pension payments made by the Veterans Administration are excluded from gross income.

128. ***G.I. Bill benefits.***—G.I. Bill benefits paid by the Veterans Administration are excluded from gross income.

129. ***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

130. ***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), equipment acquisition, and other public purposes is tax-exempt. Interest on bonds issued by Indian tribal governments for essential governmental purposes is also tax-exempt.

131. ***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.

132. ***Business income earned in U.S. possessions.***—U.S. corporations operating in a U.S. possession (e.g., Puerto Rico) can claim a credit against some or all of their U.S. tax liability on possession business income. The credit expires December 31, 2005.

Interest

133. ***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 (indexed) 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 2000, this credit allows each taxpayer to make a $675,000 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 2006.[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 2000–2006 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. Up to 40 percent of the value of land subject to certain conservation easements may be excluded from taxable estates; the maximum amount of the exclusion is $300,000 in 2000 and increases to $400,000 in 2001 and to $500,000 in 2002.

Agriculture

2. ***Special-use valuation of farms.***—In 2000, up to $750,000 (indexed) 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.

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 gross 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. A 2-percent interest rate (non-deductible) is applied to the first $1 million (indexed) of deferred taxable value.

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

[6] An additional tax, at a flat rate of 55 percent, is imposed on lifetime, generation-skipping transfers in excess of $1 million (indexed). 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.

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.***—Certain family-owned businesses that are bequeathed to qualified heirs can be excluded from taxable estates. The exclusion cannot exceed $675,000. The combined value of the exclusion and the exemption value of the unified credit cannot exceed $1.3 million. The exclusion is recaptured if certain conditions are not maintained for 10 years.

Education, Training, Employment, and Social Services

7. ***Charitable contributions to educational institutions.***—Bequests to educational institutions can be deducted under the estate tax.

8. ***Charitable contributions, other than education and health.***—Bequests to charitable, religious, and certain other nonprofit organizations can be deducted under the estate tax.

Health

9. ***Charitable contributions to health institutions.***—Bequests to health institutions can be deducted under the estate tax.

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. ESTIMATES FOR TAX EXPENDITURES IN THE FEDERAL UNIFIED TRANSFER TAX

(In millions of dollars)

	Description	2000	2001	2002	2003	2004	2005	2006	2002–2006
	Natural Resources and Environment:								
1	Donations of conservation easements	.....	.....	.....	10	10	10	20	50
	Agriculture:								
2	Special use valuation of farm real property	110	110	120	120	130	130	130	630
3	Tax deferral of closely held farms	.....	.....	10	10	20	20	30	90
	Commerce:								
4	Special use valuation of real property used in closely held businesses	10	10	10	10	10	10	10	50
5	Tax deferral of closely held business	–20	30	60	80	100	130	140	510
6	Exclusion for family owned businesses	130	140	150	160	170	170	170	820
	Education, training, employment, and social services:								
7	Deduction for charitable contributions (education)	780	880	960	990	1,030	1,060	1,100	5,140
8	Deduction for charitable contributions (other than education and health)	2,300	2,600	2,830	2,930	3,050	3,120	3,260	15,190
	Health:								
9	Deduction for charitable contributions (health)	700	800	870	900	930	960	1,000	4,660
	General government:								
10	Credit for State death taxes	6,420	6,720	7,030	7,340	7,660	8,000	8,350	38,380

4. FEDERAL RECEIPTS

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

The Federal Government also collects income from the public from market-oriented activities. Collections from these activities, which are subtracted from gross outlays, rather than added to taxes and other governmental receipts, are discussed in the following chapter.

Growth in receipts.—Total receipts in 2003 are estimated to be $2,048.1 billion, an increase of $101.9 billion or 5.2 percent relative to 2002. Receipts are projected to grow at an average annual rate of 5.9 percent between 2003 and 2007, rising to $2,571.7 billion. This growth in receipts is largely due to assumed increases in incomes resulting from both real economic growth and inflation.

As a share of GDP, receipts are projected to decline from 19.6 percent in 2001 to 18.8 percent in 2002 and 2003. The receipts share of GDP is projected to increase to 19.1 percent in 2007, despite the phasein of legislated tax reductions and the President's proposed tax plan.

Table 4–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	2001 actual	Estimate					
		2002	2003	2004	2005	2006	2007
Individual income taxes	994.3	949.2	1,006.4	1,058.6	1,112.0	1,157.3	1,221.7
Corporation income taxes	151.1	201.4	205.5	212.0	237.1	241.4	250.6
Social insurance and retirement receipts	694.0	708.0	749.2	789.8	835.2	868.7	908.3
(On-budget)	(186.4)	(190.8)	(203.9)	(216.3)	(227.0)	(235.1)	(243.0)
(Off-budget)	(507.5)	(517.2)	(545.3)	(573.5)	(608.2)	(633.7)	(665.3)
Excise taxes	66.1	66.9	69.0	71.2	73.6	75.3	77.5
Estate and gift taxes	28.4	27.5	23.0	26.6	23.4	26.4	23.2
Customs duties	19.4	18.7	19.8	21.9	23.0	24.7	26.2
Miscellaneous receipts	37.8	36.4	40.2	42.8	43.2	44.4	46.2
Bipartisan economic security plan	.....	–62.0	–65.0	–47.5	–9.5	17.0	18.0
Total receipts	**1,991.0**	**1,946.1**	**2,048.1**	**2,175.4**	**2,338.0**	**2,455.3**	**2,571.7**
(On-budget)	*(1,483.5)*	*(1,428.9)*	*(1,502.7)*	*(1,601.9)*	*(1,729.8)*	*(1,821.6)*	*(1,906.4)*
(Off-budget)	*(507.5)*	*(517.2)*	*(545.3)*	*(573.5)*	*(608.2)*	*(633.7)*	*(665.3)*

Table 4–2. EFFECT ON RECEIPTS OF CHANGES IN THE SOCIAL SECURITY TAXABLE EARNINGS BASE

(In billions of dollars)

	Estimate				
	2003	2004	2005	2006	2007
Social security (OASDI) taxable earnings base increases:.					
$84,900 to $89,700 on Jan. 1, 2003	2.2	5.8	6.4	7.0	7.7
$89,700 to $92,400 on Jan. 1, 2004	.....	1.3	3.3	3.6	3.9
$92,400 to $96,000 on Jan. 1, 2005	.....	.....	1.7	4.5	4.9
$96,000 to $99,900 on Jan. 1, 2006	.....	.....	.....	1.9	4.9
$99,900 to $103,800 on Jan. 1, 2007	.....	.....	.....	.....	1.9

ENACTED LEGISLATION

Several laws were enacted in 2001 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001 (EGTRRA)

From the Administration's first day in office, President Bush worked to deliver on his campaign promise of meaningful tax relief. Congress moved with exceptional speed and on June 7, 2001, this Act was signed by President Bush. The major provisions of this Act, which are described in greater detail below, create a new 10-percent individual income tax rate bracket; reduce marginal income tax rates for individuals; eliminate the estate tax; reduce the marriage penalty; provide relief from the alternative minimum tax (AMT); modify the timing of estimated tax payments by corporations; and modify tax benefits for children, education, and pension and retirement savings. Almost all of the provisions phase in over a number of years and sunset on December 31, 2010.

Individual Income Tax Relief

Create a new 10-percent individual income tax rate bracket.—Effective for taxable years beginning after December 31, 2000 and before January 1, 2011, the prior law 15-percent individual income tax rate bracket is split into two tax rate brackets of 10 and 15 percent. The new 10-percent tax rate bracket applies to the first $6,000 of taxable income for single taxpayers and married taxpayers filing separate returns (increasing to $7,000 for taxable years beginning after December 31, 2007), the first $10,000 of taxable income for heads of household, and the first $12,000 of taxable income for married taxpayers filing a joint return (increasing to $14,000 of taxable income for taxable years beginning after December 31, 2007). Taxable income above these thresholds that was taxed at the 15-percent rate under prior law will continue to be taxed at that rate. The income thresholds for the new tax rate bracket will be adjusted annually for inflation, effective for taxable years beginning after December 31, 2008 and before January 1, 2011.

For 2001, most taxpayers received the benefit of the new 10-percent tax rate bracket through an advanced credit, issued by the Department of Treasury in the form of a check. The amount of the advanced credit was equal to 5 percent of taxable income reported on tax returns filed for 2000, up to a maximum credit of $300 for single taxpayers and married taxpayers filing separate returns, $500 for heads of household, and $600 for married taxpayers filing a joint return. Taxpayers are entitled to a similar credit on tax returns filed for 2001 to the extent that it exceeds the advanced credit, if any, that they received on the basis of tax returns filed for 2000.

Reduce individual income tax rates.—In addition to splitting the 15-percent tax rate bracket of prior law into two tax rate brackets (see preceding discussion), this Act replaces the four remaining statutory individual income tax rate brackets of prior law (28, 31, 36, and 39.6 percent) with a rate structure of 25, 28, 33, and 35 percent. The reduced tax rate structure is phased in over a period of six years, effective for taxable years beginning after December 31, 2000, as follows: the 28-percent rate is reduced to 27.5 percent for 2001, 27 percent for 2002 and 2003, 26 percent for 2004 and 2005, and 25 percent for 2006 through 2010; the 31 percent rate is reduced to 30.5 for 2001, 30 percent for 2002 and 2003, 29 percent for 2004 and 2005, and 28 percent for 2006 through 2010; the 36 percent rate is reduced to 35.5 percent for 2001, 35 percent for 2002 and 2003, 34 percent for 2004 and 2005, and 33 percent for 2006 through 2010; and the 39.6 percent rate is reduced to 39.1 percent for 2001, 38.6 percent for 2002 and 2003, 37.6 percent for 2004 and 2005, and 35 percent for 2006 through 2010. The income thresholds for these tax rate brackets are adjusted annually for inflation as provided under prior law.

Repeal phaseout of personal exemptions.—Under prior law, the deduction for taxpayer and dependent personal exemptions ($2,900 for taxable year 2001), began to be phased out for taxpayers with adjusted gross income (AGI) over certain thresholds (for taxable year 2001, the thresholds were $132,950 for single taxpayers, $166,200 for heads of household, $99,725 for married taxpayers filing separate returns, and $199,450 for married taxpayers filing a joint return). For taxable year 2001, the deduction for personal exemptions was fully phased out above AGI of $255,450 for single taxpayers, $288,700 for heads of household, $160,975 for married taxpayers filing separate returns, and $321,950 for married taxpayers filing a joint return. This Act phases in the repeal of the phaseout of personal exemptions over a five-year period, effective for taxable years beginning after December 31, 2005. The otherwise applicable personal exemption phaseout is reduced by one-third for taxable years 2006 and 2007, is reduced by two-thirds for taxable years 2008 and 2009, and is repealed for taxable year 2010.

Repeal limitation on itemized deductions.—Under prior law, the amount of otherwise allowable itemized deductions (other than medical expenses, investment interest, theft and casualty losses, and wagering losses) was reduced by three percent of AGI in excess of certain thresholds (for taxable year 2001, the thresholds were $66,475 for married taxpayers filing separate returns and $132,950 for all other taxpayers). This Act phases in the repeal of the limitation on itemized deductions over a five-year period, effective for taxable years beginning after December 31, 2005. The otherwise applicable limitation on itemized deduc-

tions is reduced by one-third for taxable years 2006 and 2007, is reduced by two-thirds for taxable years 2008 and 2009, and is repealed for taxable year 2010.

Tax Benefits for Children

Increase and expand the child tax credit.—Under prior law, taxpayers were provided a tax credit of up to $500 for each qualifying child under the age of 17. This Act doubles the maximum amount of the credit to $1,000 over a 10-year period, effective for taxable years beginning after December 31, 2000. The credit increases to $600 for taxable years 2001 through 2004, $700 for taxable years 2005 through 2008, $800 for taxable year 2009, and $1,000 for taxable year 2010.

Generally, the credit was nonrefundable under prior law; however, taxpayers with three or more qualifying children could be eligible for an additional refundable child tax credit if they had little or no individual income tax liability. The additional credit could be offset against social security payroll tax liability, provided that liability exceeded the refundable portion of the earned income tax credit (EITC). Under this Act, the child credit is refundable to the extent of 10 percent of the taxpayer's earned income in excess of $10,000 for taxable years 2001 through 2004. The percentage increases to 15 percent for taxable years 2005 through 2010. The $10,000 earned income threshold is indexed annually for inflation beginning in 2002. Families with three or more children are allowed a refundable credit for the amount by which their social security payroll taxes exceed their earned income credit (the prior law rule), if that amount is greater than the refundable credit based on their earned income in excess of $10,000. This Act also provides that the refundable portion of the child credit does not constitute income and shall not be treated as resources for purposes of determining eligibility or the amount or nature of benefits or assistance under any Federal program or any State or local program financed with Federal funds.

Under prior law, beginning in taxable year 2002, the child tax credit would have been allowed only to the extent that an individual's regular individual income tax liability exceeded his or her tentative minimum tax. In addition, beginning in taxable year 2002, the refundable child tax credit would have been reduced by the amount of the individual's alternative minimum tax. Effective for taxable years beginning after December 31, 2001 and before January 1, 2011, this Act allows the child credit to offset both the regular tax and the alternative minimum tax; in addition, the refundable credit will not be reduced by the amount of the alternative minimum tax.

Extend and expand adoption tax benefits.—Prior law provided a permanent nonrefundable 100-percent tax credit for the first $6,000 of qualified expenses incurred in the adoption of a child with special needs. A nonrefundable 100-percent tax credit was provided for the first $5,000 of qualified expenses incurred before January 1, 2002 in the adoption of a child without special needs. The adoption credit (including the credit for the adoption of a child with special needs) phased out ratably for taxpayers with modified AGI between $75,000 and $115,000. In addition, for taxable years beginning after December 31, 2001, the otherwise allowable adoption credit was allowed only to the extent that the taxpayer's regular income tax liability exceeded the taxpayer's tentative minimum tax. This Act increases the credit for qualified expenses incurred in the adoption of a child, including a child with special needs, to $10,000, effective for qualified expenses incurred after December 31, 2001 and before January 1, 2011. The $10,000 amount is indexed annually for inflation, effective for taxable years beginning after December 31, 2002. For the adoption of a child with special needs finalized after December 31, 2002 and before January 1, 2011, the credit is provided regardless of whether qualified adoption expenses are incurred. Effective for taxable years beginning after December 31, 2001 and before January 1, 2011, the credit (including the credit for the adoption of a child with special needs) phases out ratably for taxpayers with modified AGI between $150,000 and $190,000. The start of the phase-out range is indexed annually for inflation effective for taxable years beginning after December 31, 2002, but the width of the phase-out range remains at $40,000. In addition, for taxable years beginning after December 31, 2001 and before January 1, 2011, the adoption tax credit is allowed against the alternative minimum tax.

Under prior law, up to $5,000 per child in qualified adoption expenses paid or reimbursed by an employer under an adoption assistance program could be excluded from the gross income of an employee. The maximum exclusion was $6,000 for the adoption of a child with special needs. The exclusion, which applied to amounts paid or expenses incurred before January 1, 2002, was phased out ratably for taxpayers with modified AGI (including the full amount of the employer adoption benefit) between $75,000 and $115,000. This Act increases the maximum exclusion to $10,000 per child, including the adoption of a child with special needs, effective for expenses incurred after December 31, 2001 and before January 1, 2011. The $10,000 amount is indexed annually for inflation, effective for taxable years beginning after December 31, 2002. For the adoption of a child with special needs finalized after December 31, 2002 and before January 1, 2011, the exclusion is provided regardless of whether qualified adoption expenses are incurred. Effective for taxable years beginning after December 31, 2001 and before January 1, 2011, the exclusion (including the exclusion for the adoption of a child with special needs) phases out ratably for taxpayers with modified AGI between $150,000 and $190,000. The start of the phase-out range is indexed annually for inflation effective for taxable years beginning after December 31, 2002, but the width of the phase-out range remains at $40,000.

Expand dependent care tax credit.—Under prior law, a taxpayer could receive a nonrefundable tax credit for a percentage of a limited amount of dependent care

expenses ($2,400 for one qualifying dependent and $4,800 for two or more qualifying dependents) paid in order to work. The credit rate was phased down from 30 percent of expenses (for taxpayers with AGI of $10,000 or less) to 20 percent of expenses (for taxpayers with AGI above $28,000). Effective for taxable years beginning after December 31, 2002 and before January 1, 2011, this Act increases the maximum amount of eligible employment related expenses to $3,000 for one qualifying dependent and to $6,000 for two or more qualifying dependents. In addition, the maximum credit rate is increased to 35 percent for taxpayers with AGI of $15,000 or less, and the phase down is modified so that the 20 percent rate applies to taxpayers with AGI above $43,000.

Provide tax credit for employer-provided child care facilities.—A 25-percent tax credit is provided to employers for qualified expenses incurred to build, acquire, rehabilitate, expand, or operate a child care facility for employee use, or to provide child care services to children of employees directly or through a third party. A 10-percent credit is provided for qualified expenses incurred to provide employees with child care resource and referral services. The maximum total credit for an employer may not exceed $150,000 per taxable year, and is effective for taxable years beginning after December 31, 2001 and before January 1, 2011. Any deduction the employer would otherwise be entitled to take for the expenses is reduced by the amount of the credit. The taxpayer's basis in a facility is reduced to the extent that a credit is claimed for expenses of constructing, rehabilitating, expanding, or acquiring a facility; in addition, the credit is subject to recapture for the first ten years after the qualified child care facility is placed in service.

Marriage Penalty Relief

Increase standard deduction for married taxpayers filing a joint return.—The basic standard deduction amount for single taxpayers under prior law was equal to 60 percent of the basic standard deduction amount for married taxpayers filing a joint return. Therefore, two single taxpayers had a combined standard deduction that exceeded the standard deduction of a married couple filing a joint return. This Act increases the standard deduction for married couples filing a joint return to double the standard deduction for single taxpayers over a five-year period, beginning after December 31, 2004. Under the phasein, the standard deduction for married taxpayers filing a joint return increases to 174 percent of the standard deduction for single taxpayers in taxable year 2005, 184 percent in taxable year 2006, 187 percent in taxable year 2007, 190 percent in taxable year 2008, and 200 percent in taxable years 2009 and 2010.

Expand the 15-percent tax rate bracket for married taxpayers filing a joint return.—The size of the 15-percent tax rate bracket for married taxpayers filing a joint return is increased to twice the size of the corresponding tax rate bracket for single taxpayers. The increase, which is phased in over four years, beginning after December 31, 2004, is as follows: the 15-percent tax rate bracket for married taxpayers filing a joint return increases to 180 percent of the corresponding tax rate bracket for single taxpayers in taxable year 2005, 187 percent in taxable year 2006, 193 percent in taxable year 2007, and 200 percent in taxable years 2008, 2009 and 2010.

Modify the phaseout of the earned income credit (EITC) for married taxpayers filing a joint return and simplify the EITC.— The maximum earned income tax credit is phased in as an individual's earned income increases. The credit phases out for individuals with earned income (or, if greater, modified AGI) over certain levels. For married taxpayers filing a joint return, both the phasein and phaseout of the credit are calculated based on the couples' combined income. Under this Act, for married taxpayers filing a joint return, the income threshold at which the credit begins to phase out is increased, effective for taxable years beginning after December 31, 2001 and before January 1, 2011. For married taxpayers filing a joint return the phase-out threshold increases by $1,000 for taxable years 2002 through 2004, $2,000 for taxable years 2005 through 2007, and $3,000 for taxable years 2008 through 2010. The $3,000 amount is increased annually for inflation beginning in taxable year 2009.

This Act also simplifies EITC eligibility criteria and allows the Internal Revenue Service (IRS) to use more cost efficient procedures to deny certain questionable EITC claims. In addition, effective for taxable years beginning after December 31, 2001 and before January 1, 2011, the prior law rule that reduced the EITC by the amount of the alternative minimum tax is repealed.

Education Incentives

Increase and expand education savings accounts.—Under prior law, taxpayers were permitted to contribute up to $500 per year to an education savings account (an "education IRA") for beneficiaries under age 18. The contribution limit was phased out for taxpayers with modified AGI between $95,000 and $110,000 (between $150,000 and $160,000 for married couples filing a joint return). Contributions to an education IRA were not deductible, but earnings on contributions were allowed to accumulate tax-free. Distributions were excludable from gross income to the extent they did not exceed qualified higher education expenses incurred during the year the distribution was made. The earnings portion of a distribution not used to cover qualified higher education expenses was included in the gross income of the beneficiary and was generally subject to an additional 10-percent tax. If any portion of a distribution from an education savings account was excluded from gross income, an education tax credit could not be claimed with respect to the same student for the same taxable year. An excise tax

of six percent was imposed on contributions to an education IRA in any year in which contributions were also made to a qualified State tuition program on behalf of the same beneficiary.

Effective for taxable years beginning after December 31, 2001 and before January 1, 2011, this Act increases the annual contribution limit to education IRAs to $2,000 and increases the contribution phase-out range for married couples filing a joint return to twice the range for single taxpayers ($190,000 to $220,000 of AGI). As under prior law, contributions to an education IRA are not deductible, but earnings on contributions are allowed to accumulate tax-free. In addition to allowing tax-free and penalty-free distributions for qualified higher education expenses, this Act expands education savings accounts to allow tax-free and penalty-free distributions for qualified elementary, secondary and after school expenses. Qualified expenses at public, private, and religious educational institutions providing elementary and secondary education generally include: tuition; fees; academic tutoring; special needs services; books; supplies; computer equipment; and certain expenses for room and board, uniforms, and transportation. Under this Act: (1) the rule prohibiting contributions after the beneficiary attains age 18 does not apply in the case of a special needs beneficiary, as defined by Treasury Department regulations, (2) both an education tax credit and a tax-free distribution from an education savings account are allowed with respect to the same student in the same taxable year, provided the credit and the distribution are not used for the same expenses, and (3) the excise tax on contributions made to an education IRA on behalf of a beneficiary during any taxable year in which contributions are made to a qualifying State tuition program on behalf of the same beneficiary is repealed.

Allow tax-free distributions from Qualified State Tuition Plans (QSTPs) for certain higher education expenses and allow private colleges to offer prepaid tuition plans.—QSTP programs generally take two forms - prepaid tuition plans and savings plans. Under a prepaid tuition plan, an individual may purchase tuition credits or certificates on behalf of a designated beneficiary, which entitle the beneficiary to the waiver or payment of qualified higher education expenses at participating educational institutions. Under a savings plan, an individual may make contributions to an account, which is established for the purpose of meeting the qualified higher education expenses of a designated beneficiary. Distributions from QSTPs for nonqualified expenses generally are subject to a more than de minimis penalty (typically 10 percent of the earnings portion of the distribution). There is no specific dollar cap on annual contributions to a QSTP; in addition, there is no limit on contributions to a QSTP based on the contributor's income. Contributions to a QSTP are permitted at any time during the beneficiary's lifetime and the account can remain open after the beneficiary reaches age 30. However, a QSTP must provide adequate safeguards to prevent contributions on behalf of a designated beneficiary in excess of amounts necessary to provide for qualified education expenses.

Two basic tax benefits were provided to contributions to, and beneficiaries of, QSTPs under prior law: (1) earnings on amounts invested in a QSTP were not subject to tax until a distribution was made (or educational benefits were provided), and (2) distributions made on behalf of a beneficiary were taxed at the beneficiary's (rather than the contributor's) individual income tax rate.

Effective for taxable years beginning after December 31, 2001 and before January 1, 2011, this Act provides for tax-free withdrawals from QSTPs for qualified higher education expenses, including tuition and fees; certain expenses for room and board; certain expenses for books, supplies, and equipment; and expenses of a special needs beneficiary that are necessary in connection with enrollment or attendance at an eligible education institution. An education tax credit, a tax-free distribution from an education savings account, and a tax-free distribution from a QSTP are allowed with respect to the same student in the same taxable year, provided the credit and the distributions are not used for the same expenses. Effective for taxable years beginning after December 31, 2003 and before January 1, 2011, this Act allows private educational institutions to establish qualified prepaid tuition plans (but not savings plans), provided the institution is eligible to participate in Federal financial aid programs under Title IV of the Higher Education Act of 1965. In addition, the prior law rule imposing a more than de minimis monetary penalty on any refund of earnings not used for qualified higher education expenses is repealed and replaced with an additional 10-percent tax on any payment includible in gross income; however, effective for taxable years beginning before January 1, 2004, the 10-percent tax does not apply to any distribution from a private prepaid tuition program that is includible in gross income but used for qualified higher education expenses.

Provide deduction for qualified higher education expenses.—An above-the-line deduction is provided for qualified higher education expenses, effective for expenses paid in taxable years beginning after December 31, 2001 and before January 1, 2006. Taxpayers with AGI less than or equal to $65,000 ($130,000 for married taxpayers filing a joint return) are provided a maximum deduction of $3,000 in taxable years 2002 and 2003, which increases to $4,000 in taxable years 2004 and 2005. Taxpayers with AGI greater than $65,000 and less than or equal to $80,000 (greater than $130,000 and less than or equal to $160,000 for married taxpayers filing a joint return) are provided a maximum deduction of $2,000 for taxable years 2004 and 2005. For a given taxable year, the deduction may not be claimed for the qualified education expenses of a student if an education tax credit is claimed for the same student. In addition, the deduction may not be claimed for amounts taken into account in determining the amount excludable from income due to a distribution

from an education IRA or the amount of interest excludable from income with respect to education savings bonds. A taxpayer may not claim a deduction for the amount of a distribution from a qualified tuition plan that is excludable from income; however the deduction may be claimed for the amount of a distribution from a qualified tuition plan that is not attributable to earnings.

Extend and expand exclusion for employer-provided educational assistance.—Certain amounts paid or incurred by an employer for educational assistance provided to an employee 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, which applied to undergraduate courses beginning before January 1, 2002 under prior law, is extended to apply to courses beginning after December 31, 2001 and before January 1, 2011, and is expanded to apply to graduate courses.

Modify student loan interest deduction.—Prior law allowed certain individuals to claim an above-the-line deduction for up to $2,500 in annual interest paid on qualified education loans, during the first 60 months in which interest payments were required. The maximum annual interest deduction was phased out ratably for single taxpayers with AGI between $40,000 and $55,000 ($60,000 and $75,000 for married taxpayers filing a joint return). The deduction did not apply to voluntary payments, such as interest payments made during a period of loan forbearance. Effective for interest paid on qualified education loans after December 31, 2001 and before January 1, 2011, both the limit on the number of months during which interest paid is deductible and the restriction that voluntary payments of interest are not deductible are repealed. In addition, the income phase-out ranges for eligibility for the deduction are increased to between $50,000 and $65,000 of AGI for a single taxpayer ($100,000 and $130,000 for married taxpayers filing a joint return). The income phase-out ranges are adjusted annually for inflation after 2002.

Provide tax relief for awards under certain health education programs.—Current law provides tax-free treatment for certain scholarship and fellowship grants used to pay qualified tuition and related expenses, but not to the extent that any grant represents compensation for services. Under this Act, amounts received by an individual under the National Health Service Corps Scholarship Program or the Armed Forces Health Professions Scholarship and Financial Assistance Program may be "qualified scholarships" excludable from income, without regard to the recipient's future service obligation. This change is effective for awards received after December 31, 2001 and before January 1, 2011.

Modify arbitrage restrictions on tax-exempt bonds issued by small governmental units for public schools.—To prevent tax exempt entities from issuing more Federally subsidized tax-exempt bonds than is necessary for the activity being financed, current law includes arbitrage restrictions limiting the ability to profit from investment of tax-exempt bond proceeds. In general, arbitrage profits may be earned only during specified periods or on specified types of investments, and, subject to limited exceptions, must be rebated to the Federal Government. Under prior law, governmental bonds issued by small governmental units were not subject to the rebate. Small governmental units are defined as general purpose governmental units that issue no more than $5 million of tax-exempt governmental bonds in a calendar year ($10 million of governmental bonds if at least $5 million of the bonds are used to finance public schools). Effective for bonds issued after December 31, 2001 and before January 1, 2011, this Act increases to $15 million the maximum amount of governmental bonds that small governmental units may issue without being subject to the arbitrage rebate requirements, if at least $10 million of the bonds are used for public schools.

Allow States to issue tax-exempt private activity bonds for school construction.—Effective for taxable years beginning after December 31, 2001 and before January 1, 2011, the activities for which States may issue tax-exempt private activity bonds is expanded to include the construction and equipping of public school facilities owned by private, for-profit corporations pursuant to public-private partnership agreements with a State or local educational agency. Under such agreements the for-profit corporation constructs, rehabilitates, refurbishes or equips the school facility, which must be operated by a public educational agency as part of a system of public schools; ownership reverts to the public agency when the bonds are retired. Issuance of these bonds is subject to an annual per-State volume limit of $10 per resident (a minimum of $5 million is provided for small States); this is in addition to the present-law private activity bond per-State volume limit equal to the greater of $75 per resident or $225 million in 2002, and indexed annually thereafter.

Estate, Gift, and Generation-Skipping Transfer Tax Provisions

Phase out and repeal estate and generation-skipping transfer taxes, and reduce gift tax rates.—Under prior law, the unified estate and gift tax rates on taxable transfers began at 18 percent on the first $10,000 of cumulative taxable transfers and reached 55 percent on cumulative transfers in excess of $3 million. A five-percent surtax (which phased out the benefit of the graduated rates and increased the top marginal tax rate to 60 percent) was imposed on cumulative transfers between $10 million and $17,184,000. A generation-skipping transfer tax was im-

posed on transfers made either directly or through a trust or similar arrangement to a beneficiary in a generation more than one generation below that of the transferor (a "skip person"). Cumulative generation-skipping transfers in excess of $1 million (adjusted annually for inflation after 1997) were taxed at the top estate and gift tax rate of 55 percent.

Under this Act, estate, gift, and generation-skipping transfer tax rates are reduced for decedents dying and gifts made after December 31, 2001 and before January 1, 2010. Estate and generation-skipping transfer taxes are repealed for decedents dying after December 31, 2009 and before January 1, 2011, while the maximum tax rate on gifts made after December 31, 2009 and before January 1, 2011 is reduced to 35 percent on gifts in excess of a lifetime exclusion of $1 million (see discussion of unified credit below). The reduction in tax rates begins in 2002 with the repeal of the five-percent surtax and the reduction of the 53 percent and 55 percent rates to 50 percent. The maximum tax rate on estates, gifts, and generation-skipping transfers is reduced from 50 percent in 2002 to 49 percent in 2003, 48 percent in 2004, 47 percent in 2005, 46 percent in 2006, and 45 percent in 2007 through 2009.

Increase unified credit exemption amount.—Under prior law, the unified credit applicable to cumulative taxable transfers by gift and at death effectively exempted from tax transfers totaling $675,000 in 2001, $700,000 in 2002 and 2003, $850,000 in 2004, $950,000 in 2005 and $1 million in 2006 and subsequent years. The tax on generation-skipping transfers applied only to cumulative transfers in excess of $1 million, adjusted annually for inflation after 1997 ($1,060,000 in 2001). This Act increases the unified credit effective exemption amount for estate and gift tax purposes to $1 million in 2002. The effective exemption amount for gift tax purposes will remain at $1 million; however, the effective exemption amount for estate and generation-skipping transfer tax purposes will increase to $1.5 million in 2004 and 2005, $2.0 million in 2006 through 2008, and $3.5 million in 2009.

Reduce and modify allowance for State death taxes paid.—A credit against the Federal estate tax for any estate, inheritance, legacy, or succession taxes actually paid to any State or the District of Columbia with respect to any property included in the decedent's gross estate, was provided under prior law. The allowable credit was limited to the lesser of the tax paid or a percentage of the decedent's adjusted taxable estate (ranging from 0.8 percent of adjusted taxable estate between $40,000 and $90,000, up to 16 percent of adjusted taxable estate in excess of $10,040,000). This Act reduces the credit rates by 25 percent in 2002, 50 percent in 2003, and 75 percent in 2004. For 2005 through 2009, the credit is replaced by a deduction for taxes paid.

Modify basis of property received.—Under prior law, the basis of property passing from a decedent's estate generally was the fair market value of the property on the date of the decedent's death. This step up (or step down) in basis eliminated the recognition of income on any appreciation of the property that occurred prior to the decedent's death, and had the effect of eliminating the tax benefit from any unrealized loss. Effective for decedent's dying after December 31, 2009 and before January 1, 2011, the basis of property passing from a decedent's estate will be the lesser of the adjusted basis of the decedent or the fair market value of the property on the date of the decedent's death. Each decedent's estate generally is permitted to increase the basis of assets transferred by up to a total of $1.3 million for assets passing to any heir plus an additional $3 million for property transferred to a surviving spouse. Nonresidents who are not U.S. citizens are allowed to increase the basis of property by up to $60,000. Each estate is also allowed additional basis equal to the decedent's unused capital loss and net operating loss carryforwards and built-in capital losses.

Modify other provisions affecting estate, gift, and generation-skipping transfer taxes.—Other modifications provided in this Act: (1) expand the estate tax exclusion for qualified conservation easements, (2) change the generation-skipping transfer tax rules to ensure that a taxpayer does not inadvertently lose the benefit of the generation-skipping transfer tax exemption, and (3) expand eligibility for the payment of estate and gift taxes in installments.

Pension and Retirement Provisions

Increase contributions to Individual Retirement Accounts (IRAs).—There are two types of IRAs under present law - Roth IRAs and traditional IRAs. Individuals with AGI below certain thresholds may make nondeductible contributions to a Roth IRA (deductible contributions are not allowed). The maximum allowable annual contribution to a Roth IRA is phased out for single taxpayers with AGI between $95,000 and $110,000 (between $150,000 and $160,000 for married taxpayers filing a joint return). Account earnings are not includible in income, and qualified distributions from a Roth IRA are tax-free. Both deductible and nondeductible contributions may be made to a traditional IRA. Contributions to a traditional IRA are deductible if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan. If the individual is an active participant in an employer-sponsored retirement plan, the deduction limit is phased out between $34,000 and $44,000 of AGI for single taxpayers (between $54,000 and $64,000 of AGI for married taxpayers filing a joint return). If the individual is not an active participant in an employer-sponsored retirement plan but the individual's spouse is an active participant, the deduction limit is phased out between $150,000 and $160,000 of AGI. All taxpayers may make nondeductible contributions to a traditional IRA, regardless of income. Account earnings from IRAs are not includible in income when

earned. However, distributions from traditional IRAs are includible in income, except to the extent they are a return of nondeductible contributions.

Under prior law, the maximum annual contribution to an IRA was the lesser of $2,000 or the individual's compensation. In the case of married taxpayers filing a joint return, annual contributions of up to $2,000 were allowed for each spouse, provided the combined compensation of the spouses was at least equal to the contributed amount. This Act increases the maximum annual contribution to an IRA to $3,000 for taxable years 2002 through 2004, $4,000 for taxable years 2005 through 2007, and $5,000 for taxable year 2008. For taxable years 2009 and 2010, the limit is adjusted annually for inflation in $500 increments. Effective for taxable years beginning after December 31, 2001, individuals who attain age 50 before the end of the year may make additional catch-up contributions to an IRA. For these individuals, the otherwise maximum contribution limit (before application of the AGI phase-out limits) is increased by $500 for taxable years 2002 through 2005 and by $1,000 for taxable years 2006 through 2010.

Increase contribution and benefit limits under qualified pension plans.—Limits on contributions and benefits under qualified pension plans are based on the type of plan. Under prior law, annual additions to a defined contribution plan with respect to each plan participant were limited to the lesser of (1) 25 percent of compensation or (2) $35,000 (for 2001), adjusted for inflation in $5,000 increments. Under prior law, the maximum annual benefit payable at an individual's social security retirement age under a defined benefit plan was generally the lesser of (1) 100 percent of average compensation, or (2) $140,000 (for 2001), adjusted for inflation in $5,000 increments. The annual compensation of each participant that could be taken into account for purposes of determining contributions and benefits under a plan generally was limited to $170,000 (for 2001), adjusted for inflation in $10,000 increments. Maximum annual elective deferrals that an individual was allowed to make to a qualified cash or deferred arrangement (401(k) plan), a tax-sheltered annuity (section 403(b) annuity), or a salary reduction simplified employee pension plan (SEP) under prior law were limited to $10,500 (for 2001), adjusted for inflation in increments of $500. The maximum amount of annual elective deferrals that an individual was allowed to make to a savings incentive match plan (SIMPLE plan) under prior law was $6,500 (for 2001), adjusted for inflation in increments of $500. Under prior law the maximum annual deferral under an eligible deferred compensation plan of a State or local government or a tax-exempt organization (a section 457 plan) was the lesser of (1) $8,500 (for 2001), adjusted for inflation in increments of $500, or (2) 33 1/3 percent of compensation. In the three years prior to retirement, the limit on contributions to an eligible section 457 plan is generally increased to twice the otherwise applicable dollar limit.

Effective for taxable years beginning after December 31, 2001, the contribution limit to a defined contribution plan is increased to the lesser of 100 percent of compensation or $40,000 (adjusted annually for inflation in $1,000 increments after 2002). Effective for taxable years ending after December 31, 2001, the benefit limit for defined benefit plans is increased to $160,000 (adjusted annually for inflation for plans ending after December 31, 2002, in increments of $1,000) and calculated as a benefit payable at age 62. The compensation that may be taken into account under a plan is increased to $200,000 in 2002 (indexed annually thereafter in $5,000 increments). The dollar limit on annual elective deferrals under section 401(k) plans, section 403(b) annuities and salary reduction SEPs is increased to $11,000 in 2002, and increased annually thereafter in $1,000 increments, reaching $15,000 in 2006 (adjusted annually for inflation in increments of $500 after 2006). The dollar limit on annual elective deferrals to a SIMPLE plan is increased to $7,000 in 2002, and increased annually thereafter in $1,000 increments, reaching $10,000 in 2005 (adjusted for inflation in increments of $500 after 2006). The dollar limit on contributions to an eligible section 457 plan is increased to the lesser of (1) 100 percent of includable compensation or (2) $11,000 in 2002, $12,000 in 2003, $13,000 in 2004, $14,000 in 2005, and $15,000 in 2006 (adjusted for inflation in increments of $500 after 2006).

Permit catch-up contributions to certain salary reduction arrangements.—Effective for taxable years beginning after December 31, 2001, the otherwise applicable dollar limit on elective deferrals under a section 401(k) plan, section 403(b) annuity, SEP or SIMPLE plan, or deferrals under a section 457 plan is increased for individuals who attain age 50 by the end of the year. The additional amount of elective contributions that is permitted to be made by an eligible individual participating in such a plan is the lesser of: (1) the applicable dollar amount or (2) the participant's compensation for the year after reduction by any other elective deferrals of the participant for the year. The applicable dollar amount under a 401(k) plan, section 403(b) plan, SEP, or section 457 plan is $1,000 for 2002, $2,000 for 2003, $3,000 for 2004, $4,000 for 2005, and $5,000 for 2006 through 2010 (adjusted annually for inflation in $500 increments beginning in 2007). The applicable dollar amount under a SIMPLE plan is $500 for 2002, $1,000 for 2003, $1,500 for 2004, $2,000 for 2005, and $2,500 for 2006 through 2010 (adjusted annually for inflation in $500 increments beginning in 2007).

Provide a nonrefundable tax credit to certain individuals for elective deferrals and IRA contributions.—For taxable years beginning after December 31, 2001 and before January 1, 2007, a nonrefundable tax credit is provided for up to $2,000 in contributions made by eligible taxpayers to a qualified plan or to a traditional or Roth IRA. The credit, which is in addition to any deduction or exclusion that would

otherwise apply with respect to the contribution, is available to single taxpayers with AGI less than or equal to $25,000 ($37,500 for heads of household and $50,000 for married taxpayers filing a joint return). The credit is available to individuals who are 18 years of age or older (other than individuals who are full-time students or claimed as a dependent on another taxpayer's return) and is offset against both the regular and alternative minimum tax. The credit rate is 50 percent for single taxpayers with AGI less than or equal to $15,000 ($30,000 for married taxpayers filing a joint return and $22,500 for heads of household), 20 percent for single taxpayers with AGI between $15,000 and $16,250 (between $30,000 and $32,500 for married taxpayers filing a joint return and between $22,500 and $24,375 for heads of household), and 10 percent for single taxpayers with AGI between $16,250 and $25,000 (between $32,500 and $50,000 for married taxpayers filing a joint return and between $24,375 and $37,500 for heads of household).

Provide tax credit for new retirement plan expenses of small businesses.—Effective for taxable years beginning after December 31, 2001, a nonrefundable tax credit is provided for qualified administrative and retirement-education expenses incurred by a small business (an employer that did not employ, in the preceding year, more than 100 employees with compensation in excess of $5,000) that adopts a new qualified defined benefit or defined contribution plan (including a section 401(k) plan), SIMPLE plan, or SEP. The credit applies to 50 percent of the first $1,000 in qualifying expenses for the plan for each of the first three years of the plan. The 50 percent of qualifying expenses offset by the credit are not deductible; the other 50 percent of qualifying expenses (and other expenses) are deductible as under prior law.

Modify other pension and retirement provisions.—In addition to the provisions described above, this Act expands coverage in pension and retirement plans through provisions that: (1) require accelerated vesting for matching employer contributions, (2) modify the definition of key employee, (3) eliminate IRS user fees for certain determination letter requests regarding employer plans, (4) modify the application of the deduction limitation with regard to elective deferral contributions, (5) repeal the rules coordinating contributions to eligible section 457 plans with contributions under other types of plans, (6) increase the annual limitation on the amount of deductible contributions made by an employer to a profit-sharing or stock bonus plan, (7) modify the definition of compensation for purposes of the deduction rules, (8) provide the option to treat elective deferrals as after-tax contributions, (9) improve notice to employees for pension amendments reducing future accruals, (10) increase portability, (11) strengthen pension security and enforcement, and (12) reduce regulatory burdens.

Other Provisions

Provide minimum tax relief to individuals.—An alternative minimum tax is imposed on individuals to the extent that the tentative minimum tax exceeds the regular tax. An individual's tentative minimum tax generally is equal to the sum of: (1) 26 percent of the first $175,000 ($87,500 in the case of a married individual filing a separate return) of alternative minimum taxable income (taxable income modified to take account of specified preferences and adjustments) in excess of an exemption amount and (2) 28 percent of the remaining alternative minimum taxable income. The AMT exemption amounts under prior law were: (1) $45,000 for married taxpayers filing a joint return and surviving spouses; (2) $33,750 for single taxpayers, and (3) $22,500 for married taxpayers filing a separate return, estates and trusts. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's alternative minimum taxable income exceeds: (1) $150,000 for married taxpayers filing a joint return and surviving spouses, (2) $112,500 for single taxpayers, and (3) $75,000 for married taxpayers filing a separate return, estates and trusts. The exemption amounts, the threshold phase-out amounts, and the rate brackets are not indexed for inflation. Effective for taxable years beginning after December 31, 2001 and before January 1, 2005, the exemption amount is increased to $49,000 for married taxpayers filing a joint return and surviving spouses, $35,750 for single taxpayers, and $24,500 for married taxpayers filing a separate return, estates and trusts.

Modify the timing of estimated tax payments by corporations.—Corporations generally are required to pay their income tax liability in quarterly estimated payments. For corporations that keep their accounts on a calendar year basis, these payments are due on or before April 15, June 15, September 15 and December 15 (if these dates fall on a holiday or weekend, payment is due on the next business day). This Act allowed corporations to delay the estimated payment otherwise due on September 17, 2001 until October 1, 2001; 20 percent of the estimated tax payment otherwise due on September 15, 2004 may be delayed until October 1, 2004.

VICTIMS OF TERRORISM TAX RELIEF ACT OF 2001

This Act provides income and estate tax relief to the survivors of victims of (1) the September 11, 2001 terrorist attacks on the United States, (2) the April 19, 1995 Oklahoma City bombing, and (3) exposure to anthrax on or after September 11, 2001 and before January 1, 2002. General relief is also provided for victims of disasters and terrorist actions. The tax relief provided in this Act does not apply to any individual identified by the Attorney General to have been a participant or conspirator in the terrorist attack or attacks to which a specific provision applies, or a representative

of such individual. The major provisions of this Act are described below.

Provide individual income tax relief to victims of terrorist attacks.—Under current law an individual in active service as a member of the Armed Forces who dies while serving in a combat zone is not subject to income tax for the year of death (as well as for any prior taxable year ending on or after the first day the individual served in the combat zone). In addition, military and civilian employees of the United States are exempt from income taxes if they die as a result of wounds or injury incurred outside the United States in terrorist or military action. This exemption is available for the year of death and for prior taxable years beginning with the taxable year prior to the taxable year in which the wounds or injury were incurred. This Act extends relief similar to the present-law treatment of military or civilian employees of the United States who die as a result of terrorist or military activity outside the United States to individuals who die from wounds or injury incurred as a result of: (1) the terrorist attacks on September 11, 2001 or April 19, 1995, or (2) exposure to anthrax on or after September 11, 2001 and before January 1, 2002. These individuals (whether killed as a result of an attack or in rescue or recovery operations) generally are exempt from income tax for the year of death and for prior taxable years beginning with the taxable year prior to the taxable year in which the wounds or injury occurred. A minimum tax relief benefit of $10,000 will be provided to each eligible individual regardless of the income tax liability incurred during the eligible tax years.

Exclude certain death benefits from gross income.—In general, gross income includes income from whatever source derived, including payments made as a result of the death of an individual. Under this Act, amounts paid by an employer by reason of the death of an employee attributable to wounds or injury incurred as a result of the terrorist attacks on September 11, 2001 or April 19, 1995, or exposure to anthrax on or after September 11, 2001 and before January 1, 2002, are excluded from gross income. Subject to rules prescribed by the Secretary of the Treasury, the exclusion does not apply to amounts that would have been payable if the individual had died for a reason other than the specified attacks.

Provide a reduction in Federal estate taxes.—Under current law a reduction in Federal estate taxes is provided for taxable estates of U.S. citizens or residents who are active members of the U.S. Armed Forces and who are killed in action while serving in a combat zone. This estate tax reduction also applies to active service members who die as a result of wounds, disease, or injury suffered while serving in a combat zone by reason of a hazard to which the service member was subjected as an incident of such service. This Act simplifies the estate tax relief provided for combat-related deaths and generally treats individuals who die from wounds or injury incurred as a result of the terrorist attacks that occurred on September 11, 2001 and April 19, 1995, or as a result of exposure to anthrax on or after September 11, 2001 and before January 1, 2002, in the same manner as if they were active members of the U.S. Armed Forces killed in action while serving in a combat zone or dying as a result of wounds or injury suffered while serving in a combat zone. The executor of an estate eligible for the reduction may elect not to have the reduction apply if more favorable tax treatment would be available under generally applicable rules. The reduction effectively shields the first $8.8 million of a victim's estate from Federal estate taxes and reduces estate tax rates.

Treat payments by charitable organizations as exempt payments.—Under current law, charitable organizations generally are exempt from taxation. Such organizations must be organized and operated exclusively for exempt purposes and no part of the net earnings of such organizations may inure to the benefit of any private shareholder or individual. Such organizations must serve a public rather than a private interest and generally must serve a charitable class of persons that is indefinite or of sufficient size. Under this Act, charitable organizations that make payments on or after September 11, 2001 by reason of the death, injury, wounding, or illness of an individual incurred as a result of the September 11, 2001 attacks, or as a result of exposure to anthrax occurring on or after September 11, 2001 and before January 1, 2002, are not required to make a specific assessment of need for the payments to be related to the purpose or function constituting the basis for the organization's exemption. This rule applies provided that the organization makes the payments in good faith using a reasonable and objective formula that is consistently applied. Such payments must be for public and not private benefit and must serve a charitable class. Similarly, if a tax-exempt private foundation makes payments under the conditions described above, the payment will not be subject to excise taxes on self-dealing, even if made to a person who is otherwise disqualified under current law.

Provide exclusion for certain cancellations of indebtedness.—Gross income generally includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain farm indebtedness, and certain real property business indebtedness. Under this Act, an exclusion from gross income is provided for any amount realized from the discharge (in whole or in part) of indebtedness if the indebtedness is discharged by reason of the death of an individual incurred as a result of the September 11, 2001 terrorist attacks, or as a result of anthrax exposure occurring on or after September 11, 2001 and before January 1, 2002. This exclusion applies to discharges made on or after September 11, 2001 and before January 1, 2002.

Provide general tax relief for victims of terrorist/military actions, Presidentially-declared disasters, and certain other disasters.—This Act also: (1) clarifies that payments of compensation made under the Air Transportation Safety and System Stabilization Act are excludable from gross income, (2) provides a specific exclusion from gross income for "qualified disaster relief payments," (3) expands the authority of the Secretary of the Treasury to prescribe regulations concerning deadlines for performing various acts under the Internal Revenue Code and the waiver of interest on underpayments of tax liability, (4) expands the present-law exclusion from gross income for disability income of U.S. civilian employees attributable to a terrorist attack outside the United States to apply to disability income received by any individual attributable to a terrorist or military action, (5) extends the income tax relief provided under current law to U.S. military and civilian personnel who die as a result of terrorist or military activity outside the United States to such personnel regardless of where the terrorist or military action occurs, (6) modifies the tax treatment of structured settlement arrangements, (7) modifies the personal exemption deduction for certain disability trusts, and (8) expands the availability of returns and return information for purposes of investigating terrorist incidents, threats, or activities, and for analyzing intelligence concerning terrorist incidents, threats, or activities.

RAILROAD RETIREMENT AND SURVIVORS' IMPROVEMENT ACT OF 2001

The Federally administered railroad retirement system is a two-tier system consisting of social security equivalent benefits (frequently referred to as Tier I benefits) and a rail industry pension plan (frequently referred to as Tier II benefits). This Act modernizes the financing of the railroad retirement system and provides enhanced benefits to retirees and survivors. Under prior law, the Tier II payroll tax levied on the annual taxable wage base of rail industry employees was 16.1 percent for employers and 4.9 percent for employees. This Act reduces the rate for employers to 15.6 percent in 2002 and to 14.2 percent in 2003. Starting in 2004, the rates are adjusted annually and linked to the level of Tier II reserves. Under current estimates, those rates are expected to be 13.1 percent for employers and 4.9 percent for employees; the rates necessary to maintain reserves at a level sufficient to fund benefits for four years. If the reserve fund falls below the level sufficient to fund four years of benefits or increases to a level sufficient to fund more than six years of benefits, then payroll tax rates would change according to a schedule set in the Act. The rate on employers can vary between 8.2 percent and 22.1 percent, while the rate on employees can vary between zero and 4.9 percent.

INVESTOR AND CAPITAL MARKETS FEE RELIEF ACT

The Securities and Exchange Commission (SEC) collects fees for registrations, mergers, and transactions of securities. Under prior law, some of these fees were classified as receipts and others were classified as offsetting collections (outlays). The specific fees collected included the following: (1) Transaction fees equal to 1/300th of a percent (1/800th of a percent beginning in 2008) of the aggregate dollars traded through national securities exchanges, national securities associations, brokers, and dealers. (2) Registration fees equal to $200 per $1 million ($67 per $1 million beginning in 2007) of the maximum aggregate price for securities that are proposed to be offered. Additional registration fees (subject to appropriation) equal to $39 per $1 million for 2002 ($28 for 2003, $9 for 2004, $5 for 2005 and zero for 2006 and subsequent years) of the aggregate price for securities proposed to be offered. (3) Merger fees equal to $200 per $1 million of the value of securities proposed to be purchased as part of a merger. (4) Assessments on transactions of single stock futures equal to $.02 per transaction ($.0075 per transaction beginning in 2007).

This Act reclassifies all of these fees as offsetting collections (outlays) and adjusts the fee rates as follows: (1) Transaction fees are reduced to $15 per $1 million of the aggregate dollars traded. For 2003 and each subsequent year, the SEC is required to establish a rate that would generate transaction fee collections equal to a target amount for that year. (2) Registration fees are reduced to $92 per $1 million of the maximum aggregate price for securities that are proposed to be offered. For 2003 and each subsequent year, the SEC is required to establish a fee rate that would generate collections equal to a target amount. (3) Merger fees are reduced to $92 per $1 million of the value of securities proposed to be purchased as part of a merger. For 2003 and each subsequent year, these fees would be equal to the rate for registration fees. (4) Assessments on transactions of single stock futures would be reduced to $0.009 per transaction for 2002 through 2006 and then fall to $0.0042 per transaction for 2007 and subsequent years.

ADMINISTRATION PROPOSALS

The President's plan provides tax incentives for charitable giving, education, the disabled, health care, farmers, and the environment. It also provides tax incentives designed to increase domestic production of oil and gas and promote energy conservation, extends for two years provisions that expired in 2001, permanently extends the research and experimentation (R&E) tax credit, and permanently extends the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 that sunset on December 31, 2010. In addition, the President intends to work with the Congress in a bipartisan manner to enact an economic security plan

that will provide an immediate and effective stimulus to the Nation's economy. In addition, the Treasury Department will be conducting a thorough review of means of simplifying the tax code. The Administration intends to work with Congress, tax practitioners, tax administrators, and taxpayers to produce meaningful simplification. An introduction to these efforts is contained at the end of this Chapter.

BIPARTISAN ECONOMIC SECURITY PLAN

The President believes that it is crucial for Congress to quickly pass an economic security bill that will reinvigorate economic growth and assist workers affected by the economic downturn that has followed the terrorist attacks of September 11, 2001. To prevent further job losses and help displaced workers get back to work quickly, the Administration will continue to work with Congress in a bipartisan manner to enact an economic stimulus package and a worker assistance package to provide additional temporary, quick, and effective help for those who have lost their jobs

TAX INCENTIVES

Provide Incentives for Charitable Giving

Provide charitable contribution deduction for nonitemizers.—Under current law, individual taxpayers who do not itemize their deductions (nonitemizers) are not able to deduct contributions to qualified charitable organizations. The Administration proposes to allow nonitemizers to deduct charitable contributions in addition to claiming the standard deduction, effective for taxable years beginning after December 31, 2001. The deduction would be phased in between 2002 and 2012, as follows: (1) Single taxpayers would be allowed a maximum deduction of $100 in 2002 through 2004, $300 in 2005 through 2011, and $500 in 2012 and subsequent years. (2) Married taxpayers filing a joint return would be allowed a maximum deduction of $200 in 2002 through 2004, $600 in 2005 through 2011, and $1,000 in 2012 and subsequent years. Deductible contributions would be subject to existing rules governing itemized charitable contributions, such as the substantiation requirements and the percentage-of-AGI limitations.

Permit tax-free withdrawals from IRAs for charitable contributions.—Under current law, eligible individuals may make deductible or non-deductible contributions to a traditional IRA. Pre-tax contributions and earnings in a traditional IRA are included in income when withdrawn. Effective for distributions after December 31, 2001, the Administration proposes to allow individuals who have attained age 59½ to exclude from gross income IRA distributions made directly to a charitable organization. The exclusion would apply without regard to the percentage-of-AGI limitations that apply to deductible charitable contributions. The exclusion would apply only to the extent the individual receives no return benefit in exchange for the transfer, and no charitable deduction would be allowed with respect to any amount that is excludable from income under this provision.

Raise the cap on corporate charitable contributions.—Current law limits deductible charitable contributions by corporations to 10 percent of net income (calculated before the deduction of the charitable contributions and certain other deductions). The Administration proposes to increase the limit on deductible charitable contributions by corporations from 10 percent to 15 percent of net income, effective for taxable years beginning after December 31, 2001.

Expand and increase the enhanced charitable deduction for contributions of food inventory.—A taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically cost) in the inventory. However, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of: (1) basis plus one half of the fair market value in excess of basis, or (2) two times basis. To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization, and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis.

Under the Administration's proposal, which is designed to encourage contributions of food inventory to charitable organizations, any taxpayer engaged in a trade or business would be eligible to claim an enhanced deduction for donations of food inventory. The enhanced deduction for donations of food inventory would be increased to the lesser of: (1) fair market value, or (2) two times basis. However, to ensure consistent treatment of all businesses claiming an enhanced deduction for donations of food inventory, the enhanced deduction for qualified food donations by S corporations and non-corporate taxpayers would be limited to 15 percent of net income from the trade or business. A special provision would allow taxpayers with a zero or low basis in the qualified food donation (e.g., taxpayers that use the cash method of accounting for purchases and sales, and taxpayers that are not required to capitalize indirect costs) to assume a basis equal to 25 percent of fair market value. The enhanced deduction would be available only for donations of "apparently wholesome food" (food intended for human consumption that meets all quality and labeling standards imposed by Federal, State, and local laws and regulations, even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions). The fair market value of "apparently wholesome food" that cannot or will not be

sold solely due to internal standards of the taxpayer or lack of market, would be determined by taking into account the price at which the same or substantially the same food items are sold by the taxpayer at the time of the contribution or, if not sold at such time, in the recent past. These proposed changes in the enhanced deduction for donations of food inventory would be effective for taxable years beginning after December 31, 2001.

Reform excise tax based on investment income of private foundations.—Under current law, private foundations that are exempt from Federal income tax are subject to a two-percent excise tax on their net investment income (one-percent if certain requirements are met). The tax on private foundations that are not exempt from Federal income tax, such as certain charitable trusts, is equal to the excess of the sum of the excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. To encourage increased charitable activity and simplify the tax laws, the Administration proposes to replace the two rates of tax on the net investment income of private foundations that are exempt from Federal income tax with a single tax rate of one percent. The tax on private foundations not exempt from Federal income tax would be equal to the excess of the sum of the one-percent excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax what would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. The proposed change would be effective for taxable years beginning after December 31, 2001.

Modify tax on unrelated business taxable income of charitable remainder trusts.—A charitable remainder annuity trust is a trust that is required to pay, at least annually, a fixed dollar amount of at least five percent of the initial value of the trust to a non-charity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A charitable remainder unitrust is a trust that generally is required to pay, at least annually, a fixed percentage of at least five percent of the fair market value of the trust's assets determined at least annually to a non-charity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A trust does not qualify as a charitable remainder annuity if the annuity for a year is greater than 50 percent of the initial fair market value of the trust's assets. A trust does not qualify as a charitable remainder unitrust if the percentage of assets that are required to be distributed at least annually is greater than 50 percent. A trust does not qualify as a charitable remainder annuity trust or a charitable remainder unitrust unless the value of the remainder interest in the trust is at least 10 percent of the value of the assets contributed to the trust. Distributions from a charitable remainder annuity trust or charitable remainder unitrust, which are included in the income of the beneficiary for the year that the amount is required to be distributed, are treated in the following order as: (1) ordinary income to the extent of the trust's current and previously undistributed ordinary income for the trust's year in which the distribution occurred, (2) capital gains to the extent of the trust's current capital gain and previously undistributed capital gain for the trust's year in which the distribution occurred, (3) other income to the extent of the trust's current and previously undistributed other income for the trust's year in which the distribution occurred, and (4) corpus (trust principal).

Charitable remainder annuity trusts and charitable remainder unitrusts are exempt from Federal income tax; however, such trusts lose their income tax exemption for any year in which they have unrelated business taxable income. Any taxes imposed on the trust are required to be allocated to trust corpus. The Administration proposes to levy a 100-percent excise tax on the unrelated business taxable income of charitable remainder trusts, in lieu of removing the Federal income tax exemption for any year in which unrelated business taxable income is incurred. This change, which is a more appropriate remedy than loss of tax exemption, is proposed to become effective for taxable years beginning after December 31, 2001, regardless of when the trust was created.

Modify basis adjustment to stock of S corporations contributing appreciated property.—Under current law, each shareholder in an S corporation separately accounts for his/her pro rata share of the S corporation's charitable contributions in determining his/her income tax liability. A shareholder's basis in the stock of the S corporation must be reduced by the amount of his/her pro-rata share of the S corporation's charitable contribution. In order to preserve the benefit of providing a charitable contribution deduction for contributions of appreciated property and to prevent the recognition of gain on the contributed property on the disposition of the S corporation stock, the Administration proposes to allow a shareholder in an S corporation to increase his/her basis in the stock of an S corporation by an amount equal to the excess of the shareholder's pro rata share of the S corporation's charitable contribution over the stockholder's pro rata share of the adjusted basis of the contributed property. The proposal would be effective for taxable years beginning after December 31, 2001.

Allow expedited consideration of applications for exempt status.—The Administration proposes to allow expedited consideration of applications for exempt status by organizations formed for the primary purpose of providing social services to the poor and the needy. To be eligible, the organization must have applied for a grant under a Federal, State, or local program that provides funding for social service programs on or be-

fore the day that the organization applies to the Secretary of the Treasury for determination of its exempt status. Organizations that demonstrate that under the terms of the grant program exempt status is required before the organization is eligible to apply for a grant would also qualify for expedited consideration. Each organization would be required to include with its application for exempt status a copy of its completed grant application. The proposal would be effective for taxable years beginning after December 31, 2001.

Strengthen and Reform Education

Provide refundable tax credit for certain costs of attending a different school for pupils assigned to failing public schools.—Under the Administration's proposal, a refundable tax credit would be allowed for 50 percent of the first $5,000 of qualifying elementary and secondary education expenses incurred during the taxable year with respect to enrollment of a qualifying student in a qualifying school. Qualifying students would be those who, for a given school year, would normally attend a public school determined by the State as not having made "adequate yearly progress" under the terms of the Elementary and Secondary Education Act as amended by the No Child Left Behind Act of 2001. A qualifying student in one school year generally would qualify for an additional school year even if the school normally attended made adequate yearly progress by the beginning of the second school year. A qualifying school would be any public school making adequate yearly progress or private elementary or secondary school. Qualifying expenses generally would be tuition, required fees, and transportation costs incurred by the taxpayer in connection with the attendance at a qualifying school. The proposal would be effective with respect to expenses incurred beginning with the 2002–2003 school year through the 2006–2007 school year.

Allow teachers to deduct out-of-pocket classroom expenses.—Under current law, teachers who incur unreimbursed, job-related expenses may deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceed 2 percent of AGI, but only if the teacher itemizes deductions (i.e., does not use the standard deduction). Effective for expenses incurred in taxable years beginning after December 31, 2003, the Administration proposes to allow certain teachers and other elementary and secondary school professionals to treat up to $400 in qualified out-of-pocket classroom expenses as a non-itemized deduction (above-the-line deduction). Unreimbursed expenditures for certain books, supplies and equipment related to classroom instruction and for certain professional training programs would qualify for the deduction.

Invest in Health Care

Provide refundable tax credit for the purchase of health insurance.—Current law provides a tax preference for employer-provided group health insurance plans, but not for individually purchased health insurance coverage except to the extent that deductible medical expenses exceed 7.5 percent of AGI or the individual has self-employment income. The Administration proposes to make health insurance more affordable for individuals not covered by an employer plan or a public program. Effective for taxable years beginning after December 31, 2002, a new refundable tax credit would be provided for the cost of health insurance purchased by individuals under age 65. The credit would provide a subsidy for a percentage of the health insurance premium, up to a maximum includable premium. The maximum subsidy percentage would be 90 percent for low-income taxpayers and would phase down with income. The maximum credit would be $1,000 for an adult and $500 for a child. The credit would be phased out at $30,000 for single taxpayers and $60,000 for families purchasing a family policy.

Individuals could claim the tax credit for health insurance premiums paid as part of the normal tax-filing process. Alternatively, beginning July 1, 2003, the tax credit would be available in advance at the time the individual purchases health insurance. The advance credit would reduce the premium paid by the individual to the health insurer, and the health insurer would be reimbursed directly by the Department of Treasury for the amount of the advance credit. Eligibility for an advance credit would be based on an individual's prior year tax return. To qualify for the credit, a health insurance policy would have to include coverage for catastrophic medical expenses. Qualifying insurance could be purchased in the individual market. Qualifying health insurance could also be purchased through private purchasing groups, State-sponsored insurance purchasing pools, and high-risk pools. Such groups may help reduce health insurance costs and increase coverage options for individuals, including older and higher-risk individuals. Individuals would not be allowed to claim the credit and make a contribution to an Archer Medical Savings Account (MSA) for the same taxable year.

Provide an above-the-line deduction for long-term care insurance premiums.—Current law provides a tax preference for employer-paid long-term care insurance. However, the vast majority of the long-term care insurance market consists of individually purchased policies, for which no tax preference is provided except to the extent that deductible medical expenses exceed 7.5 percent of AGI or the individual has self-employment income. Premiums on qualified long-term care insurance are deductible as a medical expense, subject to annual dollar limitations that increase with age. The Administration proposes to make individually-

purchased long-term care insurance (the vast majority of the long-term care insurance market) more affordable by creating an above-the-line deduction for qualified long-term care insurance premiums. To qualify for the deduction, the long-term care insurance would be required to meet certain standards providing consumer protections. The deduction would be available to taxpayers who individually purchase qualified long-term care insurance and to those who pay at least 50 percent of the cost of employer-provided coverage. The deduction would be effective for taxable years beginning after December 31, 2003 but would be phased in over five years. The deduction would be subject to current law annual dollar limitations on qualified long-term care insurance premiums.

Allow up to $500 in unused benefits in a health flexible spending arrangement to be carried forward to the next year.—Under current law, unused benefits in a health flexible spending arrangement under a cafeteria plan for a particular year revert to the employer at the end of the year. Effective for plan years beginning after December 31, 2003, the Administration proposes to allow up to $500 in unused benefits in a health flexible spending arrangement at the end of a particular year to be carried forward to the next plan year.

Provide additional choice with regard to unused benefits in a health flexible spending arrangement.—In addition to the proposed carryforward of unused benefits (see preceding discussion), the Administration proposes to allow up to $500 in unused benefits in a health flexible spending arrangement at the end of a particular year to be distributed to the participant as taxable income, contributed to an Archer MSA, or contributed to the employer's 401(k), 403(b), or governmental 457(b) retirement plan. Amounts distributed to the participant would be subject to income tax withholding and employment taxes. Amounts contributed to an Archer MSA or retirement plan would be subject to the normal rules applicable to elective contributions to the receiving plan or account. The proposal would be effective for plan years beginning after December 31, 2003.

Permanently extend and reform Archer Medical Savings Accounts.—Current law allows only self-employed individuals and employees of small firms to establish Archer MSAs, and caps the number of accounts at 750,000. In addition to other requirements, (1) individuals who establish MSAs must be covered by a high-deductible health plan (and no other plan) with a deductible of at least $1,650 but not greater than $2,500 for policies covering a single person and a deductible of at least $3,300 but not greater than $4,950 in all other cases, (2) tax-preferred contributions are limited to 65 percent of the deductible for single policies and 75 percent of the deductible for other policies, and (3) either an individual or an employer, but not both, may make a tax-preferred contribution to an MSA for a particular year. The Administration proposes to permanently extend the MSA program, which is scheduled to expire on December 31, 2002, and to modify the program to make it more consistent with currently available health plans. Effective after December 31, 2002, the Administration proposes to remove the 750,000 cap on the number of accounts. In addition, the program would be reformed by (1) expanding eligibility to include all individuals and employees of firms of all sizes covered by a high-deductible health plan, (2) modifying the definition of high deductible to permit a deductible as low as $1,000 for policies covering a single person and $2,000 in all other cases, (3) increasing allowable tax-preferred contributions to 100 percent of the deductible, (4) allowing tax-preferred contributions by both employers and employees for a particular year, up to the applicable maximum, (5) allowing contributions to MSAs under cafeteria plans, and (6) permitting qualified plans to provide, without counting against the deductible, up to $100 of coverage for allowable preventive services per covered individual each year. Individuals would not be allowed to make a contribution to an MSA and claim the proposed refundable tax credit for health insurance premiums for the same taxable year.

Provide an additional personal exemption to home caretakers of family members.—Current law provides a tax deduction for certain long-term care expenses. In addition, taxpayers are allowed to claim exemptions for themselves (and their spouses, if married) and dependents who they support. However, neither provision may meet the needs of taxpayers who provide long-term care in their own home for close family members. Effective for taxable years beginning after December 31, 2003, the Administration proposes to provide an additional personal exemption to taxpayers who care for certain qualified family members who reside with the taxpayer in the household maintained by the taxpayer. A taxpayer is considered to maintain a household only if he/she furnishes over half of the annual cost of maintaining the household. Qualified family members would include any individual with long-term care needs who (1) is the spouse of the taxpayer or an ancestor of the taxpayer or the spouse of such an ancestor and (2) is a member of the taxpayer's household for the entire year. An individual would be considered to have long-term care needs if he or she were certified by a licensed physician (prior to the filing of a return claiming the exemption) as being unable for at least 180 consecutive days to perform at least two activities of daily living without substantial assistance from another individual due to a loss of functional capacity. Alternatively, an individual would be considered to have long-term care needs if he or she were certified by a licensed physician as, for at least 180 consecutive days, (1) requiring substantial supervision to be protected from threats to his or her own health and safety due to severe cognitive impairment and (2) being unable to perform at least one activity of daily living or being unable to engage in age appropriate activities.

Assist Americans With Disabilities

Exclude from income the value of employer-provided computers, software and peripherals.—The Administration proposes to allow individuals with disabilities to exclude from income the value of employer-provided computers, software or other office equipment that are necessary for the individual to perform work for the employer at home. To qualify for the exclusion, the employee would be required to make substantial use of the equipment (relative to overall use) performing work for his or her employer. However, unlike current law, which limits the exclusion to the extent that the equipment is used to perform work for the employer, the proposed exclusion would apply to all use of such equipment, including use by the employee for personal or non-employer-related trade or business purposes. Employees would be required to provide their employer with a certification from a licensed physician that they meet eligibility criteria. The proposal would be effective for taxable years beginning after December 31, 2003.

Help Farmers and Fishermen Manage Economic Downturns

Establish Farm, Fish and Ranch Risk Management (FFARRM) savings accounts.—Current law does not provide for the elective deferral of farm or fishing income. However, farmers can elect to average their farming income over a three-year period, and farmers may carry back net operating losses over the five previous years. In addition, taxes can be deferred on certain forms of income, including disaster payments, crop insurance and proceeds from emergency livestock sales. The Administration proposes to allow up to 20 percent of taxable income attributable to an eligible farming or fishing business to be contributed to a FFARRM savings account each year and deducted from income. Earnings on contributions would be taxable as earned and distributions from the account (except those attributable to earnings on contributions) would be included in gross income. Any amount not distributed within five years of deposit would be deemed to have been distributed and included in gross income; in addition, such distributions would be subject to a 10-percent surtax. The proposal would be effective for taxable years beginning after December 31, 2003.

Increase Housing Opportunities

Provide tax credit for developers of affordable single-family housing.—The Administration proposes to provide annual tax credit authority to States (including U.S. possessions) designed to promote the development of affordable single-family housing in low-income urban and rural neighborhoods. Beginning in calendar year 2003, first-year credit authority of $1.75 per capita (indexed annually for inflation thereafter) would be made available to each State. State housing agencies would award first-year credits to single-family housing units comprising a project located in a census tract with median income equal to 80 percent or less of area median income. Units in condominiums and cooperatives could qualify as single-family housing. Credits would be awarded as a fixed amount for individual units comprising a project. The present value of the credits, determined on the date of a qualifying sale, could not exceed 50 percent of the cost of constructing a new home or rehabilitating an existing property. The taxpayer (developer or investor partnership) owning the housing unit immediately prior to the sale to a qualified buyer would be eligible to claim credits over a 5-year period beginning on the date of sale. Eligible homebuyers would be required to have incomes equal to 80 percent or less of area median income. Technical features of the provision would follow similar features of current law with respect to the low-income housing tax credit and mortgage revenue bonds.

Encourage Saving

Establish Individual Development Accounts (IDAs).—The Administration proposes to allow eligible individuals to make contributions to a new savings vehicle, the Individual Development Account, which would be set up and administered by qualified financial institutions, nonprofit organizations, or Indian tribes (qualified entities). Citizens or legal residents of the United States between the ages of 18 and 60 who cannot be claimed as a dependent on another taxpayer's return, are not students, and who meet certain income limitations would be eligible to establish and contribute to an IDA. A single taxpayer would be eligible to establish and contribute to an IDA if his/her modified AGI in the preceding taxable year did not exceed $20,000 ($30,000 for heads of household, and $40,000 for married taxpayers filing a joint return). These thresholds would be indexed annually for inflation beginning in 2004. Qualified entities that set up and administer IDAs would be required to match, dollar-for-dollar, the first $500 contributed by an eligible individual to an IDA in a taxable year. Qualified entities would be allowed a 100 percent tax credit for up to $500 in annual matching contributions to each IDA, and a $50 tax credit for each IDA maintained at the end of a taxable year with a balance of not less that $100 (excluding the taxable year in which the account was established). Matching contributions and the earnings on those contributions would be deposited in a separate "parallel account." Contributions to an IDA by an eligible individual would not be deductible, and earnings on those contributions would be included in income. Matching contributions by qualified entities and the earnings on those contributions would be tax-free. Withdrawals from the parallel account may be made only for qualified purposes (higher education, the first-time purchase of a home, business start-up, and qualified rollovers). Withdrawals from the IDA for other than qualified purposes may result in the forfeiture of some or all matching contributions and the earnings on those contributions. The proposal would be effective for contributions

made after December 31, 2002 and before January 1, 2010, to the first 900,000 IDA accounts opened before January 1, 2008.

Protect the Environment

Permanently extend expensing of brownfields remediation costs.—Taxpayers may elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred. Under current law, the ability to deduct such expenditures expires with respect to expenditures paid or incurred after December 31, 2003. The Administration proposes to permanently extend this provision, facilitating its use by businesses to undertake projects that may extend beyond the current expiration date and be uncertain in overall duration.

Exclude 50 percent of gains from the sale of property for conservation purposes.—The Administration proposes to create a new incentive for private, voluntary land protection. This incentive is a cost-effective, non-regulatory approach to conservation. Under the proposal, when land (or an interest in land or water) is sold for conservation purposes, only 50 percent of any gain would be included in the seller's income. To be eligible for the exclusion, the sale may be either to a government agency or to a qualified conservation organization, and the buyer must supply a letter of intent that the acquisition will serve conservation purposes. In addition, the taxpayer or a member of the taxpayer's family must have owned the property for the three years immediately preceding the sale. The provision would be effective for sales taking place after December 31, 2003.

Increase Energy Production and Promote Energy Conservation

Extend and modify the tax credit for producing electricity from certain sources.—Taxpayers are provided a 1.5-cent-per-kilowatt-hour tax credit, adjusted for inflation after 1992, for electricity produced from wind, closed-loop biomass (organic material from a plant grown exclusively for use at a qualified facility to produce electricity), and poultry waste. To qualify for the credit, the electricity must be sold to an unrelated third party and must be produced during the first 10 years of production at a facility placed in service before January 1, 2002. The Administration proposes to extend the credit for electricity produced from wind and biomass to facilities placed in service before January 1, 2005. In addition, eligible biomass sources would be expanded to include certain biomass from forest-related resources, agricultural sources, and other specified sources. Special rules would apply to biomass facilities placed in service before January 1, 2002. Electricity produced at such facilities from newly eligible sources would be eligible for the credit only from January 1, 2002 through December 31, 2004, and at a rate equal to 60 percent of the generally applicable rate. Electricity produced from newly eligible biomass cofired in coal plants would also be eligible for the credit only from January 1, 2002 through December 31, 2004, and at a rate equal to 30 percent of the generally applicable rate. The Administration also proposes to modify the rules relating to governmental financing of qualified facilities. There would be no percentage reduction in the credit for governmental financing attributable to tax-exempt bonds. Instead, such financing would reduce the credit only to the extent necessary to offset the value of the tax exemption. The rules relating to leased facilities would also be modified to permit the lessee, rather than the owner, to claim the credit.

Provide tax credit for residential solar energy systems.—Current law provides a 10-percent investment tax credit to businesses for qualifying equipment that uses solar energy to generate electricity; to heat, cool or provide hot water for use in a structure; or to provide solar process heat. A credit currently is not provided for nonbusiness purchases of solar energy equipment. The Administration proposes a new tax credit for individuals who purchase solar energy equipment to generate electricity (photovoltaic equipment) or heat water (solar water heating equipment) for use in a dwelling unit that the individual uses as a residence, provided the equipment is used exclusively for purposes other than heating swimming pools. The proposed nonrefundable credit would be equal to 15 percent of the cost of the equipment and its installation; each individual taxpayer would be allowed a maximum credit of $2,000 for photovoltaic equipment and $2,000 for solar water heating equipment. The credit would apply to photovoltaic equipment placed in service after December 31, 2001 and before January 1, 2008 and to solar water heating equipment placed in service after December 31, 2001 and before January 1, 2006.

Modify treatment of nuclear decommissioning funds.—Under current law, deductible contributions to nuclear decommissioning funds are limited to the amount included in the taxpayer's cost of service for ratemaking purposes. For deregulated utilities, this limitation may result in the denial of any deduction for contributions to a nuclear decommissioning fund. The Administration proposes to repeal this limitation.

Also under current law, deductible contributions are not permitted to exceed the amount the IRS determines to be necessary to provide for level funding of an amount equal to the taxpayer's post-1983 decommissioning costs. The Administration proposes to permit funding of all decommissioning costs through deductible contributions. Any portion of these additional contributions relating to pre-1983 costs that exceeds the amount previously deducted (other than under the nuclear decommissioning fund rules) or excluded from the taxpayer's gross income on account of the taxpayer's liability for decommissioning costs, would be allowed as a deduction ratably over the remaining useful life of the nuclear power plant.

The Administration's proposal would also permit taxpayers to make deductible contributions to a qualified fund after the end of the nuclear power plant's estimated useful life and would provide that nuclear decommissioning costs are deductible when paid. These changes in the treatment of nuclear decommissioning funds are proposed to be effective for taxable years beginning after December 31, 2001.

Provide tax credit for purchase of certain hybrid and fuel cell vehicles.—Under current law, a 10-percent tax credit up to $4,000 is provided for the cost of a qualified electric vehicle. The full amount of the credit is available for purchases prior to 2002. The credit begins to phase down in 2002 and is not available after 2004. A qualified electric vehicle is a motor vehicle that is powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electric current, the original use of which commences with the taxpayer, and that is acquired for use by the taxpayer and not for resale. Electric vehicles and hybrid vehicles (those that have more than one source of power on board the vehicle) have the potential to reduce petroleum consumption, air pollution and greenhouse gas emissions. To encourage the purchase of such vehicles, the Administration is proposing the following tax credits: (1) A credit of up to $4,000 would be provided for the purchase of qualified hybrid vehicles after December 31, 2001 and before January 1, 2008. The amount of the credit would depend on the percentage of maximum available power provided by the rechargeable energy storage system and the amount by which the vehicle's fuel economy exceeds the 2000 model year city fuel economy. (2) A credit of up to $8,000 would be provided for the purchase of new qualified fuel cell vehicles after December 31, 2001 and before January 1, 2008. A minimum credit of $4,000 would be provided, which would increase as the vehicle's fuel efficiency exceeded the 2000 model year city fuel economy, reaching a maximum credit of $8,000 if the vehicle achieved at least 300 percent of the 2000 model year city fuel economy.

Provide tax credit for energy produced from landfill gas.—Taxpayers that produce gas from biomass (including landfill methane) are eligible for a tax credit equal to $3 per barrel-of-oil equivalent (the amount of gas that has a British thermal unit content of 5.8 million), adjusted by an inflation adjustment factor for the calendar year in which the sale occurs. To qualify for the credit, the gas must be produced domestically from a facility placed in service by the taxpayer before July 1, 1998, pursuant to a written binding contract in effect before January 1, 1997. In addition, the gas must be sold to an unrelated person before January 1, 2008. The Administration proposes to extend the credit to apply to landfill methane produced from a facility (or portion of a facility) placed in service after December 31, 2001 and before January 1, 2011, and sold (or used to produce electricity that is sold) before January 1, 2011. The credit for fuel produced at landfills subject to EPA's 1996 New Source Performance Standards/Emissions Guidelines would be limited to two-thirds of the otherwise applicable amount beginning on January 1, 2008, if any portion of the facility for producing fuel at the landfill was placed in service before July 1, 1998, and beginning on January 1, 2002, in all other cases.

Provide tax credit for combined heat and power property.—Combined heat and power (CHP) systems are used to produce electricity (and/or mechanical power) and usable thermal energy from a single primary energy source. Depreciation allowances for CHP property vary by asset use and capacity. No income tax credit is provided under current law for investment in CHP property. CHP systems utilize thermal energy that is otherwise wasted in producing electricity by more conventional methods and achieve a greater level of overall energy efficiency, thereby lessening the consumption of primary fossil fuels, lowering total energy costs, and reducing carbon emissions. To encourage increased energy efficiency by accelerating planned investments and inducing additional investments in such systems, the Administration is proposing a 10-percent investment credit for qualified CHP systems with an electrical capacity in excess of 50 kilowatts or with a capacity to produce mechanical power in excess of 67 horsepower (or an equivalent combination of electrical and mechanical energy capacities). A qualified CHP system would be required to produce at least 20 percent of its total useful energy in the form of thermal energy and at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof) and would also be required to satisfy an energy-efficiency standard. For CHP systems with an electrical capacity in excess of 50 megawatts (or a mechanical energy capacity in excess of 67,000 horsepower), the total energy efficiency would have to exceed 70 percent. For smaller systems, the total energy efficiency would have to exceed 60 percent. Investments in qualified CHP assets that are otherwise assigned cost recovery periods of less than 15 years would be eligible for the credit, provided that the taxpayer elected to treat such property as having a 22-year class life. The credit, which would be treated as an energy credit under the investment credit component of the general business credit, and could not be used in conjunction with any other credit for the same equipment, would apply to investments in CHP property placed in service after December 31, 2001 and before January 1, 2007.

Provide excise tax exemption (credit) for ethanol.—Under current law an income tax credit and an excise tax exemption are provided for ethanol and renewable source methanol used as a fuel. In general, the income tax credit for ethanol is 53 cents per gallon, but small ethanol producers (those producing less than 30 million gallons of ethanol per year) qualify for a credit of 63 cents per gallon on the first 15 million gallons of ethanol produced in a year. A credit of 60

cents per gallon is allowed for renewable source methanol. As an alternative to the income tax credit, gasohol blenders may claim a gasoline tax exemption of 53 cents for each gallon of ethanol and 60 cents for each gallon of renewable source methanol that is blended into qualifying gasohol. The rates for the ethanol credit and exemption are each reduced by 1 cent per gallon in 2003 and by an additional 1 cent per gallon in 2005. The income tax credit expires on December 31, 2007 and the excise tax exemption expires on September 30, 2007. Neither the credit nor the exemption apply during any period in which motor fuel taxes dedicated to the Highway Trust Fund are limited to 4.3 cents per gallon. The Administration proposes to extend both the income tax credit and the excise tax exemption through December 31, 2010. The current law rule providing that neither the credit nor the exemption apply during any period in which motor fuel taxes dedicated to the Highway Trust Fund are limited to 4.3 cents per gallon would be retained.

Promote Trade

Extend and expand Andean trade preferences.—The Administration proposes to renew and enhance the Andean Trade Preference Act (ATPA), which expired on December 4, 2001, through December 31, 2005. The ATPA, which was enacted in 1991, was designed to provide economic alternatives for Bolivia, Columbia, Ecuador, and Peru in their fight against narcotics production and trafficking.

Initiate a new trade preference program for Southeast Europe.—The Administration is proposing the Southeast Europe Trade Preference Act (SETPA), which would initiate a new five-year trade preference program for Southeast Europe, beginning October 1, 2002. The program is designed to rebuild the economies of Southeast Europe that were harmed by recent ethnic conflict in the area and will fulfill a commitment made by the United States, along with our European partners, when we signed the Stability Pact for Southeast Europe.

Implement free trade agreements with Chile and Singapore.—Free trade agreements are expected to be completed with Chile and Singapore in 2002, with ten-year implementation to begin in fiscal year 2003. These agreements will benefit U.S. producers and consumers, as well as strengthen the economies of Chile and Singapore. In addition, these agreements will establish precedents in our market opening efforts in two important and dynamic regions - Latin America and Southeast Asia.

Improve Tax Administration

Modify the IRS Restructuring and Reform Act of 1998 (RRA98).—The proposed modification to RRA98 is comprised of six parts. The first part modifies employee infractions subject to mandatory termination and permits a broader range of available penalties. It strengthens taxpayer privacy while reducing employee anxiety resulting from unduly harsh discipline or unfounded allegations. The second part adopts measures to curb frivolous submissions and filings that are intended to impede or delay tax administration. The third part allows IRS to terminate installment agreements when taxpayers fail to make timely tax deposits and file tax returns on current liabilities. The fourth part streamlines jurisdiction over collection due process cases in the Tax Court, thereby reducing the cycle time for certain collection due process cases. The fifth part permits taxpayers to enter into installment agreements that do not guarantee full payment of liability over the life of the agreement. It allows the IRS to enter into agreements with taxpayers that desire to resolve their tax obligations but cannot make payments large enough to satisfy their entire liability and for whom an offer in compromise is not a viable alternative. The sixth part eliminates the requirement that the IRS Chief Counsel provide an opinion for any accepted offer-in-compromise of unpaid tax (including interest and penalties) equal to or exceeding $50,000. This proposal requires that the Treasury Secretary establish standards to determine when an opinion is appropriate.

Initiate IRS cost savings measures.—The Administration has six proposals to improve IRS efficiency and performance from current resources. The first proposal permits the IRS to use certificates of mailing as an alternative to certified mail for notices and letters that currently require such mailing. The second proposal eliminates the requirement that notices of an intent to levy and right to a pre-levy hearing be sent with return receipt requested, but retains the requirement that such notices be sent by certified or registered mail or by first-class mail evidenced by a certificate of mailing. These two proposals reduce postal costs while retaining proof of first-class mailing. The third proposal eliminates the requirement that dual notices be sent to joint filers who reside at the same address. The fourth proposal treats as nullities certain tax returns that the Criminal Investigation Division determines contain insufficient information to compute tax, contain false information, or lack a valid signature. Under this proposal, such returns that have been filed to impede or delay tax administration are excluded from deficiency procedures. The fifth proposal modifies the way that Financial Management Services (FMS) recovers its transaction fees for processing IRS levies by permitting FMS to retain a portion of the amount collected before transmitting the balance to the IRS. The offset amount would be included as part of the 15-percent limit on levies against income and would also be credited against the taxpayer's liability, thereby reducing Government transactions costs. Finally, the sixth proposal extends the April filing date for electronically filed tax returns by at least ten days to help encourage the growth of electronic filing.

Reform Unemployment Insurance

Reform unemployment insurance administrative financing.—Current law funds the administrative costs of the unemployment insurance system and related programs out of the Federal Unemployment Tax (FUTA) paid by employers. FUTA is set at 0.8 percent of the first $7,000 in covered wages, which includes a 0.2 percent surtax scheduled to expire in 2007. State unemployment taxes are deposited into the Unemployment Trust Fund and used by States to pay unemployment benefits. Under current law, FUTA balances in excess of statutory ceilings are distributed to the States to pay unemployment benefits or the administrative costs of the system (these are known as Reed Act transfers). The Administration supports an immediate distribution of $9 billion in Reed Act funds as part of a bipartisan economic security plan. This would take the place of the smaller Reed Act transfer projected for October 1, 2002. In addition, the Administration has a comprehensive proposal to reform the administrative financing of this system. It proposes to eliminate the FUTA surtax in 2003, and make additional rate cuts to achieve a net FUTA tax rate of 0.2 percent in 2007. The proposal will transfer administrative funding control to the States in 2005 and allow them to use their benefit taxes to pay these costs. Federal administrative grants to the States will be significantly reduced. During the transition to State financing, special Reed Act distributions will be made to the States, and additional Federal funds for administrative expenses will be provided.

EXPIRING PROVISIONS

Extend Provisions that Expired in 2001 for Two Years

Extend the work opportunity tax credit.—The work opportunity tax credit provides an incentive for employers to expand the number of entry level positions for individuals from certain targeted groups. The credit generally applies to the first $6,000 of wages paid to several categories of economically disadvantaged or handicapped workers. The credit rate is 25 percent of qualified wages for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. The Administration proposes to extend the credit for two years, making the credit available for workers hired after December 31, 2001 and before January 1, 2004.

Extend the welfare-to-work tax credit.—The welfare-to-work tax credit entitles employers to claim a tax credit for hiring certain recipients of long-term family assistance. The purpose of the credit is to expand job opportunities for persons making the transition from welfare to work. 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. Eligible wages include cash wages plus the cash value of certain employer-paid health, dependent care, and educational fringe benefits. The minimum employment period that employees must work before employers can claim the credit is 400 hours. The Administration proposes to extend the credit for two years, to apply to individuals who begin work after December 31, 2001 and before January 1, 2004.

Extend minimum tax relief for individuals.—A temporary provision of prior law permits nonrefundable personal tax credits to be offset against both the regular tax and the alternative minimum tax. The temporary provision expires after taxable year 2001. The Administration is concerned that the AMT may limit the benefit of personal tax credits and impose financial and compliance burdens on taxpayers who have few, if any, tax preference items and who were not the originally intended targets of the AMT. The Administration proposes to extend minimum tax relief for nonrefundable personal tax credits two years, to apply to taxable years 2002 and 2003. The proposed extension does not apply to the child credit, the earned income tax credit or the adoption credit, which were provided AMT relief through December 31, 2010 under the Economic Growth and Tax Relief Reconciliation Act of 2001, as explained above. The refundable portion of the child credit and the earned income tax credit are also allowed against the AMT through December 31, 2010.

Extend exceptions provided under subpart F for certain active financing income.—Under the Subpart F rules, certain U.S. shareholders of a controlled foreign corporation (CFC) are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, "foreign personal holding company income" and insurance income. Foreign personal holding company income generally includes many types of income derived by a financial service company, such as dividends; interest; royalties; rents; annuities; net gains from the sale of certain property, including securities, commodities and foreign currency; and income from notional principal contracts and securities lending activities. For taxable years beginning before 2002, certain income derived in the active conduct of a banking, financing, insurance, or similar business is excepted from Subpart F. The Administration proposes to extend the exception for two years, to apply to taxable years beginning in 2002 and 2003.

Extend suspension of net income limitation on percentage depletion from marginal oil and gas wells.—Taxpayers are allowed to recover their investment in oil and gas wells through depletion deductions. For certain properties, deductions may be determined using the percentage depletion method; however, in any year, the amount deducted generally may not exceed 100 percent of the net income from the property. For taxable years beginning after December 31, 1997 and

before January 1, 2002, domestic oil and gas production from "marginal" properties is exempt from the 100-percent of net income limitation. The Administration proposes to extend the exemption to apply to taxable years beginning after December 31, 2001 and before January 1, 2004.

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. The Administration proposes to extend this program, which expired after September 30, 2001, through September 30, 2003.

Extend authority to issue Qualified Zone Academy Bonds.—Prior law allows State and local governments 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 must be used for teacher training, purchases of equipment, curriculum development, or rehabilitation and repairs at certain public school facilities. A nationwide total of $400 million of qualified zone academy bonds was authorized to be issued in each of calendar years 1998 through 2001. In addition, unused authority arising in 1998 and 1999 may be carried forward for up to three years and unused authority arising in 2000 and 2001 may be carried forward for up to two years. The Administration proposes to authorize the issuance of an additional $400 million of qualified zone academy bonds in each of calendar years 2002 and 2003.

Permanently Extend Expiring Provisions

Permanently extend provisions expiring in 2010.—As explained in the discussion of the Economic Growth and Tax Relief Reconciliation Act of 2001, most of the provisions of the Act sunset on December 31, 2010. The Administration proposes to permanently extend these provisions.

Permanently extend the research and experimentation (R&E) tax credit.—The Administration proposes to permanently extend the 20-percent tax credit for qualified research and experimentation expenditures above a base amount and the alternative incremental credit, which are scheduled to expire on June 30, 2004.

TAX SIMPLIFICATION

In addition to the proposals summarized above, the Administration is developing both short-term and longer-term tax simplification proposals. The project to develop short-term proposals, which is described below, focuses on immediately achievable reforms of the current tax system, while the longer-term project focuses on more fundamental reforms of the tax system.

As many recent studies and proposals have highlighted, the U.S. income tax system is extraordinarily complex. Many taxpayers and businesses face significant challenges in understanding the tax laws, keeping required records, and filling out numerous complicated and detailed tax forms, which often require working through lengthy abstruse instructions and cumbersome calculations. Fortunately, our tax system is not complicated for everyone. Millions of taxpayers who have relatively uncomplicated financial and family circumstances and are able to file form 1040EZ, for example, avoid most of the complexity of the tax system. But for many others, coping with the tax system is daunting. The need to deal with complexities in the tax system is not limited to multinational corporations or high-income investors with complex financial assets; many taxpayers facing overwhelmingly complicated tax situations are lower- and middle-income families, single mothers, elderly people, small business owners and entrepreneurs.

Tax complexity is costly to taxpayers and the economy. Credible estimates of the cost to taxpayers of complying with the income tax range from $70 billion to $125 billion per year. Additional costs may be imposed on the economy if taxpayers avoid certain investments, savings vehicles, business transactions, etc., because of the tax complexities they would involve or because of uncertainty about how the tax system would apply to them. Extensive tax planning engaged in by some taxpayers and businesses is a wasteful use of resources. Complexity makes it more costly for the IRS to administer the tax system. It makes it more difficult for the IRS to train its staff, to give correct answers to increased numbers of taxpayers seeking help in understanding the tax laws, and to check and audit tax returns. These costs are a significant burden on the economy. Tax simplification can cut these costs and contribute to greater economic efficiency.

Tax complexity also may have other undesirable effects. Complexity may undermine confidence in the tax system. If taxpayers conclude that the tax system is so complex that no one can really figure it out, it will destroy confidence that the tax system is accomplishing its objectives, that other taxpayers are paying their fair share of tax, and that the IRS can administer the system fairly. It may thereby undermine compliance with the tax system and confidence in the government in general. Reducing tax complexity is, therefore, an important policy objective.

But tax simplification is not simple. Complexity in the tax system has not arisen merely because the writers of the tax laws have been inattentive or because of a desire to provide jobs for tax accountants and lawyers. Many legitimate factors contribute to tax complexity. The modern, highly-productive U.S. economy is very complex, and many taxpayers and companies have complex financial and economic situations. Appli-

cation of the tax system to these complex financial and economic arrangements is also unavoidably complex. Many taxpayers have complex family arrangements or have special circumstances that affect their needs or their ability to pay taxes. Many special provisions have been added to the tax system to recognize the special circumstances of certain groups of taxpayers and adjust their tax burdens accordingly. The tax system has also been used extensively to provide incentives or benefits for taxpayers engaging in certain kinds of activities ranging from saving for retirement to saving energy that are deemed to be socially beneficial. While all of these tax provisions are well intended and presumptively have beneficial effects, they also contribute to complexity in the tax system. At some point, the complexity itself detracts from the ability of the tax system to function effectively and to accomplish these other objectives.

Because of the multiple objectives involved in shaping any particular tax provision, the effort to simplify the tax system frequently involves tradeoffs. There may be a few places in the tax code where it is possible to draft less complex provisions that will accomplish all of the policy objectives equally well or even better. Such complexities may have arisen because of insufficient time to draft less complex provisions as a tax bill was being passed or because a series of provisions has been enacted, revised, and added to over time without an effort to consider the whole set of provisions and how they could be combined and simplified to better achieve their objectives. In many cases, however, simplification will result in some compromise in achieving other policy objectives, less precise targeting of a tax benefit, treatment of a type of income or expense in a way that is less consistent with its true economic nature, etc. In many areas, therefore, developing simplification proposals involves identifying areas of the tax system and specific simplification schemes for which the simplification that can be achieved is regarded as more valuable than the resulting decrease in achievement of other policy goals.

The purpose of tax simplification, therefore, may be stated succinctly as implementing changes that will reduce the compliance burden on taxpayers and/or administrative costs of the IRS while enhancing or resulting in acceptably small sacrifices in the achievement of other policy objectives such as efficiency, fairness, revenue, and enforceability.

The Administration has established the following objectives for the simplification project and principles for developing the simplification proposals.

Objectives of Simplification

- To reduce burdens on taxpayers and the IRS.
- Greater economic growth.
- Increased voluntary compliance, including use of the tax benefits provided by the law.
- Lower administrative and compliance costs.
- Fewer errors made by taxpayers and the IRS.
- Fewer inquiries taxpayers must make and the IRS must handle.
- Fewer disputes between the IRS and taxpayers.
- Increased predictability (i.e., transparency) of the tax law.
- Improvement of taxpayers' confidence in the system.
- Similar treatment of similarly situated taxpayers.
- Similar treatment of transactions with similar economic results.
- Fewer complex and expensive tax planning strategies.

Principles for Developing Tax Simplification Proposals

- Reduce or eliminate rules or requirements when the cost of compliance and/or enforcement outweighs the benefits of the rules or requirements.
- Improve the readability of the law.
- Reduce overly technical and overly vague language in the law.
- Avoid highly detailed conditions and requirements.
- Eliminate duplicative or overlapping provisions.
- Eliminate differing definitions of similar terms or concepts.
- Reduce the amount of subjectivity necessary to apply the tax law by providing clear rules and clear distinctions.
- Reduce structural complexity.
- Reduce the number of phase-out provisions or coordinate the amounts in different phase-out provisions.
- Reduce the number and/or complexity of computations.
- Reduce record keeping and information gathering requirements; coordinate record keeping and information gathering requirements with business practices.
- Reduce inconsistencies in the law so that similarly situated taxpayers are treated the same.
- Reduce distortions among economic activities.
- Eliminate provisions or rules no longer needed because other provisions or rules have changed or because the provisions or rules are outdated.
- Reduce the number of temporary or sunset provisions.

Highest priority will be given to simplification proposals that will yield the largest benefits, i.e., that will affect the most people and have the largest effects in reducing compliance burdens and administrative costs.

Examples of areas in the tax system where the Administration's tax simplification project is focusing include the following:

Individual AMT.—The AMT was enacted to ensure that taxpayers with substantial amounts of economic income do not avoid significant tax liability by using combinations of exclusions, deductions, and tax credits. Structural defects in the AMT, including lack of index-

ing for inflation or adjustment for family size, have resulted in the tax affecting millions of taxpayers to whom it was not intended to apply. Millions of additional taxpayers must complete AMT schedules or forms to determine that they are not subject to the AMT.

The number of taxpayers affected by the AMT and the amount of revenue raised by the AMT are rising rapidly, making simplification of the AMT an increasingly important objective of tax policy. This year, 2 million individual filers will be subject to the AMT and therefore required to file the 65-line AMT form. The temporary increase in the AMT exemption under EGTRRA will reduce the increase in the number of AMT taxpayers through 2004. Nevertheless, that number will increase to 5 million in 2004, and more than double, increasing to 12 million in 2005 when the temporary provision expires. In 2005, 47 percent of taxpayers with AGI between $100,000 and $200,000 (in 2002 dollars) and 75 percent of taxpayers with AGI between $200,000 and $500,000 (in 2002 dollars) will pay AMT. By 2010, these percentages will increase to 90 percent and 96 percent, respectively. By 2012, the number of AMT taxpayers will be 39 million (assuming EGTRRA is extended), which is 34 percent of all taxpayers with individual income tax liability.

Family-related provisions.— Taxpayers with family responsibilities face confusing and sometimes conflicting rules. Many taxpayers are entitled to both the EITC and the additional child tax credit. Both credits are based on earned income and the number of children in the family. But the two credits use different definitions of earned income, and different definitions of qualifying children. Further, many taxpayers with three or more children must compute the additional child tax credit twice to determine which formula yields the larger credit. Similarly, some taxpayers can offset the costs of child care assistance using either a child and dependent care tax credit or an exclusion from income, but they must make multiple computations to determine which of the two is most advantageous. Conforming eligibility criteria and reducing the number of computations taxpayers must make would help simplify family-related tax provisions, thus reducing burdens on families.

Uniform definition of a child.—The tax code provides assistance to families with children through the dependent exemption, head-of-household filing status, child tax credit, child and dependent care tax credit, and EITC. But to obtain these benefits, taxpayers must wade through pages of bewildering rules and instructions because each provision defines "qualifying child" differently. For example, to claim the dependent exemption and the child tax credit, a taxpayer must demonstrate that he or she provides most of the support of the child. To claim the EITC, the taxpayer must demonstrate that he or she resides with the child for a specified period of time. Replacing the support test, which is difficult to understand and to administer, with a uniform residency test would reduce both compliance and administrative costs.

Income based phaseouts.—Various tax provisions are phased out in order to target the effects of the provisions and to limit the associated revenue loss. The major provisions subject to income-based phaseouts are the EITC, the child tax credit, the child and dependent care tax credit, IRAs, the HOPE and Lifetime Learning tax credits, the deduction for higher-education expenses, the deduction for student loan interest, the exclusion for interest on education savings bonds, and the adoption credit and exclusion. Two additional phase-out provisions are scheduled to be reduced beginning in 2006 and eliminated completely in 2010: the overall limitation on itemized deductions; and the phaseout of personal exemptions. Phaseouts are complicated and increase marginal tax rates, sometimes significantly. Complexity is increased even more by the fact that different benefits are phased out differently. As a result, taxpayers must often consider multiple phase-out provisions.

Education incentives.—The various tax code provisions providing incentives for higher education use differing definitions of the various elements that make up qualifying higher education expenses. The definitional differences add to the complexity taxpayers face when they use the education incentives. The array of education incentives from which taxpayers may choose means further complexity.

Individual Retirement Accounts.—The current multiple sets of IRA income limits are complex and contain marriage penalties. The income limits complicate participation in IRAs by disallowing participation among certain workers depending on type of IRA, income level, filing status, and both spouses' coverage under an employer retirement plan. Taxpayers need to make year-end calculations to determine their eligibility for a deduction or contribution. Taxpayers in the income range over which eligibility for the benefits phases out need to make calculations to determine the deductible portion of contributions to a traditional IRA, or the allowable amount of contributions to a Roth IRA. Taxpayers face uncertainty at the start of the year, because they need to forecast their year-end income to estimate their eligibility.

Individual capital gains.—Under current law, long-term capital gains in excess of any short-term losses are taxed separately from other income, and may be taxed at 8, 10, 18, 20, 25 or 28 percent rates. Special rules apply to collectibles, recapture of certain depreciation deductions, certain small business stock, principal residences, certain investments in Enterprise Zones and similar qualified zones, and certain like-kind exchanges. These multiple capital gains rates and exclusions result in complicated tax forms and schedules, and the need for careful tax planning.

Excise taxes.—A number of excise taxes no longer have a policy rationale, and in several cases involve a significant number of taxpayers but generate relatively little revenue. Some excise taxes could be restructured to better accomplish policy objectives, reflect recent technological changes, and reduce compliance burdens for both taxpayers and the IRS. Other changes would both improve excise tax compliance and simplify their administration.

Tax-exempt bonds.—Two areas of the statutory tax-exempt bond rules are particularly complex: the definition of a private activity bond and the arbitrage-related provisions. The definition of a private activity bond could be simplified without undoing the policy objective of limiting the issuance of these bonds in tax-exempt form. Compliance with arbitrage rules can be burdensome for issuers even in cases in which bond proceeds are used for traditional governmental purposes. Simplifying changes could be made while still avoiding incentives for premature or over issuance of tax-exempt bonds.

Corporate AMT.—The corporate AMT is a separate tax regime within the Federal income tax system. Under present law, corporations with average gross receipts of at least $7.5 million for the prior three years are required to calculate their tax liability twice: once using the rules of the regular tax system and a second time using the corporate AMT rules. Under the corporate AMT rules, many of the advantageous deductions and credits allowed under the regular tax rules are not allowed, but income under the AMT is taxed at a lower rate than under the regular corporate tax (20 percent, rather than 35 percent). If tax liability calculated under the AMT rules exceeds regular tax liability, the corporation is required to pay AMT in addition to its regular tax. Because payment of AMT represents a prepayment of regular tax, the amount of AMT paid generates AMT credits that can be used to offset regular tax in subsequent years (subject to certain limitations).

The corporate AMT rules increase compliance burdens by causing corporations to devote additional resources to tax planning and record keeping. Because the AMT rules limit the use of tax preferences only for corporations that are AMT payers, corporations that engage in tax-preferred activities incur expenditures to develop strategies to minimize the effect of the AMT rules. In addition, the AMT requires corporations to keep extensive records of numerous adjustments and preferences. For example, depreciation allowances for newly invested property generally are calculated one way under the regular tax and a different way under the AMT. Although a corporation may not have AMT liability, it is required to calculate the AMT to determine whether it owes AMT. The AMT tax regime is difficult and burdensome for corporations to comply with and for IRS to administer.

Depreciation.—There are several sources of complexity in tax depreciation. One source is ambiguity in determining an asset's class life, which determines the asset's annual depreciation allowance. New types of assets, assets used in multiple activities, and building-related expenditures are sometimes difficult to classify and so lead to disputes between taxpayers and the IRS. New assets may be particularly difficult to fit within existing classification guidelines, which generally have not been updated since the mid-1980s.

Placed-in-service conventions also can add to complexity and create uncertainty. Generally, an asset does not receive a full year's depreciation during the tax year in which it is initially placed in service. Instead, the asset receives a fraction of the annual depreciation allowances, as determined by the date on which statutory convention deems the asset to have been placed in service. The placed-in-service conventions sometimes require taxpayers to wait until the end of the taxable year to determine the proper depreciation allowance for property that may have been placed in service at various dates throughout the year.

Capitalization.— Substantial ambiguity exists over whether many items of cost may be deducted currently or instead must be capitalized. Case law holds that the determination of whether an item of cost must be capitalized is based on each particular taxpayer's facts and circumstances. While no one factor has been held to be determinative, the current legal standard relies heavily on whether the item creates a significant future benefit, but the degree of future benefit required for capitalization is ambiguous. Thus, taxpayers and the IRS may end up in dispute over whether certain costs, which traditionally have been deducted, should instead be capitalized. The present uncertain legal environment has elevated capitalization to the top of the list of contested audit issues for businesses.

Tax accounting.—There are many sources of complexity in tax accounting. These include issues related to accrual and inventory accounting, uniform capitalization rules, and the percentage of completion method. Compliance problems generally are more severe for small companies.

Accrual accounting and inventory accounting can be complex and add to the burden of complying with the tax law, especially for small taxpayers. Some of this complexity arises from the additional record keeping required to measure taxes on an accrual basis when the taxpayer uses cash accounting for financial reporting. Additional complexity arises from legal ambiguities about whether certain taxpayers are required to keep inventory accounts. Recently implemented IRS Revenue Procedures provide substantial simplification and certainty by exempting many small taxpayers from the record-keeping burdens of accrual and inventory accounting. For small businesses that do not qualify for tax relief under these Procedures, however, accrual and inventory accounting may continue to impose complexity and record keeping costs.

The LIFO (Last In First Out, a method of accounting for inventories) conformity requirement, that requires firms to use the LIFO method for financial reporting when they use LIFO for tax accounting, also adds to complexity. Conformity violations are more a matter of how information is provided than of what information is provided, creating complications and traps for the unwary.

The uniform capitalization (UNICAP) rules require that both direct and indirect costs be added to basis or included in inventory. Measuring and accounting for all capitalizable costs can be difficult, especially for small taxpayers. Yet, for many taxpayers the UNICAP rules have only a small effect on tax liability, compared to simpler methods, and so add to complexity without substantially affecting tax results.

The percentage of completion method used for determining income from a long-term contract requires the taxpayer to estimate costs and receipts over the life of the contract, with timing errors corrected by a look-back adjustment once the contract is completed. The calculations and record keeping required can be burdensome, especially for small taxpayers. Moreover, in some cases simpler tax accounting methods would cause only a small reduction in tax liability.

International tax rules.—There is much that can be done to reduce the complexity of our international tax rules. This area of the tax law is singled out by businesses as one of the biggest sources of administrative complexity and compliance costs. Moreover, the global economy has changed dramatically since the U.S. international tax rules were developed. It is time to re-examine the rules with a view toward significant rationalization. The focus of efforts in this area will be to reduce the instances in which the international tax rules impose conditions or requirements on U.S. taxpayers that are not consistent with the way businesses operate in the global marketplace and that require efforts that otherwise are unnecessary or non-economic.

Table 4–3. EFFECT OF PROPOSALS ON RECEIPTS

(In millions of dollars)

	Estimate							
	2002	2003	2004	2005	2006	2007	2003–2007	2003–2012
Bipartisan Economic Security Plan [1]	–62,000	–65,000	–47,500	–9,500	17,000	18,000	–87,000	–43,500
Tax Incentives:								
Provide incentives for charitable giving:								
Provide charitable contribution deduction for nonitemizers	–570	–1,429	–1,437	–2,288	–3,567	–3,591	–12,312	–32,636
Permit tax-free withdrawals from IRAs for charitable contributions	–93	–192	–205	–219	–230	–238	–1,084	–2,632
Raise the cap on corporate charitable contributions	–24	–169	–121	–127	–139	–156	–712	–1,730
Expand and increase the enhanced charitable deduction for contributions of food inventory	–10	–49	–54	–59	–66	–72	–300	–789
Reform excise tax based on investment income of private foundations	–122	–177	–181	–189	–198	–205	–950	–2,101
Modify tax on unrelated business taxable income of charitable remainder trusts	–1	–3	–3	–4	–4	–4	–18	–48
Modify basis adjustment to stock of S corporations contributing appreciated property	–8	–11	–13	–17	–21	–25	–87	–282
Allow expedited consideration of applications for exempt status [2]	.....	.....	.....	.....	.....	.....	.....	.....
Strengthen and reform education:								
Provide refundable tax credit for certain costs of attending a different school for pupils assigned to failing public schools [3]	.....	–10	–24	–38	–52	–62	–186	–219
Allow teachers to deduct out-of-pocket classroom expenses	.....	.....	–16	–163	–191	–207	–577	–1,718
Invest in health care:								
Provide refundable tax credit for the purchase of health insurance [4]	.....	–245	–1,689	–2,811	–2,774	–2,951	–10,470	–29,116
Provide an above-the-line deduction for long-term care insurance premiums	.....	–328	–406	–605	–1,222	–2,158	–4,719	–20,730
Allow up to $500 in unused benefits in a health flexible spending arrangement to be carried forward to the next year	.....	.....	–441	–723	–782	–830	–2,776	–7,819
Provide additional choice with regard to unused benefits in a health flexible spending arrangement	.....	.....	–23	–39	–45	–52	–159	–566
Permanently extend and reform Archer MSAs	.....	.....	–43	–468	–530	–607	–1,648	–5,691
Provide an additional personal exemption to home caretakers of family members	.....	–314	–383	–362	–345	–348	–1,752	–3,957
Assist Americans with disabilities:								
Exclude from income the value of employer-provided computers, software and peripherals	.....	.....	–2	–6	–6	–6	–20	–52
Help farmers and fishermen manage economic downturns:								
Establish FFARRM savings accounts	.....	.....	–133	–350	–244	–171	–898	–1,233
Increase housing opportunities:								
Provide tax credit for developers of affordable single-family housing	.....	–7	–76	–302	–715	–1,252	–2,352	–15,257
Encourage saving:								
Establish Individual Development Accounts (IDAs)	.....	–124	–267	–319	–300	–255	–1,265	–1,722

Table 4–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

	Estimate							
	2002	2003	2004	2005	2006	2007	2003–2007	2003–2012
Protect the environment:								
Permanently extend expensing of brownfields remediation costs	.....	.....	–193	–306	–299	–289	–1,087	–2,390
Exclude 50 percent of gains from the sale of property for conservation purposes	.....	–2	–44	–90	–94	–98	–328	–918
Increase energy production and promote energy conservation:								
Extend and modify tax credit for producing electricity from certain sources	–92	–227	–303	–212	–143	–146	–1,031	–1,779
Provide tax credit for residential solar energy systems	–3	–6	–7	–8	–17	–24	–62	–72
Modify treatment of nuclear decommissioning funds	–89	–156	–168	–178	–188	–199	–889	–2,042
Provide tax credit for purchase of certain hybrid and fuel cell vehicles	–21	–80	–181	–349	–530	–763	–1,903	–3,027
Provide tax credit for energy produced from landfill gas	–12	–34	–59	–86	–120	–140	–439	–1,130
Provide tax credit for combined heat and power property	–97	–208	–235	–238	–296	–139	–1,116	–1,091
Provide excise tax exemption (credit) for ethanol [2]	.....	.....	.....	.....	.....	.....	.....	.....
Promote trade:								
Extend and expand Andean trade preferences [5]	–130	–192	–213	–226	–58	.....	–689	–689
Initiate a new trade preference program for Southeast Europe [5]	.....	–19	–23	–25	–7	.....	–74	–74
Implement free trade agreements with Chile and Singapore [5]	.....	–21	–86	–109	–131	–155	–502	–1,560
Improve tax administration:								
Implement IRS administrative reforms	.....	60	49	50	52	54	265	559
Reform unemployment insurance:								
Reform unemployment insurance administrative financing [5]	.....	–1,002	–1,451	–2,902	–2,982	–4,429	–12,766	–6,924
Expiring Provisions:								
Extend provisions that expired in 2001 for two years:								
Work opportunity tax credit	–43	–153	–200	–127	–60	–29	–569	–576
Welfare-to-work tax credit	–9	–37	–57	–48	–32	–22	–196	–209
Minimum tax relief for individuals	–122	–353	–256	.....	.....	.....	–609	–609
Exceptions provided under Subpart F for certain active financing income	–864	–1,502	–630	.....	.....	.....	–2,132	–2,132
Suspension of net income limitation on percentage depletion from marginal oil and gas wells	–25	–44	–18	.....	.....	.....	–62	–62
Generalized System of Preferences (GSP) [5]	–370	–415	.....	.....	.....	.....	–415	–415
Authority to issue qualified zone academy bonds	–4	–13	–25	–35	–37	–37	–147	–332
Permanently extend expiring provisions:								
Provisions expiring in 2010:								
Marginal individual income tax rate reductions	.....	.....	.....	.....	.....	.....	.....	–183,769
Child tax credit [6]	.....	.....	.....	.....	.....	.....	.....	–31,697
Marriage penalty relief [7]	.....	.....	.....	.....	.....	.....	.....	–12,976
Education incentives	–1	–5	–10	–15	–20	–26	–76	–2,810
Repeal of estate and generation-skipping transfer taxes, and modification of gift taxes	178	–550	–1,097	–1,485	–1,987	–2,178	–7,297	–103,659
Modifications of IRAs and pension plans	.....	.....	.....	.....	.....	.....	.....	–6,490
Other incentives for families and children	.....	.....	.....	.....	.....	.....	.....	–1,298
Research and experimentation (R&E) tax credit	.....	.....	–906	–2,949	–4,654	–5,623	–14,132	–51,051
Total effect of proposals	**–64,532**	**–73,017**	**–59,130**	**–27,927**	**–6,034**	**–9,433**	**–175,541**	**–591,020**

[1] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $27,000 million for 2002, $8,000 for 2003, $1,500 million for 2004, $9,500 million for 2003–2007, and $9,500 million for 2003–2012.

[2] Policy proposal with a receipt effect of zero.

[3] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $165 million for 2003, $449 million for 2004, $699 million for 2005, $975 million for 2006, $1,213 million for 2007, $3,501 million for 2003–2007, and $4,155 million for 2003–2012.

[4] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $667 million for 2003, $5,185 million for 2004, $6,292 million for 2005, $6,560 million for 2006, $6,441 million for 2007, $25,145 million for 2003–2007, and $59,873 million for 2003–2012.

[5] Net of income offsets.

[6] Affects both receipts and outlays. Only the receipt effect is shown here. The outlays effect is $8,745 million for 2003–2012.

[7] Affects both receipts and outlays. Only the receipt effect is shown here. The outlays effect is $1,527 million for 2003–2012,

Table 4–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	2001 Actual	Estimate					
		2002	2003	2004	2005	2006	2007
Individual income taxes (federal funds):							
Existing law	994,339	949,885	1,009,047	1,063,560	1,119,913	1,167,409	1,233,065
Proposed Legislation (PAYGO)	.....	–646	–2,693	–4,966	–7,904	–10,133	–11,378
Total individual income taxes	**994,339**	**949,239**	**1,006,354**	**1,058,594**	**1,112,009**	**1,157,276**	**1,221,687**
Corporation income taxes:							
Federal funds:							
Existing law	151,071	202,547	207,960	215,170	241,952	248,397	258,890
Proposed Legislation (PAYGO)	.....	–1,102	–2,471	–3,182	–4,865	–6,949	–8,275
Total Federal funds corporation income taxes	151,071	201,445	205,489	211,988	237,087	241,448	250,615
Trust funds:							
Hazardous substance superfund	4	.....	.....	.....	.....	.....	.....
Total corporation income taxes	**151,075**	**201,445**	**205,489**	**211,988**	**237,087**	**241,448**	**250,615**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	434,057	442,131	466,185	490,228	519,907	541,680	568,723
Disability insurance (Off-budget)	73,462	75,067	79,158	83,244	88,286	91,984	96,576
Hospital insurance	149,651	151,677	159,310	167,667	178,255	185,997	195,448
Railroad retirement:							
Social Security equivalent account	1,614	1,704	1,721	1,749	1,771	1,795	1,818
Rail pension and supplemental annuity	2,658	2,556	2,412	2,307	2,299	2,332	2,366
Total employment and general retirement	661,442	673,135	708,786	745,195	790,518	823,788	864,931
On-budget	153,923	155,937	163,443	171,723	182,325	190,124	199,632
Off-budget	507,519	517,198	545,343	573,472	608,193	633,664	665,299
Unemployment insurance:							
Deposits by States [1]	20,824	23,254	29,887	34,564	36,363	36,744	36,914
Proposed Legislation (PAYGO)	.....	.....	–1	–5	–462	63	–289
Federal unemployment receipts [1]	6,937	6,934	7,065	7,237	7,410	7,580	7,749
Proposed Legislation (PAYGO)	.....	.....	–1,252	–1,809	–3,165	–3,790	–5,247
Railroad unemployment receipts [1]	51	100	150	156	120	94	103
Total unemployment insurance	27,812	30,288	35,849	40,143	40,266	40,691	39,230
Other retirement:							
Federal employees' retirement—employee share	4,647	4,550	4,527	4,424	4,337	4,221	4,068
Non-Federal employees retirement [2]	66	62	50	46	42	39	36
Total other retirement	4,713	4,612	4,577	4,470	4,379	4,260	4,104
Total social insurance and retirement receipts	**693,967**	**708,035**	**749,212**	**789,808**	**835,163**	**868,739**	**908,265**
On-budget	186,448	190,837	203,869	216,336	226,970	235,075	242,966
Off-budget	507,519	517,198	545,343	573,472	608,193	633,664	665,299
Excise taxes:							
Federal funds:							
Alcohol taxes	7,624	7,627	7,664	7,748	7,831	7,877	7,923
Tobacco taxes	7,396	8,045	8,115	7,974	7,875	7,782	7,692
Transportation fuels tax	1,150	1,138	1,180	1,216	1,266	304	312
Telephone and teletype services	5,769	5,984	6,345	6,753	7,179	7,612	8,050
Ozone depleting chemicals and products	32	22	13	7	.....	.....	.....
Other Federal fund excise taxes	2,151	1,963	1,867	1,854	1,911	1,976	2,030
Proposed Legislation (PAYGO)	.....	–122	–177	–181	–189	–198	–205
Total Federal fund excise taxes	24,122	24,657	25,007	25,371	25,873	25,353	25,802
Trust funds:							
Highway	31,469	31,926	32,952	34,121	35,414	36,919	38,038
Proposed Legislation (PAYGO)	.....	.....	.....	–7	–17	–29	–38

Table 4–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	2001 Actual	Estimate					
		2002	2003	2004	2005	2006	2007
Airport and airway	9,191	8,939	9,680	10,269	10,878	11,518	12,178
Aquatic resources	358	385	393	414	424	435	443
Black lung disability insurance	522	554	573	597	616	628	638
Inland waterway	113	97	98	98	99	100	101
Hazardous substance superfund	2	.....	.....	.....	.....	.....	.....
Vaccine injury compensation	112	123	125	125	127	128	129
Leaking underground storage tank	179	190	193	199	204	214	218
Total trust funds excise taxes	41,946	42,214	44,014	45,816	47,745	49,913	51,707
Total excise taxes	**66,068**	**66,871**	**69,021**	**71,187**	**73,618**	**75,266**	**77,509**
Estate and gift taxes:							
Federal funds	28,400	27,484	23,559	27,638	24,769	28,121	24,992
Proposed Legislation (PAYGO)	.....	6	–560	–1,050	–1,343	–1,736	–1,794
Total estate and gift taxes	**28,400**	**27,490**	**22,999**	**26,588**	**23,426**	**26,385**	**23,198**
Customs duties:							
Federal funds	18,583	18,538	19,781	21,424	22,549	23,964	25,283
Proposed Legislation (PAYGO)	.....	–668	–863	–430	–482	–262	–207
Trust funds	786	796	887	905	977	1,041	1,075
Total customs duties	**19,369**	**18,666**	**19,805**	**21,899**	**23,044**	**24,743**	**26,151**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	94	109	111	113	115	117	119
United Mine Workers of America combined benefit fund	150	143	138	132	127	123	117
Deposit of earnings, Federal Reserve System	26,124	25,596	29,025	31,512	32,084	33,214	34,832
Defense cooperation	7	6	6	6	6	6	6
Fees for permits and regulatory and judicial services	8,483	7,905	8,463	8,650	8,478	8,607	8,794
Fines, penalties, and forfeitures	2,724	2,685	2,523	2,509	2,517	2,525	2,534
Gifts and contributions	284	244	219	185	186	179	180
Refunds and recoveries	–54	–298	–305	–317	–325	–327	–335
Total miscellaneous receipts	**37,812**	**36,390**	**40,180**	**42,790**	**43,188**	**44,444**	**46,247**
Proposed bipartisan economic security plan (PAYGO)	.....	–62,000	–65,000	–47,500	–9,500	17,000	18,000
Total budget receipts	**1,991,030**	**1,946,136**	**2,048,060**	**2,175,354**	**2,338,035**	**2,455,301**	**2,571,672**
On-budget	1,483,511	1,428,938	1,502,717	1,601,882	1,729,842	1,821,637	1,906,373
Off-budget	507,519	517,198	545,343	573,472	608,193	633,664	665,299
MEMORANDUM							
Federal funds	1,255,504	1,195,158	1,255,629	1,338,515	1,453,879	1,535,377	1,610,437
Trust funds	445,470	465,179	497,771	518,623	542,161	564,491	587,613
Interfund transactions	–217,463	–231,399	–250,683	–255,256	–266,198	–278,231	–291,677
Total on-budget	**1,483,511**	**1,428,938**	**1,502,717**	**1,601,882**	**1,729,842**	**1,821,637**	**1,906,373**
Off-budget (trust funds)	**507,519**	**517,198**	**545,343**	**573,472**	**608,193**	**633,664**	**665,299**
Total	**1,991,030**	**1,946,136**	**2,048,060**	**2,175,354**	**2,338,035**	**2,455,301**	**2,571,672**

[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 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.

5. USER FEES AND OTHER COLLECTIONS

In addition to collecting taxes and other receipts by the exercise of its sovereign powers, which is discussed in the previous chapter, the Federal Government collects income from the public from market-oriented activities and the financing of regulatory expenses. Some of these collections are classified as user fees, which include the sale of postage stamps and electricity, fees for admittance to national parks, and premiums for deposit insurance; and some are other offsetting collections or receipts, such as rents and royalties for the right to extract oil from the Outer Continental Shelf.

Depending on the laws that authorize the collections, the collections can be credited directly to expenditure accounts as "offsetting collections," or to receipt accounts as "offsetting receipts." Usually offsetting collections are authorized to be spent for the purposes of the account without further action by the Congress. Offsetting receipts may or may not be earmarked for a specific purpose, depending on the legislation that authorizes them, and the authorizing legislation may either authorize them to be spent without further action by the Congress, or require them to be appropriated in annual appropriations acts before they can be spent.

The budget refers to them as offsetting collections and offsetting receipts, because they are subtracted from gross outlays rather than added to taxes on the receipts side of the budget. 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. [1]

Offsetting collections and receipts include most user fees, which are discussed below, as well as some amounts that are not user fees. Table 5–1 summarizes these transactions. For 2003, total offsetting collections and receipts from the public are estimated to be $231.2 billion, and total user fees are estimated to be $154.3 billion.

The following section discusses user fees and the Administration's user fee proposals. The subsequent section displays more information on offsetting collections and receipts. The offsetting collections and receipts by agency are also displayed in Table 21–1, "Outlays to the Public, Net and Gross," which appears in Chapter 21 of this volume.

Table 5–1. GROSS OUTLAYS, USER FEES, OTHER OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, AND NET OUTLAYS

(In billions of dollars)

	2001 Actual	Estimate	
		2002	2003
Gross outlays	2,084.5	2,275.7	2,359.5
Offsetting collections and receipts from the public:			
User fees [1]	–132.1	–140.2	–152.7
Other	–88.4	–83.2	–78.5
Subtotal, offsetting collections and receipts from the public	–220.6	–223.4	–231.2
Net outlays	1,863.9	2,052.3	2,128.2

[1] Total user fees are shown below. They include user fees that are classified on the receipts side of the budget in addition to the amounts shown on this line. For additional details of total user fees, see table 5–2. "Total User Fee Collections."

Total user fees:			
Offsetting collections and receipts from the public	132.1	140.2	152.7
Receipts	1.5	1.5	1.6
Total, user fees	133.7	141.6	154.3

[1] Showing collections from business-type transactions as offsets on the spending side of the budget follows the concept recommended by the 1967 Report of the President's Commission on Budget Concepts. The concept is discussed in Chapter 25: "Budget System and Concepts and Glossary" in this volume.

USER FEES

I. Introduction and Background

The Federal Government may charge user fees to those who benefit directly from a particular activity or those subject to regulation. According to the definition of user fees used in this chapter, Table 5–2 shows that user fees were $133.7 billion in 2001, and are estimated to increase to $141.6 billion in 2002 and to $154.3 billion in 2003, growing to an estimated $176.9 billion in 2007, including the user fee proposals that are shown in Table 5–3. This table shows that the Administration is proposing to increase user fees by an estimated $1.5 billion in 2003, growing to an estimated $2.9 billion in 2007.

Definition. The term "user fee" as defined here is fees, charges, and assessments levied on groups or individuals directly benefitting from, or subject to regulation by, a government program or activity, and to be utilized solely to support the program or activity. In addition, the payers of the fee must be limited to those benefitting 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 it is charged, including directly associated agency functions, not for unrelated programs or activities and not for the broad purposes of the Government or an agency.

- Examples of business-type or market-oriented user fees include fees for the sale of postal services (the sale of stamps), electricity (e.g., sales by the Tennessee Valley Authority), payments for Medicare voluntary supplemental medical insurance, life insurance premiums for veterans, recreation fees for parks, NASA fees for shuttle services, the sale of weather maps and related information by the Department of Commerce, the sale of commemorative coins, and fees for the sale of books.
- Examples of regulatory and licensing user fees include fees for regulating the nuclear energy industry, bankruptcy filing fees, immigration fees, food inspection fees, passport fees, and patent and trademark fees.

User fees do not include all offsetting collections and receipts, such as the interest and repayments received from credit programs; proceeds from the sale of loans and other financial investments; interest, dividends, and other earnings; cost sharing contributions; the sale of timber, minerals, oil, commodities, and other natural resources; proceeds from asset sales (property, plant, and equipment); Outer Continental Shelf receipts; or spectrum auction proceeds. Neither do they include earmarked taxes (such as taxes paid to social insurance programs or excise taxes), or customs duties, fines, penalties, and forfeitures.

Alternative definitions. The definition used in this chapter is useful because it identifies goods, services, and regulations financed by earmarked collections and receipts.[2] Other definitions may be used for other purposes. Much of the discussion of user fees below—their purpose, when they should be levied, and how the amount should be set—applies to these alternatives as well.

OMB uses the broader concept of "user charges" to establish policy for charging prices to the public for the sale or use of goods, services, property, and resources (see OMB Circular A–25, "User Charges," July 8, 1993). User charges are all amounts assessed for the provision of Government services and for the sale or use of Government goods, property, or resources. The payers of the user charge must be limited in the authorizing legislation to those receiving special benefits from, or subject to regulation by, the program or activity beyond the benefits received by the general public or broad segments of the public (such as those who pay income taxes or customs duties). The term is broader than user fees as defined in this chapter in two ways. First, user charges encompass proceeds from the sale of government goods and services regardless of whether they are earmarked to fund the specific program or activity for which they are charged. Second, the term includes proceeds from the sale of natural resources (such as timber, oil, and minerals) and asset sales (such as property, plant, and equipment) as well as goods and services.

Other alternative definitions of user fees could, for example:

- be narrower than the one used here, by excluding regulatory fees and analyzing them as a separate category.
- interpret more broadly whether a program has private beneficiaries, or whether the proceeds are earmarked to benefit directly those paying the fee. A broader interpretation might include beneficiary- or liability-based excise taxes.[3]

What is the purpose of user fees? The purpose of user fees is to improve the efficiency and equity of certain Government activities, and to reduce the burden on the taxpayer to finance activities whose benefits accrue to a relatively limited number of people.

User fees that are set to cover the costs of production of goods and services can provide efficiency in the allocation of resources within the economy. They allocate goods and services to those who value them the most, and they signal to the Government how much of the goods or services it should provide. Prices in private, competitive markets serve the same purposes.

[2] The definition of user fees used here is similar to one the House of Representatives uses as a guide for purposes of committee jurisdiction. The definition helps differentiate between taxes, which are under the jurisdiction of the Ways and Means Committee, and fees, which can be under the jurisdiction of other committees. See the Congressional Record, January 3, 1991, p. H31, item 8.

[3] Beneficiary- and liability-based taxes are terms taken from the Congressional Budget Office, *The Growth of Federal User Charges,* August 1993, and updated in October 1995. Examples of beneficiary-based taxes include taxes on gasoline, which finance grants to States for highway construction, or taxes on airline tickets, which finance air traffic control activities and airports. An example of a liability-based tax is the excise tax that formerly helped fund the hazardous substance superfund in the Environmental Protection Agency. This tax was paid by industry groups to finance environmental cleanup activities related to the industry activity but not necessarily caused by the payer of the fee.

User fees for goods and services that do not have special social benefits improve equity, or fairness, by requiring that those who benefit from an activity are the same people who pay for it. The public often perceives user fees as fair because those who benefit from the good or service pay for it in whole or in part, and those who do not benefit do not pay.

When should the Government charge a fee? Discussions of whether to finance spending with a tax or a fee often focus on whether the benefits of the activity are to the public in general or to a limited group of people. In general, if the benefits accrue broadly to the public, then the program should be financed by taxes paid by the public; in contrast, if the benefits accrue to a limited number of private individuals or groups, then the program should be financed by fees paid by the private beneficiaries. For Federal programs where the benefits are entirely public or entirely private, applying this principle is relatively easy. For example, according to this principle, the benefits from national defense accrue to the public in general and should be (and are) financed by taxes. In contrast, the benefits of electricity sold by the Tennessee Valley Authority accrue exclusively to those using the electricity, and should be (and are) financed by user fees.

In many cases, however, an activity has benefits that accrue to both public and to private groups, and it may be difficult to identify how much of the benefits accrue to each. Because of this, it can be difficult to know how much of the program should be financed by taxes and how much by fees. For example, the benefits from recreation areas are mixed. Fees for visitors to these areas are appropriate because the visitors benefit directly from their visit, but the public in general also benefits because these areas protect the Nation's natural and historical heritage now and for posterity.

As a further complication, where a fee may be appropriate to finance all or part of an activity, some consideration must be given to the ease of administering the fee.

What should be the amount of the fee? For programs that have private beneficiaries, the amount of the fee should depend on the costs of producing the goods or services and the portion of the program that is for private benefits. If the benefit is primarily private, and any public benefits are incidental, current policies support fees that cover the full cost to the Government, including both direct and indirect costs.[4]

The Executive Branch is working to put cost accounting systems in place across the Government that would make the calculation of full cost more feasible. The difficulties in measuring full cost are associated in part with allocating to an activity the full costs of capital, retirement benefits, and insurance, as well as other Federal costs that may appear in other parts of the budget. Guidance in the Statement of Federal Financial Accounting Standards No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government (July 31, 1995), should underlie cost accounting in the Federal Government.

Classification of user fees in the budget. As shown in Table 5–1, most user fees are classified as offsets to outlays on the spending side of the budget, but a few are classified on the receipts side of the budget. An estimated $1.6 billion in 2003 are classified this way and are included in the totals described in Chapter 4. "Federal Receipts." They are classified as receipts because they are regulatory fees collected by the Federal Government by the exercise of its sovereign powers.

The remaining user fees, an estimated $152.7 billion in 2003, are classified as offsetting collections and receipts on the spending side of the budget. Some of these are collected by the Federal Government by the exercise of its sovereign powers and would normally appear on the receipts side of the budget, but are required by law to be classified as offsetting collections or receipts.

An estimated $108.8 billion of user fees for 2003 are credited directly to expenditure accounts, and are generally available for expenditure when they are collected, without further action by the Congress. An estimated $43.9 billion of user fees for 2003 are deposited in offsetting receipt accounts, and are available to be spent only according to the legislation that established the fees.

As a further classification, the accompanying Tables 5–2 and 5–3 identify the fees as discretionary or mandatory. These classifications are terms from the Budget Enforcement Act of 1990 as amended and are used frequently in the analysis of the budget. "Discretionary" in this chapter refers to fees generally controlled through annual appropriations acts and under the jurisdiction of the appropriations committees in the Congress. These fees offset discretionary spending under the discretionary caps. "Mandatory" refers to fees controlled by permanent laws and under the jurisdiction of the authorizing committees. These fees are subject to rules of paygo, whereby changes in law affecting mandatory programs and receipts cannot result in a net cost. Mandatory spending is sometimes referred to as direct spending.

These and other classifications are discussed further in this volume in Chapter 25, "Budget System and Concepts and Glossary."

II. Current User Fees

As shown in Table 5–2, total user fee collections (including those proposed in this budget) are estimated to be $154.3 billion in 2003, increasing to $176.9 billion in 2007. User fee collections by the Postal Service and Medicare premiums are the largest and are estimated to be almost two-thirds of total user fee collections in 2003.

[4] Policies for setting user charges are promulgated in OMB Circular No. A–25: "User Charges" (July 8, 1993). These policies are required regardless of whether or not the proceeds are earmarked to finance the related activity.

Table 5–2. TOTAL USER FEE COLLECTIONS

(In millions of dollars)

	2001 Actual	Estimates					
		2002	2003	2004	2005	2006	2007
Receipts							
Agricultural quarantine inspection fees	265	215	260	259	266	272	279
Corps of Engineers, Harbor maintenance fees	722	733	823	839	909	972	1,005
Other governmental receipts user fees	545	515	532	538	548	552	559
Subtotal, receipts	1,532	1,463	1,615	1,636	1,723	1,796	1,843
Offsetting Collections and Receipts from the Public							
Discretionary							
Department of Agriculture: Food safety inspection and other fees	153	185	221	233	238	241	246
Department of Commerce: Patent and trademark, fees for weather services, and other fees	1,366	1,665	1,826	1,985	2,145	2,299	2,405
Department of Defense: Commissary and other fees	5,834	5,828	6,052	6,052	6,052	6,052	6,052
Department of Energy: Federal Energy Regulatory Commission, power marketing, and other fees	917	1,297	1,276	1,303	1,329	1,362	1,393
Department of Health and Human Services: Food and Drug Administration, Centers for Medicare and Medicaid Services, and other fees	273	294	529	531	543	545	549
Department of the Interior: Minerals Management Service and other fees	212	210	209	212	217	223	227
Department of Justice: Antitrust and other fees	304	414	435	441	446	452	458
Department of State: Passport and other fees	544	508	656	670	685	701	717
Department of Transportation: Railroad safety, navigation, and other fees	38	144	381	629	640	652	665
Department of the Treasury: Sale of commemorative coins and other fees	1,489	1,257	1,910	1,439	1,470	1,505	1,539
Department of Veterans Affairs: Medical care and other fees	774	808	1,087	1,288	1,377	1,467	1,558
Social Security Administration: State supplemental fees, supplemental security income	91	106	111	119	126	134	143
Federal Communications Commission: Regulatory fees	208	227	248	253	258	264	270
Federal Trade Commission: Regulatory fees	91	163	178	182	187	192	197
Nuclear Regulatory Commission: Regulatory fees	453	479	518	523	528	545	563
Securities and Exchange Commission: Regulatory fees	735	1,149	1,332	1,542	1,837	2,171	1,142
All other agencies, discretionary user fees	220	267	293	338	346	354	365
Subtotal, discretionary user fees	13,702	15,001	17,262	17,740	18,424	19,159	18,489
Mandatory							
Department of Agriculture: Crop insurance and other fees	1,240	1,100	1,097	1,198	1,237	1,199	1,215
Department of Defense: Commissary surcharge and other fees	265	743	599	599	599	599	599
Department of Energy: Proceeds from the sale of energy, nuclear waste disposal fees, and other fees	4,851	4,623	4,508	4,650	4,295	4,246	4,237
Department of Health and Human Services: Medicare Part B insurance premiums and other fees	23,764	25,637	27,363	29,063	31,082	33,264	35,568
Department of the Interior: Recreation and other fees	634	672	626	641	643	646	649
Department of Justice: Immigration and other fees	1,821	2,241	2,320	2,312	2,352	2,394	2,438
Department of Labor: Insurance premiums to guaranty private pensions	850	886	829	818	830	827	823
Department of the Treasury: Customs, bank regulation, and other fees	1,929	1,992	2,143	717	736	751	766
Department of Veterans Affairs: Veterans life insurance and other fees	1,553	1,974	2,114	2,101	2,059	2,077	2,035
Federal Emergency Management Agency: Flood insurance fees	1,603	1,729	1,785	1,839	1,906	1,980	2,069
Office of Personnel Management: Federal employee health and life insurance fees	7,404	8,037	9,881	10,680	11,372	12,091	12,886
Federal Communications Commission: Analog spectrum lease fee	.....	.....	.....	.....	.....	.....	500
Federal Deposit Insurance Corporation: Deposit insurance fees	83	86	893	2,123	2,274	2,333	2,375
Postal Service: Fees for postal services	64,871	67,794	73,727	75,796	77,996	79,996	81,996
Tennessee Valley Authority: Proceeds from the sale of energy	7,326	7,348	7,205	7,462	7,674	7,806	8,018
All other agencies, mandatory user fees	224	322	337	372	384	397	405
Subtotal, mandatory user fees	118,418	125,184	135,427	140,371	145,439	150,606	156,579
Subtotal, offsetting collections and receipts from the public	132,120	140,185	152,689	158,111	163,863	169,765	175,068
Total, User fees	133,652	141,648	154,304	159,747	165,586	171,561	176,911

User fee collections are used to offset outlays in both the discretionary and mandatory parts of the budget. User fee collections classified in the discretionary part of the budget are estimated to be $17.3 billion in 2003, and those in the mandatory part are estimated to be $135.4 billion in 2003.

III. User Fee Proposals

As shown in Table 5–3, the Administration is proposing new or increased user fees that would increase collections by an estimated $1.5 billion in 2003, increasing to $2.9 billion in 2007.

A. User Fee Proposals to Offset Discretionary Spending

1. Offsetting collections

Department of Agriculture

Animal and Plant Health Inspection Service.—Legislation will be proposed to establish user fees for APHIS costs for animal welfare inspections, such as for animal research centers, humane societies, and kennels.

Grain Inspection, Packers and Stockyards Administration.—Legislation will be proposed to establish a fee for the standardization activities of the Grain Inspection, Packers and Stockyards Administration, and a licensing fee to cover the costs of administering these programs.

Department of Commerce

Patent and Trademark Office.—The Administration proposes changes to patent and trademark fee schedules effective in 2004 to fully support the PTO's long-term objectives to reduce application processing times and increase patent and trademark quality. As a first step, the Administration is proposing a one-year surcharge on all patent and trademark fees in 2003 as a proxy for the draft legislation.

International Trade Administration.—The Budget proposes an increase in fee collections of $10 million in 2003 and later years for ITA. In addition, ITA will study different fee options in 2002 to determine an appropriate model for cost recovery from firms that receive trade promotion services.

Department of Health and Human Services

User Fees for Medicare providers for paper claims and duplicate or unprocessable claims.—The Administration is proposing new user fees for providers submitting paper claims and duplicate or unprocessable claims. Under this proposal, providers would be charged $1.50 for every paper claim submitted for payment. The fee is necessary because processing paper claims is more costly than processing electronic claims. Paper claim fees would be waived for rural and poor providers.

The Centers for Medicare and Medicaid Services and its contractors go to great lengths to ensure that providers are aware of billing requirements and the need to submit accurate claims. Charging a fee for duplicate or unprocessable claims would heighten provider awareness of these issues and increase efficiency by deterring this action.

Fees for the review of new prescription drugs.—The Administration is proposing the reauthorization of the Prescription Drug User Fee Act (PDUFA). Originally authorized in 1992 and reauthorized in 1997, PDUFA assesses user fees to pharmaceutical manufacturers for the Food and Drug Administration (FDA) review of new prescription drugs for safety and efficacy. FDA review of a new prescription drug is required before these drugs are available to consumers on the market. Spending financed by these fees would be in addition to regular appropriations.

Department of State

Machine readable visa fee.—The State Department plans to increase machine readable visa (MRV) collection fees by more than 30 percent, from $45 to $65. Since 1996, MRVs have been available at all 221 U.S. visa issuing posts around the world. These visas provide increased border security control through the use of biometric technology. MRVs currently include digitized photographs and personal information related to the traveler. However, they have the capability to encode retinal images, fingerprints and other personal details, which can then be read electronically and relayed to other Federal agencies to be compared to other database information. Approximately 5 million visas are processed annually.

Commodity Futures Trading Commission

Fees on each round-turn commodities futures and options transactions.—The Commodities Futures Trading Commission regulates U.S. futures and options markets. It strives to protect investors by preventing fraud and abuse and ensuring adequate disclosure of information. The President's Budget includes a fee on each round-turn commodities futures and options transaction that will be phased in during 2003. This proposal recognizes that market participants derive direct benefits from CFTC's oversight, which provides legal certainty and contributes to the integrity and soundness of the markets.

Federal Trade Commission

Do Not Call List fee.—The Federal Trade Commission is proposing new fees that will be assessed, collected and used to cover costs of developing, implementing and maintaining a national database of telephone numbers of consumers who choose not to receive telephone solicitations, as authorized by the Telephone Consumer and Abuse Prevention Act.

2. Offsetting receipts

Department of Transportation

Hazardous materials transportation safety fees.—Beginning in 2003, hazardous materials transportation safety activities previously financed by general fund appropriations to the Research and Special Programs Administration are proposed to be financed instead by an increase in hazardous materials registration fees. Appropriation language is proposed to increase the fees

Table 5–3. USER FEE PROPOSALS

(Estimated collections in millions of dollars)

	2003	2004	2005	2006	2007	2003–2007
DISCRETIONARY						
1. Offsetting collections						
Department of Agriculture						
Animal Plant and Health Inspection Service	5	5	5	5	5	25
Grain Inspection, Packers, and Stockyards Administration	29	29	29	29	29	145
Department of Commerce						
Patent and Trademark Office: Increase current fees and raise fee rates	.....	136	79	40	40	295
International Trade Administration: Increased fee revenues for export promotion	10	10	10	10	10	50
Department of Health and Human Services						
User fees for Medicare providers for paper claims and duplicate or unprocessable claims	130	130	130	130	130	650
Food and Drug Administration: Fees for the review of new prescription drugs	272	272	272	272	272	1,360
Department of State						
Machine readable visa fee	139	144	150	155	161	749
Commodity Futures Trading Commission						
Fees on each round-turn commodities futures and options transactions	33	70	73	78	83	337
Federal Trade Commission						
Do Not Call List fee	3	3	3	3	3	15
2. Offsetting receipts						
Department of Transportation						
Hazardous materials transportation safety fees	6	25	25	25	25	106
Railroad safety inspection fees	59	120	122	124	127	552
Coast Guard commercial navigation assistance fee	165	330	336	342	349	1,522
Department of the Treasury						
Customs Service air/sea passenger fee and cruise vessel fee	250	.....	.....	.....	.....	250
Department of Veterans Affairs						
Implement $1,500 deductible for priority level 7 (non-disabled, higher income) veterans for health care	363	381	400	420	441	2,005
Environmental Protection Agency						
Abolish cap on pre-manufacturing notification fees	4	8	8	8	8	36
Nuclear Regulatory Commission						
Extend NRC fees at their 2005 level for 2006 and later	.....	.....	.....	345	357	702
Subtotal, discretionary fee proposals	1,468	1,663	1,642	1,986	2,040	8,799
MANDATORY						
1. Offsetting collections						
Federal Emergency Managment Agency						
Flood insurance fees	8	43	83	130	191	455
2. Offsetting receipts						
Department of Agriculture						
Food Safety and Inspection Service user fees	.....	72	72	74	74	292
Forest Service ski fee permits	.....	3	10	14	15	42
Forest Service recreation and entrance fees	.....	.....	43	44	44	131
Department of the Interior						
Recreation and entrance fees	.....	.....	43	44	44	131
Corps of Engineers						
Recreation user fees	6	11	16	21	21	75
Federal Communications Commission						
Analog spectrum lease fee	.....	.....	.....	.....	500	500
Subtotal, mandatory user fee proposals	14	129	267	327	889	1,626
Total, user fee proposals	**1,482**	**1,792**	**1,909**	**2,313**	**2,929**	**10,425**

paid by shippers and carriers of hazardous materials in 2003 to fund these safety activities.

Railroad safety inspection fee.—This proposal would fund Federal Railroad Administration safety inspections and the safety component of the railroad research and development program. The fees would be collected from the primary beneficiaries of these services, the railroad carriers, and be based upon a calculation of their usage as established through regulations. The estimated 2003 collections are 50 percent of the anticipated cost of safety services. In subsequent years these services would be fully funded with user fees.

. *Coast Guard commercial navigation assistance fee.*—This proposal would partially recover the costs of providing Coast Guard navigational assistance services. The fees would be collected from the primary beneficiaries of these services, which are commercial cargo and cruise vessels. The estimated 2003 collections assume a six month implementation period for this new fee and represent 50 percent of the anticipated full year receipts.

Department of the Treasury

Customs Service air/sea passenger fee and cruise vessel fee.—The Administration proposes an increase in two of the user fees collected by the Customs Service. The air/sea passenger fee was established in 1986 at $5.00 per passenger. The cruise vessel passenger fee was established at $1.75 per passenger. The receipts from these fees are used to pay for Customs' overtime inspections and related expenses. The air/sea fee would increase to $11 per passenger. The cruise vessel fee would increase to $2 per passenger. The new fee levels would help to offset higher costs incurred by the Customs Service.

Department of Veterans Affairs

Implement a $1,500 deductible for priority level 7 veterans for health care.—The budget request includes a proposal to establish a $1,500 annual deductible for priority level 7 veterans (non-disabled, higher-income). This proposal is in response to the significant growth in enrollment and usage by priority level 7 veterans over the last 3 years, as well as anticipated future growth. The objective is to have these veterans pay a larger portion of the cost of their health care. Coupled with the recent increase in pharmacy copayments and decrease in outpatient care copayments, this proposal makes certain that VA's health care system is able to continue providing high-quality health care to its core population—disabled and low-income veterans.

Environmental Protection Agency

Abolish cap on pre-manufacturing notification fees.—EPA collects fees from chemical manufacturers seeking to bring new chemicals into commerce. These fees are authorized by the Toxic Substances Control Act and are now subject to an outdated statutory cap. The Administration is proposing appropriations language to modify the cap so that EPA can increase fees to fully cover the cost of the program.

Nuclear Regulatory Commission

Extend NRC fees at their 2005 level for 2006 and later.—The Omnibus Budget Reconciliation Act (OBRA) of 1990, as amended, required that the Nuclear Regulatory Commission (NRC) assess license and annual fees that recover approximately 94 percent of its budget authority in 2003, less the appropriation from the Nuclear Waste Fund. Licensees are required to reimburse NRC for its services, because licensees benefit from such services.

Under OBRA, as amended, the budget authority recovery requirement decreases by 2 percentage points per year until it reaches 90 percent in 2005. After 2005, the requirement reverts to 33 percent per year. If the 90 percent requirement is not extended beyond 2005, fees would drop from an estimated $528 million in 2005 to $200 million in 2006; with an extension at 90 percent, fees would be an estimated $545 million in 2006, an increase of $345 million.

B. User Fee Proposals to Offset Mandatory Spending

1. Offsetting collections

Federal Emergency Management Agency

Flood insurance fees.—The Administration proposes to phase out subsidized premiums for flood insurance for vacation homes, rental properties, and other non-primary residences. Insurance rates for primary residences, which represent the majority of the program's policies, would not change under these proposal. In addition, the Administration proposes to include the cost of expected erosion losses for flood insurance policies in coastal areas, require that mortgage borrowers insure the full replacement value of their properties, and end State taxation of flood insurance polices.

2. Offsetting receipts

Department of Agriculture

Food Safety and Inspection Service.—Legislation will be proposed replacing the existing overtime fee structure with a revised structure that would distribute fees more proportionately between large and small plants. Overtime fees would also apply to all inspection hours provided after one eight hour shift. However, since the goal of the proposed fee is equity, rather than revenue, the costs for the overtime would be shared with the Federal Government paying 50 percent of the total overtime costs.

In addition to overtime fees, the legislative proposal would recover some overhead costs by charging all plants an annual fee in direct proportion to the plants volume of output. The funds collected would be available without appropriation to cover food safety-related activities and research.

Forest Service ski fees permits.—This proposal would require the receipt of fair market value from use and occupancy of ski resorts on national forest lands. The proposal would amend the Omnibus Parks and Public Lands Management Act (P.L. 104–333), which established a new fee schedule for ski resorts on National Forest System lands. The amendment would adjust percentages of gross revenue that determine fees to the Government. Funds collected are available for forest restoration of landscapes impacted by ski resorts.

Forest Service recreation and entrance fees.—The Administration proposes to permanently extend the current pilot program that allows the Forest Service to collect increased recreation and entrance fees. These receipts would be available for use without further appropriation and are necessary to maintain and improve recreation facilities and services. A similar proposal affects recreation fees for the National Park Service, the Bureau of Land Management, and the Fish and Wildlife Service in the Department of the Interior.

Department of the Interior

Recreation and entrance fees.—The Administration proposes to extend permanently the current recreation fee demonstration program. Since 1996, this program

has allowed the National Park Service, the Bureau of Land Management, and the Fish and Wildlife Service to collect increased recreation and entrance fees and spend the receipts without further appropriation on facility improvements, visitor programs, and other services. At least half of the National Park Service receipts will be used to address deferred maintenance needs. A related proposal affects recreation fees for the Forest Service in the Department of Agriculture.

Corps of Engineers

Recreation user fees.—The Administration proposes to phase in recreation user fee increases with the entire increase available without further legislative action for spending on operation, maintenance, and improvements of the recreation facilities of the Corps of Engineers, many of which are obsolete. Legislation will be required to increase limits on existing recreation user fees, authorize new fees, or reclassify existing fees. In addition, the Administration recommends extending the recreation demonstration program, which makes available to the Corps without further appropriation recreation fee revenues above a baseline of $34 million per year, to be used for operation and maintenance of its recreation facilities. The Corps spends about $250 million annually on these activities.

Federal Communications Commission

Analog spectrum lease fee.—The Administration proposes authorizing the FCC to establish an annual lease fee totaling $500 million for the use of analog spectrum by commercial broadcasters beginning in 2007, to facilitate the clearing of analog television broadcast spectrum and provide taxpayers some compensation for use of this scarce resource.

OTHER OFFSETTING COLLECTIONS AND RECEIPTS

Table 5–4 shows that total offsetting collections and receipts from the public are estimated to be $231.2 billion in 2003. Of these, an estimated $149.3 billion are offsetting collections credited to appropriation accounts and an estimated $81.9 billion are deposited in offsetting receipt accounts.

The user fees in Table 5–4 were discussed in the previous section. Major offsetting collections deposited in expenditure accounts that are not user fees are precredit reform loan repayments, collections from States to supplement payments in the supplemental security income program, and collections for the Federal Savings and Loan resolution fund. Major offsetting receipts that are not user fees include spectrum auction receipts, military assistance program sales, rents and royalties for oil and gas on the Outer Continental Shelf, and interest income.

Table 5–5 includes all offsetting receipts 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 to be $511.5 billion in 2003—$429.6 billion are intragovernmental transactions, and $81.9 billion are from the public, shown in the table as proprietary receipts from the public and offsetting governmental receipts.

As noted above, offsetting collections and receipts by agency are also displayed in Table 21–1, "Outlays to the Public, Net and Gross," which appears in Chapter 21 of this volume.

Table 5–4. OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC

(In millions of dollars)

	2001 Actual	Estimate	
		2002	2003
Offsetting collections credited to expenditure accounts:			
User fees:			
Postal service stamps and other postal fees	64,871	67,794	73,727
Defense Commissary Agency	5,083	5,101	5,351
Employee contributions for employees and retired employees health benefits funds [1]	5,855	6,503	.....
Sale of energy:			
Tennessee Valley Authority	7,326	7,348	7,205
Bonneville Power Administration	3,937	3,697	3,616
All other user fees	14,880	16,942	18,871
Subtotal, user fees	101,952	107,385	108,770
Other collections credited to expenditure accounts:			
Pre-credit reform loan repayments	14,078	14,851	13,551
Supplemental security income (collections from the States)	3,160	3,797	3,937
Federal Savings and Loan Insurance Corporation resolution fund	1,688	1,243	267
Other collections	19,386	20,082	22,786
Subtotal, other collections	38,312	39,973	40,541
Subtotal, offsetting collections credited to expenditure accounts	140,264	147,358	149,311
Offsetting receipts:			
User fees:			
Medicare premiums	23,748	25,622	27,347
Employee contributions for employees and retired employees health benefits funds [1]	.....	.....	8,264
All other user fees	6,420	7,178	8,308
Subtotal, user fees deposited in receipt accounts	30,168	32,800	43,919
Other collections deposited in receipt accounts:			
Spectrum auction receipts	1,024	530	460
Military assistance program sales	10,229	10,300	10,410
OCS rents, bonuses, and royalties	7,194	3,806	2,832
Interest income	12,175	12,513	13,887
All other collections deposited in receipt accounts	19,497	16,086	10,402
Subtotal, other collections deposited in receipt accounts	50,119	43,235	37,991
Subtotal, collections deposited in receipt accounts	80,287	76,035	81,910
Total, offsetting collections and receipts from the public	**220,551**	**223,393**	**231,221**
Total, offsetting collections and receipts excluding off-budget	**155,554**	**155,454**	**157,344**
ADDENDUM:			
User fees that are offsetting collections and receipts [2]	132,120	140,185	152,689
Other offsetting collections and receipts from the public	88,431	83,208	78,532
Total, offsetting collections and receipts from the public	220,551	223,393	231,221

[1] Beginning in 2003, amounts received by the Federal Employees Health Benefits Program (FEHBP), previously treated as offsetting collections, are now treated as offsetting receipts. This reflects a change in the FEHBP from a trust revolving fund to a special fund and is consistent with the President's proposed Managerial Flexibility Act.

[2] Excludes user fees that are classified on the receipts side of the budget. For total user fees, see Table 5.1 or Table 5.2.

Table 5–5. OFFSETTING RECEIPTS BY TYPE

(In millions of dollars)

Source	2001 Actual	Estimate					
		2002	2003	2004	2005	2006	2007
INTRAGOVERNMENTAL TRANSACTIONS							
On-budget receipts:							
Federal intrafund transactions:							
Distributed by agency:							
Interest from the Federal Financing Bank	2,157	1,930	1,484	1,724	2,044	2,342	2,230
Interest on Government capital in enterprises	1,091	1,095	1,075	1,047	1,165	932	826
Interest received by retirement and health benefits funds	.....	.....	773	1,335	1,899	2,491	3,112
General fund payments to retirement and health benefits funds:							
Employees health benefits fund	.....	.....	11,622	11,026	11,026	11,026	11,026
DoD retiree health care fund	.....	.....	16,351	24,455	27,034	29,816	32,817
Miscellaneous Federal retirement funds [1]	.....	.....	888	893	902	912	923
Subsidy balance transfers	4,026	909	.....	.....	.....	.....	.....
Other	3,323	2,403	2,475	2,538	2,661	2,779	2,896
Undistributed by agency:							
Employing agency contributions:							
Employees health benefits fund	.....	.....	16,404	17,475	18,587	19,800	21,168
DoD retiree health care fund	.....	.....	8,312	15,475	16,416	17,418	18,500
Miscellaneous Federal retirement funds	8,219	8,683	279	331	288	285	286
Total Federal intrafunds	18,816	15,020	59,663	76,299	82,022	87,801	93,784
Trust intrafund transactions:							
Distributed by agency:							
Payments to railroad retirement	3,283	3,863	3,854	3,807	3,808	3,658	3,911
Other	1	1	1	1	1	1	1
Total trust intrafunds	3,284	3,864	3,855	3,808	3,809	3,659	3,912
Total intrafund transactions	22,100	18,884	63,518	80,107	85,831	91,460	97,696
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Contributions to insurance programs:							
Military retirement fund	16,089	17,047	17,643	18,261	18,900	19,563	20,247
Supplementary medical insurance	69,838	77,295	80,905	84,790	90,003	96,284	103,019
Proposed Legislation (non-PAYGO)	.....	.....	–19	–1	102	74	54
Hospital insurance	5,594	11,544	9,423	9,807	10,385	10,963	11,657
Railroad social security equivalent fund	98	95	100	103	106	109	114
Rail industry pension fund	229	242	254	265	275	284	296
Civilian supplementary retirement contributions	21,890	22,399	29,660	29,666	29,669	29,672	29,674
Unemployment insurance	432	517	531	526	522	526	541
Other contributions	560	482	506	508	535	533	536
Subtotal	114,730	129,621	139,003	143,925	150,497	158,008	166,138
Miscellaneous payments	1,520	930	988	944	901	882	865
Proposed Legislation (non-PAYGO)	.....	.....	2,066	.....	.....	.....	.....
Subtotal	116,250	130,551	142,057	144,869	151,398	158,890	167,003
Trust fund payments to Federal funds:							
Quinquennial adjustment for military service credits	836	.....	.....	.....	.....	.....	.....
Other	2,301	1,141	1,171	1,193	1,217	1,242	1,278
Proposed Legislation (non-PAYGO)	.....	.....	1,606	–446	–435	–430	–427
Subtotal	3,137	1,141	2,777	747	782	812	851
Total interfunds distributed by agency	119,387	131,692	144,834	145,616	152,180	159,702	167,854
Undistributed by agency:							
Employer share, employee retirement (on-budget):							
Civil service retirement and disability insurance	10,072	10,612	14,233	14,599	14,956	15,239	15,475
CSRDI from Postal Service	6,600	6,780	6,932	7,089	7,320	7,555	7,745
Hospital insurance (contribution as employer) [2]	2,031	2,183	2,299	2,402	2,538	2,645	2,755
Postal employer contributions to FHI	673	711	733	756	781	808	836
Military retirement fund	11,371	12,491	11,934	12,396	12,911	13,383	13,847

Table 5–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2001 Actual	Estimate					
		2002	2003	2004	2005	2006	2007
Other Federal employees retirement	136	134	138	142	147	152	157
Total employer share, employee retirement (on-budget)	30,883	32,911	36,269	37,384	38,653	39,782	40,815
Interest received by on-budget trust funds	75,302	74,287	77,254	80,145	83,559	87,259	91,793
Proposed Legislation (non-PAYGO)	.....	.....	–9	–44	–93	–149	–204
Total interfund transactions undistributed by agency	106,185	107,198	113,514	117,485	122,119	126,892	132,404
Total interfund transactions	225,572	238,890	258,348	263,101	274,299	286,594	300,258
Total on-budget receipts	247,672	257,774	321,866	343,208	360,130	378,054	397,954
Off-budget receipts:							
Trust intrafund transactions:							
Distributed by agency:							
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Old-age, survivors, and disability insurance	12,528	13,478	14,282	15,149	16,041	16,841	17,990
Undistributed by agency:							
Employer share, employee retirement (off-budget)	7,910	9,243	9,564	10,232	11,034	11,744	12,448
Interest received by off-budget trust funds	68,811	76,822	83,849	92,029	101,015	110,959	122,109
Total off-budget receipts:	89,249	99,543	107,695	117,410	128,090	139,544	152,547
Total intragovernmental transactions	**336,921**	**357,317**	**429,561**	**460,618**	**488,220**	**517,598**	**550,501**
PROPRIETARY RECEIPTS FROM THE PUBLIC							
Distributed by agency:							
Interest:							
Interest on foreign loans and deferred foreign collections	576	651	639	633	625	608	632
Interest on deposits in tax and loan accounts	951	451	585	585	585	585	585
Other interest (domestic—civil) [3]	10,647	11,411	12,663	13,283	13,770	14,238	14,659
Total interest	12,174	12,513	13,887	14,501	14,980	15,431	15,876
Dividends and other earnings	.....	.....	.....	.....	.....	.....	.....
Royalties and rents	2,235	1,458	1,494	1,551	1,526	1,604	1,635
Sale of products:							
Sale of timber and other natural land products	218	623	635	400	407	397	387
Proposed Legislation (PAYGO)	.....	.....	.....	3	10	14	15
Sale of minerals and mineral products	31	27	30	33	32	32	30
Sale of power and other utilities	562	721	683	695	695	714	717
Proposed Legislation (PAYGO)	.....	.....	–149	–149	–150	–150	–150
Other [3]	73	89	77	77	77	77	77
Total sale of products	884	1,460	1,276	1,059	1,071	1,084	1,076
Fees and other charges for services and special benefits:							
Medicare premiums and other charges (trust funds)	23,748	25,622	27,347	29,013	30,984	33,152	35,529
Proposed Legislation (PAYGO)	.....	.....	.....	35	82	95	23
Employees health benefits premiums	.....	.....	8,352	9,077	9,717	10,380	11,121
Nuclear waste disposal revenues	689	640	647	612	637	621	609
Veterans life insurance (trust funds)	194	198	184	170	154	139	125
Other [3]	2,409	3,124	3,480	3,780	3,808	3,990	4,133
Proposed Legislation (PAYGO)	.....	.....	6	93	189	207	208
Total fees and other charges	27,040	29,584	40,016	42,780	45,571	48,584	51,748
Sale of Government property:							
Sale of land and other real property [3]	86	150	412	110	110	110	107
Military assistance program sales (trust funds)	10,229	10,300	10,410	10,380	10,570	10,730	10,890
Other	358	759	90	65	66	41	7
Total sale of Government property	10,673	11,209	10,912	10,555	10,746	10,881	11,004

Table 5–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2001 Actual	Estimate					
		2002	2003	2004	2005	2006	2007
Realization upon loans and investments:							
Negative subsidies and downward reestimates	8,627	6,027	751	757	764	773	748
Repayment of loans to foreign nations	291	71	85	88	94	108	25
Other	83	117	97	93	89	85	83
Total realization upon loans and investments	9,001	6,215	933	938	947	966	856
Recoveries and refunds [3]	3,730	2,780	2,882	3,011	3,119	3,201	3,305
Proposed Legislation (PAYGO)	.....	.....	7	14	–103	–164	–172
Miscellaneous receipt accounts [3]	2,293	1,909	1,916	1,924	1,928	1,941	1,945
Total proprietary receipts from the public distributed by agency	68,030	67,128	73,323	76,333	79,785	83,528	87,273
Undistributed by agency:							
Other interest: Interest received from Outer Continental Shelf escrow account	1	.....	.....	.....	.....	.....	.....
Rents, bonuses, and royalties:							
Outer Continental Shelf rents and bonuses	719	834	466	509	427	396	347
Outer Continental Shelf royalties	6,475	2,972	2,366	2,443	3,243	3,573	3,671
Arctic National Wildlife Refuge:							
Proposed Legislation (PAYGO)	.....	.....	.....	2,402	2	202	2
Sale of major assets	.....	.....	.....	.....	323	.....	.....
Total proprietary receipts from the public undistributed by agency	7,195	3,806	2,832	5,354	3,995	4,171	4,020
Total proprietary receipts from the public [4]	**75,225**	**70,934**	**76,155**	**81,687**	**83,780**	**87,699**	**91,293**
OFFSETTING GOVERNMENTAL RECEIPTS							
Distributed by agency:							
Regulatory fees [3]	3,964	4,494	4,739	3,015	3,056	3,111	3,168
Proposed Legislation (non-PAYGO)	.....	.....	313	128	130	132	135
Other	74	77	243	409	416	423	431
Undistributed by agency:							
Spectrum auction proceeds	1,024	530	4,510	10,565	8,770	675	680
Proposed Legislation (PAYGO)	.....	.....	–4,050	3,350	2,700	4,700	500
Total offsetting governmental receipts	5,062	5,101	5,755	17,467	15,072	9,041	4,914
Total offsetting receipts	**417,208**	**433,352**	**511,471**	**559,772**	**587,072**	**614,338**	**646,708**

[1] 2001 and 2002 amounts are offsets for the Administration's retirement acrual proposal.
[2] Includes provision for covered Federal civilian employees and military personnel.
[3] Includes both Federal funds and trust funds.
[4] Consists of:

MEMORANDUM

Composition of proprietary receipts from the public

	2001 Actual	*Estimate*					
		2002	*2003*	*2004*	*2005*	*2006*	*2007*
On-budget:							
Federal funds	39,952	33,366	36,428	40,180	40,076	41,639	42,775
Trust funds	35,190	37,489	39,646	41,423	43,618	45,972	48,427
Off-budget	83	79	81	84	86	88	91

6. TAX EXPENDITURES

The Congressional Budget Act of 1974 (Public Law 93–344) requires that a list of "tax expenditures" be included in the budget. Tax expenditures are defined in the law as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability." The Act suggests that tax expenditures are exceptions to some norm or standard tax concept that is not specified in the law. Hence, different analyses may use different baseline tax structures; indeed, the budget presentation here provides tax expenditure estimates measured against more than one baseline.

Due, in part, to the degree of arbitrariness in the tax expenditure baseline, the Administration believes the meaningfulness of tax expenditure estimates is uncertain and that the "tax expenditure" presentation can be improved by consideration of alternative or additional tax bases. A description of an ongoing Treasury study to reevaluate the tax expenditure concept is presented at the beginning of this chapter. The tax expenditure estimates and related discussion following the description of this study, however, are based on materials and formats developed and included in previous budgets. Tax expenditure estimates under the unified transfer (i.e., estate and gift) tax have been eliminated from the presentation because there is no generally accepted normal baseline for transfer taxes and this tax has been repealed under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).

The largest reported tax expenditures tend to be associated with the individual income tax. For example, sizeable deferrals, deductions and exclusions are provided for pension contributions and earnings, employer contributions for medical insurance, mortgage interest payments on owner-occupied homes, capital gains, and payments of State and local individual income and property taxes. Reported tax expenditures under the corporate income tax tend to be related to timing differences in 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.

Each tax expenditure estimate in this chapter was calculated assuming other parts of the tax code remained unchanged. The estimates would be different if all tax expenditures or major groups of tax expenditures were changed simultaneously because of potential interactions among provisions. For that reason, this chapter does not present a grand total for the estimated 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.

Tax expenditures relating to the individual and corporate income taxes are estimated for fiscal years 2001–2007 using three methods of accounting: revenue effects, outlay equivalent, and present value. The present value approach provides estimates of the revenue effects for tax expenditures that involve deferrals of tax payments into the future or have similar long-term effects.

The section of the chapter on performance measures and economic effects presents information related to assessment of the effect of tax expenditures on the achievement of program performance goals. This section is a complement to the government-wide performance plan required by the Government Performance and Results Act of 1993.

FUTURE REVISIONS TO THE TAX EXPENDITURE PRESENTATION

Policymakers and researchers have long recognized that certain income tax code provisions have policy purposes other than simply raising revenue and that it is useful to understand better the nature of these provisions. It is important to know the amounts of revenue associated with them, whether they are achieving desired results, and their consequences for the economy. The answers to these questions are important simply as a source of information, but also so that policymakers and the public can review these features of the income tax regularly to see if change is warranted. Thus it was that in 1974 the Congress mandated as part of the Congressional Budget Act of 1974 that the annual Federal budget presentation include a list of "tax expenditures", where tax expenditures were defined as:

> ...those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability....

Though imperfect, the tax expenditure budget has expanded our understanding of policy programs operating through the Federal income tax and, more generally, the workings of the Federal income tax.

The complexity of our economy and society on the one hand, and the complexity of the income tax on the other, suggest the need for a variety of analyses

to understand their interaction better. The Treasury Department has begun an effort to review the tax expenditure presentation, and will be considering possible revisions and improvements in methodology and approach. The need for this effort was raised in the President's Fiscal Year 2002 budget submission, which noted that the current tax expenditure analysis was developed relative to an arbitrary tax base and that:

> Because of the breadth of this arbitrary tax base, the Administration believes that the concept of "tax expenditure" is of questionable analytic value. [1]

This review is intended to improve the quality and range of information available regarding the Federal income tax and its effects on the economy. The Treasury Department's efforts in this area will continue over the coming year, assisted by public debate and comment.

The Need for Change

The definition of the baseline against which tax expenditures are measured is crucial to the definition and calculation of tax expenditures. For purposes of calculating tax expenditures, the 1974 Budget Act did not specify the provisions of the baseline tax law, which, quoting further from the Fiscal Year 2002 budget, means that: "Deciding whether provisions are exceptions (from the normal baseline), therefore, is a matter of judgement." As the normal baseline and deviations from the baseline are constructed from a set of potentially subjective judgements, differences of opinion can arise as to the correct classification of specific provisions of the tax code. While the normal baseline follows a theoretically appealing measure of a comprehensive income tax in many ways, it deviates in other important ways. These deviations may reflect judgements along a number of dimensions, including administrative concerns, political judgements, social policy, and historical methods of taxing income. But these deviations inject a degree of subjectivity that can limit the value of the underlying analysis.

One problem with injecting subjective elements into the definition of the baseline income tax is that common notions of what constitutes a "normal" income tax will change over time. For example, although the tax exemption for employer-provided pensions is labeled a tax expenditure, the growing presence of tax-deferred savings vehicles in the tax code suggests that these may today be part of "normal" income tax circa 2002. It is not clear, however, whether the "normal" income tax of 2002 is more appropriate than that in place in any other year if one is interested in better understanding deviations of the current income tax from a more objective standard of a comprehensive income tax.

A highly subjective baseline also may not inform policymakers and the public about those aspects of social or economic policy that are implemented through the tax code. The Federal income tax contains many provisions for providing income support for lower-income citizens. Examples include the Earned Income Tax Credit, the Work Opportunity Credit, and the Child Tax Credit. Each of these provisions is appropriately labeled a tax expenditure in the current tax expenditure presentation. The personal exemption, which cannot be claimed by higher-income taxpayers because of a phase-out of the exemption, however, is not presently labeled a tax expenditure although it can also be viewed as a component of the income support policies effected through the income tax. In many other ways, the "normal tax" baseline may fail to capture the extent to which the tax system serves such programmatic purposes.

Finally, the public and policymakers are interested in the tax subsidies and excises imbedded in the tax code and their effects on individual behavior and on economic activity. Tax subsidies and excises arise when the relative prices of goods, services, or activities are distorted by the tax system. A highly subjective "normal tax" may shed little light on these issues.

Because of the controversy that accompanies the existing "normal tax" concept, it may be appropriate to reconsider a comprehensive income tax as a baseline for the tax expenditure budget. Comprehensive income is a well-accepted theoretical concept, and so avoids some subjectivity that plagues the "normal tax" baseline. A comprehensive measure of income, however, would not eliminate all contentious issues. Any practical implementation of a comprehensive tax base would involve judgements, e.g., about which items of theoretical income or expense are too abstract or difficult to estimate to include in the baseline, but that other analysts may see as necessary.

Focus of the Reconsideration and Revision Effort

The effort to improve the tax expenditure presentation will focus on three aspects. The first relates to the definition of an income tax or standard against which tax expenditures are identified and measured as discussed above. The study will consider redefining the baseline income concept to be more consistent with a comprehensive income tax base, as well as other alternative definitions of income.

The study will also consider issues involved in estimating "negative" tax expenditures in addition to the conventional positive tax expenditures currently reported in the Budget. A negative tax expenditure arises whenever a tax provision causes a taxpayer to pay more tax than would be consistent with the baseline income tax. Negative tax expenditures have not been identified and calculated in the past, in part because they did not appear to relate to the original purpose of the tax expenditure analysis to identify implicit spending programs operating through the tax system. Nevertheless, negative tax expenditures provide an important additional perspective and may offer a useful source of information to analysts and policy makers.

Academics and tax specialists have studied intensively whether the United States should adopt a con-

[1] Analytical Perspectives, Budget of the United States, Fiscal Year 2002, Chapter 5.

sumption tax at the Federal level, either as a source of additional revenue, or in place of some or all of the current sources of Federal revenue. Though the existing Federal individual income tax is thought of as a tax on income, in many respects it has evolved into a hybrid tax containing some elements consistent both with a comprehensive income tax and a consumption tax, as well as many elements consistent with neither an income nor a consumption tax. Therefore, the third aspect of the Treasury's effort will be to consider estimating tax expenditures relative to a hypothetical consumption tax, as well as relative to an income tax. This would allow a comparison of the Federal income tax vis-à-vis the two baseline systems. It would also serve to give additional perspective on the tax expenditure analysis by highlighting those provisions in the Federal income tax that may give rise to a tax expenditure or negative expenditure in one system but not in the other.

When completed, this review can significantly improve the overall understanding of the effects of the Federal income tax on the economy. For example, reconsideration of the income tax baseline is intended to provide a baseline definition that can better capture the numerous ways in which the tax system influences economic behavior relative to a comprehensive income tax system. Similarly, the definition and calculation of negative tax expenditures can provide useful new information about those activities subject to a tax surcharge relative to the baseline tax. Viewing these negative tax expenditures alongside the traditional tax expenditure presentation can provide important context for the overall tax expenditure budget. The calculation of tax expenditures and negative tax expenditures relative to a consumption tax budget can provide further context for the traditional tax expenditure presentation while providing important new information about the effects of the tax system on the economy. Finally, a consumption tax base analysis can help illuminate some of the central issues that would arise in any effort to enact a Federal consumption tax.

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

All tax expenditure estimates presented here are based upon current tax law enacted as of December 31, 2001. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 2001. 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 effects for tax expenditures for fiscal years 2001–2007 are displayed according to the budget's functional categories in Table 6–1. Descriptions of the specific tax expenditure provisions follow the tables of estimates and the 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 effects for these items are zero using the reference tax rules. The alternative baseline concepts are discussed in detail following the tables.

Table 6–2 reports the respective portions of the total revenue effects that arise under the individual and corporate income taxes separately. The location of the 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 could be shareholders, employees, customers, or other providers of capital, depending on economic forces.

Table 6–3 ranks the major tax expenditures by the size of their FY 2003 revenue effect.

Interpreting Tax Expenditure Estimates

The estimates shown for individual tax expenditures in Tables 6–1, 6–2, and 6–3 do not necessarily equal the increase in Federal revenues (or the change in the budget balance) that would result from repealing these 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 activity or of other tax provisions 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. Such indirect effects are not reflected in the estimates.

Tax expenditures are interdependent even without incentive effects. Repeal of a tax expenditure provision can increase or decrease the tax revenues associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the revenue costs from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the revenue cost 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, because each is estimated assum-

ing that the other remains in force. In addition, the estimates reported in Table 6–1 are the totals of individual and corporate income tax revenue effects reported in Table 6–2 and do not reflect any possible interactions between the individual and corporate income tax receipts. For this reason, the estimates in Table 6–1 (as well as those in Table 6–5, 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 6–4. 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. Although 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 effect on receipts to the Government because the newly deferred taxes will ultimately be received. Present-value estimates, which are a useful complement to the cash-basis estimates for provisions involving deferrals, are discussed below.

Present-Value Estimates

Discounted present-value estimates of revenue effects are presented in Table 6–4 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 effects, net of future tax payments, that follow from activities undertaken during calendar year 2001 that cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 2001 would cause a deferral of tax payments on wages in 2001 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 2001 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 6–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES

(In millions of dollars)

		Total from corporations and individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007
	National Defense								
1	Exclusion of benefits and allowances to armed forces personnel	2,160	2,190	2,210	2,240	2,260	2,290	2,310	11,310
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	2,450	2,540	2,660	2,690	2,760	2,810	3,170	14,090
3	Exclusion of certain allowances for Federal employees abroad	760	800	840	880	920	960	1,020	4,620
4	Extraterritorial income exclusion	4,490	4,820	5,150	5,510	5,890	6,290	6,730	29,570
5	Inventory property sales source rules exception	1,400	1,470	1,540	1,620	1,700	1,790	1,880	8,530
6	Deferral of income from controlled foreign corporations (normal tax method)	6,600	7,000	7,450	7,900	8,400	8,930	9,550	42,230
7	Deferred taxes for financial firms on certain income earned overseas	1,300	550	0	0	0	0	0	0
	General science, space, and technology:								
8	Expensing of research and experimentation expenditures (normal tax method)	2,020	1,780	2,380	2,880	3,400	3,910	4,160	16,730
9	Credit for increasing research activities	5,370	6,010	4,590	4,020	2,330	990	410	12,350
	Energy:								
10	Expensing of exploration and development costs, fuels	50	60	70	90	90	100	100	450
11	Excess of percentage over cost depletion, fuels	250	260	270	290	300	310	320	1,490
12	Alternative fuel production credit	900	850	410	130	130	130	130	930
13	Exception from passive loss limitation for working interests in oil and gas properties	20	20	20	20	20	20	20	100
14	Capital gains treatment of royalties on coal	100	100	110	120	120	130	140	620
15	Exclusion of interest on energy facility bonds	90	90	100	120	130	140	150	640
16	Enhanced oil recovery credit	310	360	440	530	640	760	910	3,280
17	New technology credit	60	80	100	100	100	90	90	480
18	Alcohol fuel credits [1]	30	30	30	30	30	30	30	150
19	Tax credit and deduction for clean-fuel burning vehicles	50	50	50	20	–10	–50	–50	–40
20	Exclusion from income of conservation subsidies provided by public utilities	70	70	70	70	70	70	60	340
	Natural resources and environment:								
21	Expensing of exploration and development costs, nonfuel minerals	10	10	10	10	10	10	10	50
22	Excess of percentage over cost depletion, nonfuel minerals	250	260	270	290	300	300	310	1,470
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	400	420	440	480	530	580	630	2,660
24	Capital gains treatment of certain timber income	100	100	110	120	120	130	140	620
25	Expensing of multiperiod timber growing costs	360	360	370	380	390	400	410	1,950
26	Tax incentives for preservation of historic structures	180	200	210	220	230	240	250	1,150
	Agriculture:								
27	Expensing of certain capital outlays	170	170	170	170	170	170	170	850
28	Expensing of certain multiperiod production costs	120	130	130	130	120	120	120	620
29	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	990	1,040	1,100	1,160	1,220	1,290	1,360	6,130
31	Income averaging for farmers	70	70	70	70	80	80	80	380
32	Deferral of gain on sale of farm refiners	10	10	10	10	10	10	10	50
	Commerce and housing:								
	Financial institutions and insurance:								
33	Exemption of credit union income	1,000	1,070	1,150	1,230	1,320	1,420	1,530	6,650
34	Excess bad debt reserves of financial institutions	60	50	30	20	10	0	0	60
35	Exclusion of interest on life insurance savings	16,290	17,710	19,250	20,940	22,780	24,790	26,930	114,690
36	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	220	230	250	260	280	290	300	1,380
38	Small life insurance company deduction	100	100	100	100	100	100	100	500
	Housing:								
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	800	830	870	960	1,050	1,140	1,240	5,260
40	Exclusion of interest on rental housing bonds	160	170	180	200	220	240	260	1,100
41	Deductibility of mortgage interest on owner-occupied homes	64,510	64,190	66,110	68,070	70,870	73,560	76,870	355,480
42	Deductibility of State and local property tax on owner-occupied homes	22,410	22,680	23,580	23,210	20,330	16,300	14,410	97,830
43	Deferral of income from post 1987 installment sales	1,040	1,050	1,080	1,100	1,120	1,140	1,160	5,600
44	Capital gains exclusion on home sales	19,090	19,670	20,260	20,860	21,490	22,140	22,800	107,550
45	Exception from passive loss rules for $25,000 of rental loss	4,800	4,400	4,070	3,780	3,530	3,290	3,090	17,760
46	Credit for low-income housing investments	3,220	3,330	3,460	3,630	3,810	3,980	4,130	19,010
47	Accelerated depreciation on rental housing (normal tax method)	5,190	5,440	5,710	5,790	5,800	5,720	5,800	28,820
	Commerce:								
48	Cancellation of indebtedness	30	30	30	40	40	40	40	190
49	Exceptions from imputed interest rules	80	80	80	80	80	80	80	400
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	67,800	61,810	60,200	56,990	56,180	50,670	49,880	273,920
51	Capital gains exclusion of small corporation stock	70	100	130	160	210	250	300	1,050
52	Step-up basis of capital gains at death	26,540	27,610	28,710	29,860	31,050	32,300	33,590	155,510
53	Carryover basis of capital gains on gifts	530	600	680	760	900	1,080	1,130	4,550
54	Ordinary income treatment of loss from small business corporation stock sale	40	40	40	50	50	50	50	240
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	4,540	4,560	4,240	3,960	3,800	4,160	4,880	21,040

Table 6–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(In millions of dollars)

		Total from corporations and individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007
56	Accelerated depreciation of machinery and equipment (normal tax method)	37,860	37,130	36,480	36,790	37,430	38,520	40,930	190,150
57	Expensing of certain small investments (normal tax method)	1,670	1,430	1,420	1,390	1,360	1,480	1,720	7,370
58	Amortization of start-up costs (normal tax method)	130	160	200	240	250	270	270	1,230
59	Graduated corporation income tax rate (normal tax method)	4,940	5,590	6,210	6,580	7,120	7,450	7,880	35,240
60	Exclusion of interest on small issue bonds	310	310	330	360	390	430	470	1,980
	Transportation:								
61	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
62	Exclusion of reimbursed employee parking expenses	1,980	2,090	2,190	2,300	2,420	2,550	2,670	12,130
63	Exclusion for employer-provided transit passes	220	280	360	410	470	540	600	2,380
	Community and regional development:								
64	Investment credit for rehabilitation of structures (other than historic)	30	30	30	30	30	30	30	150
65	Exclusion of interest for airport, dock, and similar bonds	630	640	680	750	820	890	980	4,120
66	Exemption of certain mutuals' and cooperatives' income	60	60	60	60	70	70	70	330
67	Empowerment zones, Enterprise communities, and Renewal communities	380	730	1,130	1,170	1,280	1,410	1,580	6,570
68	New markets tax credit	10	90	190	290	430	610	830	2,350
69	Expensing of environmental remediation costs	80	100	100	20	–20	–10	–10	80
	Education, training, employment, and social services:								
	Education:								
70	Exclusion of scholarship and fellowship income (normal tax method)	1,210	1,200	1,210	1,240	1,330	1,380	1,390	6,550
71	HOPE tax credit	4,130	4,110	3,520	2,880	2,930	2,730	2,900	14,960
72	Lifetime Learning tax credit	2,370	2,290	2,360	3,140	2,980	2,740	2,960	14,180
73	Education Individual Retirement Accounts	30	50	80	130	220	330	470	1,230
74	Deductibility of student-loan interest	390	450	640	660	680	700	720	3,400
75	Deduction for higher education expenses	0	430	2,290	2,960	3,710	3,010	0	11,970
76	State prepaid tuition plans	190	270	340	400	460	530	590	2,320
77	Exclusion of interest on student-loan bonds	230	230	240	260	290	310	350	1,450
78	Exclusion of interest on bonds for private nonprofit educational facilities	540	550	580	640	700	760	830	3,510
79	Credit for holders of zone academy bonds	30	50	70	80	90	90	90	420
80	Exclusion of interest on savings bonds redeemed to finance educational expenses	10	20	20	20	20	20	20	100
81	Parental personal exemption for students age 19 or over	1,010	1,070	1,120	1,170	1,230	1,280	1,340	6,140
82	Deductibility of charitable contributions (education)	3,830	3,980	4,200	4,440	4,600	4,840	5,030	23,110
83	Exclusion of employer-provided educational assistance	260	410	500	530	560	590	620	2,800
	Training, employment, and social services:								
84	Work opportunity tax credit	300	230	140	60	30	10	0	240
85	Welfare-to-work tax credit	90	70	40	20	10	0	0	70
86	Employer provided child care exclusion	720	740	770	810	930	1,020	1,080	4,610
87	Employer-provided child care credit	0	40	90	130	150	150	160	680
88	Assistance for adopted foster children	190	220	250	260	270	280	290	1,350
89	Adoption credit and exclusion	130	140	220	450	500	540	560	2,270
90	Exclusion of employee meals and lodging (other than military)	710	740	780	810	850	890	930	4,260
91	Child credit [2]	19,840	19,760	19,680	19,550	20,550	21,530	21,240	102,550
92	Credit for child and dependent care expenses	2,670	2,610	2,670	2,960	2,700	2,150	1,920	12,400
93	Credit for disabled access expenditures	50	50	50	50	60	60	60	280
94	Deductibility of charitable contributions, other than education and health	30,150	30,810	32,080	33,830	35,190	36,890	38,290	176,280
95	Exclusion of certain foster care payments	500	510	520	530	540	570	610	2,770
96	Exclusion of parsonage allowances	350	370	400	420	450	470	490	2,230
	Health:								
97	Exclusion of employer contributions for medical insurance premiums and medical care	82,800	90,910	99,260	106,940	115,380	124,050	134,960	580,590
98	Self-employed medical insurance premiums	1,520	1,730	2,420	3,570	3,870	4,170	4,430	18,460
99	Workers' compensation insurance premiums	4,730	4,870	5,080	5,230	5,410	5,570	5,790	27,080
100	Medical Savings Accounts	20	20	20	20	20	20	20	100
101	Deductibility of medical expenses	4,990	5,260	5,530	5,840	6,280	6,600	7,100	31,350
102	Exclusion of interest on hospital construction bonds	1,100	1,130	1,190	1,310	1,440	1,570	1,700	7,210
103	Deductibility of charitable contributions (health)	4,010	4,180	4,420	4,690	4,850	5,100	5,320	24,380
104	Tax credit for orphan drug research	140	150	170	190	220	240	270	1,090
105	Special Blue Cross/Blue Shield deduction	270	300	340	310	300	270	300	1,520
	Income security:								
106	Exclusion of railroad retirement system benefits	380	390	400	400	400	400	400	2,000
107	Exclusion of workers' compensation benefits	5,560	5,810	6,070	6,320	6,600	6,900	7,200	33,090
108	Exclusion of public assistance benefits (normal tax method)	370	380	400	410	430	450	470	2,160
109	Exclusion of special benefits for disabled coal miners	70	70	60	60	60	50	50	280
110	Exclusion of military disability pensions	110	120	120	120	130	130	140	640
	Net exclusion of pension contributions and earnings:								
111	Employer plans	42,070	48,070	53,080	54,500	55,630	58,980	63,320	285,510
112	401(k) plans	44,080	52,960	59,510	62,770	65,290	69,230	73,320	330,120

Table 6–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(In millions of dollars)

		Total from corporations and individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007
113	Individual Retirement Accounts	18,680	18,090	18,660	19,050	18,930	19,230	18,330	94,200
114	Low and moderate income savers credit	0	550	1,960	1,940	1,900	1,800	1,280	8,880
115	Keogh plans	6,160	6,520	6,770	7,040	7,250	7,490	7,730	36,280
	Exclusion of other employee benefits:								
116	Premiums on group term life insurance	1,750	1,780	1,800	1,830	1,860	1,890	1,920	9,300
117	Premiums on accident and disability insurance	210	220	230	240	250	260	270	1,250
118	Small business retirement plan credit	0	20	50	90	120	130	150	540
119	Income of trusts to finance supplementary unemployment benefits	20	20	30	30	30	30	30	150
120	Special ESOP rules	1,290	1,340	1,420	1,490	1,570	1,640	1,730	7,850
121	Additional deduction for the blind	40	40	40	40	40	40	40	200
122	Additional deduction for the elderly	1,970	1,890	1,950	2,060	2,100	2,150	2,050	10,310
123	Tax credit for the elderly and disabled	30	30	30	30	30	30	30	150
124	Deductibility of casualty losses	210	250	310	360	410	450	490	2,020
125	Earned income tax credit [3]	4,940	4,370	4,800	4,930	5,100	5,180	5,390	25,400
	Social Security:								
	Exclusion of social security benefits:								
126	Social Security benefits for retired workers	17,830	18,000	18,180	18,560	18,850	19,720	20,890	96,200
127	Social Security benefits for disabled	2,690	2,930	3,240	3,630	4,020	4,470	5,020	20,380
128	Social Security benefits for dependents and survivors	3,720	3,870	4,060	4,320	4,560	4,820	5,170	22,930
	Veterans benefits and services:								
129	Exclusion of veterans death benefits and disability compensation	3,150	3,190	3,300	3,490	3,680	3,870	4,080	18,420
130	Exclusion of veterans pensions	70	80	80	80	90	90	100	440
131	Exclusion of GI bill benefits	90	90	90	100	100	110	110	510
132	Exclusion of interest on veterans housing bonds	40	40	40	40	50	50	60	240
	General purpose fiscal assistance:								
133	Exclusion of interest on public purpose State and local bonds	23,100	23,680	24,270	24,880	25,500	26,140	26,800	127,590
134	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	45,520	46,160	48,150	47,730	43,270	34,820	30,890	204,860
135	Tax credit for corporations receiving income from doing business in U.S. possessions	2,190	2,240	2,240	2,240	2,200	1,300	0	7,980
	Interest:								
136	Deferral of interest on U.S. savings bonds	290	300	310	330	330	350	360	1,680
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	22,410	22,680	23,580	23,210	20,330	16,300	14,410	97,830
	Nonbusiness State and local taxes other than on owner-occupied homes	45,520	46,160	48,150	47,730	43,270	34,820	30,890	204,860
	Exclusion of interest on State and local bonds for:								
	Public purposes	23,100	23,680	24,270	24,880	25,500	26,140	26,800	127,590
	Energy facilities	90	90	100	120	130	140	150	640
	Water, sewage, and hazardous waste disposal facilities	400	420	440	480	530	580	630	2,660
	Small-issues	310	310	330	360	390	430	470	1,980
	Owner-occupied mortgage subsidies	800	830	870	960	1,050	1,140	1,240	5,260
	Rental housing	160	170	180	200	220	240	260	1,100
	Airports, docks, and similar facilities	630	640	680	750	820	890	980	4,120
	Student loans	230	230	240	260	290	310	350	1,450
	Private nonprofit educational facilities	540	550	580	640	700	760	830	3,510
	Hospital construction	1,100	1,130	1,190	1,310	1,440	1,570	1,700	7,210
	Veterans' housing	40	40	40	40	50	50	60	240
	Credit for holders of zone academy bonds	30	50	70	80	90	90	90	420

[1] The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of "income" that is larger in scope than is "income" as defined under general U.S. income tax principles. For tax reasons, the tax expenditure estimates include, for example, estimates related to the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation.

[2] 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: 2001 $990; 2002 $1,020; 2003 $1,050; 2004 $1,080; 2005 $1,080; 2006 $1,100; and 2007 $1,120.

[3] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2001 $980; 2002 $7,390; 2003 $7,390; 2004 $7,210; 2005 $6,950; 2006 $9,380; and 2007 $9,200.

[4] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2001 $26,120; 2002 $28,280; 2003 $30,630; 2004 $31,080; 2005 $31,720; 2006 $33,130; and 2007 $34,090.

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 $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Table 6–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES

(In millions of dollars)

		Corporations								Individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007	2001	2002	2003	2004	2005	2006	2007	2003–2007
	National Defense																
1	Exclusion of benefits and allowances to armed forces personnel	.....	.....	.....	.....	.....	.....	.....	.....	2,160	2,190	2,210	2,240	2,260	2,290	2,310	11,310
	International affairs:																
2	Exclusion of income earned abroad by U.S. citizens	.....	.....	.....	.....	.....	.....	.....	.....	2,450	2,540	2,660	2,690	2,760	2,810	3,170	14,090
3	Exclusion of certain allowances for Federal employees abroad	.....	.....	.....	.....	.....	.....	.....	.....	760	800	840	880	920	960	1,020	4,620
4	Extraterritorial income exclusion	4,490	4,820	5,150	5,510	5,890	6,290	6,730	29,570	.....	.....	.....	.....	.....	.....	.....	.....
5	Inventory property sales source rules exception	1,400	1,470	1,540	1,620	1,700	1,790	1,880	8,530	.....	.....	.....	.....	.....	.....	.....	.....
6	Deferral of income from controlled foreign corporations (normal tax method)	6,600	7,000	7,450	7,900	8,400	8,930	9,550	42,230	.....	.....	.....	.....	.....	.....	.....	.....
7	Deferred taxes for financial firms on certain income earned overseas	1,300	550	.....	.....	.....	.....	.....	0	.....	.....	.....	.....	.....	.....	.....	.....
	General science, space, and technology:																
8	Expensing of research and experimentation expenditures (normal tax method)	1,980	1,750	2,330	2,820	3,330	3,830	4,080	16,390	40	30	50	60	70	80	80	340
9	Credit for increasing research activities	5,310	5,950	4,540	3,980	2,310	990	410	12,240	60	60	50	40	20	.....	.....	110
	Energy:																
10	Expensing of exploration and development costs, fuels	40	50	60	70	70	80	80	360	10	10	10	20	20	20	20	90
11	Excess of percentage over cost depletion, fuels	220	230	240	250	260	270	280	1,300	30	30	30	40	40	40	40	190
12	Alternative fuel production credit	860	810	390	120	120	120	120	870	40	40	20	10	10	10	10	60
13	Exception from passive loss limitation for working interests in oil and gas properties	.....	.....	.....	.....	.....	.....	.....	.....	20	20	20	20	20	20	20	100
14	Capital gains treatment of royalties on coal	.....	.....	.....	.....	.....	.....	.....	.....	100	100	110	120	120	130	140	620
15	Exclusion of interest on energy facility bonds	20	20	20	30	30	30	30	140	70	70	80	90	100	110	120	500
16	Enhanced oil recovery credit	280	330	400	480	580	690	830	2,980	30	30	40	50	60	70	80	300
17	New technology credit	60	80	100	100	100	90	90	480	.....	.....	.....	.....	.....	.....	.....	.....
18	Alcohol fuel credits [1]	20	20	20	20	20	20	20	100	10	10	10	10	10	10	10	50
19	Tax credit and deduction for clean-fuel burning vehicles	30	30	20	0	–20	–40	–40	–80	20	20	30	20	10	–10	–10	40
20	Exclusion from income of conservation subsidies provided by public utilities	.....	.....	.....	.....	.....	.....	.....	.....	70	70	70	70	70	70	60	340
	Natural resources and environment:																
21	Expensing of exploration and development costs, nonfuel minerals	10	10	10	10	10	10	10	50	.....	.....	.....	.....	.....	.....	.....	.....
22	Excess of percentage over cost depletion, nonfuel minerals	240	250	260	270	280	280	290	1,380	10	10	10	20	20	20	20	90
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	100	110	110	110	110	120	120	570	300	310	330	370	420	460	510	2,090
24	Capital gains treatment of certain timber income	.....	.....	.....	.....	.....	.....	.....	.....	100	100	110	120	120	130	140	620
25	Expensing of multiperiod timber growing costs	240	240	250	260	260	270	280	1,320	120	120	120	120	130	130	130	630
26	Tax incentives for preservation of historic structures	170	180	190	200	210	220	230	1,050	10	20	20	20	20	20	20	100
	Agriculture:																
27	Expensing of certain capital outlays	20	20	20	20	20	20	20	100	150	150	150	150	150	150	150	750
28	Expensing of certain multiperiod production costs	10	20	20	20	20	20	20	100	110	110	110	110	100	100	100	520
29	Treatment of loans forgiven for solvent farmers	.....	.....	.....	.....	.....	.....	.....	.....	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	.....	.....	.....	.....	.....	.....	.....	.....	990	1,040	1,100	1,160	1,220	1,290	1,360	6,130
31	Income averaging for farmers	.....	.....	.....	.....	.....	.....	.....	.....	70	70	70	70	80	80	80	380
32	Deferral of gain on sale of farm refiners	10	10	10	10	10	10	10	50	.....	.....	.....	.....	.....	.....	.....	.....

Table 6–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES—Continued

(In millions of dollars)

		Corporations								Individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007	2001	2002	2003	2004	2005	2006	2007	2003–2007
	Commerce and housing:																
	Financial institutions and insurance:																
33	Exemption of credit union income	1,000	1,070	1,150	1,230	1,320	1,420	1,530	6,650	.....	.....	.....	.....	.....	.....	.....	.....
34	Excess bad debt reserves of financial institutions	60	50	30	20	10	0	0	60	.....	.....	.....	.....	.....	.....	.....	.....
35	Exclusion of interest on life insurance savings	1,650	1,770	1,890	2,020	2,160	2,280	2,490	10,840	14,640	15,940	17,360	18,920	20,620	22,510	24,440	103,850
36	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50	.....	.....	.....	.....	.....	.....	.....	.....
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	220	230	250	260	280	290	300	1,380	.....	.....	.....	.....	.....	.....	.....	.....
38	Small life insurance company deduction	100	100	100	100	100	100	100	500	.....	.....	.....	.....	.....	.....	.....	.....
	Housing:																
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	200	210	210	220	230	230	240	1,130	600	620	660	740	820	910	1,000	4,130
40	Exclusion of interest on rental housing bonds	40	40	40	50	50	50	50	240	120	130	140	150	170	190	210	860
41	Deductibility of mortgage interest on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	.....	64,510	64,190	66,110	68,070	70,870	73,560	76,870	355,480
42	Deductibility of State and local property tax on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	.....	22,410	22,680	23,580	23,210	20,330	16,300	14,410	97,830
43	Deferral of income from post 1987 installment sales	270	270	280	290	290	300	300	1,460	770	780	800	810	830	840	860	4,140
44	Capital gains exclusion on home sales	.....	.....	.....	.....	.....	.....	.....	.....	19,090	19,670	20,260	20,860	21,490	22,140	22,800	107,550
45	Exception from passive loss rules for $25,000 of rental loss	.....	.....	.....	.....	.....	.....	.....	.....	4,800	4,400	4,070	3,780	3,530	3,290	3,090	17,760
46	Credit for low-income housing investments	2,420	2,500	2,600	2,730	2,860	2,990	3,100	14,280	800	830	860	900	950	990	1,030	4,730
47	Accelerated depreciation on rental housing (normal tax method)	390	410	440	450	460	470	480	2,300	4,800	5,030	5,270	5,340	5,340	5,250	5,320	26,520
	Commerce:																
48	Cancellation of indebtedness	.....	.....	.....	.....	.....	.....	.....	.....	30	30	30	40	40	40	40	190
49	Exceptions from imputed interest rules	.....	.....	.....	.....	.....	.....	.....	.....	80	80	80	80	80	80	80	400
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	.....	.....	.....	.....	.....	.....	.....	.....	67,800	61,810	60,200	56,990	56,180	50,670	49,880	273,920
51	Capital gains exclusion of small corporation stock	.....	.....	.....	.....	.....	.....	.....	.....	70	100	130	160	210	250	300	1,050
52	Step-up basis of capital gains at death	.....	.....	.....	.....	.....	.....	.....	.....	26,540	27,610	28,710	29,860	31,050	32,300	33,590	155,510
53	Carryover basis of capital gains on gifts	.....	.....	.....	.....	.....	.....	.....	.....	530	600	680	760	900	1,080	1,130	4,550
54	Ordinary income treatment of loss from small business corporation stock sale	.....	.....	.....	.....	.....	.....	.....	.....	40	40	40	50	50	50	50	240
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	2,690	2,620	2,450	2,180	1,990	2,050	2,310	10,980	1,850	1,940	1,790	1,780	1,810	2,110	2,570	10,060
56	Accelerated depreciation of machinery and equipment (normal tax method)	30,750	30,220	29,750	30,200	30,860	31,970	34,070	156,850	7,110	6,910	6,730	6,590	6,570	6,550	6,860	33,300
57	Expensing of certain small investments (normal tax method)	530	470	460	460	450	490	570	2,430	1,140	960	960	930	910	990	1,150	4,940
58	Amortization of start-up costs (normal tax method)	90	110	140	160	170	180	180	830	40	50	60	80	80	90	90	400
59	Graduated corporation income tax rate (normal tax method)	4,940	5,590	6,210	6,580	7,120	7,450	7,880	35,240	.....	.....	.....	.....	.....	.....	.....	.....
60	Exclusion of interest on small issue bonds	80	80	80	80	80	90	90	420	230	230	250	280	310	340	380	1,560
	Transportation:																
61	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100	.....	.....	.....	.....	.....	.....	.....	.....

Table 6–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES—Continued

(In millions of dollars)

		Corporations								Individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007	2001	2002	2003	2004	2005	2006	2007	2003–2007
62	Exclusion of reimbursed employee parking expenses	...	...	...	...	...	...	...	...	1,980	2,090	2,190	2,300	2,420	2,550	2,670	12,130
63	Exclusion for employer-provided transit passes	...	...	...	...	...	...	...	...	220	280	360	410	470	540	600	2,380
	Community and regional development:																
64	Investment credit for rehabilitation of structures (other than historic)	20	20	20	20	20	20	20	100	10	10	10	10	10	10	10	50
65	Exclusion of interest for airport, dock, and similar bonds	160	160	170	170	180	180	190	890	470	480	510	580	640	710	790	3,230
66	Exemption of certain mutuals' and cooperatives' income	60	60	60	60	70	70	70	330	...	...	...	...	...	...	...	...
67	Empowerment zones, Enterprise communities, and Renewal communities	100	220	300	300	320	350	390	1,660	280	510	830	870	960	1,060	1,190	4,910
68	New markets tax credit	0	20	50	70	110	150	210	590	10	70	140	220	320	460	620	1,760
69	Expensing of environmental remediation costs	70	80	80	20	–20	–10	–10	60	10	20	20	...	...	...	...	20
	Education, training, employment, and social services:																
	Education:																
70	Exclusion of scholarship and fellowship income (normal tax method)	...	...	...	...	...	...	...	...	1,210	1,200	1,210	1,240	1,330	1,380	1,390	6,550
71	HOPE tax credit	...	...	...	...	...	...	...	...	4,130	4,110	3,520	2,880	2,930	2,730	2,900	14,960
72	Lifetime Learning tax credit	...	...	...	...	...	...	...	...	2,370	2,290	2,360	3,140	2,980	2,740	2,960	14,180
73	Education Individual Retirement Accounts	...	...	...	...	...	...	...	...	30	50	80	130	220	330	470	1,230
74	Deductibility of student-loan interest	...	...	...	...	...	...	...	...	390	450	640	660	680	700	720	3,400
75	Deduction for higher education expenses	...	...	...	...	...	...	...	...	0	430	2,290	2,960	3,710	3,010	0	11,970
76	State prepaid tuition plans	...	...	...	...	...	...	...	...	190	270	340	400	460	530	590	2,320
77	Exclusion of interest on student-loan bonds	60	60	60	60	60	60	70	310	170	170	180	200	230	250	280	1,140
78	Exclusion of interest on bonds for private nonprofit educational facilities	140	140	140	150	150	150	160	750	400	410	440	490	550	610	670	2,760
79	Credit for holders of zone academy bonds	30	50	70	80	90	90	90	420	...	...	...	...	...	...	...	...
80	Exclusion of interest on savings bonds redeemed to finance educational expenses	...	...	...	...	...	...	...	...	10	20	20	20	20	20	20	100
81	Parental personal exemption for students age 19 or over	...	...	...	...	...	...	...	...	1,010	1,070	1,120	1,170	1,230	1,280	1,340	6,140
82	Deductibility of charitable contributions (education)	590	680	770	830	840	900	950	4,290	3,240	3,300	3,430	3,610	3,760	3,940	4,080	18,820
83	Exclusion of employer-provided educational assistance	...	...	...	...	...	...	...	...	260	410	500	530	560	590	620	2,800
	Training, employment, and social services:																
84	Work opportunity tax credit	260	190	120	50	20	10	0	200	40	40	20	10	10	0	0	40
85	Welfare-to-work tax credit	80	60	30	20	10	0	0	60	10	10	10	0	0	0	0	10
86	Employer provided child care exclusion	...	...	...	...	...	...	...	...	720	740	770	810	930	1,020	1,080	4,610
87	Employer-provided child care credit	0	40	90	130	150	150	160	680	...	...	...	...	...	...	...	...
88	Assistance for adopted foster children	...	...	...	...	...	...	...	...	190	220	250	260	270	280	290	1,350
89	Adoption credit and exclusion	...	...	...	...	...	...	...	...	130	140	220	450	500	540	560	2,270
90	Exclusion of employee meals and lodging (other than military)	...	...	...	...	...	...	...	...	710	740	780	810	850	890	930	4,260
91	Child credit [2]	...	...	...	...	...	...	...	...	19,840	19,760	19,680	19,550	20,550	21,530	21,240	102,550
92	Credit for child and dependent care expenses	...	...	...	...	...	...	...	...	2,670	2,610	2,670	2,960	2,700	2,150	1,920	12,400
93	Credit for disabled access expenditures	10	10	10	10	20	20	20	80	40	40	40	40	40	40	40	200
94	Deductibility of charitable contributions, other than education and health	730	850	950	1,040	1,040	1,110	1,180	5,320	29,420	29,960	31,130	32,790	34,150	35,780	37,110	170,960
95	Exclusion of certain foster care payments	...	...	...	...	...	...	...	...	500	510	520	530	540	570	610	2,770

Table 6–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES—Continued

(In millions of dollars)

		Corporations								Individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007	2001	2002	2003	2004	2005	2006	2007	2003–2007
96	Exclusion of parsonage allowances	...	...	...	...	...	...	...	...	350	370	400	420	450	470	490	2,230
	Health:																
97	Exclusion of employer contributions for medical insurance premiums and medical care	...	...	...	...	...	...	...	...	82,800	90,910	99,260	106,940	115,380	124,050	134,960	580,590
98	Self-employed medical insurance premiums	...	...	...	...	...	...	...	...	1,520	1,730	2,420	3,570	3,870	4,170	4,430	18,460
99	Workers' compensation insurance premiums	...	...	...	...	...	...	...	...	4,730	4,870	5,080	5,230	5,410	5,570	5,790	27,080
100	Medical Savings Accounts	...	...	...	...	...	...	...	...	20	20	20	20	20	20	20	100
101	Deductibility of medical expenses	...	...	...	...	...	...	...	...	4,990	5,260	5,530	5,840	6,280	6,600	7,100	31,350
102	Exclusion of interest on hospital construction bonds	280	290	290	300	310	320	320	1,540	820	840	900	1,010	1,130	1,250	1,380	5,670
103	Deductibility of charitable contributions (health)	710	820	920	1,010	1,010	1,080	1,150	5,170	3,300	3,360	3,500	3,680	3,840	4,020	4,170	19,210
104	Tax credit for orphan drug research	140	150	170	190	220	240	270	1,090	...	...	...	...	...	...	...	...
105	Special Blue Cross/Blue Shield deduction	270	300	340	310	300	270	300	1,520	...	...	...	...	...	...	...	...
	Income security:																
106	Exclusion of railroad retirement system benefits	...	...	...	...	...	...	...	...	380	390	400	400	400	400	400	2,000
107	Exclusion of workers' compensation benefits	...	...	...	...	...	...	...	...	5,560	5,810	6,070	6,320	6,600	6,900	7,200	33,090
108	Exclusion of public assistance benefits (normal tax method)	...	...	...	...	...	...	...	...	370	380	400	410	430	450	470	2,160
109	Exclusion of special benefits for disabled coal miners	...	...	...	...	...	...	...	...	70	70	60	60	60	50	50	280
110	Exclusion of military disability pensions	...	...	...	...	...	...	...	...	110	120	120	120	130	130	140	640
	Net exclusion of pension contributions and earnings:																
111	Employer plans	...	...	...	...	...	...	...	...	42,070	48,070	53,080	54,500	55,630	58,980	63,320	285,510
112	401(k) plans	...	...	...	...	...	...	...	...	44,080	52,960	59,510	62,770	65,290	69,230	73,320	330,120
113	Individual Retirement Accounts	...	...	...	...	...	...	...	...	18,680	18,090	18,660	19,050	18,930	19,230	18,330	94,200
114	Low and moderate income savers credit	...	...	...	...	...	...	...	...	0	550	1,960	1,940	1,900	1,800	1,280	8,880
115	Keogh plans	...	...	...	...	...	...	...	...	6,160	6,520	6,770	7,040	7,250	7,490	7,730	36,280
	Exclusion of other employee benefits:																
116	Premiums on group term life insurance	...	...	...	...	...	...	...	...	1,750	1,780	1,800	1,830	1,860	1,890	1,920	9,300
117	Premiums on accident and disability insurance	...	...	...	...	...	...	...	...	210	220	230	240	250	260	270	1,250
118	Small business retirement plan credit	0	10	30	50	70	80	90	320	0	10	20	40	50	50	60	220
119	Income of trusts to finance supplementary unemployment benefits	20	20	30	30	30	30	30	150	...	...	...	...	...	...	...	...
120	Special ESOP rules	980	1,020	1,080	1,140	1,200	1,260	1,330	6,010	310	320	340	350	370	380	400	1,840
121	Additional deduction for the blind	...	...	...	...	...	...	...	...	40	40	40	40	40	40	40	200
122	Additional deduction for the elderly	...	...	...	...	...	...	...	...	1,970	1,890	1,950	2,060	2,100	2,150	2,050	10,310
123	Tax credit for the elderly and disabled	...	...	...	...	...	...	...	...	30	30	30	30	30	30	30	150
124	Deductibility of casualty losses	...	...	...	...	...	...	...	...	210	250	310	360	410	450	490	2,020
125	Earned income tax credit [3]	...	...	...	...	...	...	...	...	4,940	4,370	4,800	4,930	5,100	5,180	5,390	25,400
	Social Security:																
	Exclusion of social security benefits:																
126	Social Security benefits for retired workers	...	...	...	...	...	...	...	...	17,830	18,000	18,180	18,560	18,850	19,720	20,890	96,200
127	Social Security benefits for disabled	...	...	...	...	...	...	...	...	2,690	2,930	3,240	3,630	4,020	4,470	5,020	20,380
128	Social Security benefits for dependents and survivors	...	...	...	...	...	...	...	...	3,720	3,870	4,060	4,320	4,560	4,820	5,170	22,930
	Veterans benefits and services:																
129	Exclusion of veterans death benefits and disability compensation	...	...	...	...	...	...	...	...	3,150	3,190	3,300	3,490	3,680	3,870	4,080	18,420
130	Exclusion of veterans pensions	...	...	...	...	...	...	...	...	70	80	80	80	90	90	100	440
131	Exclusion of GI bill benefits	...	...	...	...	...	...	...	...	90	90	90	100	100	110	110	510
132	Exclusion of interest on veterans housing bonds	10	10	10	10	10	10	10	50	30	30	30	30	40	40	50	190

Table 6–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES—Continued

(In millions of dollars)

		Corporations								Individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007	2001	2002	2003	2004	2005	2006	2007	2003–2007
	General purpose fiscal assistance:																
133	Exclusion of interest on public purpose State and local bonds	5,860	6,010	6,160	6,310	6,470	6,630	6,800	32,370	17,240	17,670	18,110	18,570	19,030	19,510	20,000	95,220
134	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	.....	45,520	46,160	48,150	47,730	43,270	34,820	30,890	204,860
135	Tax credit for corporations receiving income from doing business in U.S. possessions	2,190	2,240	2,240	2,240	2,200	1,300	0	7,980	.....	.....	.....	.....	.....	.....	.....	.....
	Interest:																
136	Deferral of interest on U.S. savings bonds	.....	.....	.....	.....	.....	.....	.....	.....	290	300	310	330	330	350	360	1,680
	Addendum: Aid to State and local governments:																
	Deductibility of:																
	Property taxes on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	.....	22,410	22,680	23,580	23,210	20,330	16,300	14,410	97,830
	Nonbusiness State and local taxes other than on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	.....	45,520	46,160	48,150	47,730	43,270	34,820	30,890	204,860
	Exclusion of interest on State and local bonds for:																
	Public purposes	5,860	6,010	6,160	6,310	6,470	6,630	6,800	32,370	17,240	17,670	18,110	18,570	19,030	19,510	20,000	95,220
	Energy facilities	20	20	20	30	30	30	30	140	70	70	80	90	100	110	120	500
	Water, sewage, and hazardous waste disposal facilities	100	110	110	110	110	120	120	570	300	310	330	370	420	460	510	2,090
	Small-issues	80	80	80	80	80	90	90	420	230	230	250	280	310	340	380	1,560
	Owner-occupied mortgage subsidies	200	210	210	220	230	230	240	1,130	600	620	660	740	820	910	1,000	4,130
	Rental housing	40	40	40	50	50	50	50	240	120	130	140	150	170	190	210	860
	Airports, docks, and similar facilities	160	160	170	170	180	180	190	890	470	480	510	580	640	710	790	3,230
	Student loans	60	60	60	60	60	60	70	310	170	170	180	200	230	250	280	1,140
	Private nonprofit educational facilities	140	140	140	150	150	150	160	750	400	410	440	490	550	610	670	2,760
	Hospital construction	280	290	290	300	310	320	320	1,540	820	840	900	1,010	1,130	1,250	1,380	5,670
	Veterans' housing	10	10	10	10	10	10	10	50	30	30	30	30	40	40	50	190
	Credit for holders of zone academy bonds	30	50	70	80	90	90	90	420	.....	.....	.....	.....	.....	.....	.....	.....

[1] The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of "income" that is larger in scope than is "income" as defined under general U.S. income tax principles. For tax reasons, the tax expenditure estimates include, for example, estimates related to the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation.

[2] 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: 2001 $990; 2002 $1,020; 2003 $1,050; 2004 $1,080; 2005 $1,080; 2006 $1,100; and 2007 $1,120.

[3] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2001 $980; 2002 $7,390; 2003 $7,390; 2004 $7,210; 2005 $6,950; 2006 $9,380; and 2007 $9,200.

[4] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2001 $26,120; 2002 $28,280; 2003 $30,630; 2004 $31,080; 2005 $31,720; 2006 $33,130; and 2007 $34,090.

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 $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Table 6–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2003 PROJECTED REVENUE EFFECT

(In millions of dollars)

Provision	2003	2003–2007
Exclusion of employer contributions for medical insurance premiums and medical care	99,260	580,590
Deductibility of mortgage interest on owner-occupied homes	66,110	355,480
Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	60,200	273,920
Net exclusion of pension contributions and earnings: 401(k) plans	59,510	330,120
Net exclusion of pension contributions and earnings: Employer plans	53,080	285,510
Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	48,150	204,860
Accelerated depreciation of machinery and equipment (normal tax method)	36,480	190,150
Deductibility of charitable contributions, other than education and health	32,080	176,280
Step-up basis of capital gains at death	28,710	155,510
Exclusion of interest on public purpose State and local bonds	24,270	127,590
Deductibility of State and local property tax on owner-occupied homes	23,580	97,830
Capital gains exclusion on home sales	20,260	107,550
Child credit	19,680	102,550
Exclusion of interest on life insurance savings	19,250	114,690
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	18,660	94,200
Exclusion of Social Security benefits for retired workers	18,180	96,200
Deferral of income from controlled foreign corporations (normal tax method)	7,450	42,230
Net exclusion of pension contributions and earnings: Keogh plans	6,770	36,280
Graduated corporation income tax rate (normal tax method)	6,210	35,240
Exclusion of workers' compensation benefits	6,070	33,090
Accelerated depreciation on rental housing (normal tax method)	5,710	28,820
Deductibility of medical expenses	5,530	31,350
Extraterritorial income exclusion	5,150	29,570
Workers' compensation insurance premiums	5,080	27,080
Earned income tax credit	4,800	25,400
Credit for increasing research activities	4,590	12,350
Deductibility of charitable contributions (health)	4,420	24,380
Accelerated depreciation of buildings other than rental housing (normal tax method)	4,240	21,040
Deductibility of charitable contributions (education)	4,200	23,110
Exception from passive loss rules for $25,000 of rental loss	4,070	17,760
Exclusion of Social Security benefits for dependents and survivors	4,060	22,930
HOPE tax credit	3,520	14,960
Credit for low-income housing investments	3,460	19,010
Exclusion of veterans death benefits and disability compensation	3,300	18,420
Exclusion of Social Security benefits for disabled	3,240	20,380
Credit for child and dependent care expenses	2,670	12,400
Exclusion of income earned abroad by U.S. citizens	2,660	14,090
Self-employed medical insurance premiums	2,420	18,460
Expensing of research and experimentation expenditures (normal tax method)	2,380	16,730
Lifetime Learning tax credit	2,360	14,180
Deduction for higher education expenses	2,290	11,970
Tax credit for corporations receiving income from doing business in U.S. possessions	2,240	7,980
Exclusion of benefits and allowances to armed forces personnel	2,210	11,310
Exclusion of reimbursed employee parking expenses	2,190	12,130
Net exclusion of pension contributions and earnings: Low and moderate income savers credit	1,960	8,880
Additional deduction for the elderly	1,950	10,310
Net exclusion of pension contributions and earnings: Premiums on group term life insurance	1,800	9,300
Inventory property sales source rules exception	1,540	8,530
Special ESOP rules	1,420	7,850
Expensing of certain small investments (normal tax method)	1,420	7,370
Exclusion of scholarship and fellowship income (normal tax method)	1,210	6,550
Exclusion of interest on hospital construction bonds	1,190	7,210
Exemption of credit union income	1,150	6,650
Empowerment zones, Enterprise communities, and Renewal communities	1,130	6,570
Parental personal exemption for students age 19 or over	1,120	6,140
Capital gains treatment of certain income	1,100	6,130
Deferral of income from post 1987 installment sales	1,080	5,600
Exclusion of interest on owner-occupied mortgage subsidy bonds	870	5,260
Exclusion of certain allowances for Federal employees abroad	840	4,620
Exclusion of employee meals and lodging (other than military)	780	4,260
Employer provided child care exclusion	770	4,610
Carryover basis of capital gains on gifts	680	4,550
Exclusion of interest for airport, dock, and similar bonds	680	4,120
Deductibility of student-loan interest	640	3,400
Exclusion of interest on bonds for private nonprofit educational facilities	580	3,510
Exclusion of certain foster care payments	520	2,770
Exclusion of employer-provided educational assistance	500	2,800
Enhanced oil recovery credit	440	3,280
Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	440	2,660

Table 6–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2003 PROJECTED REVENUE EFFECT—Continued

(In millions of dollars)

Provision	2003	2003–2007
Alternative fuel production credit	410	930
Exclusion of parsonage allowances	400	2,230
Exclusion of public assistance benefits (normal tax method)	400	2,160
Exclusion of railroad retirement system benefits	400	2,000
Expensing of multiperiod timber growing costs	370	1,950
Exclusion for employer-provided transit passes	360	2,380
State prepaid tuition plans	340	2,320
Special Blue Cross/Blue Shield deduction	340	1,520
Exclusion of interest on small issue bonds	330	1,980
Deductibility of casualty losses	310	2,020
Deferral of interest on U.S. savings bonds	310	1,680
Excess of percentage over cost depletion, fuels	270	1,490
Excess of percentage over cost depletion, nonfuel minerals	270	1,470
Tax exemption of certain insurance companies owned by tax-exempt organizations	250	1,380
Assistance for adopted foster children	250	1,350
Exclusion of interest on student-loan bonds	240	1,450
Net exclusion of pension contributions and earnings: Premiums on accident and disability insurance	230	1,250
Adoption credit and exclusion	220	2,270
Tax incentives for preservation of historic structures	210	1,150
Amortization of start-up costs (normal tax method)	200	1,230
New markets tax credit	190	2,350
Exclusion of interest on rental housing bonds	180	1,100
Tax credit for orphan drug research	170	1,090
Expensing of certain capital outlays	170	850
Work opportunity tax credit	140	240
Capital gains exclusion of small corporation stock	130	1,050
Expensing of certain multiperiod production costs	130	620
Exclusion of military disability pensions	120	640
Capital gains treatment of royalties on coal	110	620
Capital gains treatment of certain timber income	110	620
Exclusion of interest on energy facility bonds	100	640
Small life insurance company deduction	100	500
New technology credit	100	480
Expensing of environmental remediation costs	100	80
Employer-provided child care credit	90	590
Exclusion of GI bill benefits	90	510
Education Individual Retirement Accounts	80	1,230
Exclusion of veterans pensions	80	440
Exceptions from imputed interest rules	80	400
Expensing of exploration and development costs, fuels	70	450
Credit for holders of zone academy bonds	70	420
Income averaging for farmers	70	380
Exclusion from income of conservation subsidies provided by public utilities	70	340
Exemption of certain mutuals' and cooperatives' income	60	330
Exclusion of special benefits for disabled coal miners	60	280
Small business retirement plan credit	50	540
Credit for disabled access expenditures	50	280
Tax credit and deduction for clean-fuel burning vehicles	50	–40
Ordinary income treatment of loss from small business corporation stock sale	40	240
Exclusion of interest on veterans housing bonds	40	240
Additional deduction for the blind	40	200
Welfare-to-work tax credit	40	70
Cancellation of indebtedness	30	190
Alcohol fuel credits	30	150
Investment credit for rehabilitation of structures (other than historic)	30	150
Income of trusts to finance supplementary unemployment benefits	30	150
Tax credit for the elderly and disabled	30	150
Excess bad debt reserves of financial institutions	30	60
Exception from passive loss limitation for working interests in oil and gas properties	20	100
Deferral of tax on shipping companies	20	100
Exclusion of interest on savings bonds redeemed to finance educational expenses	20	100
Medical Savings Accounts	20	100
Expensing of exploration and development costs, nonfuel minerals	10	50
Treatment of loans forgiven for solvent farmers	10	50
Deferral of gain on sale of farm refiners	10	50
Special alternative tax on small property and casualty insurance companies	10	50
Deferred taxes for financial firms on certain income earned overseas	0	0

Table 6–4. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 2001

(In millions of dollars)

	Provision	Present Value of Revenue Loss
1	Deferral of income from controlled foreign corporations (normal tax method)	6,760
2	Deferred taxes for financial firms on income earned overseas	1,170
3	Expensing of research and experimentation expenditures (normal tax method)	1,700
4	Expensing of exploration and development costs - fuels	130
5	Expensing of exploration and development costs - nonfuels	0
6	Expensing of multiperiod timber growing costs	220
7	Expensing of certain multiperiod production costs - agriculture	230
8	Expensing of certain capital outlays - agriculture	260
9	Deferral of income on life insurance and annuity contracts	22,920
10	Accelerated depreciation of rental housing (normal tax method)	4,750
11	Accelerated depreciation of buildings other than rental housing (normal tax method)	540
12	Accelerated depreciation of machinery and equipment (normal tax method)	31,210
13	Expensing of certain small investments (normal tax method)	990
14	Amortization of start-up costs (normal tax method)	20
15	Deferral of tax on shipping companies	20
16	Credit for holders of zone academy bonds	120
17	Credit for low-income housing investments	2,850
18	Deferral for state prepaid tuition plans	190
19	Exclusion of pension contributions - employer plans	97,290
20	Exclusion of 401(k) contributions	69,980
21	Exclusion of IRA contributions and earnings	6,090
22	Exclusion of contributions and earnings for Keogh plans	9,780
23	Exclusion of interest on public-purpose bonds	20,730
24	Exclusion of interest on non-public purpose bonds	5,560
25	Deferral of interest on U.S. savings bonds	330

Outlay Equivalents

The concept of "outlay equivalents" is another theoretical measure of the budget effect of tax expenditures. It is the amount of budget outlays that would be required to provide the taxpayer the same after-tax income as would be received through the tax provision. The outlay-equivalent measure allows the cost of a tax expenditure to be compared with a direct Federal outlay on a more even footing. Outlay equivalents are reported in Table 6–5.

Table 6–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX

(In millions of dollars)

		Outlay Equivalents							
		2001	2002	2003	2004	2005	2006	2007	2003–2007
	National Defense								
1	Exclusion of benefits and allowances to armed forces personnel	2,510	2,540	2,570	2,600	2,620	2,650	2,680	13,120
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	3,270	3,380	3,540	3,570	3,670	3,720	4,210	18,710
3	Exclusion of certain allowances for Federal employees abroad	1,020	1,060	1,130	1,170	1,230	1,270	1,350	6,150
4	Extraterritorial income exclusion	6,910	7,410	7,930	8,470	9,060	9,680	10,350	45,490
5	Inventory property sales source rules exception	2,150	2,260	2,370	2,490	2,620	2,750	2,890	13,120
6	Deferral of income from controlled foreign corporations (normal tax method)	6,600	7,000	7,450	7,900	8,400	8,930	9,550	42,230
7	Deferred taxes for financial firms on certain income earned overseas	1,300	550	.....	.....	.....	.....	.....	0
	General science, space, and technology:								
8	Expensing of research and experimentation expenditures (normal tax method)	2,020	1,780	2,380	2,880	3,400	3,910	4,160	16,730
9	Credit for increasing research activities	8,270	9,240	7,060	6,190	3,580	1,530	640	18,990
	Energy:								
10	Expensing of exploration and development costs, fuels	80	80	100	120	120	130	130	600
11	Excess of percentage over cost depletion, fuels	290	300	310	320	340	340	360	1,670
12	Alternative fuel production credit	1,210	1,130	540	170	170	170	170	1,220
13	Exception from passive loss limitation for working interests in oil and gas properties	20	20	20	20	20	20	20	100
14	Capital gains treatment of royalties on coal	130	140	150	150	160	170	180	810
15	Exclusion of interest on energy facility bonds	130	130	150	170	180	200	210	1,170
16	Enhanced oil recovery credit	370	440	530	640	770	920	1,110	3,970
17	New technology credit	90	130	150	150	150	150	150	750
18	Alcohol fuel credits [1]	30	30	30	30	30	30	30	150
19	Tax credit and deduction for clean-fuel burning vehicles	70	70	70	30	-20	-60	-60	-40
20	Exclusion from income of conservation subsidies provided by public utilities	90	90	90	90	90	90	90	450

Table 6–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

		Outlay Equivalents							
		2001	2002	2003	2004	2005	2006	2007	2003–2007
	Natural resources and environment:								
21	Expensing of exploration and development costs, nonfuel minerals	10	10	10	10	10	10	10	50
22	Excess of percentage over cost depletion, nonfuel minerals	340	360	370	380	380	400	410	1,940
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	570	600	630	690	760	840	910	3,830
24	Capital gains treatment of certain timber income	130	140	150	150	160	170	180	810
25	Expensing of multiperiod timber growing costs	460	470	480	500	510	520	540	2,550
26	Tax incentives for preservation of historic structures	190	200	210	220	230	240	250	1,150
	Agriculture:								
27	Expensing of certain capital outlays	210	210	210	210	210	210	210	1,050
28	Expensing of certain multiperiod production costs	150	160	160	150	150	140	140	740
29	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	1,320	1,380	1,460	1,550	1,630	1,720	1,810	8,170
31	Income averaging for farmers	80	90	90	90	90	100	100	470
32	Deferral of gain on sale of farm refiners	10	10	10	10	10	10	10	50
	Commerce and housing:								
	Financial institutions and insurance:								
33	Exemption of credit union income	1,330	1,430	1,530	1,640	1,770	1,890	2,030	8,860
34	Excess bad debt reserves of financial institutions	80	70	40	30	10	0	0	80
35	Exclusion of interest on life insurance savings	16,290	17,710	19,250	20,940	22,780	24,790	26,930	114,690
36	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	300	310	340	350	380	390	410	1,870
38	Small life insurance company deduction	130	130	130	130	130	130	130	650
	Housing:								
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	1,150	1,190	1,250	1,380	1,510	1,640	1,780	7,560
40	Exclusion of interest on rental housing bonds	230	250	260	290	320	350	370	1,590
41	Deductibility of mortgage interest on owner-occupied homes	64,510	64,190	66,110	68,070	70,870	73,560	76,870	355,480
42	Deductibility of State and local property tax on owner-occupied homes	22,410	22,680	23,580	23,210	20,330	16,300	14,410	97,830
43	Deferral of income from post 1987 installment sales	1,020	1,040	1,060	1,080	1,100	1,120	1,140	5,500
44	Capital gains exclusion on home sales	23,870	24,580	25,320	26,080	26,860	27,670	28,500	134,430
45	Exception from passive loss rules for $25,000 of rental loss	4,800	4,400	4,070	3,780	3,530	3,290	3,090	17,760
46	Credit for low-income housing investments	4,360	4,510	4,700	4,930	5,170	5,400	5,610	25,810
47	Accelerated depreciation on rental housing (normal tax method)	5,190	5,440	5,710	5,790	5,800	5,720	5,800	28,820
	Commerce:								
48	Cancellation of indebtedness	30	30	30	40	40	40	40	190
49	Exceptions from imputed interest rules	80	80	80	80	80	80	80	400
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	90,400	82,420	80,260	75,980	74,910	67,560	66,510	365,220
51	Capital gains exclusion of small corporation stock	90	130	170	220	270	340	400	1,400
52	Step-up basis of capital gains at death	35,390	36,810	38,280	39,810	41,400	43,060	44,780	207,330
53	Carryover basis of capital gains on gifts	530	600	680	760	900	1,080	1,130	4,550
54	Ordinary income treatment of loss from small business corporation stock sale	50	50	50	60	60	60	60	290
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	4,540	4,560	4,240	3,960	3,800	4,160	4,880	21,040
56	Accelerated depreciation of machinery and equipment (normal tax method)	37,860	37,130	36,480	36,790	37,430	38,520	40,930	190,150
57	Expensing of certain small investments (normal tax method)	1,670	1,430	1,420	1,390	1,360	1,480	1,720	7,370
58	Amortization of start-up costs (normal tax method)	130	160	200	240	250	270	270	1,230
59	Graduated corporation income tax rate (normal tax method)	7,590	8,590	9,560	10,130	10,950	11,460	12,130	54,230
60	Exclusion of interest on small issue bonds	440	440	470	520	560	610	670	2,830
	Transportation:								
61	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
62	Exclusion of reimbursed employee parking expenses	2,560	2,690	2,830	2,970	3,130	3,280	3,450	15,660
63	Exclusion for employer-provided transit passes	310	390	500	570	660	750	840	3,320
	Community and regional development:								
64	Investment credit for rehabilitation of structures (other than historic)	20	30	30	30	30	30	30	150
65	Exclusion of interest for airport, dock, and similar bonds	900	920	980	1,080	1,180	1,280	1,400	5,920
66	Exemption of certain mutuals' and cooperatives' income	60	60	60	60	70	70	70	330
67	Empowerment zones and enterprise communities	380	730	1,120	1,170	1,280	1,410	1,580	6,560
68	New markets tax credit	20	90	190	300	420	610	830	2,350
69	Expensing of environmental remediation costs	110	120	130	40	-20	-20	-20	110
	Education, training, employment, and social services:								
	Education:								
70	Exclusion of scholarship and fellowship income (normal tax method)	1,330	1,320	1,330	1,360	1,460	1,520	1,530	7,200
71	HOPE tax credit	5,300	5,270	4,510	3,690	3,760	3,500	3,720	19,180
72	Lifetime Learning tax credit	3,030	2,940	3,030	4,020	3,830	3,520	3,800	18,200
73	Education Individual Retirement Accounts	40	60	90	150	260	390	550	1,440
74	Deductibility of student-loan interest	460	540	760	790	810	840	850	4,050
75	Deduction for higher education expenses	0	560	2,940	3,790	4,760	3,860	0	15,350
76	State prepaid tuition plans	250	340	430	510	590	680	760	2,970
77	Exclusion of interest on student-loan bonds	330	330	340	370	410	440	510	2,070
78	Exclusion of interest on bonds for private nonprofit educational facilities	770	780	830	920	1,010	1,090	1,190	5,040

Table 6–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

		Outlay Equivalents							
		2001	2002	2003	2004	2005	2006	2007	2003–2007
79	Credit for holders of zone academy bonds	40	70	100	120	120	120	120	580
80	Exclusion of interest on savings bonds redeemed to finance educational expenses	10	20	20	20	20	20	20	100
81	Parental personal exemption for students age 19 or over	1,120	1,180	1,250	1,300	1,360	1,420	1,480	6,810
82	Deductibility of charitable contributions (education)	5,420	5,610	5,910	6,260	6,460	6,800	7,070	32,500
83	Exclusion of employer-provided educational assistance	320	510	620	660	690	730	770	3,470
	Training, employment, and social services:								
84	Work opportunity tax credit	300	230	140	60	30	10	0	240
85	Welfare-to-work tax credit	90	70	40	20	10	0	0	70
86	Exclusion of employer provided child care	950	990	1,020	1,080	1,240	1,360	1,450	6,150
87	Employer-provided child care	0	60	120	170	190	210	220	790
88	Assistance for adopted foster children	220	250	280	290	300	310	320	1,500
89	Adoption credit and exclusion	160	180	280	570	640	690	710	2,890
90	Exclusion of employee meals and lodging (other than military)	870	910	950	990	1,030	1,080	1,130	5,180
91	Child credit [2]	26,460	26,350	26,240	26,070	27,400	28,700	28,320	136,730
92	Credit for child and dependent care expenses	3,560	3,480	3,560	3,950	3,600	2,860	2,550	16,520
93	Credit for disabled access expenditures	60	70	70	70	80	80	80	380
94	Deductibility of charitable contributions, other than education and health	42,130	42,750	44,450	46,820	48,580	50,980	52,760	243,590
95	Exclusion of certain foster care payments	580	590	600	610	630	660	700	3,200
96	Exclusion of parsonage allowances	400	420	460	480	510	540	560	2,550
	Health:								
97	Exclusion of employer contributions for medical insurance premiums and medical care	106,750	117,750	128,760	138,400	149,240	160,370	173,450	750,220
98	Self-employed medical insurance premiums	1,900	2,140	3,000	4,420	4,790	5,160	5,470	22,840
99	Workers' compensation insurance premiums	5,900	6,070	6,330	6,510	6,730	6,920	7,190	33,680
100	Medical Savings Accounts	20	20	30	30	30	30	20	140
101	Deductibility of medical expenses	4,990	5,260	5,530	5,840	6,280	6,600	7,100	31,350
102	Exclusion of interest on hospital construction bonds	1,580	1,620	1,700	1,880	2,070	2,250	2,440	10,340
103	Deductibility of charitable contributions (health)	5,710	5,920	6,250	6,630	6,830	7,210	7,490	34,410
104	Tax credit for orphan drug research	200	230	260	290	320	360	400	1,630
105	Special Blue Cross/Blue Shield deduction	340	380	430	390	380	340	380	1,920
	Income security:								
106	Exclusion of railroad retirement system benefits	380	390	400	400	400	400	400	2,000
107	Exclusion of workers' compensation benefits	5,560	5,810	6,070	6,320	6,600	6,900	7,200	33,090
108	Exclusion of public assistance benefits (normal tax method)	370	380	400	410	430	450	470	2,160
109	Exclusion of special benefits for disabled coal miners	70	70	60	60	60	50	50	280
110	Exclusion of military disability pensions	110	120	120	120	130	130	140	640
	Net exclusion of pension contributions and earnings:								
111	Employer plans	52,590	59,350	65,130	66,460	67,840	71,930	77,220	348,580
112	401(k) plans	55,100	65,380	73,020	76,550	79,620	84,430	89,410	403,030
113	Individual Retirement Accounts	23,980	24,250	25,280	25,590	25,630	25,890	25,450	127,840
114	Low and moderate income savers credit	0	660	2,330	2,290	2,240	2,120	1,500	10,480
115	Keogh plans	7,880	8,330	8,620	8,930	9,150	9,410	9,680	45,790
	Exclusion of other employee benefits:								
116	Premiums on group term life insurance	2,330	2,370	2,400	2,440	2,480	2,520	2,560	12,400
117	Premiums on accident and disability insurance	280	290	310	320	330	350	360	1,670
118	Small business retirement plan credit	0	30	70	120	160	180	200	730
119	Income of trusts to finance supplementary unemployment benefits	20	20	30	30	30	30	30	150
120	Special ESOP rules	1,710	1,780	1,880	1,980	2,080	2,180	2,300	10,420
121	Additional deduction for the blind	50	50	50	50	50	50	50	250
122	Additional deduction for the elderly	2,390	2,280	2,360	2,490	2,550	2,600	2,480	12,480
123	Tax credit for the elderly and disabled	40	40	40	40	40	40	40	200
124	Deductibility of casualty losses	230	280	340	390	450	500	490	2,170
125	Earned income tax credit [3]	5,480	4,850	5,330	5,480	5,670	5,750	5,990	28,220
	Social Security:								
	Exclusion of social security benefits:								
126	Social Security benefits for retired workers	17,830	18,000	18,180	18,560	18,850	19,720	20,890	96,200
127	Social Security benefits for disabled	2,690	2,930	3,240	3,630	4,020	4,470	5,020	20,380
128	Social Security benefits for dependents and survivors	3,720	3,870	4,060	4,320	4,560	4,820	5,170	22,930
	Veterans benefits and services:								
129	Exclusion of veterans death benefits and disability compensation	3,150	3,190	3,300	3,490	3,680	3,870	4,080	18,420
130	Exclusion of veterans pensions	70	80	80	80	90	90	100	440
131	Exclusion of GI bill benefits	90	90	90	100	100	110	110	510
132	Exclusion of interest on veterans housing bonds	50	50	50	50	70	70	80	320
	General purpose fiscal assistance:								
133	Exclusion of interest on public purpose State and local bonds	33,100	33,930	34,780	35,660	36,540	37,460	38,410	182,850
134	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	45,520	46,160	48,150	47,730	43,270	34,820	30,890	204,860
135	Tax credit for corporations receiving income from doing business in U.S. possessions	3,130	3,190	3,190	3,190	3,140	1,860	0	11,380
	Interest:								
136	Deferral of interest on U.S. savings bonds	290	300	310	330	330	350	360	1,680

Table 6–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

	Outlay Equivalents							
	2001	2002	2003	2004	2005	2006	2007	2003–2007
Addendum: Aid to State and local governments:								
Deductibility of:								
Property taxes on owner-occupied homes	22,410	22,680	23,580	23,210	20,330	16,300	14,410	97,830
Nonbusiness State and local taxes other than on owner-occupied homes	45,520	46,160	48,150	47,730	43,270	34,820	30,890	204,860
Exclusion of interest on State and local bonds for:								
Public purposes	33,100	33,930	34,780	35,660	36,540	37,460	38,410	182,850
Energy facilities	130	130	150	170	180	200	210	1,170
Water, sewage, and hazardous waste disposal facilities	570	600	630	690	760	840	910	3,830
Small-issues	440	440	470	520	560	610	670	2,830
Owner-occupied mortgage subsidies	1,150	1,190	1,250	1,380	1,510	1,640	1,780	7,560
Rental housing	230	250	260	290	320	350	370	1,590
Airports, docks, and similar facilities	900	920	980	1,080	1,180	1,280	1,400	5,920
Student loans	330	330	340	370	410	440	510	2,070
Private nonprofit educational facilities	770	780	830	920	1,010	1,090	1,190	5,040
Hospital construction	1,580	1,620	1,700	1,880	2,070	2,250	2,440	10,340
Veterans' housing	50	50	50	50	70	70	80	320
Credit for holders of zone academy bonds	40	70	100	120	120	120	120	580

[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: 2001 $990; 2002 $1,020; 2003 $1,050; 2004 $1,080; 2005 $1,080; 2006 $1,100; and 2007 $1,120.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2001 $980; 2002 $7,390; 2003 $7,390; 2004 $7,210; 2005 $6,950; 2006 $9,380; and 2007 $9,200.

[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2001 $26,120; 2002 $28,280; 2003 $30,630; 2004 $31,080; 2005 $31,720; 2006 $33,130 and 2007 $34,090.

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 $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Tax Expenditure Baselines

A tax expenditure is an exception to baseline provisions of the tax structure. The 1974 Congressional Budget Act, which mandated the tax expenditure budget, did not specify the baseline provisions of the tax law. As noted previously, deciding whether provisions are 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 it is closer to existing law. Tax expenditures under the reference law baseline are generally tax expenditures under the normal tax baseline, but 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 only when it is 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).

Although 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

The Government Performance and Results Act of 1993 (GPRA) directs Federal agencies to develop annual and strategic plans for their programs and activities. These plans set out performance objectives to be achieved over a specific time period. Most of these objectives will be achieved through direct expenditure programs. Tax expenditures, however, may also contribute to achieving these goals. The report of the Senate Governmental Affairs Committee on GPRA[4] calls on the Executive branch to undertake a series of analyses to assess the effect of specific tax expenditures on the achievement of agencies' performance objectives.

The Executive Branch is continuing to focus on the availability of data needed to assess the effects of the tax expenditures designed to increase savings. Treasury's Office of Tax Analysis and Statistics of Income Division (IRS) have developed a new sample of individual income tax filers as one part of this effort. This new "panel" sample will follow the same taxpayers over a period of at least ten years. The first year of this panel sample was drawn from tax returns filed in 2000 for tax year 1999. The sample will capture the changing demographic and economic circumstances of individuals and the effects of changes in tax law over an extended period of time. Data from the sample will therefore permit more extensive, and better, analyses of many tax provisions than can be performed using only annual ("cross-section") data. In particular, data from this panel sample will enhance our ability to analyze the effect of tax expenditures designed to increase savings. Other efforts by OMB, Treasury, and other agencies to improve data available for the analysis of savings tax expenditures will continue over the next several years.

Comparison 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. Because there is an existing public administrative and private compliance structure for the tax system, the

[2] Gross income does, however, include transfer paymnents 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 interst, 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. In addition, costs of earning income may be limited under the alternative minimum tax.

[4] Committee on Government Affairs, United States Senate, "Government Performance and Results Act of 1993" (Report 103–58, 1993).

incremental administrative and compliance costs for a tax expenditure may be low in many cases. In addition, some tax expenditures actually simplify the tax system, (for example, the exclusion for up to $500,000 of capital gains on home sales). Tax expenditures also implicitly subsidize certain activities. Spending, regulatory or tax-disincentive policies can also modify behavior, but may have different economic effects. Finally, a variety of tax expenditure tools can be used—e.g., deductions; credits; exemptions; deferrals; floors; ceilings; phase-ins; 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 economic effects.

Tax expenditures also have limitations. In many cases they add to the complexity of the tax system, which raises both administrative and compliance costs. For example, targeting personal exemptions and credits can complicate filing and decisionmaking. The income tax system may have little or no contact with persons who have no or very low incomes, and does not require information on certain characteristics of individuals used in some spending programs, such as wealth. 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 activities to be addressed with specific resources in a way that is difficult to emulate with tax expenditures. Finally, tax expenditures may not receive the same level of scrutiny afforded to other programs.

Outlay programs 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 tax return. Outlay programs may also receive more year-to-year oversight and fine tuning, through the legislative and executive budget process. In addition, many different 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—provide flexibility for policy design. On the other hand, 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, which can impose further costs by diverting resources from their most efficient uses. Finally, spending programs, particularly on the discretionary side, may respond less readily to changing activity levels and economic conditions than tax expenditures.

Regulations have more direct and immediate effects than outlay and tax-expenditure programs because regulations apply directly and immediately to the regulated party (i.e., the intended actor)—generally in the private sector. Regulations can also be fine-tuned more quickly than tax expenditures, because they can generally be changed by the executive branch without legislation. Like tax expenditures, regulations often rely largely 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. This reliance can diminish their economic efficiency, although this feature can also promote full compliance where (as in certain safety-related cases) policymakers believe that trade-offs with economic considerations are not of paramount importance. Also, regulations generally do not directly affect Federal outlays or receipts. Thus, like tax expenditures, they may escape the type of scrutiny that outlay programs receive. However, most regulations are subjected to a formal benefit-cost analysis that goes well beyond the analysis required for outlays and tax-expenditures. To some extent, the GPRA requirement for performance evaluation will address this lack of formal analysis.

Some policy objectives are achieved using multiple approaches. For example, minimum wage legislation, the earned income tax credit, and the food stamp program are regulatory, tax expenditure, and direct outlay programs, respectively, all having the objective of improving the economic welfare of low-wage workers.

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., the exclusion for up to $500,000 of capital gains on home sales); 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, accelerated depreciation may encourage investment. 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 revenue effect. 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). Effects on the incomes of members of particular groups 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 provisions. In addition, such assessments can raise significant challenges in economic modeling.

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 goals such as tax neutrality. These include the exclusion for income earned abroad by nongovernmental employees and exclusions for income of U.S.-controlled foreign corporations. Measuring the effectiveness of these provisions raises challenging issues.

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 (e.g., research spending, exploration activity, equipment) might 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 size of tax expenditures. Measures could also indicate the 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. The mortgage interest deduction on personal residences is a tax expenditure because the value of owner-occupied housing services is not included in a taxpayer's taxable income. Taxpayers also may exclude up to $500,000 of the capital gains from the sale of personal residences. 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 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 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 grants 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 pooling of risks. 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.

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). 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 value of benefits funded at the firm level to individuals.

Other provisions principally affect the incomes of members of certain groups, rather than affecting incentives. 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 earned-income tax credit, in contrast, should be evaluated for its effects on labor force participation as well as the income it provides lower-income workers.

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, although broad, is nevertheless incomplete, omitting important details 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. As indicated above, over the next few years the Executive Branch's focus will be on the availability of the data needed to assess the effects of the tax expenditures designed to increase savings.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported upon in this chapter follow. These descriptions relate to current law as of December 31, 2001, and do not reflect proposals made elsewhere in the Budget.

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.***—U.S. citizens who lived abroad, worked in the private sector, and satisfied a foreign residency requirement in 2001 may exclude up to $78,000 in foreign earned income from U.S. taxes.

The exclusion increases to $80,000 in 2002 (and thereafter). In addition, if these taxpayers receive a specific allowance for foreign housing from their employers, they may also exclude the value of that allowance. If they do not receive a specific allowance for housing expenses, they may deduct against their U.S. taxes that portion of such expenses that exceeds one-sixth the salary of a civil servant at grade GS–14, step 1 ($67,765 in 2001).

3. ***Exclusion of certain allowances for Federal employees abroad.***—U.S. Federal civilian employees and Peace Corps members who work outside the continental United States are allowed to exclude from U.S. taxable income certain special allowances they receive to compensate them for the relatively high costs associated with living overseas. The allowances supplement wage income and cover expenses like rent, education, and the cost of travel to and from the United States.

4. ***Extraterritorial income exclusion*[5].**—For purposes of calculating U.S. tax liability, a taxpayer may exclude from gross income the qualifying foreign trade income attributable to foreign trading gross receipts. The exclusion generally applies to income from the sale or lease of qualifying foreign trade property and certain types of services income. The FSC Repeal and Extraterritorial Income Exclusion Act of 2000 created the extraterritorial income exclusion to replace the foreign sales corporation provisions, which the Act repealed. The exclusion is generally available for transactions entered into after September 30, 2000.

5. ***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.

6. ***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 considered to be 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.

7. ***Exceptions under subpart F for active financing income.***—Financial firms can defer taxes on income earned overseas in an active business. Taxes on income earned through December 31, 2001 can be deferred.

General Science, Space, and Technology

8. ***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.

9. ***R&E credit.***—The research and experimentation (R&E) 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" by the average amount of the company's gross receipts for the prior four years. The taxpayer's fixed base percentage generally is the ratio of its research expenses to gross receipts for 1984 through 1988. Taxpayers may also elect an alternative credit regime. Under the alternative credit regime the taxpayer is assigned a three-tiered fixed-base percentage that is lower than the fixed-base percentage that would otherwise apply, and the credit rate is reduced (the rates range from 2.65 percent to 3.75 percent). A 20-percent credit with a separate threshold is provided for a taxpayer's payments to universities for basic research. The credit applies to research conducted before July 1, 2004 and extends to research conducted in Puerto Rico and the U.S. possessions.

Energy

10. ***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.

11. ***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

[5] The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of "income" that is larger in scope than is "income" as defined under general U.S. income tax principles. For that reason, the tax expenditure extimates include, for example, estimtes related to the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation.

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.

12. ***Alternative fuel production credit.***—A nontaxable credit of $3 per oil-equivalent barrel of production (in 1979 dollars) 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.

13. ***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.

14. ***Capital gains treatment of royalties on coal.***—Sales of certain coal under royalty contracts can be treated as capital gains rather than ordinary income.

15. ***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.

16. ***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.

17. ***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, biomass, and poultry waste facilities. The renewable resources credit applies only to electricity produced by a facility placed in service on or before December 31, 2001.

18. ***Alcohol fuel credits.***—An income tax credit is provided for ethanol that is derived from renewable sources and used as fuel. The credit equals 53 cents per gallon in 2001 and 2002; 52 cents per gallon in 2003 and 2004; and 51 cents per gallon in 2005, 2006, and 2007. To the extent that ethanol is mixed with taxable motor fuel to create gasohol, taxpayers may claim an exemption of the Federal excise tax rather than the income tax credit. In addition, small ethanol producers are eligible for a separate 10 cents per gallon credit.

19. ***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.

20. ***Exclusion of utility conservation subsidies.***—Non-business customers can exclude from gross income subsidies received from public utilities for expenditures on energy conservation measures.

Natural Resources and Environment

21. ***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.

22. ***Percentage depletion.***—Most nonfuel mineral extractors may use percentage depletion rather than cost depletion, with percentage depletion rates ranging from 22 percent for sulfur to 5 percent for sand and gravel.

23. ***Sewage, water, solid and hazardous waste facility 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 a capital gain 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. ***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

27. ***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.

28. ***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.

29. ***Loans forgiven solvent farmers.***—Farmers are forgiven the tax liability on certain forgiven debt. Normally, a 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 reduces carryover losses, then unused credits, and then basis; any remainder of the forgiven debt is excluded from tax. Farmers with forgiven debt are considered insolvent for tax purposes, and thus qualify for income tax forgiveness.

30. ***Capital gains treatment of certain income.***—Certain agricultural income, such as unharvested crops, can be treated as capital gains rather than ordinary income.

31. ***Income averaging for farmers.***—Taxpayers can lower their tax liability by averaging, over the prior three-year period, their taxable income from farming.

32. ***Deferral of gain on sales of farm refiners.***—A taxpayer who sells stock in a farm refiner to a farmers' cooperative can defer recognition of gain if the taxpayer reinvests the proceeds in qualified replacement property.

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 $2.1 million 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 these and other private activity is limited. The combined volume cap for private activity bonds, including mortgage housing bonds, rental housing bonds, student loan bonds, and industrial development bonds is $62.50 per capita ($187.5 million minimum) per State in 2001, and $75 per capita ($225 million minimum) in 2002. The Community Renewal Tax Relief Act of 2000 accelerated the scheduled increase in the state volume cap and indexed the cap for inflation, beginning in 2003. States may issue mortgage credit certificates (MCCs) in lieu of mortgage revenue 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 value of owner-occupied housing services is not included in a taxpayer's taxable 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 who 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 million is, therefore, a tax expenditure.

44. ***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 may not be used more than once every two years.

45. ***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.

46. ***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. State agencies determine who receives the credit; States are limited in the amount of credit they may authorize annually. The Community Renewal Tax Relief Act of 2000 increased the per-resident limit to $1.50 in 2001 and to $1.75 in 2002 and indexed the limit for inflation, beginning in 2003. The Act also created a $2 million minimum annual cap for small States beginning in 2002; the cap is indexed for inflation, beginning in 2003.

47. ***Accelerated depreciation of rental property.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to 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, a 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.

48. ***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.

49. ***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. 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.

50. ***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 most assets held for more than 1 year, the top capital gains tax rate is 20 percent. For assets acquired after December 31, 2000, the top capital gains tax rate for assets held for more than 5 years is 18 percent. On January 1, 2001, taxpayers may mark-to-market existing assets to start the 5-year holding period. Losses from the mark-to-market are not recognized.

For assets held for more than 1 year by taxpayers in the 15-percent ordinary tax bracket, the top capital gains tax rate is 10 percent. After December 31, 2000, the top capital gains tax rate for assets held by these taxpayers for more than 5 years is 8 percent.

51. ***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.

52. ***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. After repeal of the estate tax under EGTRRA for 2010, the basis for property acquired from a decedent will be the lesser of fair market value or the decedent's basis. Certain types of additions to basis will be allowed so that assets in most estates that are not currently subject to estate tax will not be subject to capital gains tax in the hands of the heirs.

53. ***Carryover basis of capital gains on gifts.***—When a gift is made, the donor's basis in the transferred property (the cost that was incurred when the transferred property was first acquired) carries-over to the donee. The carryover of the donor's basis allows a continued deferral of unrealized capital gains. Even though the estate tax is repealed for 2010 under EGTRRA, the gift tax is retained with a lifetime exemption of $1 million.

54. ***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.

55. ***Accelerated depreciation of non-rental-housing buildings.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to 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.

56. ***Accelerated depreciation of machinery and equipment.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under reference law. Under the normal tax baseline, this tax depreciation allowance is measured relative to straight-line depreciation using Asset Depreciation Range (ADR) lives. Statutory depreciation of machinery and equipment is accelerated relative to this baseline, thereby creating a tax expenditure under the normal tax rules.

57. ***Expensing of certain small investments.***—In 2001, qualifying investments in tangible property up to $24,000 can be expensed rather than depreciated over time. The expensing limit increases to $25,000 in 2003. To the extent that qualifying investment during the year exceeds $200,000, the amount eligible for expensing is decreased. In 2001, the amount expensed is completely phased out when qualifying investments exceed $224,000.

58. ***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.

59. ***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 $75,000. 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.

60. ***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

61. ***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.

62. ***Exclusion of employee parking expenses.***—Employee parking expenses that are paid for by the employer or that are received in lieu of wages are excludable from the income of the employee. In 2001, the maximum amount of the parking exclusion is $180 (indexed) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

63. ***Exclusion of employee transit pass expenses.***—Transit passes, tokens, fare cards, and vanpool expenses paid for by an employer or provided in lieu of wages to defray an employee's commuting costs are excludable from the employee's income. In 2001, the maximum amount of the exclusion is $65 (indexed) per month. In 2002, the maximum amount of the exclusion increases to $100 (indexed) per month.

Community and Regional Development

64. ***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.

65. ***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.

66. ***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.

67. ***Empowerment zones, enterprise communities, and renewal 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, accelerated depreciation, and certain capital gains incentives. In addition, certain first-time buyers of a principal residence in the District of Columbia can receive a tax credit on homes purchased on or before December 31, 2003, and investors in certain D.C. property can receive a capital gains break. The Community Renewal Tax Relief Act of 2000 created the renewal communities tax benefits, which begin on January 1, 2002 and expire on December 31, 2009. The Act also created additional empowerment zones, increased the tax benefits for empowerment zones, and extended the expiration date of (1) empowerment zones from December 31, 2004 to December 31, 2009, and (2) the D.C. home-buyer credit from December 31, 2001 to December 31, 2003.

68. ***New markets tax credit.***—Taxpayers who invest in a community development entity (CDE) after December 31, 2000 are eligible for a tax credit. The total equity investment available for the credit across all CDEs is $1.0 billion in 2001, $1.5 billion in 2002 and 2003, $2.0 billion in 2004 and 2005, and $3.5 billion in 2006 and 2007. The amount of the credit equals (1) 5 percent in the year of purchase and the following 2 years, and (2) 6 percent in the following 4 years. A CDE is any domestic firm whose primary mission is to serve or provide investment capital for low-income communities/individuals; a CDE must be accountable to residents of low-income communities. The Community Renewal Tax Relief Act of 2000 created the new markets tax credit.

69. ***Expensing of environmental remediation costs.***—Taxpayers who clean up certain hazardous substances at a qualified site may 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 on or before December 31, 2003. The Community Renewal Tax Relief Act of 2000 extended the expiration date from December 31, 2001 to December 31, 2003. The Act also expanded the number of qualified sites.

Education, Training, Employment, and Social Services

70. ***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).

71. ***HOPE tax credit.***—The non-refundable HOPE tax credit 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) (indexed beginning in 2002).

72. ***Lifetime learning tax credit.***—The non-refundable Lifetime Learning tax credit allows a credit for 20 percent of an eligible student's tuition and fees. For tuition and fees paid before January 1, 2003, 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) (indexed beginning in 2002). The credit applies to both undergraduate and graduate students.

73. ***Deduction for higher education expenses.***—EGTRRA provides a new above-the-line deduction for qualified higher education expenses. The maximum annual deduction is $3,000 beginning in 2002 for taxpayers with adjusted gross income up to $130,000 on a joint return ($65,000 for singles). The maximum deduction increases to $4,000 in 2004. Taxpayers with adjusted gross income up to $160,000 on a joint return ($80,000 for singles) may deduct up to $2,000 beginning in 2004. No deduction is allowed for expenses paid after December 31, 2005.

74. ***Education Individual Retirement Accounts.***—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 in 2001 is $500 per beneficiary. In 2001, 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). EGTRRA increases the maximum contribution to $2,000 and the phase-out range for joint filers to $190,000 through $220,000 of modified AGI, double the range of singles. EGTRRA also allows elementary and secondary school expenses to be paid tax-free from such accounts.

75. ***Student-loan interest.***—Taxpayers may claim an above-the-line deduction of up to $2,500 on interest paid on an education loan. Interest may only be deducted for the first five years in which interest payments are required. In 2001, 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). EGTRRA increased the income thresholds for the phase down to $100,000 and $130,000 ($50,000 and $65,000 for singles) (indexed) and repealed the five year rule for interest payments made after December 21, 2001.

76. ***State prepaid tuition plans.***—Some States have adopted prepaid tuition plans and prepaid room and board plans, which allow persons to pay in advance for college expenses for designated beneficiaries. In 2001 taxes on the earnings from these plans are paid by the beneficiaries and are deferred until tuition is actually paid. Beginning in 2002, investment income is not taxed when earned, and is tax-exempt when withdrawn to pay for qualified expenses. These changes were the result of EGTRRA.

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.

79. ***Credit for holders of zone academy bonds.***—Financial institutions that own zone academy bonds receive a non-refundable tax credit (at a rate set by the Treasury Department) rather than interest. The credit is included in gross income. Proceeds from zone academy bonds may only be used to renovate, but not construct, qualifying schools and for certain other school purposes. The total amount of zone academy bonds that may be issued is limited to $1.6 billion—$400 million in each year from 1998 to 2001.

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 $83,650 and $113,650 ($55,750 and $70,750 for singles) in 2001.

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. ***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.

83. ***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. EGTRRA permanently extended this exclusion and extended the exclusion to also include graduate education (beginning in 2002).

84. ***Work opportunity tax credit.***—Employers can claim a tax credit for qualified wages paid to individuals who begin work on or before December 31, 2001 and who are certified as members of various targeted groups. The amount of the credit that can be claimed is 25 percent for employment of less than 400 hours and 40 percent for employment of 400 hours or more. The maximum credit per employee is $2,400 and can only be claimed on the first year of wages an individual earns from an employer. Employers must reduce their deduction for wages paid by the amount of the credit claimed.

85. ***Welfare-to-work tax credit.***—An employer is eligible for a 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 on or before December 31, 2001.

86. ***Employer-provided child care exclusion.***—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.

87. ***Employer-provided child care credit.***—Employers can deduct expenses for supporting child care or child care resource and referral services. EGTRRA provides a tax credit to employers for qualified expenses beginning in 2002. The credit is equal to 25 percent of qualified expenses for employee child care and 10 percent of qualified expenses for child care resource and referral services. Employer deductions for such expenses are reduced by the amount of the credit. The maximum total credit is limited to $150,000 per taxable year.

88. ***Assistance for adopted foster children.***—Taxpayers who adopt eligible children from the public foster care system can receive monthly payments for the children's significant and varied needs and a reimbursement of up to $2,000 for nonrecurring adoption expenses. These payments are excluded from gross income.

89. ***Adoption credit and exclusion.***—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) for 2001. The credit is phased-out ratably for taxpayers with modified AGI

between $75,000 and $115,000 in 2001. EGTRRA increased the maximum credit for non-special needs children to $10,000, set a flat credit amount of $10,000 for special needs children, and increased the start point of the phase-out to $150,000 beginning in 2002. The credit amounts and the phase-out thresholds are indexed for inflation beginning in 2003. Unused credits may be carried forward and used during the five subsequent years. Taxpayers may also exclude qualified adoption expenses from income, subject to the same maximum amounts and phase-out as the credit. The same expenses cannot qualify for tax benefits under both programs; however, a taxpayer may use the benefits of the exclusion and the tax credit for different expenses. Stepchild adoptions are not eligible for either benefit. Both the credit and the exclusion were made permanent by EGTRRA.

90. ***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.

91. ***Child credit.***—Taxpayers with children under age 17 can qualify for a $600 refundable per child credit. The maximum credit is increased to $700 in 2005, $800 in 2009, and $1,000 in 2010. 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).

92. ***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 single parents and by divorced or separated parents who have custody of children. Expenditures up to a maximum $2,400 for one dependent and $4,800 for two or more dependents are eligible for the credit. EGTRRA increased the maximum expenditure limit to $3,000 for one dependent and $6,000 for two or more dependents beginning in 2003. The credit is equal to 30 percent of qualified expenditures (35 percent beginning in 2003) for taxpayers with incomes of $10,000 or less ($15,000 or less beginning in 2003). The credit is reduced to a minimum of 20 percent by one percentage point for each $2,000 of income in excess of $10,000 ($15,000 beginning in 2003).

93. ***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.

94. ***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.

95. ***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.

96. ***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

97. ***Employer-paid medical insurance and expenses.***—Employer-paid health insurance premiums and other medical expenses (including long-term care) are deducted as a business expense by employers, but they are not included in employee gross income. The self-employed also may deduct part of their family health insurance premiums.

98. ***Self-employed medical insurance premiums.***—Self-employed taxpayers may deduct a percentage of their family health insurance premiums. Taxpayers without self-employment income are not eligible for the special percentage deduction. The deductible percentage is 60 percent in 2001, 70 percent in 2002, and 100 percent in 2003 and thereafter.

99. ***Workers compensation insurance premiums.***—Workers compensation insurance premiums are paid by employers and deducted as a business expense, but the premiums are not included in employee gross income.

100. ***Medical savings accounts.***—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, 2002. The Community Renewal Tax Relief Act of 2000 extended the expiration date from December 31, 2000 to December 31, 2002.

101. ***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.

102. ***Hospital construction bonds.***—Interest earned on State and local government debt issued to finance

hospital construction is excluded from income subject to tax.

103. ***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.

104. ***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.

105. ***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

106. ***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.

107. ***Workers' compensation benefits.***—Workers compensation provides payments to disabled workers. These benefits, although income to the recipients, are not subject to the income tax.

108. ***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.

109. ***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.

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

111. ***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.

112. ***401(k) plans.***—Individual taxpayers can make tax-preferred contributions to certain types of employer-provided 401(k) plans (and 401(k)-type plans like 403(b) plans and the Federal government's Thrift Savings Plan). In 2001, an employee could exclude up to $10,500 (indexed) of wages from AGI under a qualified arrangement with an employer's 401(k) plan. EGTRRA increases the exclusion amount to $11,000 in 2002, $12,000 in 2003, $13,000 in 2004, $14,000 in 2005 and $15,000 in 2006 (indexed thereafter). The tax on the investment income earned by 401(k)-type plans is deferred until withdrawn.

EGTRRA also allows employees to make after-tax contributions to 401(k) and 401(k)-type plans beginning in 2002. These contributions are not excluded from AGI, but the investment income of such after-tax contributions is not taxed when earned or withdrawn.

113. ***Individual Retirement Accounts.***—Individual taxpayers can take advantage of several different Individual Retirement Accounts (IRAs): deductible IRAs, non-deductible IRAs, and Roth IRAs. In 2001, employees can make annual contributions to an IRA up to $2,000 (or 100 percent of compensation, if less). The annual contributions limit applies to the total of a taxpayer's deductible, non-deductible, and Roth IRAs contributions. EGTRRA increases the IRA contribution limit to $3,000 in 2002, $4,000 in 2005, and $5,000 in 2008 (indexed thereafter) and allows taxpayers over age 50 to make additional "catch-up" contributions of $1,000 (by 2006).

Taxpayers whose AGI is below $53,000 ($33,000 for non-joint filers) in 2001 can claim a deduction for IRA contributions. In 2001, the IRA deduction is phased out for taxpayers with AGI between $53,000 and $63,000 ($33,000 and $43,000 for non-joint). The phase-out range increases annually until it reaches $80,000 to $100,000 in 2007 ($50,000 to $60,000 in 2005 for non-joint filers). Taxpayers whose AGI is above the phase-out range can also claim a deduction for their IRA contributions depending on whether they (or their spouse) are an active participant in an employer-provided retirement plan. The tax on the investment income earned by 401(k) plans, non-deductible IRAs, and deductible IRAs is deferred until the money is withdrawn.

Taxpayers with incomes below $150,000 ($90,000 for nonjoint filers) can make contributions to Roth IRAs. 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). Investment income of a Roth IRA is not taxed when earned nor when withdrawn. Withdrawals from a Roth IRA are penalty 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.

Taxpayers can contribute to a non-deductible IRA regardless of their income and whether they are an active participant in an employer-provided retirement plan. The tax on investment income earned by non-deductible IRAs is deferred until the money is withdrawn.

114. ***Low and moderate income savers' credit.***—EGTRRA provides an additional incentive for lower-income taxpayers to save through a nonrefundable credit of up to 50 percent on IRA contributions. This credit is in addition to any deduction or exclusion. The credit is completely phased out by $50,000 for joint filers and $25,000 for single filers. This temporary credit is in effect from 2002 through 2006.

115. ***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 $35,000 in 2001. Total plan contributions are limited to 15 percent of a firm's total wages. EGTRRA increases the percent of pay limit to 100 percent of the income of the self-employed by 2005 and increases the dollar limit on contributions to $40,000 beginning in 2002. EGTRRA also increased the plan limit to 25 percent of a firm's total wages and excluded employee contributions from this limit beginning in 2002. The tax on the investment income earned by Keogh plans is deferred until withdrawn.

116. ***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.

117. ***Small business retirement plan credit.***—EGTRRA provides businesses with 100 or fewer employees a credit for 50 percent of the qualified startup costs associated with a new qualified retirement plan. The credit is limited to $500 annually and may only be claimed for expenses incurred during the first three years from the start of the qualified plan. Qualified startup expenses include expenses related to the establishment and administration of the plan, and the retirement-related education of employees. The credit applies to costs incurred beginning in 2002.

118. ***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.

119. ***Employer-provided supplementary unemployment benefits.***—Employers may establish trusts to pay supplemental unemployment benefits to employees separated from employment. Interest payments to such trusts are exempt from taxation.

120. ***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 corporations 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.

121. ***Additional deduction for the blind.***—Taxpayers who are blind may take an additional $1,100 standard deduction if single, or $900 if married.

122. ***Additional deduction for the elderly.***—Taxpayers who are 65 years or older may take an additional $1,100 standard deduction if single, or $900 if married.

123. ***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.

124. ***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.

125. ***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 $7,140 of earned income in 2001. The credit is 40 percent of the first $10,020 of income for a family with two or more qualifying children. The credit is phased out beginning when the taxpayer's income exceeds $13,090 at the rate of 15.98 percent (21.06 percent if two or more qualifying children are present). It is completely phased out when the taxpayer's modified adjusted gross income reaches $28,281 ($32,121 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 2001, the credit is 7.65 percent of the first $4,760 of earned income. When the taxpayer's income exceeds $5,950, the credit is phased out at the rate of 7.65 percent. It is completely phased out at $10,710 of modified adjusted gross income.

For workers with or without children, the income levels at which the credit begins to phase-out and the maximum amounts of income on which the credit can be taken are adjusted for inflation. For married taxpayers filing a joint return, EGTRRA increases the base amount for the phase-out by $1,000 in 2002 through 2004, $2,000 in 2005 through 2007, and $3,000 in 2008 (indexed thereafter). 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

126. ***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.

127. ***Social Security benefits for the disabled.***—Benefit payments from the Social Security Trust Fund, for disability and for dependents and survivors, are excluded from a beneficiary's gross incomes.

128. ***Social Security benefits for dependents and survivors.***—Benefit payments from the Social Security Trust Fund for dependents and survivors are excluded from a beneficiary's gross income.

Veterans Benefits and Services

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

130. ***Veterans pension payments.***—Pension payments made by the Veterans Administration are excluded from gross income.

131. ***G.I. Bill benefits.***—G.I. Bill benefits paid by the Veterans Administration are excluded from gross income.

132. ***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

133. ***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), equipment acquisition, and other public purposes is tax-exempt. Interest on bonds issued by Indian tribal governments for essential governmental purposes is also tax-exempt.

134. ***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.

135. ***Business income earned in U.S. possessions.***—U.S. corporations operating in a U.S. possession (e.g., Puerto Rico) can claim a credit against some or all of their U.S. tax liability on possession business income. The credit expires December 31, 2005.

Interest

136. ***U.S. savings bonds.***—Taxpayers may defer paying tax on interest earned on U.S. savings bonds until the bonds are redeemed.

4. FEDERAL RECEIPTS

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

The Federal Government also collects income from the public from market-oriented activities. Collections from these activities, which are subtracted from gross outlays, rather than added to taxes and other governmental receipts, are discussed in the following chapter.

Growth in receipts.—Total receipts in 2004 are estimated to be $1922.0 billion, an increase of $85.8 billion or 4.7 percent relative to 2003. Receipts are projected to grow at an average annual rate of 7.0 percent between 2004 and 2008, rising to $2,520.9 billion. This growth in receipts is largely due to assumed increases in incomes resulting from both real economic growth and inflation. These estimates reflect an adjustment for revenue uncertainty of -$25 billion in 2003 and -$15 billion in 2004. As this description suggests, these latter amounts reflect an additional adjustment to receipts beyond what the economic and tax models forecast and have been made in the interest of cautious and prudent forecasting.

As a share of GDP, receipts are projected to decline from 17.9 percent in 2002 to 17.1 percent in 2003 and 17.0 percent in 2004. The receipts share of GDP is projected to increase annually thereafter, rising to 18.3 percent in 2008.

Table 4–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	2002 actual	Estimate					
		2003	2004	2005	2006	2007	2008
Individual income taxes	858.3	849.1	849.9	934.6	1,014.1	1,103.4	1,175.3
Corporation income taxes	148.0	143.2	169.1	229.3	233.8	237.8	243.7
Social insurance and retirement receipts	700.8	726.6	764.5	810.9	845.8	883.6	922.2
(On-budget)	(185.4)	(195.0)	(208.4)	(221.4)	(231.0)	(239.1)	(249.0)
(Off-budget)	(515.3)	(531.6)	(556.2)	(589.5)	(614.8)	(644.4)	(673.2)
Excise taxes	67.0	68.4	70.9	73.3	75.6	77.8	80.0
Estate and gift taxes	26.5	20.2	23.4	21.1	23.2	20.8	21.2
Customs duties	18.6	19.1	20.7	21.2	23.9	26.0	27.6
Miscellaneous receipts	33.9	34.7	38.5	44.8	46.9	48.8	51.0
Adjustment for revenue uncertainty	.....	–25.0	–15.0	.....	.....	.....	.....
Total receipts	**1,853.2**	**1,836.2**	**1,922.0**	**2,135.2**	**2,263.2**	**2,398.1**	**2,520.9**
(On-budget)	*(1,337.9)*	*(1,304.7)*	*(1,365.9)*	*(1,545.7)*	*(1,648.4)*	*(1,753.6)*	*(1,847.7)*
(Off-budget)	*(515.3)*	*(531.6)*	*(556.2)*	*(589.5)*	*(614.8)*	*(644.4)*	*(673.2)*

Table 4–2. EFFECT ON RECEIPTS OF CHANGES IN THE SOCIAL SECURITY TAXABLE EARNINGS BASE

(In billions of dollars)

	Estimate				
	2004	2005	2006	2007	2008
Social security (OASDI) taxable earnings base increases:.					
$87,000 to $88,200 on Jan. 1, 2004	0.5	1.4	1.6	1.7	1.9
$88,200 to $92,100 on Jan. 1, 2005	.....	1.8	4.8	5.3	5.8
$92,100 to $96,000 on Jan. 1, 2006	.....	.....	1.8	4.8	5.3
$96,000 to $99,900 on Jan. 1, 2007	.....	.....	.....	1.8	4.8
$99,900 to $103,500 on Jan. 1, 2008	.....	.....	.....	.....	1.7

ENACTED LEGISLATION

Several laws were enacted in 2002 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

JOB CREATION AND WORKER ASSISTANCE ACT OF 2002 (JCWAA)

In the fall of 2001, President Bush called on the Congress to enact an economic security bill designed to reinvigorate economic growth and assist workers affected by the economic downturn that followed the terrorist attacks of September 11, 2001. The Congress responded in early 2002 and on March 9 President Bush signed the Job Creation and Worker Assistance Act of 2002. In addition to providing increased spending for extended unemployment benefits and funding for the Temporary Assistance for Needy Families supplemental grant program, this Act provides tax incentives to encourage business investment, provides tax incentives to help an area of New York City referred to as the Liberty Zone recover from the September 11th terrorist attacks, and extends a number of tax incentives that had expired or were scheduled to expire. The major provisions of the Act that affect receipts are described below.

Business Tax Relief

Provide a special depreciation allowance for certain property.—Taypayers are allowed to recover the cost of certain property used in a trade or business or for the production of income through annual depreciation deductions. The amount of the allowable depreciation deduction for a taxable year is generally determined under the modified accelerated cost recovery system, which assigns applicable recovery periods and depreciation methods to different types of property.

Effective for qualifying assets acquired after September 10, 2001 (a binding written contract for purchase must not have been in effect before September 11, 2001) and before September 11, 2004, this Act allows an additional first-year depreciation deduction equal to 30 percent of the adjusted basis of the property. The additional first-year depreciation deduction is allowed for both regular and alternative minimum tax purposes in the year the property is placed in service. The basis of the property and the depreciation deductions allowable in other years are adjusted to reflect the additional first-year depreciation deduction. Qualifying property includes tangible property with depreciation recovery periods of 20 years or less, certain software, water utility property, and qualified leasehold improvements. To qualify for the special depreciation allowance, the original use of the property must commence with the taxpayer after September 10, 2001 (except for certain sale-leaseback property) and the property must be placed in service before January 1, 2005 (January 1, 2006 for certain longer production period property). In addition, the limitation on first-year allowable depreciation for certain automobiles is increased by $4,600.

Allow five-year carryback of net operating losses.—A net operating loss (NOL) generally is the amount by which a taxpayer's allowable deductions exceed the taxpayer's gross income. A carryback of an NOL generally results in a refund of Federal income taxes paid for the carryback year. A carryforward of an NOL generally reduces Federal income tax payments for the carryforward year. Under prior law, an NOL generally could be carried back two years and carried forward 20 years; however, NOL deductions could not reduce a taxpayer's alternative minimum taxable income (AMTI) by more than 90 percent.

For NOLs arising in taxable years ending in 2001 and 2002, this Act generally extends the carryback period to five years. In addition, this Act allows NOL deductions attributable to NOL carrybacks arising in taxable years ending in 2001 and 2002, as well as NOL carryforwards to these taxable years, to offset 100 percent of a taxpayer's AMTI.

Unemployment Assistance

Allow special Reed Act transfers.—The Federal Unemployment Tax (FUTA) paid by employers funds the administrative costs of the unemployment insurance system and related programs. State unemployment taxes are deposited into the Unemployment Trust Fund and used by States to pay unemployment benefits. Under current law, FUTA balances in excess of statutory ceilings are distributed to the States to pay unemployment benefits or the administrative costs of the system (these are known as Reed Act distributions). However, the Balanced Budget Act of 1997 limited Reed Act transfers to states to $100 million after each of fiscal years 1999, 2000, and 2001, and limited the use of these $100 million distributions to paying administrative expenses of unemployment compensation laws.

Under JCWAA the $100 million limit on distributions from excess federal funds available at the end of fiscal year 2001, as well as the limitation on the use of the distributions, are repealed. This allows the Secretary of the Treasury to transfer excess FUTA balances as of the close of fiscal year 2001 into the account of each State in the Unemployment Trust Fund. Total transfers are capped at $8 billion.

Tax Benefits for the New York Liberty Zone

Expand eligibility for the work opportunity tax credit.—This Act temporarily expands eligibility for the work opportunity tax credit to include: (1) employees who perform substantially all of their services in the New York Liberty Zone (a specified area of downtown Manhattan surrounding the site of the World Trade Center) for a business located in the New York Liberty Zone, and (2) employees who perform substantially all

their services in New York City for a business that relocated from the New York Liberty Zone to elsewhere in New York City as a result of the events of September 11, 2001. The credit is available for wages paid or incurred for work performed by eligible individuals after December 31, 2001 and before January 1, 2004, and applies to wages paid to both new hires and existing employees. In addition, the portion of each employer's work opportunity tax credit attributable to this new targeted group of employees is allowed against the alternative minimum tax (AMT).

Provide a special depreciation allowance to certain property.—Under this Act, certain qualifying assets used in the New York Liberty Zone are eligible for an additional first-year depreciation deduction equal to 30 percent of the adjusted basis of the property. The additional first-year depreciation deduction is allowed for both regular and alternative minimum tax purposes in the year the property is placed in service. The basis of the property and the depreciation deductions allowable in other years are adjusted to reflect the additional first-year depreciation deduction. Qualifying assets include tangible property with depreciation recovery periods of 20 years or less, certain software, water utility property, and certain real property. Nonresidential real property and residential rental property are eligible for the special depreciation deduction only to the extent such property rehabilitates real property damaged, or replaces real property destroyed or condemned, as a result of the terrorist attacks of September 11, 2001. Assets qualifying for the additional first-year depreciation allowance (described above under Business Tax Relief) and qualified New York Liberty Zone leasehold improvement property are not eligible for the New York Liberty Zone special depreciation allowance. To qualify for the special depreciation allowance, substantially all of the use of the property must be in the New York Liberty Zone, the original use of the property in the New York Liberty Zone must commence with the taxpayer after September 10, 2001 (except for certain sale-leaseback property), the taxpayer must acquire the property by purchase after September 10, 2001, a binding written contract for purchase of the property must not have been in effect before September 11, 2001, and the property must be placed in service on or before December 31, 2006 (December 31, 2009 for nonresidential real property and residential rental property).

Authorize issuance of tax-exempt private activity bonds.—Interest on bonds issued by state and local governments to finance activities carried out and paid for by private persons (private activity bonds) is taxable unless the activities are specified in the Internal Revenue Code. The volume of certain tax-exempt private activity bonds that state and local governments may issue in each calendar year is limited by state-wide volume limits. Under this Act, an aggregate of $8 billion of tax-exempt private activity bonds may be issued during calendar years 2002, 2003 and 2004 for the acquisition, construction, reconstruction and renovation of nonresidential real property, residential rental property, and public utility property in the New York City Liberty Zone. Projects for which the bonds may be issued are limited to those approved by the Mayor of New York City or the Governor of New York State, each of whom may designate up to $4 billion of the bonds. In addition, each of those officials may designate up to $1 billion of the bonds to be used for the acquisition, construction, reconstruction and renovation of commercial real property located outside the Zone and within New York City, provided the property meets specified criteria. These bonds are not subject to the aggregate annual state private activity bond volume limit; several additional exceptions and modifications to the general rules applicable to the issuance of exempt-facility private activity bonds also apply.

Allow one additional advance refunding for certain previously refunded bonds.—Refunding bonds are used to redeem previously issued bonds. Different rules apply to "current" and "advance" refunding bonds. A current refunding occurs when the refunded debt is retired within 90 days of issuance of the refunding bonds. Tax-exempt bonds may be currently refunded an indefinite number of times. An advance refunding occurs when the refunded debt is not retired within 90 days after the refunding bonds are issued; instead, the proceeds of the refunding bonds are invested in an escrow account and held until a future date when the refunded debt may be retired. In general, governmental bonds and tax-exempt private activity bonds for charitable organizations (qualified 501 (c)(3) bonds) may be advance refunded one time.

This Act permits certain bonds for facilities located in New York City to be advance refunded one additional time. Eligible bonds include only those bonds for which all present-law advance refunding authority was exhausted before September 12, 2001, and with respect to which the advance refunding bonds authorized under present law were outstanding on September 11, 2001. In addition, at least 90 percent of the net proceeds of the refunded bonds must have been used to finance facilities located in New York City and the bonds must be: (1) governmental general obligation bonds of New York City; (2) governmental bonds issued by the Metropolitan Transportation Authority of the State of New York; (3) governmental bonds issued by the New York City Municipal Water Finance Authority; or (4) qualified 501 (c)(3) bonds issued by or on behalf of New York State or New York City to finance hospital facilities. The maximum aggregate amount of advance refunding bonds that may be issued in calendar years 2002, 2003, and 2004 is $9 billion. Eligible advance refunding bonds must be designated by the Mayor of New York City or the Governor of New York State, each of whom may designate up to $4.5 billion of the bonds.

Increase expensing for certain business property.—In lieu of depreciation, taxpayers with a suffi-

ciently small amount of annual investment (those that annually invest less than $200,000) generally may elect to deduct up to $24,000 ($25,000 for taxable years beginning after 2002) of the cost of qualifying property placed in service during the taxable year. Effective for certain qualifying capital assets acquired and placed in service after September 10, 2001 and before January 1, 2007, this Act increases the amount that may be deducted by such businesses to the lesser of $35,000 or the cost of the qualifying property. For property to qualify for the increased expensing: (1) substantially all of the use of the property must be in the New York Liberty Zone in the active conduct of a trade or business located in the Liberty Zone, and (2) the original use of the property in the Liberty Zone must commence with the taxpayer after September 10, 2001.

Extend replacement period for certain involuntarily converted property.—A taxpayer generally may elect not to recognize gain on property that is involuntarily converted if property similar or related in service or use is acquired within a designated replacement period. In general, the replacement period begins with the date of the disposition of the converted property and ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized. The replacement period is extended to three years if the converted property is real property held for productive use in a trade or business, or for investment. This Act extends the replacement period to five years for property involuntarily converted within the New York Liberty Zone as a result of the terrorist attacks of September 11, 2001, if substantially all of the use of the replacement property is in New York City.

Modify treatment of qualified leasehold improvement property.—The depreciation deduction allowed for improvements made on leased property is determined under the modified accelerated cost recovery system, even if the recovery period assigned to the property is longer than the term of the lease. Leasehold improvements are depreciated using the straight-line method and a recovery period that corresponds to the type of real property being improved (39 years in the case of nonresidential real property). Under this Act, qualified leasehold improvement property placed in service in the New York Liberty Zone after September 10, 2001 and before January 1, 2007, and which is not subject to a written binding contract in effect before September 11, 2001, is to be depreciated over five years using the straight-line method. The alternative depreciation system recovery period for such property is nine years under this Act. Qualified New York City Liberty Zone leasehold improvement property is not eligible for the special depreciation allowance available to qualified New York Liberty Zone property or the special first-year depreciation allowance created by this Act and described above under Business Tax Relief.

Miscellaneous and Technical Provisions

Modify interest rate used in determining additional required contributions to defined benefit plans and Pension Benefit Guaranty Corporation (PBGC) variable rate premiums.—Minimum and maximum funding requirements are imposed on defined benefit pension plans under current law. Minimum funding requirements generally are the amount needed to fund benefits earned during the year, plus the year's portion of the amortized cost of other liabilities. If a defined benefit plan is underfunded under a statutorily specified calculation, additional contributions are required. The PBGC also insures the benefits owed under defined benefit pension plans, requiring that employers pay premiums to the PBGC for this insurance coverage. If a plan is underfunded, additional premiums (referred to as variable rate premiums), based on the amount of unfunded vested benefits, are required. This Act expands the permissible range of the statutory interest rate used in calculating whether a defined benefit pension plan is underfunded, thereby affecting both the need for an employer to make additional contributions to a plan and the amount of those additional contributions. This Act also increases the interest rate used to determine the amount of unfunded vested benefits, thereby affecting the amount of variable rate premiums imposed. These interest rate changes are effective for plan years beginning after December 31, 2001 and before January 1, 2004.

Allow teachers to deduct out-of-pocket classroom expenses.—Under a permanent provision employees who incur unreimbursed, job-related expenses are allowed to deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceeded 2 percent of adjusted gross income (AGI), but only if the taxpayer itemizes deductions (i.e., does not use the standard deduction). Effective for expenses incurred in taxable years beginning after December 31, 2001 and before January 1, 2004, this Act allows certain teachers and other elementary and secondary school professionals to treat up to $250 in qualified out-of-pocket classroom expenses as a non-itemized deduction (above-the-line deduction). Unreimbursed expenditures for certain books, supplies and equipment related to classroom instruction qualify for the deduction.

Modify other tax provisions.—This Act also makes technical corrections to previously enacted legislation, removes the statutory impediment to providing copies of specified information returns to taxpayers electronically, expands the exclusion from income for qualified foster care payments, limits the use of the non-accrual experience method of accounting to the amount to be received for the performance of qualified professional services, and prohibits shareholders from increasing the basis of their stock in an S corporation by their pro rata share of income from the discharge of indebtedness

of the S corporation that is excluded from the S corporation's income.

Expired or Expiring Provisions

Extend alternative minimum tax relief for individuals.—A temporary provision of prior law, which had permitted nonrefundable personal tax credits to offset both the regular tax and the alternative minimum tax (AMT), had expired for taxable years beginning after December 31, 2001. This Act extends minimum tax relief for nonrefundable personal tax credits two years, to apply to taxable years 2002 and 2003. The extension does not apply to the child credit, the earned income tax credit or the adoption credit, which were provided AMT relief through December 31, 2010 under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). The refundable portion of the child credit and the earned income tax credit are also allowed against the AMT through December 31, 2010.

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 generally applies to the first $6,000 of wages paid to several categories of economically disadvantaged or handicapped workers. The credit rate is 25 percent of qualified wages for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. This Act extends the credit, which had expired with respect to workers hired after December 31, 2001, making it available for workers hired before January 1, 2004.

Extend the welfare-to-work tax credit.—The welfare-to-work tax credit entitles employers to claim a tax credit for hiring certain recipients of long-term family assistance. The purpose of the credit is to expand job opportunities for persons making the transition from welfare to work. 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. Eligible wages include cash wages plus the cash value of certain employer-paid health, dependent care, and educational fringe benefits. The minimum employment period that employees must work before employers can claim the credit is 400 hours. This Act extends the credit, which had expired with respect to individuals who began work after December 31, 2001, to apply to individuals who begin work before January 1, 2004.

Extend Archer Medical Savings Accounts (MSAs)—Self-employed individuals and employees of small firms are allowed to establish Archer MSAs; the number of accounts is capped at 750,000. In addition to other requirements, (1) individuals who establish Archer MSAs must be covered by a high-deductible health plan (and no other plan) with a deductible of at least $1,700 but not greater than $2,500 for policies covering a single person and a deductible of at least $3,350 but not greater than $5,050 in all other cases, (2) tax-preferred contributions are limited to 65 percent of the deductible for single policies and 75 percent of the deductible for other policies, and (3) either an individual or an employer, but not both, may make a tax-preferred contribution to an Archer MSA for a particular year. This Act extends the Archer MSA program, which was scheduled to expire on December 31, 2002, through December 31, 2003.

Extend tax on failure to comply with mental health parity requirements applicable to group health plans.—Under prior law, group heath plans that provided both medical and surgical benefits and mental health benefits, could not impose aggregate lifetime or annual dollar limits on mental health benefits that were not imposed on substantially all medical and surgical benefits. An excise tax of $100 per day (during the period of noncompliance) was imposed on an employer sponsoring a group plan that failed to meet these requirements. For a given taxable year, the tax was limited to the lesser of 10 percent of the employer's group health insurance expenses for the prior taxable year or $500,000. The excise tax was applicable to plan years beginning on or after January 1, 1998 and expired with respect to benefits for services provided on or after December 31, 2002. This Act extends the excise tax to apply to benefits for services provided before January 1, 2004.

Extend tax credit for purchase of electric vehicles.—Under prior law, a 10-percent tax credit up to a maximum of $4,000 was provided for the cost of a qualified electric vehicle. The full amount of the credit was available for purchases prior to January 1, 2002. The credit began to phase down in 2002 and was not available for purchases after 2004. This Act defers the phasedown of the credit for two years. The full amount of the credit is available for purchases in 2002 and 2003, but begins to phase down in 2004; the credit is not available for purchases after December 31, 2006.

Extend deduction for qualified clean-fuel vehicles and qualified clean-fuel vehicle refueling property.—Under prior law, certain costs of acquiring clean-fuel vehicles (vehicles that use certain clean-burning fuels) and property used to store or dispense clean-burning fuel, could be expensed and deducted when the property was placed in service. For qualified clean-fuel vehicles, the maximum allowable deduction was $50,000 for a truck or van with a gross vehicle weight over 26,000 pounds, or a bus with seating capacity of at least 20 adults; $5,000 for a truck or van with a gross vehicle weight between 10,000 and 26,000 pounds; and $2,000 in the case of any other motor vehicle. The full amount of the deduction could be claimed for vehicles placed in service before January 1, 2002, but began to phase down for vehicles placed in service after December 31, 2001, and was not available after December 31, 2004. For qualified property used to store or dis-

pense clean-burning fuel, or used to recharge electric vehicles, the owner was allowed to deduct up to $100,000 of the cost of the property at each location, provided the property was placed in service before January 1, 2005. This Act defers the phasedown of the deduction for clean-fuel vehicles by two years. The full amount of the deduction is available for vehicles placed in service in 2002 and 2003, begins to phase down in 2004, and is unavailable after December 31, 2006. The provision extends the placed-in-service date for clean-fuel vehicle refueling property by two years, making the deduction available for property placed in service prior to January 1, 2007.

Extend tax credit for producing electricity from certain sources.—Under prior law, taxpayers were provided a 1.5-cent-per-kilowatt-hour tax credit, adjusted for inflation after 1992, for electricity produced from wind, closed-loop biomass (organic material from a plant grown exclusively for use at a qualified facility to produce electricity), and poultry waste. To qualify for the credit, the electricity had be sold to an unrelated third party and had be produced during the first 10 years of production at a facility placed in service before January 1, 2002. This Act extends the credit to apply to electricity produced at a facility placed in service before January 1, 2004.

Extend suspension of net income limitation on percentage depletion from marginal oil and gas wells.—Taxpayers are allowed to recover their investment in oil and gas wells through depletion deductions. For certain properties, deductions may be determined using the percentage depletion method; however, in any year, the amount deducted generally may not exceed 100 percent of the net income from the property. Under prior law, for taxable years beginning after December 31, 1997 and before January 1, 2002, domestic oil and gas production from "marginal" properties was exempt from the 100-percent of net income limitation. This Act extends the exemption to apply to taxable years beginning after December 31, 2001 and before January 1, 2004.

Repeal requirement that registered motor fuels terminals offer dyed fuel as a condition of registration.—With limited exceptions, excise taxes are imposed on all highway motor fuels when they are removed from a registered terminal facility, unless the fuel is indelibly dyed and is destined for a nontaxable use. Terminal facilities are not permitted to receive and store non-tax-paid motor fuels unless they are registered with the Internal Revenue Service (IRS). Effective January 1, 2002, in order to be registered under prior law, a terminal had to offer for sale both dyed and undyed fuel (the "dyed-fuel mandate"). This Act repeals the dyed-fuel mandate effective January 1, 2002.

Extend authority to issue Qualified Zone Academy Bonds.—Prior law allowed state and local governments to issue "qualified zone academy bonds," the interest on which was effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of the bonds had to be used for teacher training, purchases of equipment, curriculum development, or rehabilitation and repairs at certain public school facilities. A nationwide total of $400 million of qualified zone academy bonds were authorized to be issued in each of calendar years 1998 through 2001. In addition, unused authority arising in 1998 and 1999 could be carried forward for up to three years and unused authority arising in 2000 and 2001 could be carried forward for up to two years. This Act authorizes the issuance of an additional $400 million of qualified zone academy bonds in each of calendar years 2002 and 2003.

Extend tax incentives for employment and investment on Indian reservations.—This Act extends for one year, through December 31, 2004, the employment tax credit for qualified workers employed on an Indian reservation and the accelerated depreciation rules for qualified property used in the active conduct of a trade or business within an Indian reservation.

For a given taxable year, the employment tax credit is equal to 20 percent of the amount by which qualified wages and health insurance costs paid by an employer exceed the amount paid by the employer in 1993. The amount of qualified wages and health insurance costs taken into account with respect to any employee for any taxable year may not exceed $20,000. A qualified employee is an individual who is an enrolled member of an Indian tribe (or is the spouse of an enrolled member), lives on or near the reservation where he or she works, performs services that are all or substantially all within the Indian reservation, and receives wages from the employer that are less than or equal to $30,000 (adjusted annually for inflation after 1994) when determined at an annual rate. The employment tax credit is not available for employees involved in certain gaming activities or who work in a building that houses certain gaming activities.

The accelerated depreciation recovery periods for qualified Indian reservation property are: 2 years for 3-year property, 3 years for 5-year property, 4 years for 7-year property, 6 years for 10-year property, 9 years for 15-year property, 12 years for 20-year property, and 22 years for nonresidential real property. Qualifying property must be used predominantly in the active conduct of a trade or business within an Indian reservation, cannot be used outside the reservation on a regular basis (except for qualified infrastructure property if the purpose of such property is to connect with qualified infrastructure property located within the reservation), and cannot be acquired from a related person. Property used to conduct or house certain gaming activities is not eligible for the accelerated depreciation recovery periods.

Extend exceptions provided under subpart F for certain active financing income.—Under the Sub-

part F rules, certain U.S. shareholders of a controlled foreign corporation (CFC) are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, "foreign personal holding company income" and insurance income. Foreign personal holding company income generally includes many types of income derived by a financial service company, such as dividends; interest; royalties; rents; annuities; net gains from the sale of certain property, including securities, commodities and foreign currency; and income from notional principal contracts and securities lending activities. Under prior law, for taxable years beginning before 2002, certain income derived in the active conduct of a banking, financing, insurance, or similar business was excepted from Subpart F. This Act extends the exception for five years, to apply to taxable years beginning before January 1, 2007.

Suspend temporarily the provision that disallows certain deductions of mutual life insurance companies.—Life insurance companies may generally deduct policyholder dividends, while dividends to stockholders are not deductible. Section 809 of the Internal Revenue Code attempts to identify amounts returned by mutual life insurance companies to holders of participating polices in their role as owners of the company, and generally disallows a deduction for mutual company policyholder dividends (or otherwise increases taxable income by reducing the amount of end-of-year reserves) in an amount equal to the amount identified by section 809. The section 809 imputed amount is termed the company's differential earnings amount, and equals the product of the individual company's average equity base and an industry-wide computed differential earnings rate. The differential earnings rate is initially computed using the average mutual earnings rate for the second year preceding the current taxable year, but is later recomputed using the current year's average mutual earnings rate. Any difference between the differential earnings amount and the recomputed differential earnings amount is taken into account in computing taxable income for the following taxable year. Effective for taxable years beginning in 2001, 2002, and 2003, this Act provides a zero differential earnings rate for purposes of computing the differential earnings amount and the recomputed differential earnings amount, thereby temporarily suspending the income imputation for mutual life insurance companies provided under section 809.

TRADE ACT OF 2002

This Act authorizes the President to enter into trade agreements with foreign countries regarding tariff and non-tariff barriers whenever he determines that these barriers unduly burden or restrict U.S. foreign trade or adversely affect the U.S. economy. Expedited procedures for Congressional consideration of the legislation to implement these trade agreements, without amendment, are also authorized. Other provisions of the Act reauthorize the Customs Service, reauthorize and expand certain benefits under the Trade Adjustment Assistance program, extend and expand trade benefits to Andean countries, reauthorize duty-free treatment under the Generalized System of Preferences program for developing countries, and make other trade-related changes. The major provisions of the Act that affect receipts are described below.

Provide refundable tax credit for the purchase of qualified health insurance by certain individuals.—A refundable tax credit is provided to eligible individuals for the cost of qualified health insurance for the individual and qualifying family members. The credit is equal to 65 percent of the amount paid by certain individuals certified as eligible for Trade Adjustment Assistance or alternative Trade Adjustment Assistance, and certain retired workers whose pensions are paid by the Pension Benefit Guaranty Corporation and who are not eligible for Medicare. Payment of the credit is available on an advance basis (i.e, prior to the filing of the taxpayer's return) pursuant to a program to be established by the Secretary of the Treasury no later than August 1, 2003. The credit first became available for months beginning December 2002.

Extend and expand Andean trade preferences.—This Act extends and enhances the Andean Trade Preference Act (ATPA), which expired on December 4, 2001, through December 31, 2006. The ATPA, which was enacted in 1991, was designed to provide economic alternatives for Bolivia, Columbia, Ecuador, and Peru in their fight against narcotics production and trafficking.

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 Act extends this program, which had expired after September 30, 2001, through December 31, 2006.

Modify miscellaneous trade provisions.—Other trade-related changes made by this Act include: (1) modification of benefits provided under the Caribbean Basin Trade Partnership Act and the Africa Growth and Opportunity Act, (2) an increase in the aggregate value of goods that U.S. residents traveling abroad may bring into the United States duty free, and (3) the provision of duty-free treatment to certain steam or vapor generating boilers used in nuclear facilities.

ADMINISTRATION PROPOSALS

The President's plan provides tax incentives for charitable giving, strengthening education, investing in health care, and protecting the environment. It also provides tax incentives designed to increase energy production and promote energy conservation, temporarily extends provisions that are scheduled to expire, permanently extends the research and experimentation (R&E) tax credit, and permanently extends the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) that sunset on December 31, 2010. In addition, the President intends to work with the Congress to enact an economic growth package that will increase the momentum of the economic recovery and enhance long-term growth.

Last year's Budget announced the Administration's tax simplification project, which is focusing on immediately achievable reforms of the current tax system. Several proposals in this year's Budget result from this project. They include the proposals relating to: creating a uniform definition of a qualifying child, eliminating the phaseout of adoption tax benefits, repealing the restrictions on the use of qualified 501(c)(3) bonds in refinancing taxable debt and working capital debt and in providing residential rental housing, simplifying use of the orphan drug tax credit for pre-designation costs, excluding from income the value of employer-provided computers, consolidating IRAs into Lifetime Savings Accounts and Retirement Savings Accounts (LSAs/RSAs), consolidating defined contribution retirement plans into Employer Retirement Savings Accounts (ERSAs), allowing section 179 expensing elections to be made or revoked on amended returns, and conforming and simplifying the work opportunity tax credit and the welfare to work tax credit. Additional tax simplification proposals are under development and review and will be released during the coming year.

ECONOMIC GROWTH PACKAGE

The President believes that it is crucial for the Congress to pass an economic growth package quickly that will reinvigorate the economic recovery and provide new jobs, reduce tax burdens, and strengthen investor confidence. The provisions of the Administration's proposal that affect receipts are described below.

Accelerate 10-percent individual income tax rate bracket expansion.—Under EGTRRA, effective for taxable years beginning before January 1, 2011, the 15-percent individual income tax rate bracket of prior law is split into two tax rate brackets of 10 and 15 percent. The 10-percent tax rate bracket applies to the first $6,000 of taxable income for single taxpayers and married taxpayers filing separate returns (increasing to $7,000 for taxable years beginning after December 31, 2007), the first $10,000 of taxable income for heads of household, and the first $12,000 of taxable income for married taxpayers filing joint returns (increasing to $14,000 of taxable income for taxable years beginning after December 31, 2007). Taxable income above these thresholds that was taxed at the 15-percent rate under prior law continues to be taxed at that rate. The income thresholds for the new tax rate brackets are adjusted annually for inflation, effective for taxable years beginning after December 31, 2008 and before January 1, 2011.

To spur consumer confidence and economic growth, the Administration proposes to accelerate the expansion of the 10-percent bracket scheduled for 2008 to 2003. Effective for taxable years beginning after December 31, 2002, the 10-percent tax rate bracket would apply to the first $7,000 of taxable income for single taxpayers and married taxpayers filing separate returns, the first $10,000 of taxable income for heads of household, and the first $14,000 of taxable income for married taxpayers filing joint returns. The income thresholds for the 10-percent tax rate brackets would be adjusted annually for inflation, effective for taxable years beginning after December 31, 2003. As a result of the Administration's proposal to extend the EGTRRA provisions permanently, the expanded 10-percent individual income tax rate bracket would also apply to taxable years beginning after December 31, 2010.

Accelerate reduction in individual income tax rates.—In addition to splitting the 15-percent tax rate bracket of prior law into two tax rate brackets (see preceding discussion), EGTRRA replaces the four remaining statutory individual income tax rate brackets of prior law (28, 31, 36, and 39.6 percent) with a rate structure of 25, 28, 33, and 35 percent. The reduced tax rate structure is phased in over a period of six years, effective for taxable years beginning after December 31, 2000, as follows: the 28-percent rate is reduced to 27.5 percent for 2001, 27 percent for 2002 and 2003, 26 percent for 2004 and 2005, and 25 percent for 2006 through 2010; the 31 percent rate is reduced to 30.5 percent for 2001, 30 percent for 2002 and 2003, 29 percent for 2004 and 2005, and 28 percent for 2006 through 2010; the 36 percent rate is reduced to 35.5 percent for 2001, 35 percent for 2002 and 2003, 34 percent for 2004 and 2005, and 33 percent for 2006 through 2010; and the 39.6 percent rate is reduced to 39.1 percent for 2001, 38.6 percent for 2002 and 2003, 37.6 percent for 2004 and 2005, and 35 percent for 2006 through 2010. The income thresholds for these tax rate brackets are adjusted annually for inflation.

To improve the incentives to work, save and invest, the Administration proposes to accelerate the reductions in income tax rates scheduled for 2004 and 2006 to 2003. Effective for taxable years beginning after December 31, 2002, the 27-percent rate would be reduced to 25 percent, the 30-percent rate would be reduced to 28 percent, the 35-percent rate would be reduced to 33 percent, and the 38.6-percent rate would be reduced to 35 percent. These rates would remain in effect for taxable years beginning after December 31, 2010

as a result of the Administration's proposal to extend the EGTRRA provisions permanently.

Accelerate 15-percent individual income tax rate bracket expansion for married taxpayers filing joint returns.—The maximum taxable income in the 15-percent tax rate bracket for a married couple filing a joint return is 167 percent of the corresponding amount for an unmarried individual filing a single return. Therefore, a two-earner couple may have a greater individual income tax liability if they file a joint return than what it would be if they were not married and each filed a separate return. Under EGTRRA, the size of the 15-percent tax rate bracket for married taxpayers filing joint returns is increased over a four-year period, beginning after December 31, 2004. The increase is as follows: the maximum taxable income in the 15-percent tax rate bracket for married taxpayers filing joint returns increases to 180 percent of the corresponding amount for single taxpayers in taxable year 2005, 187 percent in taxable year 2006, 193 percent in taxable year 2007, and 200 percent in taxable years 2008, 2009, and 2010.

The Administration proposes to reduce the marriage penalty by increasing the maximum taxable amount in the 15-percent tax rate bracket for married taxpayers filing joint returns to 200 percent of the corresponding amount for single taxpayers, effective for taxable years beginning after December 31, 2002. As a result of the Administration's proposal to extend EGTRRA permanently, the expanded 15-percent tax rate bracket for married taxpayers would also apply to taxable years beginning after December 31, 2010.

Accelerate increase in standard deduction for married taxpayers filing joint returns.—The basic standard deduction amount for a married couple filing a joint return is 167 percent of the basic standard deduction for an unmarried individual filing a single return. Therefore, two single taxpayers have a combined standard deduction that exceeds the standard deduction of a married couple filing a joint return. Under EGTRRA, the standard deduction for married couples filing joint returns is increased to double the standard deduction for single taxpayers over a five-year period, beginning after December 31, 2004. The standard deduction for married taxpayers filing joint returns increases to 174 percent of the standard deduction for single taxpayers in taxable year 2005, 184 percent in taxable year 2006, 187 percent in taxable year 2007, 190 percent in taxable year 2008, and 200 percent in taxable years 2009 and 2010.

The Administration proposes to reduce the marriage penalty by increasing the standard deduction for married taxpayers filing joint returns to 200 percent of the standard deduction for single taxpayers, effective for taxable years beginning after December 31, 2002. As a result of the Administration's proposal to extend EGTRRA permanently, the increase in the standard deduction for married taxpayers would also apply to taxable years beginning after December 31, 2010.

Accelerate increase in child tax credit.—Current law provides taxpayers a tax credit of up to $600 for each qualifying child under the age of 17. The credit increases to $700 for taxable years 2005 through 2008, $800 for taxable year 2009, and $1,000 for taxable year 2010. The credit declines to $500 in taxable year 2011. The credit is reduced by $50 for each $1,000 (or fraction thereof) by which the taxpayer's modified adjusted gross income exceeds $110,000 ($75,000 if the taxpayer is not married and $55,000 if the taxpayer is married but filing a separate return). These income thresholds are not adjusted for inflation. For taxable years before January 1, 2011, the credit offsets both the regular and the alternative minimum tax.

The child tax credit is refundable to the extent of 10 percent of the taxpayer's earned income in excess of $10,500. The percentage increases to 15 percent for taxable years 2005 through 2010. The $10,500 earned income threshold is indexed annually for inflation. Families with three or more children are allowed a refundable credit for the amount by which their social security payroll taxes exceed the refundable portion of their earned income tax credit, if that amount is greater than the refundable credit based on their earned income in excess of $10,500. For taxable years beginning after December 31, 2010, the credit is nonrefundable unless the taxpayer has three or more children and social security taxes in excess of the refundable portion of the earned income tax credit.

To assist families with the costs of raising children, the Administration proposes to increase the amount of the child tax credit by $400 to $1,000 per child. The proposal would be effective for taxable years beginning after December 31, 2002. For 2003, the increased amount of the child tax credit would be paid in advance beginning in July on the basis of information on the taxpayer's 2002 tax return filed in 2003. Advance payments would be made in a manner similar to the distribution of advance payment checks in 2001. The Administration is also proposing to extend the EGTRRA provisions permanently. Thus, in taxable years beginning after December 31, 2010, the credit would be $1,000, would offset the alternative minimum tax, and would be partially refundable for families with one or two children.

Eliminate the double taxation of corporate earnings.—For corporate stock held in taxable accounts, corporate profits may be taxed twice, once at the shareholder level and once at the corporate level. If the distribution is made through multiple corporations, profits may be taxed more than twice. In contrast, most other forms of capital income (i.e., interest payments, partnership income, and sole-proprietorship income) are taxed only once. The double taxation of corporate earnings contributes to a number of economic distortions. These include a tax bias that (a) discourages investing

in corporations in favor of investing in unincorporated forms of business and in consumer durables, (b) discourages financing corporate investment with equity in favor of financing with debt, and (c) discourages distributing earnings as dividends in favor of distributing earnings via share repurchases or retaining and reinvesting them. By reducing or eliminating these tax biases, the Administration's proposal allows markets, rather than taxes, to determine business investment and financing decisions. The Administration's proposal, which would be effective for taxable years beginning in 2003, would relieve the double tax on corporate profits by granting tax relief to shareholders. Shareholders would exclude from taxable income dividends that have been taxed at the corporate level. Excludable dividends would come from an excludable dividend account (EDA), which would reflect income on which the corporation had paid tax at the highest corporate tax rate. Relief from double taxation also would be extended to retained earnings through a shareholder basis adjustment. Shareholders would receive an increase in basis for amounts of taxed corporate earnings that are not paid out as a dividend. This would relieve the capital gains tax on the retained corporate earnings. The basis adjustment would treat the shareholder as if he or she had received a dividend and reinvested it in the corporation.

Increase expensing for small business.—In lieu of depreciation, a taxpayer with less than $200,000 in annual investment may elect to deduct up to $25,000 ($24,000 in 2001 and 2002) of the cost of qualifying property placed in service during the taxable year. The amount that a small business may expense is reduced by the amount by which the cost of qualifying property exceeds $200,000. An election for the increased deduction must generally be made on the taxpayer's initial tax return to which the election applies and the election can only be revoked with the consent of the Commissioner. The Administration proposes to increase the deduction to $75,000 for taxpayers with less than $325,000 in annual investment (with both limits indexed annually for inflation) and include off-the-shelf computer software as qualifying property. Additionally, the Administration proposes to allow expensing elections to be made or revoked on amended returns. The proposal would be effective for taxable years beginning on or after January 1, 2003.

Provide minimum tax relief to individuals.—To ensure that the benefits from the acceleration of the individual income tax reductions are not reduced by the AMT, the Administration proposes to increase the AMT exemption amount in 2003 and 2004 by $8,000 for married taxpayers and by $4,000 for single taxpayers, and maintain those exemption levels through 2005.

TAX INCENTIVES

Provide Incentives for Charitable Giving

Provide charitable contribution deduction for nonitemizers.—Under current law, individual taxpayers who do not itemize their deductions (nonitemizers) are not able to deduct contributions to qualified charitable organizations. The Administration proposes to allow nonitemizers to deduct charitable contributions of cash in addition to claiming the standard deduction, effective for taxable years beginning after December 31, 2002. Nonitemizers would be allowed to deduct cash contributions that exceed $250 ($500 for married taxpayers filing jointly), up to a maximum deduction of $250 ($500 for married taxpayers filing jointly). The deduction floor and limits would be indexed for inflation after 2003. Deductible contributions would be subject to existing rules governing itemized charitable contributions, such as the substantiation requirements.

Permit tax-free withdrawals from IRAs for charitable contributions.—Under current law, eligible individuals may make deductible or non-deductible contributions to a traditional IRA. Pre-tax contributions and earnings in a traditional IRA are included in income when withdrawn. Effective for distributions after December 31, 2002, the Administration proposes to allow individuals who have attained age 65 to exclude from gross income IRA distributions made directly to a charitable organization. The exclusion would apply without regard to the percentage-of-AGI limitations that apply to deductible charitable contributions. The exclusion would apply only to the extent the individual receives no return benefit in exchange for the transfer, and no charitable deduction would be allowed with respect to any amount that is excludable from income under this provision.

Expand and increase the enhanced charitable deduction for contributions of food inventory.—A taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically cost) in the inventory. However, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of: (1) basis plus one half of the fair market value in excess of basis, or (2) two times basis. To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer contributed to a charitable organization and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis.

Under the Administration's proposal, which is designed to encourage contributions of food inventory to charitable organizations, any taxpayer engaged in a trade or business would be eligible to claim an enhanced deduction for donations of food inventory. The enhanced deduction for donations of food inventory would be increased to the lesser of: (1) fair market value, or (2) two times basis. However, to ensure consistent treatment of all businesses claiming an enhanced deduction for donations of food inventory, the enhanced deduction for qualified food donations by S corporations and non-corporate taxpayers would be limited to 10 percent of net income from the trade or business. A special provision would allow taxpayers with a zero or low basis in the qualified food donation (e.g., taxpayers that use the cash method of accounting for purchases and sales, and taxpayers that are not required to capitalize indirect costs) to assume a basis equal to 25 percent of fair market value. The enhanced deduction would be available only for donations of "apparently wholesome food" (food intended for human consumption that meets all quality and labeling standards imposed by Federal, state, and local laws and regulations, even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions). The fair market value of "apparently wholesome food" that cannot or will not be sold solely due to internal standards of the taxpayer or lack of market, would be determined by taking into account the price at which the same or substantially the same food items are sold by the taxpayer at the time of the contribution or, if not sold at such time, in the recent past. These proposed changes in the enhanced deduction for donations of food inventory would be effective for taxable years beginning after December 31, 2002.

Reform excise tax based on investment income of private foundations.—Under current law, private foundations that are exempt from Federal income tax are subject to a two-percent excise tax on their net investment income (one-percent if certain requirements are met). The excise tax on private foundations that are not exempt from Federal income tax, such as certain charitable trusts, is equal to the excess of the sum of the excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. To encourage increased charitable activity and simplify the tax laws, the Administration proposes to replace the two rates of tax on the net investment income of private foundations that are exempt from Federal income tax with a single tax rate of one percent. The excise tax on private foundations not exempt from Federal income tax would be equal to the excess of the sum of the one-percent excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax what would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. The proposed change would be effective for taxable years beginning after December 31, 2002.

Modify tax on unrelated business taxable income of charitable remainder trusts.—A charitable remainder annuity trust is a trust that is required to pay, at least annually, a fixed dollar amount of at least five percent of the initial value of the trust to a non-charity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A charitable remainder unitrust is a trust that generally is required to pay, at least annually, a fixed percentage of at least five percent of the fair market value of the trust's assets determined at least annually to a non-charity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A trust does not qualify as a charitable remainder annuity trust if the annuity for a year is greater than 50 percent of the initial fair market value of the trust's assets. A trust does not qualify as a charitable remainder unitrust if the percentage of assets that are required to be distributed at least annually is greater than 50 percent. A trust does not qualify as a charitable remainder annuity trust or a charitable remainder unitrust unless the value of the remainder interest in the trust is at least 10 percent of the value of the assets contributed to the trust. Distributions from a charitable remainder annuity trust or charitable remainder unitrust, which are included in the income of the beneficiary for the year that the amount is required to be distributed, are treated in the following order as: (1) ordinary income to the extent of the trust's current and previously undistributed ordinary income for the trust's year in which the distribution occurred, (2) capital gains to the extent of the trust's current capital gain and previously undistributed capital gain for the trust's year in which the distribution occurred, (3) other income to the extent of the trust's current and previously undistributed other income for the trust's year in which the distribution occurred, and (4) corpus (trust principal).

Charitable remainder annuity trusts and charitable remainder unitrusts are exempt from Federal income tax; however, such trusts lose their income tax exemption for any year in which they have unrelated business taxable income. Any taxes imposed on the trust are required to be allocated to trust corpus. The Administration proposes to levy a 100-percent excise tax on the unrelated business taxable income of charitable remainder trusts, in lieu of removing the Federal income tax exemption for any year in which unrelated business taxable income is incurred. This change, which is a more appropriate remedy than loss of tax exemption, is proposed to become effective for taxable years beginning after December 31, 2002, regardless of when the trust was created.

Modify basis adjustment to stock of S corporations contributing appreciated property.—Under current law, each shareholder in an S corporation sepa-

rately accounts for his or her pro rata share of the S corporation's charitable contributions in determining his or her income tax liability. A shareholder's basis in the stock of the S corporation must be reduced by the amount of his or her pro rata share of the S corporation's charitable contribution. In order to preserve the benefit of providing a charitable contribution deduction for contributions of appreciated property and to prevent the recognition of gain on the contributed property on the disposition of the S corporation stock, the Administration proposes to allow a shareholder in an S corporation to increase his or her basis in the stock of an S corporation by an amount equal to the excess of the shareholder's pro rata share of the S corporation's charitable contribution over the stockholder's pro rata share of the adjusted basis of the contributed property. The proposal would be effective for taxable years beginning after December 31, 2002.

Repeal the $150 million limitation on qualified 501(c)(3) bonds.—Current law contains a $150 million limitation on the volume of outstanding, non-hospital, tax-exempt bonds for the benefit of any one 501(c)(3) organization. The limitation was repealed in 1997 for bonds issued after August 5, 1997, at least 95 percent of the net proceeds of which are used to finance capital expenditures incurred after that date. However, the limitation continues to apply to bonds more than five percent of the net proceeds of which finance or refinance working capital expenditures, or capital expenditures incurred on or before August 5, 1997. In order to simplify the tax laws and provide consistent treatment of bonds for 501(c)(3) organizations, the Administration proposes to repeal the $150 million limitation in its entirety.

Repeal restrictions on the use of qualified 501(c)(3) bonds for residential rental property.—Tax-exempt, 501(c)(3) organizations generally may utilize tax-exempt financing for charitable purposes. However, existing law contains a special limitation under which 501(c)(3) organizations may not use tax-exempt financing to acquire existing residential rental property for charitable purposes unless the property is rented to low-income tenants or is substantially rehabilitated. In order to simplify the tax laws and provide consistent treatment of bonds for 501(c)(3) organizations, the Administration proposes to repeal the residential rental property limitation.

Strengthen and Reform Education

Provide refundable tax credit for certain costs of attending a different school for pupils assigned to failing public schools.—Under the Administration's proposal, a refundable tax credit would be allowed for 50 percent of the first $5,000 of qualifying elementary and secondary education expenses incurred during the taxable year with respect to enrollment of a qualifying student in a qualifying school. Qualifying students would be those who, for a given school year, would normally attend a public school determined by the State as not having made "adequate yearly progress" under the terms of the Elementary and Secondary Education Act as amended by the No Child Left Behind Act of 2001. A qualifying student in one school year generally would qualify for an additional school year even if the school normally attended made adequate yearly progress by the beginning of the second school year. A qualifying school would be any public school making adequate yearly progress or private elementary or secondary school. Qualifying expenses generally would be tuition, required fees, and transportation costs incurred by the taxpayer in connection with the attendance at a qualifying school. The proposal would be effective with respect to expenses incurred beginning with the 2003–2004 school year through the 2007–2008 school year.

Extend, increase and expand the above-the-line deduction for qualified out-of-pocket classroom expenses.—Under current law, teachers who itemize deductions (do not use the standard deduction) and incur unreimbursed, job-related expenses are allowed to deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceed two percent of AGI. Current law also allows certain teachers and other elementary and secondary school professionals to treat up to $250 in annual qualified out-of-pocket classroom expenses as a non-itemized deduction (above-the-line deduction), effective for expenses incurred in taxable years beginning after December 31, 2001 and before January 1, 2004. Unreimbursed expenditures for certain books, supplies and equipment related to classroom instruction qualify for the above-the-line deduction. Expenses claimed as an above-the-line deduction cannot be claimed as an itemized deduction. The Administration proposes to extend the above-the-line deduction to apply to qualified out-of-pocket expenditures incurred after December 31, 2003, to increase the deduction to $400, and to expand the deduction to apply to unreimbursed expenditures for certain professional training programs.

Invest in Health Care

Provide refundable tax credit for the purchase of health insurance.—Current law provides a tax preference for employer-provided group health insurance plans, but not for individually purchased health insurance coverage except to the extent that deductible medical expenses exceed 7.5 percent of AGI, the individual has self-employment income, or the individual is eligible under the Trade Act of 2002 to purchase certain types of qualified health insurance. The Administration proposes to make health insurance more affordable for individuals not covered by an employer plan or a public program. Effective for taxable years beginning after December 31, 2003, a new refundable tax credit would be provided for the cost of health insurance purchased by individuals under age 65. The credit would provide a subsidy for a percentage of the

health insurance premium, up to a maximum includable premium. The maximum subsidy percentage would be 90 percent for low-income taxpayers and would phase down with income. The maximum credit would be $1,000 for an adult and $500 for a child. The credit would be phased out at $30,000 for single taxpayers and $60,000 for families purchasing a family policy.

Individuals could claim the tax credit for health insurance premiums paid as part of the normal tax-filing process. Alternatively, beginning July 1, 2005, the tax credit would be available in advance at the time the individual purchases health insurance. The advance credit would reduce the premium paid by the individual to the health insurer, and the health insurer would be reimbursed directly by the Department of Treasury for the amount of the advance credit. Eligibility for an advance credit would be based on an individual's prior year tax return. To qualify for the credit, a health insurance policy would have to include coverage for catastrophic medical expenses. Qualifying insurance could be purchased in the individual market. Qualifying health insurance could also be purchased through private purchasing groups, state-sponsored insurance purchasing pools, and high-risk pools. Such groups may help reduce health insurance costs and increase coverage options for individuals, including older and higher-risk individuals. Individuals would not be allowed to claim the credit and make a contribution to an Archer MSA for the same taxable year.

Provide an above-the-line deduction for long-term care insurance premiums.—Current law provides a tax preference for employer-paid long-term care insurance. However, the vast majority of the long-term care insurance market consists of individually purchased policies, for which no tax preference is provided except to the extent that deductible medical expenses exceed 7.5 percent of AGI or the individual has self-employment income. Premiums on qualified long-term care insurance are deductible as a medical expense, subject to annual dollar limitations that increase with age. The Administration proposes to make individually-purchased long-term care insurance (the vast majority of the long-term care insurance market) more affordable by creating an above-the-line deduction for qualified long-term care insurance premiums. To qualify for the deduction, the long-term care insurance would be required to meet certain standards providing consumer protections. The deduction would be available to taxpayers who individually purchase qualified long-term care insurance and to those who pay at least 50 percent of the cost of employer-provided coverage. The deduction would be effective for taxable years beginning after December 31, 2003 but would be phased in over four years. The deduction would be subject to current law annual dollar limitations on qualified long-term care insurance premiums.

Allow up to $500 in unused benefits in a health flexible spending arrangement to be carried forward to the next year.—Under current law, unused benefits in a health flexible spending arrangement under a cafeteria plan for a particular year revert to the employer at the end of the year. Effective for plan years beginning after December 31, 2003, the Administration proposes to allow up to $500 in unused benefits in a health flexible spending arrangement at the end of a particular year to be carried forward to the next plan year.

Provide additional choice with regard to unused benefits in a health flexible spending arrangement.—In addition to the proposed carryforward of unused benefits (see preceding discussion), the Administration proposes to allow up to $500 in unused benefits in a health flexible spending arrangement at the end of a particular year to be distributed to the participant as taxable income, contributed to an Archer MSA, or contributed as a deferral to an employer's funded retirement plan. Amounts distributed to the participant would be subject to income tax withholding and employment taxes. Amounts contributed to an Archer MSA or retirement plan would be subject to the normal rules applicable to elective contributions to the receiving plan or account. The proposal would be effective for plan years beginning after December 31, 2003.

Permanently extend and reform Archer Medical Savings Accounts.—Current law allows only self-employed individuals and employees of small firms to establish Archer MSAs, and caps the number of accounts at 750,000. In addition to other requirements, (1) individuals who establish MSAs must be covered by a high-deductible health plan (and no other plan) with a deductible of at least $1,700 but not greater than $2,500 for policies covering a single person and a deductible of at least $3,350 but not greater than $5,050 in all other cases, (2) tax-preferred contributions are limited to 65 percent of the deductible for single policies and 75 percent of the deductible for other policies, and (3) either an individual or an employer, but not both, may make a tax-preferred contribution to an MSA for a particular year. The Administration proposes to permanently extend the MSA program, which is scheduled to expire on December 31, 2003, and to modify the program to make it more consistent with currently available health plans. Effective after December 31, 2003, the Administration proposes to remove the 750,000 cap on the number of accounts. In addition, the program would be reformed by (1) expanding eligibility to include all individuals and employees of firms of all sizes covered by a high-deductible health plan, (2) modifying the definition of high deductible to permit a deductible as low as $1,000 for policies covering a single person and $2,000 in all other cases, (3) increasing allowable tax-preferred contributions to 100 percent of the deductible, (4) allowing tax-preferred contributions by both employers and employees for a particular year, up to the applicable maximum, (5) allowing contributions to MSAs under cafeteria plans, and (6) permitting qualified plans to provide, without counting against the deductible, up to $100 of coverage for allow-

able preventive services per covered individual each year. Individuals would not be allowed to make a contribution to an MSA and claim the proposed refundable tax credit for health insurance premiums for the same taxable year.

Provide an additional personal exemption to home caregivers of family members.—Current law provides a tax deduction for certain long-term care expenses. In addition, taxpayers are allowed to claim exemptions for themselves (and their spouses, if married) and dependents who they support. However, neither provision may meet the needs of taxpayers who provide long-term care in their own home for close family members. Effective for taxable years beginning after December 31, 2003, the Administration proposes to provide an additional personal exemption to taxpayers who care for certain qualified family members who reside with the taxpayer in the household maintained by the taxpayer. A taxpayer is considered to maintain a household only if he or she furnishes over half of the annual cost of maintaining the household. Qualified family members would include any individual with long-term care needs who is (1) the spouse of the taxpayer or an ancestor of the taxpayer or the spouse of such an ancestor and (2) a member of the taxpayer's household for the entire year. An individual would be considered to have long-term care needs if he or she were certified by a licensed physician (prior to the filing of a return claiming the exemption) as, for at least 180 consecutive days, unable to perform at least two activities of daily living without substantial assistance from another individual due to a loss of functional capacity; or, alternatively, (1) requiring substantial supervision to be protected from threats to his or her own health and safety due to severe cognitive impairment and (2) being unable to perform at least one activity of daily living or being unable to engage in age appropriate activities.

Allow the orphan drug tax credit for certain pre-designation expenses.—Current law provides a 50-percent credit for expenses related to human clinical testing of drugs for the treatment of certain rare diseases and conditions ("orphan drugs"). A taxpayer may claim the credit only for expenses incurred after the Food and Drug Administration (FDA) designates a drug as a potential treatment for a rare disease or condition. This creates an incentive to defer clinical testing for orphan drugs until the taxpayer receives the FDA's approval and increases complexity for taxpayers by treating pre-designation and post-designation clinical expenses differently. The Administration proposes to allow taxpayers to defer claiming the orphan drug tax credit until the drug receives FDA designation as a potential treatment for a rare disease or condition. The taxpayer would be permitted to claim the credit for pre-designation costs either in the year of approval, or to file an amended return to claim the credit for prior years. The proposal would be effective for qualified expenses incurred after December 31, 2002.

Encourage Telecommuting

Exclude from income the value of employer-provided computers, software and peripherals.—Under current law, the value of computers and related equipment and services provided by an employer to an employee for home use is generally allocated between business and personal use. The business-use portion is excluded from the employee's income whereas the personal-use portion is subject to income and payroll taxes. In order to simplify recordkeeping, improve compliance, and encourage telecommuting, the Administration proposes to allow individuals to exclude from income the value of employer-provided computers and related equipment and services necessary to perform work for the employer at home. The employee would be required to make substantial use of the equipment to perform work for the employer. Substantial business use would include standby use for periods when work from home may be required by the employer, such as during work closures caused by the threat of terrorism, inclement weather, or natural disasters. The proposal would be effective for taxable years beginning after December 31, 2003.

Increase Housing Opportunities

Provide tax credit for developers of affordable single-family housing.—The Administration proposes to provide annual tax credit authority to states (including U.S. possessions) designed to promote the development of affordable single-family housing in low-income urban and rural neighborhoods. Beginning in calendar year 2004, first-year credit authority equal to the amount provided for low-income rental housing tax credits would be made available to each state. That amount is equal to the greater of $2 million or $1.75 per capita (indexed annually for inflation after 2002). State housing agencies would award first-year credits to single-family housing units comprising a project located in a census tract with median income equal to 80 percent or less of area median income. Units in condominiums and cooperatives could qualify as single-family housing. Credits would be awarded as a fixed amount for individual units comprising a project. The present value of the credits, determined on the date of a qualifying sale, could not exceed 50 percent of the cost of constructing a new home or rehabilitating an existing property. The taxpayer (developer or investor partnership) owning the housing unit immediately prior to the sale to a qualified buyer would be eligible to claim credits over a five-year period beginning on the date of sale. Eligible homebuyers would be required to have incomes equal to 80 percent or less of area median income. Certain technical features of the provision would follow similar features of current law with respect to the low-income housing tax credit and mortgage revenue bonds.

Encourage Saving

Establish Individual Development Accounts (IDAs).—The Administration proposes to allow eligible individuals to make contributions to a new savings vehicle, the Individual Development Account, which would be set up and administered by qualified financial institutions, nonprofit organizations, or Indian tribes (qualified entities). Citizens or legal residents of the United States between the ages of 18 and 60 who cannot be claimed as a dependent on another taxpayer's return, are not students, and who meet certain income limitations would be eligible to establish and contribute to an IDA. A single taxpayer would be eligible to establish and contribute to an IDA if his or her modified AGI in the preceding taxable year did not exceed $20,000 ($30,000 for heads of household, and $40,000 for married taxpayers filing a joint return). These thresholds would be indexed annually for inflation beginning in 2005. Qualified entities that set up and administer IDAs would be required to match, dollar-for-dollar, the first $500 contributed by an eligible individual to an IDA in a taxable year. Qualified entities would be allowed a 100 percent tax credit for up to $500 in annual matching contributions to each IDA, and a $50 tax credit for each IDA maintained at the end of a taxable year with a balance of not less that $100 (excluding the taxable year in which the account was established). Matching contributions and the earnings on those contributions would be deposited in a separate "parallel account." Contributions to an IDA by an eligible individual would not be deductible, and earnings on those contributions would be included in income. Matching contributions by qualified entities and the earnings on those contributions would be tax-free. Withdrawals from the parallel account may be made only for qualified purposes (higher education, the first-time purchase of a home, business start-up, and qualified rollovers). Withdrawals from the IDA for other than qualified purposes may result in the forfeiture of some or all matching contributions and the earnings on those contributions. The proposal would be effective for contributions made after December 31, 2004 and before January 1, 2012, to the first 900,000 IDA accounts opened before January 1, 2010.

Protect the Environment

Permanently extend expensing of brownfields remediation costs.—Taxpayers may elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred. Under current law, the ability to deduct such expenditures expires with respect to expenditures paid or incurred after December 31, 2003. The Administration proposes to permanently extend this provision, facilitating its use by businesses to undertake projects that may extend beyond the current expiration date and be uncertain in overall duration.

Exclude 50 percent of gains from the sale of property for conservation purposes.—The Administration proposes to create a new incentive for private, voluntary land protection. This incentive is a cost-effective, non-regulatory approach to conservation. Under the proposal, when land (or an interest in land or water) is sold for conservation purposes, only 50 percent of any gain would be included in the seller's income. This proposal applies to conservation easements and similar sales of partial interest in land for conservation purposes, such as development rights and agricultural conservation easements. To be eligible for the exclusion, the sale may be either to a government agency or to a qualified conservation organization, and the buyer must supply a letter of intent that the acquisition will serve conservation purposes. In addition, the taxpayer or a member of the taxpayer's family must have owned the property for the three years immediately preceding the sale. Antiabuse provisions will ensure that the conservation purposes continue to be served. The provision would be effective for sales taking place on or after January 1, 2004.

Increase Energy Production and Promote Energy Conservation

Extend and modify the tax credit for producing electricity from certain sources.—Taxpayers are provided a 1.5-cent-per-kilowatt-hour tax credit, adjusted for inflation after 1992, for electricity produced from wind, closed-loop biomass (organic material from a plant grown exclusively for use at a qualified facility to produce electricity), and poultry waste. To qualify for the credit, the electricity must be sold to an unrelated third party and must be produced during the first 10 years of production at a facility placed in service before January 1, 2004. The Administration proposes to extend the credit for electricity produced from wind and biomass to facilities placed in service before January 1, 2006. In addition, eligible biomass sources would be expanded to include certain biomass from forest-related resources, agricultural sources, and other specified sources. Special rules would apply to biomass facilities placed in service before January 1, 2003. Electricity produced at such facilities from newly eligible sources would be eligible for the credit only from January 1, 2003 through December 31, 2005, and at a rate equal to 60 percent of the generally applicable rate. Electricity produced from newly eligible biomass cofired in coal plants would also be eligible for the credit only from January 1, 2003 through December 31, 2005, and at a rate equal to 30 percent of the generally applicable rate. The Administration also proposes to modify the rules relating to governmental financing of qualified facilities. There would be no percentage reduction in the credit for governmental financing attributable to tax-exempt bonds. Instead, such financing would reduce the credit only to the extent necessary to offset the value of the tax exemption. The rules relating to leased facilities would also be modified to permit the lessee, rather than the owner, to claim the credit.

Provide tax credit for residential solar energy systems.—Current law provides a 10-percent investment tax credit to businesses for qualifying equipment that uses solar energy to generate electricity; to heat, cool or provide hot water for use in a structure; or to provide solar process heat. A credit currently is not provided for nonbusiness purchases of solar energy equipment. The Administration proposes a new tax credit for individuals who purchase solar energy equipment to generate electricity (photovoltaic equipment) or heat water (solar water heating equipment) for use in a dwelling unit that the individual uses as a residence, provided the equipment is used exclusively for purposes other than heating swimming pools. The proposed nonrefundable credit would be equal to 15 percent of the cost of the equipment and its installation; each individual taxpayer would be allowed a maximum credit of $2,000 for photovoltaic equipment and $2,000 for solar water heating equipment. The credit would apply to photovoltaic equipment placed in service after December 31, 2002 and before January 1, 2008 and to solar water heating equipment placed in service after December 31, 2002 and before January 1, 2006.

Modify treatment of nuclear decommissioning funds.—Under current law, deductible contributions to nuclear decommissioning funds are limited to the amount included in the taxpayer's cost of service for ratemaking purposes. For deregulated utilities, this limitation may result in the denial of any deduction for contributions to a nuclear decommissioning fund. The Administration proposes to repeal this limitation.

Also under current law, deductible contributions are not permitted to exceed the amount the IRS determines to be necessary to provide for level funding of an amount equal to the taxpayer's post-1983 decommissioning costs. The Administration proposes to permit funding of all decommissioning costs through deductible contributions. Any portion of these additional contributions relating to pre-1984 costs that exceeds the amount previously deducted (other than under the nuclear decommissioning fund rules) or excluded from the taxpayer's gross income on account of the taxpayer's liability for decommissioning costs, would be allowed as a deduction ratably over the remaining useful life of the nuclear power plant.

The Administration's proposal would also permit taxpayers to make deductible contributions to a qualified fund after the end of the nuclear power plant's estimated useful life and would provide that nuclear decommissioning costs are deductible when paid. These changes in the treatment of nuclear decommissioning funds are proposed to be effective for taxable years beginning after December 31, 2002.

Provide tax credit for purchase of certain hybrid and fuel cell vehicles.—Under current law, a 10-percent tax credit up to $4,000 is provided for the cost of a qualified electric vehicle. The full amount of the credit is available for purchases prior to 2004. The credit begins to phase down in 2004 and is not available after 2006. A qualified electric vehicle is a motor vehicle that is powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electric current, the original use of which commences with the taxpayer, and that is acquired for use by the taxpayer and not for resale. Electric vehicles and hybrid vehicles (those that have more than one source of power on board the vehicle) have the potential to reduce petroleum consumption, air pollution and greenhouse gas emissions. To encourage the purchase of such vehicles, the Administration is proposing the following tax credits: (1) A credit of up to $4,000 would be provided for the purchase of qualified hybrid vehicles after December 31, 2002 and before January 1, 2008. The amount of the credit would depend on the percentage of maximum available power provided by the rechargeable energy storage system and the amount by which the vehicle's fuel economy exceeds the 2000 model year city fuel economy. (2) A credit of up to $8,000 would be provided for the purchase of new qualified fuel cell vehicles after December 31, 2002 and before January 1, 2008. A minimum credit of $4,000 would be provided, which would increase as the vehicle's fuel efficiency exceeded the 2000 model year city fuel economy, reaching a maximum credit of $8,000 if the vehicle achieved at least 300 percent of the 2000 model year city fuel economy.

Provide tax credit for energy produced from landfill gas.—Taxpayers that produce gas from biomass (including landfill methane) are eligible for a tax credit equal to $3 per barrel-of-oil equivalent (the amount of gas that has a British thermal unit content of 5.8 million), adjusted by an inflation adjustment factor for the calendar year in which the sale occurs. To qualify for the credit, the gas must be produced domestically from a facility placed in service by the taxpayer before July 1, 1998, pursuant to a written binding contract in effect before January 1, 1997. In addition, the gas must be sold to an unrelated person before January 1, 2008. The Administration proposes to extend the credit to apply to landfill methane produced from a facility (or portion of a facility) placed in service after December 31, 2002 and before January 1, 2011, and sold (or used to produce electricity that is sold) before January 1, 2011. The credit for fuel produced at landfills subject to EPA's 1996 New Source Performance Standards/Emissions Guidelines would be limited to two-thirds of the otherwise applicable amount beginning on January 1, 2008, if any portion of the facility for producing fuel at the landfill was placed in service before July 1, 1998, and beginning on January 1, 2003, in all other cases.

Provide tax credit for combined heat and power property.—Combined heat and power (CHP) systems are used to produce electricity (and/or mechanical power) and usable thermal energy from a single primary energy source. Depreciation allowances for CHP property vary by asset use and capacity. No income tax credit is provided under current law for investment

in CHP property. CHP systems utilize thermal energy that is otherwise wasted in producing electricity by more conventional methods and achieve a greater level of overall energy efficiency, thereby lessening the consumption of primary fossil fuels, lowering total energy costs, and reducing carbon emissions. To encourage increased energy efficiency by accelerating planned investments and inducing additional investments in such systems, the Administration is proposing a 10-percent investment credit for qualified CHP systems with an electrical capacity in excess of 50 kilowatts or with a capacity to produce mechanical power in excess of 67 horsepower (or an equivalent combination of electrical and mechanical energy capacities). A qualified CHP system would be required to produce at least 20 percent of its total useful energy in the form of thermal energy and at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof) and would also be required to satisfy an energy-efficiency standard. For CHP systems with an electrical capacity in excess of 50 megawatts (or a mechanical energy capacity in excess of 67,000 horsepower), the total energy efficiency would have to exceed 70 percent. For smaller systems, the total energy efficiency would have to exceed 60 percent. Investments in qualified CHP assets that are otherwise assigned cost recovery periods of less than 15 years would be eligible for the credit, provided that the taxpayer elects to treat such property as having a 22-year class life (and thus depreciates the property using a 15-year recovery period). The credit, which would be treated as an energy credit under the investment credit component of the general business credit, and could not be used in conjunction with any other credit for the same equipment, would apply to investments in CHP property placed in service after December 31, 2002 and before January 1, 2008.

Provide excise tax exemption (credit) for ethanol.—Under current law an income tax credit and an excise tax exemption are provided for ethanol and renewable source methanol used as a fuel. In general, the income tax credit for ethanol is 52 cents per gallon, but small ethanol producers (those producing less than 30 million gallons of ethanol per year) qualify for a credit of 62 cents per gallon on the first 15 million gallons of ethanol produced in a year. A credit of 60 cents per gallon is allowed for renewable source methanol. As an alternative to the income tax credit, gasohol blenders may claim a gasoline tax exemption of 52 cents for each gallon of ethanol and 60 cents for each gallon of renewable source methanol that is blended into qualifying gasohol. The rates for the ethanol credit and exemption are each reduced by 1 cent per gallon in 2005. The income tax credit expires on December 31, 2007 and the excise tax exemption expires on September 30, 2007. Neither the credit nor the exemption apply during any period in which motor fuel taxes dedicated to the Highway Trust Fund are limited to 4.3 cents per gallon. The Administration proposes to extend both the income tax credit and the excise tax exemption through December 31, 2010. The current law rule providing that neither the credit nor the exemption apply during any period in which motor fuel taxes dedicated to the Highway Trust Fund are limited to 4.3 cents per gallon would be retained.

Promote Trade

Implement free trade agreements with Chile and Singapore.—Free trade agreements are expected to be completed with Chile and Singapore in 2003, with ten-year implementation to begin in fiscal year 2004. These agreements will benefit U.S. producers and consumers, as well as strengthen the economies of Chile and Singapore. In addition, these agreements will establish precedents in our market opening efforts in two important and dynamic regions—Latin America and Southeast Asia.

Improve Tax Administration

Modify the IRS Restructuring and Reform Act of 1998 (RRA98).—The proposed modification to RRA98 is comprised of six parts. The first part modifies employee infractions subject to mandatory termination and permits a broader range of available penalties. It strengthens taxpayer privacy while reducing employee anxiety resulting from unduly harsh discipline or unfounded allegations. The second part adopts measures to curb frivolous submissions and filings that are intended to impede or delay tax administration. The third part allows the IRS to terminate installment agreements when taxpayers fail to make timely tax deposits and file tax returns on current liabilities. The fourth part streamlines jurisdiction over collection due process cases in the Tax Court, thereby simplifying procedures and reducing the cycle time for certain collection due process cases. The fifth part permits taxpayers to enter into installment agreements that do not guarantee full payment of liability over the life of the agreement. It allows the IRS to enter into agreements with taxpayers who desire to resolve their tax obligations but cannot make payments large enough to satisfy their entire liability and for whom an offer in compromise is not a viable alternative. The sixth part eliminates the requirement that the IRS Chief Counsel provide an opinion for any accepted offer-in-compromise of unpaid tax (including interest and penalties) equal to or exceeding $50,000. This proposal requires that the Treasury Secretary establish standards to determine when an opinion is appropriate.

Initiate IRS cost saving measures.—The Administration has two proposals to improve IRS efficiency and performance from current resources. The first proposal modifies the way that Financial Management Services (FMS) recovers its transaction fees for processing IRS levies by permitting FMS to retain a portion of the amount collected before transmitting the balance to the IRS, thereby reducing government transaction costs. The offset amount would be included as part of the

15-percent limit on levies against income and would also be credited against the taxpayer's liability. The second proposal extends the April filing date for electronically filed tax returns by at least ten days to help encourage the growth of electronic filing.

Repeal section 132 of the Revenue Act of 1978 and amend the tax code to authorize the Secretary of the Treasury to issue rules to address inappropriate nonqualified deferred compensation arrangements.—Section 132 currently prohibits the Internal Revenue Service from issuing new regulations on many aspects of nonqualified deferred compensation arrangements, restricting the ability of the IRS to respond effectively to these arrangements. Under the Administration's proposal, that prohibition would be removed and the Secretary of the Treasury would be given express authority to issue new rules. It is expected that new guidance would address when an individual's access to compensation is considered subject to substantial limitation, the extent to which company assets may be designated as available to meet deferred compensation obligations, and when an arrangement is treated as funded.

Permit private collection agencies to engage in specific, limited activities to support IRS collection efforts.—The resource and collection priorities of the IRS do not permit it to continually pursue all outstanding tax liabilities. Many taxpayers are aware of their outstanding tax liabilities but have failed to pay them. The use of private collection agencies, or PCAs, to support IRS collection efforts would enable the Government to reach these taxpayers to obtain payment while allowing the IRS to focus its own enforcement resources on more complex cases and issues. PCAs would not have any enforcement power, and they would be strictly prohibited from threatening enforcement action or violating any taxpayer confidentiality protection or other taxpayer right. The IRS would be required to closely monitor PCA activities and performance, including the protection of taxpayer rights. PCAs would be compensated out of the revenue collected through their activities, although compensation would be based on quality of service, taxpayer satisfaction, and case resolution, in addition to collection results.

Combat abusive tax avoidance transactions.—Although the vast majority of taxpayers and practitioners do their best to comply with the law, some actively promote or engage in transactions structured to generate tax benefits never intended by Congress. Such abusive transactions harm the public fisc, erode the public's respect for the tax laws, and consume valuable IRS resources. The Administration has proposed a number of regulatory and legislative changes designed to significantly enhance the current enforcement regime and curtail the use of abusive tax avoidance transactions. These proposed changes include (1) the modification of the definition of a reportable transaction, (2) the issuance of a coordinated set of disclosure, registration and investor list maintenance rules, (3) the imposition of new or increased penalties for the failure to disclose and register reportable transactions and for the failure to report an interest in a foreign financial account, (4) the prevention of "income separation" transactions structured to create immediate tax losses or to convert current ordinary income into deferred capital gain, and (5) the denial of foreign tax credits with respect to any foreign withholding taxes if the underlying property was not held for a specified minimum period of time. A number of administrative proposals already have been carried out by the Treasury Department and the IRS.

Limit related party interest deductions.—Current law (section 163(j) of the Internal Revenue Code) denies U.S. tax deductions for certain interest expenses paid to a related party where (1) the corporation's debt-equity ratio exceeds 1.5 to 1.0, and (2) net interest expenses exceed 50 percent of the corporation's adjusted taxable income (computed by adding back net interest expense, depreciation, amortization, depletion, and any net operating loss deduction). If these thresholds are exceeded, no deduction is allowed for interest in excess of the 50-percent limit that is paid to a related party and that is not subject to U.S. tax. Any interest that is disallowed in a given year is carried forward indefinitely and may be deductible in a subsequent taxable year. A three-year carryforward for any excess limitation (the amount by which interest expense for a given year falls short of the 50-percent limit) is also allowed. Because of the opportunities available under current law to inappropriately reduce U.S. tax on income earned on U.S. operations through the use of foreign related-party debt, the Administration proposes to tighten the interest disallowance rules of section 163(j).

Reform Unemployment Insurance

Reform unemployment insurance administrative financing.—Current law funds the administrative costs of the unemployment insurance system and related programs out of the Federal Unemployment Tax (FUTA) paid by employers. FUTA is set at 0.8 percent of the first $7,000 in covered wages, which includes a 0.2 percent surtax scheduled to expire in 2007. State unemployment taxes are deposited into the Unemployment Trust Fund and used by States to pay unemployment benefits. Under current law, FUTA balances in excess of statutory ceilings are distributed to the States to pay unemployment benefits or the administrative costs of the system (these are known as Reed Act transfers). The Administration has a comprehensive proposal to reform the administrative financing of this system. It proposes to eliminate the FUTA surtax in 2005, and make additional rate cuts to achieve a net FUTA tax rate of 0.2 percent in 2009. The proposal will transfer administrative funding control to the States in 2006 and allow them to use their benefit taxes to pay these costs. In addition, the Administration supports special distributions of $2.7 billion in Reed Act funds on Octo-

ber 1, 2006 and October 1, 2007, to be used for administrative expenses in the transition.

OTHER PROPOSALS

Deposit full amount of excise tax imposed on gasohol in the Highway Trust Fund.—Under current law, an 18.4-cents-per-gallon excise tax is imposed on gasoline. In general, 18.3 cents per gallon of the gasoline excise tax is deposited in the Highway Trust Fund and 0.1 cent per gallon is deposited in the Leaking Underground Storage Tank (LUST) Trust Fund. In the case of gasohol, which is taxed at a reduced rate, 2.5 cents per gallon is retained in the General Fund of the Treasury, 0.1 cent per gallon is deposited in the LUST Trust Fund, and the balance of the reduced rate is deposited in the Highway Trust Fund. The Administration believes that it is appropriate that the entire amount of the excise tax on gasohol (except for the 0.1 cent per gallon deposited in the LUST Trust Fund) be deposited in the Highway Trust Fund. Effective for collections after September 30, 2003, the Administration proposes to transfer the 2.5 cents per gallon of the gasohol excise tax that is currently retained in the General Fund of the Treasury to the Highway Trust Fund.

Increase Indian gaming activity fees.—The National Indian Gaming Commission regulates and monitors gaming operations conducted on Indian lands. Since 1998, the Commission has been prohibited from collecting more than $8 million in annual fees from gaming operations to cover the costs of its oversight responsibilities. The Administration proposes to amend the current fee structure so that the Commission can adjust its activities to the growth in the Indian gaming industry.

SIMPLIFY THE TAX LAWS

Establish uniform definition of a qualifying child.—The tax code provides assistance to families with children through the dependent exemption, head-of-household filing status, child tax credit, child and dependent care tax credit, and earned income tax credit (EITC). However, because each provision defines an eligible "child" differently, taxpayers must wade through pages of bewildering rules and instructions, resulting in confusion and error. The Administration proposes to harmonize the definition of qualifying child across these five related tax benefits, thereby reducing both compliance and administrative costs. Under the Administration's proposal, a qualifying child must meet the following three tests: (1) Relationship—The child must be the taxpayer's biological or adopted child, stepchild, sibling, or step-sibling, a descendant of one of these individuals, or a foster child. (2) Residence—The child must live with the taxpayer in the same principal home in the United States for more than half of the year. (3) Age—The child must be under age 19, a full-time student if over 18 and under 24, or totally and permanently disabled. Neither the support nor gross income tests of current law would apply to qualifying children who meet these three tests. In addition, taxpayers would no longer be required to meet a household maintenance test when claiming the child and dependent care tax credit. Current law requirements that a child be under age 13 for the dependent care credit and under age 17 for the child tax credit, would be maintained. Taxpayers generally could continue to claim individuals who do not meet the proposed relationship, residency, or age tests as dependents if they meet the requirements under current law, and no other taxpayer claims the same individual.

Simplify adoption tax provisions.—Under current law, for taxable years beginning before January 1, 2011, the following tax benefits are provided to taxpayers who adopt children: (1) a nonrefundable tax credit for qualified expenses incurred in the adoption of a child, up to a certain limit, and (2) the exclusion from gross income of qualified adoption expenses paid or reimbursed by an employer under an adoption assistance program, up to a certain limit. Taxpayers may not claim the credit for expenses that are excluded from gross income. In 2003, the limitation on qualified adoption expenses for both the credit and the exclusion is $10,160. Taxpayers who adopt children with special needs may claim the full $10,160 credit or exclusion even if adoption expenses are less than this amount. Taxpayers may carry forward unused credit amounts for up to five years. When modified adjusted gross income exceeds $152,390 (in 2003), both the credit amount and the amount excluded from gross income are reduced pro-rata over the next $40,000 of modified adjusted gross income. The maximum credit and exclusion and the income at which the phase-out range begins are indexed annually for inflation. For taxable years beginning after December 31, 2010, taxpayers will be able to claim the credit only if they incur expenses for the adoption of children with special needs. For these taxpayers the qualified expense limit will be $6,000, the credit will be reduced pro-rata between $75,000 and $115,000 of modified adjusted gross income, and the credit amount and phase-out range will not be indexed annually for inflation. Taxpayers may not exclude employer-provided adoption assistance from gross income for taxable years beginning after December 31, 2010.

To reduce marginal tax rates and simplify computations of tax liabilities, the Administration is proposing to eliminate the income phaseout of the adoption tax credit and exclusion. The proposal would be effective for taxable years beginning after December 31, 2002. The broader eligibility criteria, larger qualifying expense limitations, and the employer exclusion would apply in taxable years beginning after December 31, 2010 as a result of the Administration's proposal to extend the EGTRRA provisions permanently.

Expand tax-free savings opportunities.—Under current law, individuals can contribute to traditional

IRAs, nondeductible IRAs, and Roth IRAs, each subject to different sets of rules. For example, contributions to traditional IRAs are deductible, while distributions are taxed; contributions to Roth IRAs are taxed, but distributions are excluded from income. In addition, eligibility to contribute is subject to various age and income limits. While primarily intended for retirement saving, withdrawals for certain education, medical, and other non-retirement expenses are penalty free. The eligibility and withdrawal restrictions for these accounts complicate compliance and limit incentives to save.

The Administration proposes to replace current law IRAs with two new savings accounts: a Lifetime Savings Accounts (LSA) and a Retirement Savings Account (RSA). Regardless of age or income, individuals could make annual nondeductible contributions of $7,500 to an LSA and $7,500 (or earnings if less) to an RSA. Distributions from an LSA would be excluded from income and, unlike current law, could be made at anytime for any purpose without restriction. Distributions from an RSA would be excluded from income after attaining age 58 or in the event of death or disability. All other distributions would be included in income (to the extent they exceed basis) and subject to an additional tax. Distributions would be deemed to come from basis first. The proposal would be effective for contributions made after December 31, 2002 and future year contribution limits would be indexed for inflation.

Existing Roth IRAs would be renamed RSAs and would be subject to the new rules for RSAs. Existing traditional and nondeductible IRAs could be converted into an RSA by including the conversion amount (excluding basis) in gross income, similar to a current-law Roth conversion. However, no income limit would apply to the ability to convert. Taxpayers who convert IRAs to RSAs could spread the included conversion amount over several years. Existing traditional or nondeductible IRAs that are not converted to RSAs could not accept any new contributions. New traditional IRAs could be created to accommodate rollovers from employer plans, but they could not accept any new individual contributions. Individuals wishing to roll an amount directly from an employer plan to an RSA could do so by including the rollover amount (excluding basis) in gross income (i.e., "converting" the rollover, similar to a current law Roth conversion).

Consolidate employer-based savings accounts.—Current law provides multiple types of tax-preferred employer-based savings accounts to encourage savings for retirement. The accounts have similar goals but are subject to different sets of rules regulating eligibility, contribution limits, tax treatment, and withdrawal restrictions. For example, 401(k) plans for private employers, SIMPLE 401(k) plans for small employers, 403(b) plans for 501(c)(3) organizations and public schools, and 457 plans for State and local governments are all subject to different rules. To qualify for tax benefits, plans must satisfy multiple requirements. Among the requirements, the plan may not discriminate in favor of highly compensated employees (HCEs) with regard either to coverage or to amount or availability of contributions or benefits. Rules covering employer-based savings accounts are among the lengthiest and most complicated sections of the tax code and associated regulations. This complexity imposes substantial costs on employers, participants, and the government, and likely has inhibited the adoption of retirement plans by employers, especially small employers.

The Administration proposes to consolidate 401(k), SIMPLE 401(k), 403(b), and 457 plans, as well as SIMPLE IRAs and SARSEPs, into a single type of plan—Employee Retirement Savings Accounts (ERSAs)—that would be available to all employers. Defined-contribution plan qualification rules would be simplified, while maintaining their intent. In particular, top-heavy rules would be repealed and ERSA non-discrimination rules would be simplified and include a new ERSA non-discrimination safe-harbor. For example, under one of the safe-harbor options, a plan would satisfy the non-discrimination rules if it provided a 50-percent match on elective contributions up to six percent of compensation. By creating a simplified and uniform set of rules, the proposal would substantially reduce complexity. The proposal would be effective for taxable years beginning after December 31, 2003.

EXPIRING PROVISIONS

Temporarily Extend Expiring Provisions

Extend and modify the work opportunity tax credit and the welfare-to-work tax credit.—Under present law, the work opportunity tax credit provides incentives for hiring individuals from certain targeted groups. The credit generally applies to the first $6,000 of wages paid to several categories of economically disadvantaged or handicapped workers. The credit rate is 25 percent of qualified wages for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. The credit is available for a qualified individual who begins work before January 1, 2004.

Under present law, the welfare-to-work tax credit provides an incentive for hiring certain recipients of long-term family assistance. The credit is 35 percent of up to $10,000 of eligible wages in the first year of employment and 50 percent of wages up to $10,000 in the second year of employment. Eligible wages include cash wages plus the cash value of certain employer-paid health, dependent care, and educational fringe benefits. The minimum employment period that employees must work before employers can claim the credit is 400 hours. This credit is available for qualified individuals who begin work before January 1, 2004.

The Administration proposes to simplify employment incentives by combining the credits into one credit and making the rules for computing the combined credit simpler. The credits would be combined by creating a new welfare-to-work targeted group under the work opportunity tax credit. The minimum employment peri-

ods and credit rates for the first year of employment under the present work opportunity tax credit would apply to welfare-to-work employees. The maximum amount of eligible wages would continue to be $10,000 for welfare-to-work employees and $6,000 for other targeted groups. In addition, the second year 50-percent credit currently available under the welfare-to-work credit would continue to be available for welfare-to-work employees under the modified work opportunity tax credit. Qualified wages would be limited to cash wages. The work opportunity tax credit would also be simplified by eliminating the need to determine family income for qualifying ex-felons (one of the present targeted groups). The modified work opportunity tax credit would apply to individuals who begin work after December 31, 2003 and before January 1, 2006.

Extend minimum tax relief for individuals.—A temporary provision of current law permits nonrefundable personal tax credits to offset both the regular tax and the alternative minimum tax, for taxable years beginning before January 1, 2004. The Administration is concerned that the AMT may limit the benefit of personal tax credits and impose financial and compliance burdens on taxpayers who have few, if any, tax preference items and who were not the originally intended targets of the AMT. The Administration proposes to extend minimum tax relief for nonrefundable personal credits for two years, to apply to taxable years 2004 and 2005. The proposed extension does not apply to the child credit, the earned income credit or the adoption credit, which were provided AMT relief through December 31, 2010 under the Economic Growth and Tax Relief Reconciliation Act of 2001. The refundable portion of the child credit and the earned income tax credit are also allowed against the AMT through December 31, 2010.

A temporary provision of current law increased the AMT exemption amounts to $35,750 for single taxpayers, $49,000 for married taxpayers filing a joint return and surviving spouses, and $24,500 for married taxpayers filing a separate return and estates and trusts. Effective for taxable years beginning after December 31, 2004, the AMT exemption amounts will decline to $33,750 for single taxpayers, $45,000 for married taxpayers filing a joint return and surviving spouses, and $22,500 for married taxpayers filing a separate return and estates and trusts. The Administration proposes to extend the temporary, higher exemption amounts through taxable year 2005.

Extend the District of Columbia (DC) Enterprise Zone.—The DC Enterprise Zone includes the DC Enterprise Community and District of Columbia census tracts with a poverty rate of at least 20 percent. Businesses in the zone are eligible for: (1) a wage credit equal to 20 percent of the first $15,000 in annual wages paid to qualified employees who reside within the District of Columbia; (2) $35,000 in increased section 179 expensing; and (3) in certain circumstances, tax-exempt bond financing. In addition, a capital gains exclusion is allowed for certain investments held more than five years and made within the DC Zone, or within any District of Columbia census tract with a poverty rate of at least 10 percent. The DC Zone incentives apply for the period from January 1, 1998 through December 31, 2003. The Administration proposes to extend the DC Zone incentives for two years, making the incentives applicable through December 31, 2005.

Extend the first-time homebuyer credit for the District of Columbia.—A one-time, nonrefundable $5,000 credit is available to purchasers of a principal residence in the District of Columbia who have not owned a residence in the District during the year preceding the purchase. The credit phases out for taxpayers with modified adjusted gross income between $70,000 and $90,000 ($110,000 and $130,000 for joint returns). The credit does not apply to purchases after December 31, 2003. The Administration proposes to extend the credit for two years, making the credit available with respect to purchases after December 31, 2003 and before January 1, 2006.

Extend authority to issue Qualified Zone Academy Bonds.—Current law allows State and local governments 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 have to be used for teacher training, purchases of equipment, curriculum development, or rehabilitation and repairs at certain public school facilities. A nationwide total of $400 million of qualified zone academy bonds were authorized to be issued in each of calendar years 1998 through 2003. In addition, unused authority arising in 1998 and 1999 can be carried forward for up to three years and unused authority arising in 2000 through 2003 can be carried forward for up to two years. The Administration proposes to authorize the issuance of an additional $400 million of qualified zone academy bonds in each of calendar years 2004 and 2005; unused authority could be carried forward for up to two years. Reporting of issuance would be required.

Extend deduction for corporate donations of computer technology.—The charitable contribution deduction that may be claimed by corporations for donations of inventory property generally is limited to the lesser of fair market value or the corporation's basis in the property. However, corporations are provided augmented deductions, not subject to this limitation, for certain contributions. Under current law, an augmented deduction is provided for contributions of computer technology and equipment to public libraries and to U.S. schools for educational purposes in grades K-12. The Administration proposes to extend the deduction, which expires with respect to donations made after December 31, 2003, to apply to donations made before January 1, 2006.

Allow net operating losses to offset 100 percent of alternative minimum taxable income.—Under current law (and under law in effect prior to 2001) net operating loss (NOL) deductions cannot reduce a taxpayer's alternative minimum taxable income (AMTI) by more than 90 percent. Under JCWAA this limitation was temporarily waived. The Administration's proposal would extend this waiver through 2005. NOL carrybacks arising in taxable years ending in 2003, 2004, and 2005, or carryforwards to these years, would offset 100 percent of a taxpayer's AMTI.

Extend IRS user fees.—The Administration proposes to extend for two years, through September 30, 2005, IRS authority to charge fees for written responses to questions from individuals, corporations, and organizations related to their tax status or the effects of particular transactions for tax purposes. Under current law, these fees are scheduled to expire effective with requests made after September 30, 2003.

Extend abandoned mine reclamation fees.—Collections from abandoned mine reclamation fees are allocated to States for reclamation grants. Current fees of 35 cents per ton for surface mined coal, 15 cents per ton for underground mined coal, and 10 cents per ton for lignite coal are scheduled to expire on September 30, 2004. Abandoned land problems are expected to exist in certain States after all the money from the collection of fees under current law is expended. The Administration proposes to extend these fees until the most significant abandoned mine land problems are fixed. The Administration also proposes to modify the authorization language to allocate more of the receipts collected toward restoration of abandoned coal mine land.

Permanently Extend Expiring Provisions

Permanently extend provisions expiring in 2010.—Most of the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 sunset on December 31, 2010. The Administration proposes to permanently extend these provisions.

Permanently extend the research and experimentation (R&E) tax credit.—The Administration proposes to permanently extend the 20-percent tax credit for qualified research and experimentation expenditures above a base amount and the alternative incremental credit, which are scheduled to expire on June 30, 2004.

Repeal the disallowance of certain deductions of mutual life insurance companies.—Life insurance companies may generally deduct policyholder dividends, while dividends to stockholders are not deductible. Section 809 of the Internal Revenue Code attempts to identify amounts returned by mutual life insurance companies to holders of participating policies in their role as owners of the company, and generally disallows a deduction for mutual company policyholder dividends (or otherwise increases taxable income by reducing the amount of end-of-year reserves) in an amount equal to the amount identified under section 809. The section 809 imputed amount is termed the company's differential earnings amount, and equals the product of the individual company's average equity base and an industry-wide computed differential earnings rate. The average equity base is computed using the company's surplus and capital, adjusted for non-admitted financial assets, the excess of statutory reserves over tax reserves, certain other reserves, and by 50 percent of the provision for policyholder dividends payable in the following year. The differential earnings rate equals the excess of an imputed stock earnings rate (the average stock earnings rate for the prior three years of the 50 largest domestic stock life insurance companies, adjusted by a factor roughly equal to 0.90555) over the average earnings rate of all domestic mutual life insurance companies. The differential earnings rate equals zero if the average mutual earnings rate exceeds the imputed stock earnings rate. The differential earnings rate is initially computed using the average mutual earnings rate for the second year preceding the current taxable year, but is later recomputed using the current year's average mutual earnings rate. Any difference between the differential earnings amount and the recomputed differential earnings amount is taken into account in computing taxable income for the following taxable year. Section 809 has been criticized as being theoretically unsound, overly complex, inaccurate in its measurement of income, unfair, and increasingly irrelevant. The Job Creation and Worker Assistance Act of 2002 suspended the operation of section 809 for three years, 2001 through 2003. The Administration proposes to permanently repeal section 809.

RESPOND TO FOREIGN SALES CORPORATION/EXTRATERRITORIAL INCOME DECISIONS

World Trade Organization (WTO) panels have ruled that the extraterritorial income (ETI) exclusion provisions and the foreign sales corporation (FSC) provisions constitute prohibited export subsidies under the WTO rules. To comply with the WTO ruling and honor the United States' WTO obligations, the current-law ETI provisions would be repealed. At the same time, meaningful changes to our tax law are required to preserve the competitiveness of U.S. businesses operating in the global marketplace. The Administration is proposing reform of the U.S. international tax rules, with a particular focus on reforming those aspects of the current-law rules that can operate to tax active forms of business income earned abroad before it has been repatriated and that can operate to limit the use of the foreign tax credit in a manner that causes the double taxation of income earned abroad. The Administration intends to work closely with the Congress to reform the U.S. international tax rules to ensure the competitiveness of American workers and businesses.

Table 4–3. EFFECT OF PROPOSALS ON RECEIPTS

(In millions of dollars)

	Estimate							
	2003	2004	2005	2006	2007	2008	2004–2008	2004–2013
Economic Growth Package:								
Accelerate 10-percent individual income tax rate bracket expansion	–978	–7,782	–6,112	–6,117	–6,495	–4,275	–30,781	–47,194
Accelerate reduction in individual income tax rates	–5,808	–35,693	–17,470	–4,939	.....	.....	–58,102	–58,102
Accelerate marriage penalty relief	–2,776	–27,134	–14,680	–7,642	–3,595	–1,735	–54,786	–55,210
Accelerate increase in child tax credit [1]	–13,527	–5,060	–10,735	–8,534	–8,532	–8,502	–41,363	–53,306
Eliminate the double taxation of corporate earnings	–3,801	–24,874	–22,062	–28,218	–31,126	–33,952	–140,232	–360,324
Increase expensing for small business	–1,023	–1,652	–1,776	–1,912	–1,601	–1,431	–8,372	–14,583
Provide minimum tax relief to individuals	–3,141	–8,534	–10,353	–6,931	.....	.....	–25,818	–25,818
Total economic growth package	**–31,054**	**–110,729**	**–83,188**	**–64,293**	**–51,349**	**–49,895**	**–359,454**	**–614,537**
Tax Incentives:								
Provide incentives for charitable giving:								
Provide charitable contribution deduction for nonitemizers	–199	–1,358	–1,067	–1,128	–1,177	–1,214	–5,944	–12,571
Permit tax-free withdrawals from IRAs for charitable contributions	–66	–437	–361	–376	–382	–388	–1,944	–4,076
Expand and increase the enhanced charitable deduction for contributions of food inventory	–19	–54	–59	–66	–72	–79	–330	–872
Reform excise tax based on investment income of private foundations	–16	–264	–172	–178	–186	–198	–998	–2,192
Modify tax on unrelated business taxable income of charitable remainder trusts	–1	–3	–4	–4	–4	–4	–19	–51
Modify basis adjustment to stock of S corporations contributing appreciated property	.....	–12	–11	–14	–16	–19	–72	–216
Repeal the $150 million limitation on qualified 501(c)(3) bonds	–2	–6	–9	–10	–9	–9	–43	–82
Repeal restrictions on the use of qualified 501(c)(3) bonds for residential rental property	.....	–2	–6	–11	–17	–24	–60	–276
Strengthen and reform education:								
Provide refundable tax credit for certain costs of attending a different school for pupils assigned to failing public schools [2]	.....	–13	–29	–38	–42	–46	–168	–192
Extend, increase and expand the above-the-line deduction for qualified out-of-pocket classroom expenses	.....	–23	–229	–240	–249	–260	–1,001	–2,352
Invest in health care:								
Provide refundable tax credit for the purchase of health insurance [3]	.....	–324	–1,449	–889	–409	–139	–3,210	–1,550
Provide an above-the-line deduction for long-term care insurance premiums	.....	–112	–559	–984	–1,923	–3,063	–6,641	–28,255
Allow up to $500 in unused benefits in a health flexible spending arrangement to be carried forward to the next year	.....	–367	–640	–723	–782	–830	–3,342	–8,385
Provide additional choice with regard to unused benefits in a health flexible spending arrangement	.....	–19	–33	–39	–45	–52	–188	–595
Permanently extend and reform Archer MSAs	.....	–26	–284	–432	–486	–549	–1,777	–5,134
Provide an additional personal exemption to home caregivers of family members	.....	–70	–465	–437	–422	–417	–1,811	–3,892
Allow the orphan drug tax credit for certain pre-designation expenses	.....	.....	.....	–1	–1	–1	–3	–8
Encourage telecommuting:								
Exclude from income the value of employer-provided computers, software and peripherals	.....	–35	–51	–53	–54	–56	–249	–554
Increase housing opportunities:								
Provide tax credit for developers of affordable single-family housing	.....	–7	–78	–315	–750	–1,316	–2,466	–16,133

Table 4–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

	Estimate							
	2003	2004	2005	2006	2007	2008	2004–2008	2004–2013
Encourage saving:								
Establish Individual Development Accounts (IDAs)	.....	.....	–124	–267	–319	–300	–1,010	–1,347
Protect the environment:								
Permanently extend expensing of brownfields remediation costs	.....	–185	–282	–268	–257	–248	–1,240	–2,356
Exclude 50 percent of gains from the sale of property for conservation purposes	.....	–21	–44	–46	–48	–50	–209	–531
Increase energy production and promote energy conservation:								
Extend and modify the tax credit for producing electricity from certain sources	–124	–264	–355	–209	–90	–92	–1,010	–1,492
Provide tax credit for residential solar energy systems	–4	–7	–10	–18	–25	–11	–71	–71
Modify treatment of nuclear decommissioning funds	–14	–251	–180	–191	–201	–212	–1,035	–2,260
Provide tax credit for purchase of certain hybrid and fuel cell vehicles	–44	–154	–316	–524	–793	–631	–2,418	–3,202
Provide tax credit for energy produced from landfill gas	–5	–28	–65	–88	–99	–112	–392	–707
Provide tax credit for combined heat and power property	–45	–71	–66	–64	–77	–14	–292	–250
Provide excise tax exemption (credit) for ethanol [4]	.....	.....	.....	.....	.....	.....	.....	.....
Promote trade:								
Implement free trade agreements with Chile and Singapore [5]	.....	–25	–51	–68	–80	–92	–316	–913
Improve tax administration:								
Implement IRS administrative reforms	.....	78	54	56	57	59	304	624
Permit private collection agencies to engage in specific, limited activities to support IRS collection efforts	.....	46	128	111	94	97	476	1,008
Combat abusive tax avoidance transactions	12	45	83	98	99	103	428	1,007
Limit related party interest deductions	10	104	190	239	293	351	1,177	3,987
Reform unemployment insurance:								
Reform unemployment insurance administrative financing [5]	.....	.....	–1,068	–1,439	–3,368	–2,016	–7,891	–13,401
Total tax incentives	**–517**	**–3,865**	**–7,612**	**–8,616**	**–11,840**	**–11,832**	**–43,765**	**–107,290**
Other Proposals:								
Deposit full amount of excise tax imposed on gasohol in the Highway Trust Fund [5]	.....	.....	.....	558	576	590	1,724	4,912
Increase Indian gaming activity fees	.....	.....	3	4	4	5	16	41
Total other proposals	.....	.....	**3**	**562**	**580**	**595**	**1,740**	**4,953**
Simplify the Tax Laws:								
Establish uniform definition of a qualifying child	–2	–43	–23	–24	–28	–19	–137	–211
Simplify adoption tax provisions	–4	–36	–37	–39	–40	–42	–194	–429
Expand tax-free savings opportunities	1,390	10,572	4,803	1,915	–648	–1,822	14,820	2,002
Consolidate employer-based savings accounts	–5	–185	–253	–263	–276	–292	–1,269	–3,011
Total simplify the tax laws	**1,379**	**10,308**	**4,490**	**1,589**	**–992**	**–2,175**	**13,220**	**–1,649**
Expiring Provisions:								
Temporarily extend expiring provisions:								
Combined work opportunity/welfare-to-work tax credit	.....	–54	–201	–268	–181	–96	–800	–873
Minimum tax relief for individuals	.....	–260	–7,286	–10,343	.....	.....	–17,889	–17,889
DC tax incentives	.....	–53	–116	–58	–1	–4	–232	–357
Authority to issue Qualified Zone Academy Bonds	.....	–6	–18	–34	–52	–64	–174	–514
Deduction for corporate donations of computer technology	.....	–74	–127	–52	.....	.....	–253	–253
Net operating loss offset of 100 percent of AMTI	–639	–3,028	–2,274	–1,442	420	367	–5,957	–4,890
IRS user fees	.....	68	81	6	.....	.....	155	155
Abandoned mine reclamation fees	.....	.....	308	313	319	325	1,265	2,978
Permanently extend expiring provisions:								
Provisions expiring in 2010:								
Marginal individual income tax rate reductions	.....	.....	.....	.....	.....	.....	.....	–286,952
Child tax credit [6]	.....	.....	.....	.....	.....	.....	.....	–46,893
Marriage penalty relief [7]	.....	.....	.....	.....	.....	.....	.....	–20,654
Education incentives	–2	–11	–19	–27	–33	–42	–132	–4,685
Repeal of estate and generation-skipping transfer taxes, and modification of gift taxes	46	–292	–810	–1,319	–1,540	–1,736	–5,697	–125,991
Modifications of IRAs and pension plans	.....	.....	.....	.....	.....	.....	.....	–11,236
Other incentives for families and children	.....	.....	.....	.....	.....	.....	.....	–2,029
Other provisions:								
Research and experimentation (R&E) tax credit	.....	–1,005	–3,278	–5,187	–6,291	–7,129	–22,890	–67,922

Table 4–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

	Estimate							
	2003	2004	2005	2006	2007	2008	2004–2008	2004–2013
Suspension of disallowance of certain deductions of mutual life insurance companies	.....	–123	–137	–65	–36	–24	–385	–472
Total expiring provisions	**–595**	**–4,838**	**–13,877**	**–18,476**	**–7,395**	**–8,403**	**–52,989**	**–588,477**
Total effect of proposals	**–30,787**	**–109,124**	**–100,184**	**–89,234**	**–70,996**	**–71,710**	**–441,248**	**–1,307,000**

[1] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $300 million for 2003, $1,074 million for 2004, $4,783 million for 2005, $4,272 million for 2006, $4,195 million for 2007, $4,142 million for 2008, $18,466 million for 2004–2008, and $25,239 million for 2004–2013.

[2] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $213 million for 2004, $543 million for 2005, $714 million for 2006, $796 million for 2007, $886 million for 2008, $3,152 million for 2004–2008, and $3,626 million for 2004–2013.

[3] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $3,546 million for 2005, $8,166 million for 2006, $9,251 million for 2007, $9,827 million for 2008, $30,790 million for 2004–2008, and $87,608 million for 2004–2013.

[4] Policy proposal with a receipt effect of zero.

[5] Net of income offsets.

[6] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $20,781 million for 2004–2013.

[7] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $3,744 million for 2004–2013.

Table 4–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	2002 Actual	Estimate					
		2003	2004	2005	2006	2007	2008
Individual income taxes (federal funds):							
Existing law	858,345	877,211	953,641	1,028,720	1,094,670	1,162,565	1,235,568
Proposed Legislation (PAYGO)	.....	–28,158	–103,761	–94,164	–80,615	–59,204	–60,220
Total individual income taxes	**858,345**	**849,053**	**849,880**	**934,556**	**1,014,055**	**1,103,361**	**1,175,348**
Corporation income taxes:							
Federal funds:							
Existing law	148,037	145,799	173,659	233,213	240,064	244,618	252,020
Proposed Legislation (PAYGO)	.....	–2,613	–4,599	–3,895	–6,243	–6,859	–8,336
Total Federal funds corporation income taxes	148,037	143,186	169,060	229,318	233,821	237,759	243,684
Trust funds:							
Hazardous substance superfund	7	.....	.....	.....	.....	.....	.....
Total corporation income taxes	**148,044**	**143,186**	**169,060**	**229,318**	**233,821**	**237,759**	**243,684**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	440,541	454,405	475,436	503,931	525,531	550,896	575,470
Disability insurance (Off-budget)	74,780	77,160	80,732	85,572	89,241	93,548	97,722
Hospital insurance	149,049	152,275	159,784	170,037	177,525	186,262	194,827
Railroad retirement:							
Social Security equivalent account	1,652	1,643	1,674	1,695	1,718	1,730	1,750
Rail pension and supplemental annuity	2,525	2,349	2,237	2,228	2,259	2,279	2,303
Total employment and general retirement	668,547	687,832	719,863	763,463	796,274	834,715	872,072
On-budget	153,226	156,267	163,695	173,960	181,502	190,271	198,880
Off-budget	515,321	531,565	556,168	589,503	614,772	644,444	673,192
Unemployment insurance:							
Deposits by States [1]	20,911	27,312	33,195	37,076	39,002	40,078	41,146
Proposed Legislation (PAYGO)	.....	.....	.....	.....	.....	–563	–234
Federal unemployment receipts [1]	6,613	6,777	6,872	7,212	7,849	8,560	7,182
Proposed Legislation (PAYGO)	.....	.....	.....	–1,336	–1,800	–3,650	–2,288
Railroad unemployment receipts [1]	95	141	139	119	119	115	106
Total unemployment insurance	27,619	34,230	40,206	43,071	45,170	44,540	45,912
Other retirement:							
Federal employees' retirement—employee share	4,533	4,479	4,433	4,314	4,277	4,264	4,218
Non-Federal employees retirement [2]	61	52	46	42	39	36	33
Total other retirement	4,594	4,531	4,479	4,356	4,316	4,300	4,251
Total social insurance and retirement receipts	**700,760**	**726,593**	**764,548**	**810,890**	**845,760**	**883,555**	**922,235**
On-budget	185,439	195,028	208,380	221,387	230,988	239,111	249,043
Off-budget	515,321	531,565	556,168	589,503	614,772	644,444	673,192
Excise taxes:							
Federal funds:							
Alcohol taxes	7,764	7,840	7,979	8,087	8,168	8,262	8,384
Proposed Legislation (PAYGO)	.....	.....	–57	–78	–19	.....	.....
Tobacco taxes	8,274	8,158	8,015	7,923	7,824	7,725	7,633
Transportation fuels tax	814	869	939	1,009	290	293	296
Proposed Legislation (PAYGO)	.....	.....	–643	–711	.....	.....	.....
Telephone and teletype services	5,829	6,205	6,611	7,002	7,408	7,827	8,265
Other Federal fund excise taxes	1,336	1,815	1,745	1,770	1,822	1,880	1,948
Proposed Legislation (PAYGO)	.....	–16	–207	–94	–159	–186	–198
Total Federal fund excise taxes	24,017	24,871	24,382	24,908	25,334	25,801	26,328
Trust funds:							
Highway	32,603	32,815	34,269	35,337	36,524	37,586	38,568

Table 4–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	2002 Actual	Estimate					
		2003	2004	2005	2006	2007	2008
Proposed Legislation (PAYGO)	.....	.....	643	698	717	724	720
Airport and airway	9,031	9,381	10,218	10,910	11,537	12,157	12,803
Aquatic resources	386	393	417	430	441	452	464
Black lung disability insurance	567	561	574	603	622	634	648
Inland waterway	95	88	89	90	91	91	92
Vaccine injury compensation	109	124	124	126	127	129	130
Leaking underground storage tank	181	183	189	194	198	204	207
Proposed Legislation (PAYGO)	.....	.....	.....	.....	.....	.....	–1
Total trust funds excise taxes	42,972	43,545	46,523	48,388	50,257	51,977	53,631
Total excise taxes	**66,989**	**68,416**	**70,905**	**73,296**	**75,591**	**77,778**	**79,959**
Estate and gift taxes:							
Federal funds	26,507	20,209	23,913	22,025	24,561	22,226	22,525
Proposed Legislation (PAYGO)	.....	.....	–534	–927	–1,347	–1,474	–1,360
Total estate and gift taxes	**26,507**	**20,209**	**23,379**	**21,098**	**23,214**	**20,752**	**21,165**
Customs duties:							
Federal funds	17,884	18,252	19,892	20,341	22,937	25,032	26,536
Proposed Legislation (PAYGO)	.....	.....	–34	–69	–91	–107	–123
Trust funds	718	800	855	928	1,006	1,081	1,147
Total customs duties	**18,602**	**19,052**	**20,713**	**21,200**	**23,852**	**26,006**	**27,560**
MISCELLANEOUS RECEIPTS:[1] [3]							
Miscellaneous taxes	92	95	97	99	100	102	104
Proposed Legislation (PAYGO)	.....	.....	.....	3	4	4	5
United Mine Workers of America combined benefit fund	124	152	116	109	103	96	90
Deposit of earnings, Federal Reserve System	23,683	23,565	27,078	33,283	35,206	36,993	39,134
Defense cooperation	12	6	7	7	7	8	8
Fees for permits and regulatory and judicial services	7,280	8,359	8,720	8,495	8,590	8,763	8,737
Proposed Legislation (PAYGO)	.....	.....	.....	308	313	319	325
Fines, penalties, and forfeitures	2,812	2,597	2,609	2,623	2,640	2,662	2,681
Gifts and contributions	246	210	200	197	198	199	198
Refunds and recoveries	–323	–275	–287	–294	–295	–303	–310
Total miscellaneous receipts	**33,926**	**34,709**	**38,540**	**44,830**	**46,866**	**48,843**	**50,972**
Adjustment for revenue uncertainty[4]	.....	**–25,000**	**–15,000**	.....	.....	.....	.....
Total budget receipts	**1,853,173**	**1,836,218**	**1,922,025**	**2,135,188**	**2,263,159**	**2,398,054**	**2,520,923**
On-budget	1,337,852	1,304,653	1,365,857	1,545,685	1,648,387	1,753,610	1,847,731
Off-budget	515,321	531,565	556,168	589,503	614,772	644,444	673,192
MEMORANDUM							
Federal funds	1,108,949	1,065,477	1,112,176	1,274,830	1,366,039	1,461,380	1,543,891
Trust funds	464,990	474,018	511,003	530,431	553,840	576,262	602,856
Interfund transactions	–236,087	–234,842	–257,322	–259,576	–271,492	–284,032	–299,016
Total on-budget	**1,337,852**	**1,304,653**	**1,365,857**	**1,545,685**	**1,648,387**	**1,753,610**	**1,847,731**
Off-budget (trust funds)	**515,321**	**531,565**	**556,168**	**589,503**	**614,772**	**644,444**	**673,192**
Total	**1,853,173**	**1,836,218**	**1,922,025**	**2,135,188**	**2,263,159**	**2,398,054**	**2,520,923**

[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 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.

[4] These amounts reflect an additional adjustment to receipts beyond what the economic and tax models forecast and have been made in the interest of cautious and prudent forecasting.

2004

5. USER CHARGES AND OTHER COLLECTIONS

In addition to collecting taxes and other receipts by the exercise of its sovereign powers, which is discussed in the previous chapter, the Federal Government collects income from the public from market-oriented activities and the financing of regulatory expenses. These collections are classified as user charges, and they include the sale of postage stamps and electricity, charges for admittance to national parks, premiums for deposit insurance, and proceeds from the sale of assets, such as rents and royalties for the right to extract oil from the Outer Continental Shelf.

Depending on the laws that authorize the collections, they are credited to expenditure accounts as "offsetting collections," or to receipt accounts as "offsetting receipts." The budget refers to these amounts as "offsetting" because they are subtracted from gross outlays rather than added to taxes on the receipts side of the budget. 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. [1]

Usually offsetting collections are authorized to be spent for the purposes of the account without further action by the Congress. Offsetting receipts may or may not be earmarked for a specific purpose, depending on the legislation that authorizes them. When earmarked, the authorizing legislation may either authorize them to be spent without further action by the Congress, or require them to be appropriated in annual appropriations acts before they can be spent.

Offsetting collections and receipts include most user charges, which are discussed below, as well as some amounts that are not user charges. Table 5–1 summarizes these transactions. For 2004, total offsetting collections and receipts from the public are estimated to be $234.6 billion, and total user charges are estimated to be $176.3 billion.

The following section discusses user charges and the Administration's user charge proposals. The subsequent section displays more information on offsetting collections and receipts. The offsetting collections and receipts by agency are displayed in Table 21–1, "Outlays to the Public, Net and Gross," which appears in Chapter 21 of this volume.

Table 5–1. GROSS OUTLAYS, USER CHARGES, OTHER OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, AND NET OUTLAYS

(In billions of dollars)

	2002 Actual	Estimate	
		2003	2004
Gross outlays	2,233.0	2,378.0	2,464.0
Offsetting collections and receipts from the public:			
User charges [1]	155.3	167.7	173.5
Other	66.6	69.9	61.1
Subtotal, offsetting collections and receipts from the public	222.0	237.6	234.6
Net outlays	2,011.0	2,140.4	2,229.4

[1] Total user charges are shown below. They include user charges that are classified on the receipts side of the budget in addition to the amounts shown on this line. For additional details of total user charges, see Table 5–2, "Total User Charge Collections."

Total user charges:			
Offsetting collections and receipts from the public	155.3	167.7	173.5
Receipts	2.4	2.7	2.8
Total, User charges	157.8	170.4	176.3

[1] Showing collections from business-type transactions as offsets on the spending side of the budget follows the concept recommended by the 1967 Report of the President's Commission on Budget Concepts. The concept is discussed in Chapter 24: "Budget System and Concepts and Glossary" in this volume.

USER CHARGES

I. Introduction and Background

The Federal Government may charge those who benefit directly from a particular activity or those subject to regulation. Based on the definition used in this chapter, Table 5–2 shows that user charges were $157.8 billion in 2002, and are estimated to increase to $170.4 billion in 2003 and to $176.3 billion in 2004, growing to an estimated $198.4 billion in 2008, including the user charges proposals that are shown in Table 5–3. This table shows that the Administration is proposing to increase user charges by an estimated $2.1 billion in 2004, growing to an estimated $2.6 billion in 2008.

Definition. The term "user charge" as used here is more broadly defined than the "user fee" concept used in this chapter in prior years. User charges are fees, charges, and assessments levied on individuals or organizations directly benefiting from, or subject to regulation by, a government program or activity. In addition, the payers of the charge must be limited 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 (such as those who pay income taxes or customs duties).

- Examples of business-type or market-oriented user charges include charges for the sale of postal services (the sale of stamps), electricity (e.g., sales by the Tennessee Valley Authority), proceeds from the sale of goods by defense commissaries, payments for Medicare voluntary supplemental medical insurance, life insurance premiums for veterans, recreation fees for parks, the sale of weather maps and related information by the Department of Commerce, and proceeds from the sale of assets (property, plant, and equipment) and natural resources (such as timber, oil, and minerals).
- Examples of regulatory and licensing user charges include charges for regulating the nuclear energy industry, bankruptcy filing fees, immigration fees, food inspection fees, passport fees, and patent and trademark fees.

The broader "user charges" concept adopted this year aligns these estimates with the concept that establishes policy for charging prices to the public for the sale or use of goods, services, property, and resources (see OMB Circular No. A-25, "User Charges," July 8, 1993).

User charges do not include all offsetting collections and receipts from the public, such as repayments received from credit programs; interest, dividends, and other earnings; payments from one part of the Federal Government to another; or cost sharing contributions. Nor do they include earmarked taxes (such as taxes paid to social insurance programs or excise taxes on gasoline), or customs duties, fines, penalties, and forfeitures.

Alternative definitions. The definition used in this chapter is useful because it is similar to the definition used in OMB Circular No. A-25, "User Charges," which provides policy guidance to Executive Branch agencies on setting prices for user charges. Alternative definitions may be used for other purposes. Much of the discussion of user charges below—their purpose, when they should be levied, and how the amount should be set—applies to these alternatives as well.

Other definitions of user charges could, for example:

- be narrower than the one used here, by limiting the definition to proceeds from the sale of goods and services (and excluding the sale of assets), and by limiting the definition to include only proceeds that are earmarked to be used specifically to finance the goods and services being provided. This is the definition of user fees used in previous chapters on this subject and is similar to one the House of Representatives uses as a guide for purposes of committee jurisdiction. The definition helps differentiate between taxes, which are under the jurisdiction of the Ways and Means Committee, and fees, which can be under the jurisdiction of other committees. (See the *Congressional Record*, January 3, 1991, p. H31, item 8.)
- be even narrower than the user fee concept described above, by excluding regulatory fees and focusing solely on business-type transactions.
- be broader than the one used in this chapter by including beneficiary- or liability-based excise taxes, such as gasoline taxes.[2]

What is the purpose of user charges? The purpose of user charges is to improve the efficiency and equity of certain Government activities, and to reduce the burden on taxpayers to finance activities whose benefits accrue to a relatively limited number of people, or to impose a charge on activities that impose a cost on the public.

User charges that are set to cover the costs of production of goods and services can provide efficiency in the allocation of resources within the economy. They allocate goods and services to those who value them the most, and they signal to the Government how much of the goods or services it should provide. Prices in private, competitive markets serve the same purposes.

User charges for goods and services that do not have special social benefits improve equity, or fairness, by requiring that those who benefit from an activity are the same people who pay for it. The public often perceives user charges as fair because those who benefit from the good or service pay for it in whole or in part, and those who do not benefit do not pay.

When should the Government charge a fee? Discussions of whether to finance spending with a tax or a fee often focus on whether the benefits of the activity

[2] Beneficiary- and liability-based taxes are terms taken from the Congressional Budget Office, *The Growth of Federal User Charges*, August 1993, and updated in October 1995. In addition to gasoline taxes, examples of beneficiary-based taxes include taxes on airline tickets, which finance air traffic control activities and airports. An example of a liability-based tax is the excise tax that formerly helped fund the hazardous substance superfund in the Environmental Protection Agency. This tax was paid by industry groups to finance environmental cleanup activities related to the industry activity but not necessarily caused by the payer of the fee.

are to the public in general or to a limited group of people. In general, if the benefits accrue broadly to the public, then the program should be financed by taxes paid by the public; in contrast, if the benefits accrue to a limited number of private individuals or organizations, then the program should be financed by charges paid by the private beneficiaries. For Federal programs where the benefits are entirely public or entirely private, applying this principle is relatively easy. For example, according to this principle, the benefits from national defense accrue to the public in general and should be (and are) financed by taxes. In contrast, the benefits of electricity sold by the Tennessee Valley Authority accrue exclusively to those using the electricity, and should be (and are) financed by user charges.

In many cases, however, an activity has benefits that accrue to both public and to private groups, and it may be difficult to identify how much of the benefits accrue to each. Because of this, it can be difficult to know how much of the program should be financed by taxes and how much by fees. For example, the benefits from recreation areas are mixed. Fees for visitors to these areas are appropriate because the visitors benefit directly from their visit, but the public in general also benefits because these areas protect the Nation's natural and historical heritage now and for posterity.

As a further complication, where a fee may be appropriate to finance all or part of an activity, some consideration must be given to the ease of administering the fee.

What should be the amount of the fee? For programs that have private beneficiaries, the amount of the charge should depend on the costs of producing the goods or services and the portion of the program that is for private benefits. If the benefit is primarily private, and any public benefits are incidental, current policies support charges that cover the full cost to the Government, including both direct and indirect costs.[3]

The Executive Branch is working to put cost accounting systems in place across the Government that would make the calculation of full cost more feasible. The difficulties in measuring full cost are associated in part with allocating to an activity the full costs of capital, retirement benefits, and insurance, as well as other Federal costs that may appear in other parts of the budget. Guidance in the Statement of Federal Financial Accounting Standards No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government (July 31, 1995), should underlie cost accounting in the Federal Government.

Classification of user charges in the budget. As shown in Table 5–1, most user charges are classified as offsets to outlays on the spending side of the budget, but a few are classified on the receipts side of the budget. An estimated $2.8 billion in 2004 are classified this way and are included in the totals described in Chapter 4. "Federal Receipts." They are classified as receipts because they are regulatory charges collected by the Federal Government by the exercise of its sovereign powers. Examples include filing fees in the United States courts, agricultural quarantine inspection fees, and passport fees.

The remaining user charges, an estimated $173.5 billion in 2004, are classified as offsetting collections and receipts on the spending side of the budget. Some of these are collected by the Federal Government by the exercise of its sovereign powers and would normally appear on the receipts side of the budget, but are required by law to be classified as offsetting collections or receipts.

An estimated $126.5 billion of user charges for 2004 are credited directly to expenditure accounts, and are generally available for expenditure when they are collected, without further action by the Congress. An estimated $47.0 billion of user charges for 2004 are deposited in offsetting receipt accounts, and are available to be spent only according to the legislation that established the charges.

As a further classification, the accompanying Tables 5–2 and 5–3 identify the charges as discretionary or mandatory. These classifications are terms from the Budget Enforcement Act of 1990 as amended and are used frequently in the analysis of the budget. "Discretionary" in this chapter refers to charges generally controlled through annual appropriations acts and under the jurisdiction of the appropriations committees in the Congress. These charges offset discretionary spending under the discretionary caps. "Mandatory" refers to charges controlled by permanent laws and under the jurisdiction of the authorizing committees. These charges are subject to rules of paygo, whereby changes in law affecting mandatory programs and receipts cannot result in a net cost. Mandatory spending is sometimes referred to as direct spending.

These and other classifications are discussed further in this volume in Chapter 24, "Budget System and Concepts and Glossary."

II. Current User Charges

As shown in Table 5–2, total user charge collections (including those proposed in this budget) are estimated to be $176.3 billion in 2004, increasing to $198.4 billion in 2008. User charge collections by the Postal Service and for Medicare premiums are the largest and are estimated to be more than half of total user charge collections in 2004.

[3] Policies for setting user charges are promulgated in OMB Circular No. A-25: "User Charges" (July 8, 1993).

Table 5–2. TOTAL USER CHARGE COLLECTIONS

(In millions of dollars)

	2002 Actual	Estimates					
		2003	2004	2005	2006	2007	2008
Receipts							
Agricultural quarantine inspection fees	231	331	285	266	272	279	287
Abandoned mine reclamation fund	287	296	302	308	313	319	325
Corps of Engineers, Harbor maintenance fees	653	733	787	858	934	1,008	1,072
Other (includes immigration, passport, and consular fees; filing fees for the U.S. courts; and other fees)	1,257	1,359	1,428	1,439	1,395	1,420	1,240
Subtotal, receipts	2,428	2,719	2,802	2,871	2,914	3,026	2,924
Offsetting Collections and Receipts from the Public							
Discretionary							
Department of Agriculture: Food safety inspection and other fees	264	262	394	400	408	417	428
Department of Commerce: Patent and trademark, fees for weather services, and other fees	1,444	1,833	1,810	1,930	2,126	2,291	2,463
Department of Defense: Commissary and other fees	8,692	8,864	9,179	8,057	8,079	8,105	8,134
Department of Energy: Federal Energy Regulation Commission, power marketing, and other fees	826	1,294	1,053	1,072	1,092	1,116	1,143
Department of Health and Human Services: Food and Drug Administration, Centers for Medicare and Medicaid Services, and other fees	757	874	948	962	977	995	1,015
Department of Homeland Security, border and transportation security fees and other fees	1,149	2,441	2,523	2,570	2,622	2,680	2,748
Department of the Interior: Minerals Management Service and other fees	312	304	309	314	322	328	336
Department of Justice: Antitrust and other fees	348	399	422	430	438	448	459
Department of State: Passport and other fees	455	813	997	1,016	1,036	1,059	1,086
Department of Transportation: Railroad safety, navigation, and other fees	177	266	193	196	201	206	211
Department of the Treasury: Sale of commemorative coins and other fees	1,191	1,415	1,463	1,490	1,520	1,554	1,594
Department of Veterans Affairs: Medical care and other fees	989	1,615	2,140	2,240	2,419	2,618	2,832
Social Security Administration, State supplemental fees, supplemental security income	100	111	120	127	135	143	152
Federal Communications Commission: Regulatory fees and costs of auctions	297	336	351	358	365	373	383
Federal Trade Commission: Regulatory fees	69	166	177	180	184	188	193
Nuclear Regulatory Commission: Regulatory fees	476	499	546	556	568	580	595
Securities and Exchange Commission: Regulatory fees	1,013	1,332	1,542	1,837	2,171	1,142	1,173
All other agencies, discretionary user charges	340	553	573	587	597	610	626
Subtotal, discretionary user charges	18,899	23,377	24,740	24,322	25,260	24,853	25,571
Mandatory							
Department of Agriculture: Crop insurance and other fees	1,524	3,846	3,480	3,364	3,420	3,223	3,417
Department of Defense: Commissary surcharge and other fees	1,411	746	600	549	556	431	389
Department of Energy: Proceeds from the sale of energy, nuclear waste disposal fees, and other fees	4,899	4,947	5,155	5,160	5,006	4,576	4,668
Department of Health and Human Services: Medicare Part B insurance premiums, and other fees,	25,986	28,303	31,033	32,860	34,557	36,374	38,790
Department of Homeland Security: Customs, immigration, flood insurance, and other fees	4,647	5,619	5,530	5,632	5,830	6,037	6,254
Department of the Interior: Recreation and other fees	2,171	2,770	2,584	2,856	2,655	2,637	2,701
Department of Justice: Immigration and other fees	275	333	349	354	359	364	370
Department of Labor: Insurance premiums to guaranty private pensions	2,382	1,826	2,378	2,497	2,584	2,673	2,769
Department of the Treasury: Customs, bank regulation, and other fees	664	674	693	710	727	744	751
Department of Veterans Affairs: Veterans life insurance and other fees	2,074	1,820	1,685	1,642	1,600	1,560	1,525
Office of Personnel Management: Federal employee health and life insurance fees	8,210	9,067	9,916	10,630	11,366	12,140	13,065
Federal Deposit Insurance Corporation: Deposit insurance fees	3,925	2,059	2,323	2,518	3,677	4,112	4,394
National Credit Untion Administration: Credit union share insurance and other fees	519	573	605	565	583	619	667
Postal Service: Fees for postal services	64,957	69,437	70,159	70,897	71,586	72,376	73,065
Tennessee Valley Authority: Proceeds from the sale of energy	6,959	6,986	7,196	7,459	7,697	7,904	8,047
Undistributed Offsetting Receipts: Sale of spectrum licenses, OCS receipts, and other fees	5,025	4,380	4,189	14,230	13,282	8,396	8,098
All other agencies, mandatory user charges	818	956	857	2,123	2,137	894	909
Subtotal, mandatory user charges	136,446	144,342	148,732	164,046	167,622	165,060	169,879
Subtotal, user charges that are offsetting collections and receipts from the public	155,345	167,719	173,472	188,368	192,882	189,913	195,450
Total, User charges	157,773	170,438	176,274	191,239	195,796	192,939	198,374

III. User Charge Proposals

As shown in Table 5–3, the Administration is proposing new or increased user charges that would increase collections by an estimated $2.1 billion in 2004, increasing to $2.6 billion in 2008.

A. User Charge Proposals to Offset Discretionary Spending

1. Offsetting collections

Department of Agriculture

Animal and Plant Health Inspection Service.—Legislation will be proposed to establish user fees for APHIS costs for animal welfare inspections, such as for animal research centers, humane societies, and kennels.

Grain Inspection, Packers and Stockyards Administration.—The Administration proposes to collect a license fee to cover the cost of administering GIPSA's packers and stockyards program and a user fee to cover the cost of the standardization program.

Food Safety and Inspection Service.—The Administration proposes a new user fee for the Department of Agriculture'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 full cost of extra shifts for inspection services. FSIS would recover 100 percent of inspection costs from establishments for additional, complete work shifts beyond a primary approved shift.

Department of Commerce

Patent and Trademark Office.—The Administration proposes legislation to restructure patent fees and adjust trademark fees in support of the objectives of PTO's strategic plan to enhance examination quality, improve the efficiency of the patent and trademark examination systems, and better reflect the agency's costs.

Department of Health and Human Services

Fees for the review of new drugs for animals.—The Administration is proposing the authorization of fees for the review of new drugs for animals. The Food and Drug Administration's review of these drugs is required before they are available on the market. Spending financed by these fees would be in addition to regular appropriations.

Medicare duplicate or unprocessable claims.—The Administration proposes new user fees for providers submitting duplicate or unprocessable claims. The Centers for Medicare and Medicaid Services (CMS) and its contractors go to great lengths to ensure that providers are aware of billing requirements and the need to submit accurate claims. Charging a fee for duplicate or unprocessable claims would heighten provider awareness of these issues and increase efficiency by deterring this action.

Medicare appeals fee.—Sections 521 and 522 of the Benefit Improvements Protection Act (BIPA) of 2000 require CMS to reform the current Medicare appeals process. The Administration proposes a modest filing fee for providers who submit Medicare appeals to Qualified Independent Contractors, which represent a new level of adjudication. This proposal would heighten provider awareness of reformed appeals processes and requirements as well as deter appeals submitted with inaccurate or insufficient information.

Department of State

Machine readable visa (MRV) fees.—Both the PATRIOT Act and the Border Security Act have placed additional, costly requirements upon the State Department to update databases, interview more visa applicants, gather biometric information in the visa interview process and input that biometric information into shared databases, adjudicate a larger number of applications annually, and reduce the amount of consular activities that may be performed by foreign service nationals. Only cleared Americans may perform certain consular tasks. This is all at a time when visa applications have decreased by more than 2 million since 2001, thereby reducing receipts by an anticipated shortfall of $200 million in 2004. In July 2002, there was an increase in the MRV fee from $65 to $100. Rather than request an additional appropriation in 2004, the Administration proposes another MRV fee increase to cover the shortfall. However, prior to any new fee increase, the Department of State must evaluate in a revised cost-of-service study the likely effects of an increase.

Department of Veterans Affairs

Establish an annual enrollment fee for PL 7 and PL 8 veterans (non-disabled, higher income).—Legislation will be proposed to establish an annual enrollment fee of $250 for Priority Level 7 and 8 veterans. The increased receipts will allow the Department of Veterans Affairs to refocus the medical care system on caring for its core population, which is service-connected and lower-income veterans.

Corps of Engineers

Fees transferred from the Power Marketing Administrations.—Beginning in 2003, the Administration proposes that financing of the operation and maintenance costs of the Corps of Engineers in the Southeastern, Southwestern, and Western service areas of the Power Marketing Administrations be funded by receipts from the Power Marketing Administrations in these areas. These receipts are derived from the sale of power and related services. This proposal transfers Power Marketing Administration receipts to the Corps of Engineers equivalent to its operating and maintenance costs for the facilities in these areas. The Bonneville Power Administration already funds certain Corps of Engineers' hydropower facilities in this fashion.

Environmental Protection Agency

Extension of pesticide maintenance fee.—As authorized by the Federal Insecticide, Fungicide, and Rodenticide Act, EPA currently collects a maintenance fee to fund a portion of its pesticide reregistration and tolerance reassessment activities. The authorization to

Table 5–3. USER CHARGE PROPOSALS

(Estimated collections in millions of dollars)

	2003	2004	2005	2006	2007	2008	2004–2008
DISCRETIONARY							
1. Offsetting collections.							
Department of Agriculture							
Animal and Plant Health Inspection Service	.....	8	8	8	8	8	40
Grain Inspection, Packers and Stockyards Administration	.....	29	30	30	31	32	152
Food Safety and Inspection Service	.....	122	122	122	122	122	610
Department of Commerce							
Patent and Trademark Office	207	201	182	209	238	267	1,097
Department of Health and Human Services							
Fees for the review of new drugs for animals	.....	5	5	5	5	5	25
Medicare duplicate or unprocessable claims	60	195	195	195	195	195	975
Medicare paper claims	70	.....	.....	.....	.....	.....	.....
Medicare appeals fee	.....	6	6	6	6	6	30
Department of State							
Machine readable visa fees	67	271	280	289	300	311	1,451
Department of Veterans Affairs							
Establish an annual enrollment fee for PL 7 and PL 8 veterans (non-disabled, higher income)	.....	230	241	265	292	321	1,349
Corps of Engineers							
Fees transferred from the Power Marketing Administrations in the Department of Energy	149	145	148	151	154	158	756
Environmental Protection Agency							
Extension of pesticide maintenance fee	.....	8	8	8	.....	.....	24
Commodity Futures Trading Commission							
Fees on each round-turn commodities futures and options transactions	33	.....	.....	.....	.....	.....	.....
2. Offsetting receipts							
Environmental Protection Agency							
Abolish cap on pre-manufacturing notification fees	4	4	8	8	8	8	36
Nuclear Regulatory Commission							
Extend NRC fees at their 2005 level for 2006 and later	.....	.....	.....	367	374	384	1,125
Subtotal, discretionary user charges proposals	590	1,224	1,233	1,663	1,733	1,817	7,670
MANDATORY							
1. *Offsetting collections*							
Federal Deposit Insurance Corporation							
Deposit insurance fees	.....	-453	-764	-231	59	39	-1,350
2. Offsetting receipts							
Department of Agriculture							
Forest Service recreation and entrance fees	.....	.....	37	50	50	55	192
Department of Energy							
Arctic National Wildlife Refuge, collections for research and development	.....	.....	1,200	.....	.....	.....	1,200
Transfer certain Power Marketing Administrations fees to the Corps of Engineers	-149	-145	-148	-151	-154	-158	-756
Department of Homeland Security							
Border and transportation security conveyance and passenger fee	.....	305	320	336	353	371	1,685
Border and transportation security merchandise processing fee	.....	1,093	1,170	1,252	1,339	1,433	6,287
Department of the Interior							
Recreation fees	.....	.....	39	40	42	43	164
Bureau of Land Management land sale authority	.....	10	25	34	42	50	161
Arctic National Wildlife Refuge, collection for payments to Alaska	.....	.....	1,201	1	101	1	1,304
Arctic National Wildlife Refuge, rents	.....	.....	1	1	101	1	104
Federal Communications Commission							
Spectrum license user fees	.....	.....	10	25	50	100	185
Analog spectrum fee	.....	.....	.....	.....	500	500	1,000
Extend auction authority	.....	.....	.....	.....	-2,000	-2,000	-4,000
Subtotal, mandatory user charges proposals	-149	810	3,091	1,357	483	435	6,176
3. Governmental receipts							
Department of the Interior							
Extend abandoned mine reclamation fees	.....	.....	308	313	319	325	1,265
National Indian Gaming Commission activity fees	.....	.....	3	4	4	5	16
Department of the Treasury							
Extend Internal Revenue Service user fees	.....	68	81	6	.....	.....	155
Subtotal, governmental receipts user charges proposals	.....	68	392	323	323	330	1,436
Total, user charge proposals	441	2,102	4,716	3,343	2,539	2,582	15,282

collect these fees was scheduled to expire at the end of fiscal year 2001 but was extended through appropriations language through fiscal year 2002. The Administration is proposing to extend the authority to collect these fees at $8 million annually through fiscal year 2006.

Commodity Futures Trading Commission

Fees on each round-turn commodities futures and options transaction.—The Commodity Futures Trading Commission (CFTC) regulates U.S. futures and options markets. It strives to protect investors by preventing fraud and abuse and ensuring adequate disclosure information. The President's 2003 Budget proposed a fee on each round-turn commodities futures and options transaction. This proposal recognized that market participants derive direct benefit from CFTC's oversight, which provides legal certainty and contributes to the integrity and soundness of the markets. The fee is not proposed for 2004 and may be reconsidered after additional analysis.

2. Offsetting receipts

Environmental Protection Agency

Abolish cap on pre-manufacturing notification fees.—EPA collects fees from chemical manufacturers seeking to bring new chemicals into commerce. These fees are authorized by the Toxic Substances Control Act and are now subject to an outdated statutory cap. The Administration is proposing appropriations language to modify the cap so that EPA can increase fees to fully cover the cost of the program.

Nuclear Regulatory Commission

Extend NRC fees at their 2005 level for 2006 and later.—The Omnibus Budget Reconciliation Act (OBRA) of 1990, as amended, required that the Nuclear Regulatory Commission (NRC) assess license and annual fees that recover approximately 92 percent of its budget authority in 2008, less the appropriation from the Nuclear Waste Fund. Licensees are required to reimburse NRC for its services, because licensees benefit from such services.

Under OBRA, as amended, the budget authority recovery requirement decreases by 2 percentage points per year until it reaches 90 percent in 2005. After 2005, the requirement reverts to 33 percent per year. If the 90 percent requirement is not extended beyond 2005, fees would drop from an estimated $558 million in 2005 to $202 million in 2006. With an extension at 90 percent, fees would be an estimated $569 million in 2006, an increase of $367 million.

B. User Charge Proposals to Offset Mandatory Spending

1. Offsetting collections

Federal Deposit Insurance Corporation

Deposit insurance fees.—The Federal Deposit Insurance Corporation (FDIC) insures deposits in bank and savings associations (thrifts) through the Bank Insurance Fund (BIF) and the Savings Association Fund (SAIF). The 2004 Budget proposes to merge the BIF and the SAIF, which offer an identical product. The FDIC is required to maintain a designated reserve ratio (DRR, the ratio of insurance fund reserves to total insured deposits) of 1.25 percent. If insurance fund reserves fall below the DRR, the FDIC must charge sufficient premiums to restore the reserve ratio to 1.25 percent. The Administration's 2004 Budget assumes that some premium fees will be required to maintain the DRR in 2004 and beyond. A merged fund is projected to reduce the need for FDIC-insured depository institutions to increase premium payments over the near-term.

2. Offsetting receipts

Department of Agriculture

Forest Service recreation and entrance fees.—The Administration proposes to permanently extend the current pilot program that allows the Forest Service to collect increased recreation and entrance fees. These receipts would be available for use without further appropriation and are necessary to maintain and improve recreation facilities and services. A similar proposal affects recreation fees for the National Park Service, the Bureau of Land Management, and the Fish and Wildlife Service in the Department of the Interior.

Department of Energy

Arctic National Wildlife Refuge, collections for research and development.—The budget includes a proposal to authorize the Department of the Interior to conduct environmentally responsible oil and gas exploration and development within a small area of the Arctic National Wildlife Refuge, sometimes referred to as the "1002 Area," located in northern Alaska. The Department of the Interior estimates that recoverable oil from this area is between 5.7 and 16 billion barrels of oil. The budget assumes that the first oil and gas lease sale would be held in 2005 and would result in $2.4 billion in new revenues. Beginning in 2005 the budget would dedicate one-half of the first lease sale, $1.2 billion, to fund increased research and development on renewable energy technology by the Department of Energy over a seven-year period. All oil and gas revenues from the 1002 Area would be shared fifty percent with the State of Alaska, including the estimated $2 million annual rental payments.

Transfer certain Power Marketing Administration fees to the Corps of Engineers.—Beginning in 2003, the Administration proposes that financing of the operation and maintenance costs of the Corps of Engineers in the Southeastern, Southwestern, and Western service areas of the Power Marketing Administration be funded by receipts from the Power Marketing Administrations in these areas. This proposal is discussed under the Corps of Engineers above.

Department of Homeland Security

Border and transportation security conveyance, passenger, and merchandise processing fees.—The Administration proposes the reauthorization of two user fees: the border security conveyance and passenger fees; and the merchandise processing fee. The Border and Transportation Security Directorate currently collects nine different conveyance and passenger user fees under the Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1985 and related statues and a merchandise processing fee established by the Omnibus Budget Reconciliation Act (OBRA) of 1986, all of which are set to expire on September 30, 2003.

Department of the Interior

Recreation fees.—The Administration proposal gives permanent authority for bureaus in the Department of the Interior (DOI) to collect and spend the receipts from entrance and other recreation fees. DOI's National Park Service, Fish and Wildlife Service, and Bureau of Land Management are currently authorized to do so through 2004 under the recreation fee demonstration program.

Bureau of Land Management land sale authority.—The Administration will propose legislation to amend BLM's land sale authority under the Federal Land Transaction Facilitation Act (FLTFA) to: (1) allow BLM to use updated management plans to identify areas suitable for disposal, (2) allow a portion of the receipts to be used by BLM for restoration projects, and (3) cap receipt retention at $100 million per year. BLM is currently limited to selling lands that had been identified for disposal in land use plans that were in effect prior to enactment of FLTFA. Use of the receipts is currently limited to the purchase of other lands for conservation purposes.

Arctic National Wildlife Refuge collections for payments to Alaska.—The budget includes a proposal to authorize the Department of the Interior to conduct environmentally responsible oil and gas exploration and development within a small area of the Arctic National Wildlife Refuge, sometimes referred to as the "1002 Area," located in northern Alaska. This proposal is discussed under the Department of Energy above.

Federal Communications Commission

Spectrum license user fees.—To continue to promote efficient spectrum use, the Administration proposes new authority for the FCC to set user fees on unauctioned spectrum licenses, based on public-interest and spectrum-management principles. Fee collections are estimated to begin in 2005 and total $1.9 billion in the first ten years.

Analog spectrum fee.—To encourage television broadcasters to vacate the analog spectrum after 2006, as required by law, the Administration proposes authorizing the FCC to establish an annual lease fee totaling $500 million for the use of analog spectrum by commercial broadcasters beginning in 2007. Upon return of their analog spectrum license to the FCC, individual broadcasters will be exempt from the fee, and fee collections would decline.

Extend auction authority.—The Administration will propose legislation to extend indefinitely the FCC's authority to auction spectrum licenses, which expires in 2007. Reductions in estimated receipts in 2007 and 2008 resulting from possible shifting of spectrum auctions from 2007 into later years are more than offset by higher estimated receipts for those auctions in 2009 and 2010 as well as future new auctions. Estimated additional receipts from this proposal are $2.2 billion over the next ten years.

3. Governmental receipts

Department of the Interior

Extend abandoned mine reclamation fees.—Collections from abandoned mine reclamation fees are allocated to States for reclamation grants. Current fees of 35 cents per ton for surface mined coal, 15 cents per ton for underground mined coal, and 10 cents per ton for lignite coal are scheduled to expire on September 30, 2004. Abandoned land problems are expected to exist in certain States after all the money from the collection of fees under current law is expended. The Administration proposes to extend these fees until the most significant abandoned mine land problems are fixed. The Administration also proposes to modify the authorization language to allocate more of the receipts collected toward restoration of abandoned coal mine land.

National Indian Gaming Commission activity fees.—The National Indian Gaming Commission regulates and monitors gaming operations conducted on Indian lands. Since 1998, the Commission has been prohibited from collecting more than $8 million in annual fees from gaming operations to cover the costs of its oversight responsibilities. The Administration proposes to amend the current fee structure so that the Commission can adjust its activities to the growth in the Indian gaming industry.

Department of the Treasury

Extend Internal Revenue Service user fees.—The Administration proposes to extend for two years, through September 30, 2005, the IRS's authority to charge fees for written responses to questions from individuals, corporations, and organizations related to their tax status or the effects of particular transactions for tax purposes. Under current law, these fees are scheduled to expire effective with requests made after September 30, 2003.

OTHER OFFSETTING COLLECTIONS AND RECEIPTS

Table 5–4 shows the distribution of user charges and other offsetting collections and receipts according to whether they are offsetting collections credited to expenditure accounts or offsetting receipts. The table shows that total offsetting collections and receipts from the public are estimated to be $234.6 billion in 2004. Of these, an estimated $152.2 billion are offsetting collections credited to appropriation accounts and an estimated $82.4 billion are deposited in offsetting receipt accounts.

Information on the user charges presented in Table 5–4 is available in Tables 5–2 and 5–3 and the discussion that accompanies those tables. Major offsetting collections deposited in expenditure accounts that are not user charges are pre-credit reform loan repayments and collections from States to supplement payments in the supplemental security income program. Major offsetting receipts that are not user charges include military assistance program sales and interest income.

Table 5–5 includes all offsetting receipts 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 to be $492.6 billion in 2004—$410.2 billion are intragovernmental transactions, and $82.4 billion are from the public, shown in the table as proprietary receipts from the public and offsetting governmental receipts.

As noted above, offsetting collections and receipts by agency are also displayed in Table 21–1, “Outlays to the Public, Net and Gross,” which appears in Chapter 21 of this volume.

Table 5–4. OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC

(In millions of dollars)

	2002 Actual	Estimate	
		2003	2004
Offsetting collections credited to expenditure accounts:			
User charges:.			
Postal service stamps and other postal fees	64,597	69,437	70,159
Defense Commissary Agency	4,983	5,100	5,174
Federal employee contributions for employees and retired employees health benefits funds	6,495	7,283	8,051
Sale of energy:			
Tennessee Valley Authority	6,959	6,986	7,196
Bonneville Power Administration	3,650	3,807	4,010
All other user charges [1]	27,128	30,775	31,921
Subtotal, user charges	113,812	123,388	126,511
Other collections credited to expenditure accounts:			
Pre-credit reform loan repayments	16,132	13,526	13,763
Supplemental security income (collections from the States)	3,735	3,949	4,056
Other collections	10,008	8,637	7,829
Subtotal, other collections	29,875	26,112	25,648
Subtotal, collections credited to expenditure accounts	143,687	149,500	152,159
Offsetting receipts:			
User charges:			
Medicare premiums	25,952	28,269	30,998
Outer Continental Shelf rents, bonuses, and royalties	5,024	4,300	3,989
All other user charges [1]	10,557	11,762	11,974
Subtotal, user charges deposited in receipt accounts	41,533	44,331	46,961
Other collections deposited in receipt accounts:			
Military assistance program sales	11,225	12,259	11,974
Interest income	12,449	12,873	14,025
All other collections deposited in receipt accounts	13,084	18,617	9,464
Subtotal, other collections deposited in receipt accounts	36,758	43,749	35,463
Subtotal, collections deposited in receipt accounts	78,291	88,080	82,424
Total, offsetting collections and receipts from the public	**221,978**	**237,580**	**234,583**
Total, offsetting collections and receipts excluding off-budget	**156,902**	**167,993**	**164,286**
ADDENDUM:			
User charges that are offsetting collections and receipts [2]	155,345	167,719	173,472
Other offsetting collections and receipts from the public	66,633	69,861	61,111
Total, offsetting collections and receipts from the public	**221,978**	**237,580**	**234,583**

[1] For additional detail on items classified as user charges, see Table 5–2.
[2] Excludes user charges that are classified on the receipts side of the budget. For total user charges, see Table 5–1 or Table 5–2.

Table 5–5. OFFSETTING RECEIPTS BY TYPE

(In millions of dollars)

Source	2002 Actual	Estimate					
		2003	2004	2005	2006	2007	2008
INTRAGOVERNMENTAL TRANSACTIONS							
On-budget receipts:							
Federal intrafund transactions:							
Distributed by agency:							
Interest from the Federal Financing Bank	2,040	2,268	2,482	2,316	2,137	2,001	1,941
Proposed Legislation (non-PAYGO)	.....	–23	–72	–123	–150	–148	–133
Interest on Government capital in enterprises	1,244	1,022	1,062	1,473	1,357	1,414	1,243
General fund payments to retirement and health benefits funds:							
DoD retiree health care fund	.....	15,111	16,470	18,040	19,787	21,689	23,757
Other	3,363	2,402	2,522	2,676	2,759	2,685	2,430
Proposed Legislation (non-PAYGO)	.....	.....	.....	8	21	36	51
Undistributed by agency:							
Employing agency contributions:							
DoD retiree health care fund	.....	7,656	8,374	8,880	9,437	10,029	10,656
Total Federal intrafunds	6,647	28,436	30,838	33,270	35,348	37,706	39,945
Trust intrafund transactions:							
Distributed by agency:							
Payments to railroad retirement	5,149	21,586	4,027	6,597	6,291	6,582	6,690
Other	.....	1	1	1	1	1	1
Total trust intrafunds	5,149	21,587	4,028	6,598	6,292	6,583	6,691
Total intrafund transactions	11,796	50,023	34,866	39,868	41,640	44,289	46,636
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Contributions to insurance programs:							
Military retirement fund	17,047	17,928	18,617	19,269	19,944	20,643	21,365
Supplementary medical insurance	78,319	80,905	94,518	96,192	101,018	106,365	113,409
Proposed Legislation (non-PAYGO)	.....	.....	.....	–25	–8	.....	.....
Hospital insurance	11,693	8,460	9,028	9,505	10,191	11,007	12,150
Railroad social security equivalent fund	94	114	105	114	116	122	129
Rail industry pension fund	242	330	292	300	309	321	334
Civilian supplementary retirement contributions	22,368	22,747	23,036	23,335	23,740	24,245	24,748
Proposed Legislation (non-PAYGO)	.....	2,059	2,085	2,300	2,495	2,600	2,799
Unemployment insurance	718	1,188	641	512	507	518	537
Other contributions	540	481	511	513	515	518	516
Subtotal	131,021	134,212	148,833	152,015	158,827	166,339	175,987
Miscellaneous payments	1,429	1,026	1,674	1,462	1,509	1,491	1,547
Proposed Legislation (non-PAYGO)	.....	.....	2,468	.....	.....	.....	.....
Subtotal	132,450	135,238	152,975	153,477	160,336	167,830	177,534
Trust fund payments to Federal funds:							
Quinquennial adjustment for military service credits	.....	.....	.....	.....	.....	.....	.....
Other	1,139	1,142	1,128	1,185	1,225	1,255	1,285
Proposed Legislation (non-PAYGO)	.....	.....	1,851	–444	–433	–429	–423
Subtotal	1,139	1,142	2,979	741	792	826	862
Total interfunds distributed by agency	133,589	136,380	155,954	154,218	161,128	168,656	178,396
Undistributed by agency:							
Employer share, employee retirement (on-budget):							
Civil service retirement and disability insurance	10,731	9,975	10,739	11,565	12,555	13,235	13,856
CSRDI from Postal Service	6,763	7,026	7,221	7,479	7,584	7,822	8,233
Proposed Legislation (PAYGO)	.....	–3,490	–2,658	–2,851	–2,873	–3,065	–3,411
Hospital insurance (contribution as employer) [1]	2,191	2,333	2,402	2,533	2,639	2,747	2,902
Proposed Legislation (non-PAYGO)	.....	.....	.....	.....	.....	.....	.....
Postal employer contributions to FHI	722	684	683	706	728	751	776
Military retirement fund	12,935	12,084	12,546	12,915	13,318	13,765	14,155
Other Federal employees retirement	147	145	149	153	157	161	165

Table 5–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2002 Actual	Estimate					
		2003	2004	2005	2006	2007	2008
Total employer share, employee retirement (on-budget)	33,489	28,757	31,082	32,500	34,108	35,416	36,676
Interest received by on-budget trust funds	76,494	73,901	75,589	78,229	81,730	85,495	89,573
Proposed Legislation (non-PAYGO)	.....	24	–57	–37	–35	–27	–31
Total interfund transactions undistributed by agency	109,983	102,682	106,614	110,692	115,803	120,884	126,218
Total interfund transactions	243,572	239,062	262,568	264,910	276,931	289,540	304,614
Total on-budget receipts	255,368	289,085	297,434	304,778	318,571	333,829	351,250
Off-budget receipts:							
Trust intrafund transactions:							
Distributed by agency:							
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Old-age, survivors, and disability insurance	13,553	13,046	13,379	14,415	15,344	16,645	18,156
Proposed Legislation (non-PAYGO)	.....	.....	628	.....	.....	.....	.....
Undistributed by agency:							
Employer share, employee retirement (off-budget)	9,292	9,493	10,023	10,794	11,482	12,159	13,043
Interest received by off-budget trust funds	76,819	83,576	88,698	96,769	106,122	116,995	129,253
Total off-budget receipts:	99,664	106,115	112,728	121,978	132,948	145,799	160,452
Total intragovernmental transactions	**355,032**	**395,200**	**410,162**	**426,756**	**451,519**	**479,628**	**511,702**
PROPRIETARY RECEIPTS FROM THE PUBLIC							
Distributed by agency:							
Interest:							
Interest on foreign loans and deferred foreign collections	612	598	592	584	567	591	506
Interest on deposits in tax and loan accounts	341	225	450	700	700	700	700
Other interest (domestic—civil) [2]	11,443	12,015	12,951	14,008	14,620	15,270	16,022
Total interest	12,396	12,838	13,993	15,292	15,887	16,561	17,228
Dividends and other earnings	52	35	32	32	32	32	32
Royalties and rents	1,497	1,964	1,901	1,969	1,956	1,914	1,947
Sale of products:							
Sale of timber and other natural land products	322	211	220	220	236	248	258
Sale of minerals and mineral products	20	24	32	36	40	43	44
Sale of power and other utilities	644	684	679	691	717	728	739
Proposed Legislation (PAYGO)	.....	–149	–145	–148	–151	–154	–158
Other [2]	115	81	70	71	71	72	73
Total sale of products	1,101	851	856	870	913	937	956
Fees and other charges for services and special benefits:							
Medicare premiums and other charges (trust funds)	25,952	28,269	30,998	32,861	34,534	36,339	38,755
Proposed Legislation (non-PAYGO)	.....	.....	.....	–35	–12	.....	.....
Nuclear waste disposal revenues	712	736	743	749	754	756	767
Veterans life insurance (trust funds)	185	183	171	155	140	127	114
Other [2]	3,674	3,649	4,320	4,263	4,492	4,741	5,003
Proposed Legislation (PAYGO)	.....	.....	.....	76	90	92	98
Total fees and other charges	30,523	32,837	36,232	38,069	39,998	42,055	44,737
Sale of Government property:							
Sale of land and other real property [2]	123	299	106	107	114	135	160
Proposed Legislation (PAYGO)	.....	.....	10	25	34	42	50
Military assistance program sales (trust funds)	11,225	12,259	11,974	10,882	10,849	11,044	11,243
Other	759	127	80	55	52	9	1
Total sale of Government property	12,107	12,685	12,170	11,069	11,049	11,230	11,454
Realization upon loans and investments:							
Negative subsidies and downward reestimates	6,216	9,586	813	866	893	924	959
Repayment of loans to foreign nations	71	85	88	94	108	25	28

Table 5–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2002 Actual	Estimate					
		2003	2004	2005	2006	2007	2008
Other	105	92	88	84	80	78	75
Total realization upon loans and investments	6,392	9,763	989	1,044	1,081	1,027	1,062
Recoveries and refunds [2]	3,580	5,867	5,335	3,638	3,548	3,655	3,762
Proposed Legislation (PAYGO)	.....	.....	14	30	–56	–109	–114
Miscellaneous receipt accounts [2]	1,622	1,852	1,876	1,893	1,922	1,942	1,965
Total proprietary receipts from the public distributed by agency	69,270	78,692	73,398	73,906	76,330	79,244	83,029
Undistributed by agency:							
Other interest: Interest received from Outer Continental Shelf escrow account	1	.....	.....	.....	.....	.....	.....
Rents, bonuses, and royalties:							
Outer Continental Shelf rents and bonuses	197	569	615	499	481	583	418
Outer Continental Shelf royalties	4,827	3,731	3,374	3,996	4,674	4,761	4,778
Arctic National Wildlife Refuge:							
Arctic National Wildlife Refuge	.....	.....	.....	.....	.....	.....	.....
Proposed Legislation (PAYGO)	.....	.....	.....	2,402	2	202	2
Sale of major assets	.....	.....	.....	323	.....	.....	.....
Total proprietary receipts from the public undistributed by agency	5,025	4,300	3,989	7,220	5,157	5,546	5,198
Total proprietary receipts from the public [3]	**74,295**	**82,992**	**77,387**	**81,126**	**81,487**	**84,790**	**88,227**
OFFSETTING GOVERNMENTAL RECEIPTS							
Distributed by agency:							
Defense cooperation	12	12	12	12	12	12	12
Regulatory fees [2]	3,908	4,854	3,339	3,436	3,519	3,609	3,700
Proposed Legislation (non-PAYGO)	.....	63	4	8	8	8	8
Proposed Legislation (PAYGO)	.....	.....	1,398	1,490	1,588	1,692	1,804
Other	75	79	84	85	85	88	89
Undistributed by agency:							
Spectrum auction proceeds	1	80	200	8,200	8,100	4,300	4,300
Proposed Legislation (PAYGO)	.....	.....	.....	10	25	–1,450	–1,400
Total offsetting governmental receipts	3,996	5,088	5,037	13,241	13,337	8,259	8,513
Total offsetting receipts	**433,323**	**483,280**	**492,586**	**521,123**	**546,343**	**572,677**	**608,442**

[1] Includes provision for covered Federal civilian employees and military personnel.
[2] Includes both Federal funds and trust funds.
[3] Consists of:

	2002 Actual	*Estimate*					
		2003	*2004*	*2005*	*2006*	*2007*	*2008*
On-budget:							
Federal Funds	35,631	40,725	32,309	35,247	33,928	35,219	36,043
Trust Funds	38,581	42,185	44,995	45,795	47,473	49,483	52,094
Off-budget	83	82	83	84	86	88	90

2004

6. TAX EXPENDITURES

The Congressional Budget Act of 1974 (Public Law 93–344) requires that a list of "tax expenditures" be included in the budget. Tax expenditures are defined in the law as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability." These exceptions may be viewed as alternatives to other policy instruments, such as spending or regulatory programs. Identification and measurement of tax expenditures depends importantly on the baseline tax system against which the actual tax system is compared.

The largest reported tax expenditures tend to be associated with the individual income tax. For example, sizeable deferrals, deductions and exclusions are provided for pension contributions and earnings, employer contributions for medical insurance, capital gains, and payments of State and local individual income and property taxes. Reported tax expenditures under the corporate income tax tend to be related to timing differences in 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.

Each tax expenditure estimate in this chapter was calculated assuming other parts of the tax code remained unchanged. The estimates would be different if all tax expenditures or major groups of tax expenditures were changed simultaneously because of potential interactions among provisions. For that reason, this chapter does not present a grand total for the estimated 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.

Tax expenditures relating to the individual and corporate income taxes are estimated for fiscal years 2002–2008 using three methods of accounting: revenue effects, outlay equivalent, and present value. The present value approach provides estimates of the cumulative revenue effects for tax expenditures that involve deferrals of tax payments into the future or have similar long-term effects.

The section of the chapter on performance measures and economic effects presents information related to assessment of the effect of tax expenditures on the achievement of program performance goals. This section is a complement to the government-wide performance plan required by the Government Performance and Results Act of 1993.

The 2003 Budget included a discussion of important ambiguities in the tax expenditure concept and indicated that the Treasury Department had begun a review of the tax expenditure presentation. Particular attention of this review has focused on defining tax expenditures relative to a comprehensive income baseline, defining tax expenditures relative to a broad-based consumption tax baseline, and defining negative tax expenditures, i.e., provisions of current law that overtax certain items or activities. The Appendix presents the results from the preliminary stage of this review.

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

All tax expenditure estimates presented here are based upon current tax law enacted as of December 31, 2002. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 2002. 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 effects for tax expenditures for fiscal years 2002–2008 are displayed according to the budget's functional categories in Table 6–1. Descriptions of the specific tax expenditure provisions follow the tables of estimates and the 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 effects for these indicated items are zero using the reference tax rules. The alternative baseline concepts are discussed in detail following the tables.

Table 6–2 reports the respective portions of the total revenue effects that arise under the individual and corporate income taxes separately. The placement of the 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 could be shareholders, employees, customers, or other providers of capital, depending on economic forces.

Table 6–3 ranks the major tax expenditures by the size of their 2004–2008 revenue effect.

Interpreting Tax Expenditure Estimates

The estimates shown for individual tax expenditures in Tables 6–1, 6–2, and 6–3 do not necessarily equal the increase in Federal revenues (or the change in the budget balance) that would result from repealing these special provisions, for the following reasons:

(1) Eliminating a tax expenditure may have incentive effects that alter economic behavior. These incentives can affect the resulting magnitudes of the activity or of other tax provisions or Government programs. For example, if capital gains were taxed at ordinary rates, capital gain realizations would be expected to decline, potentially resulting in a decline in tax receipts. Such behavioral effects are not reflected in the estimates.

(2) Tax expenditures are interdependent even without incentive effects. Repeal of a tax expenditure provision can increase or decrease the tax revenues associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the revenue costs from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the revenue cost 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, because each is estimated assuming that the other remains in force. In addition, the estimates reported in Table 6–1 are the totals of individual and corporate income tax revenue effects reported in Table 6–2 and do not reflect any possible interactions between the individual and corporate income tax receipts. For this reason, the estimates in Table 6–1 (as well as those in Table 6–5, 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 6–4. 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. Although 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 effect on receipts to the Government because the newly deferred taxes will ultimately be received. Present-value estimates, which are a useful complement to the cash-basis estimates for provisions involving deferrals, are discussed below.

Present-Value Estimates

Discounted present-value estimates of revenue effects are presented in Table 6–4 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 effects, net of future tax payments, that follow from activities undertaken during calendar year 2002 which cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 2002 would cause a deferral of tax payments on wages in 2002 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 2002 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 6–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES

(In millions of dollars)

		Total from corporations and individuals							
		2002	2003	2004	2005	2006	2007	2008	2004–2008
	National Defense								
1	Exclusion of benefits and allowances to armed forces personnel	2,190	2,210	2,240	2,260	2,290	2,310	2,330	11,430
	International Affairs								
2	Exclusion of income earned abroad by U.S. citizens	2,740	2,620	2,680	2,750	2,810	2,940	3,100	14,280
3	Exclusion of certain allowances for Federal employees abroad	760	800	840	880	930	980	1,030	4,660
4	Extraterritorial income exclusion	4,820	5,150	5,510	5,890	6,290	6,730	7,200	31,620
5	Inventory property sales source rules exception	1,470	1,540	1,620	1,700	1,790	1,880	1,980	8,970
6	Deferral of income from controlled foreign corporations (normal tax method)	7,000	7,450	7,900	8,400	8,930	9,550	10,210	44,990
7	Deferred taxes for financial firms on certain income earned overseas	1,950	2,050	2,130	2,190	2,260	960	0	7,540
	General Science, Space, and Technology								
8	Expensing of research and experimentation expenditures (normal tax method)	1,660	2,200	2,760	3,390	3,990	4,270	4,380	18,790
9	Credit for increasing research activities	6,870	5,640	4,990	2,910	1,240	520	170	9,830
	Energy								
10	Expensing of exploration and development costs, fuels	150	170	150	80	60	40	30	360
11	Excess of percentage over cost depletion, fuels	610	670	650	610	620	640	650	3,170
12	Alternative fuel production credit	1,560	940	520	520	520	520	210	2,290
13	Exception from passive loss limitation for working interests in oil and gas properties	10	10	10	10	10	10	10	50
14	Capital gains treatment of royalties on coal	100	110	110	120	120	130	140	620
15	Exclusion of interest on energy facility bonds	110	120	130	140	140	150	160	720
16	Enhanced oil recovery credit	330	340	350	360	360	370	390	1,830
17	New technology credit	100	180	250	270	270	270	270	1,330
18	Alcohol fuel credits [1]	30	30	30	30	30	30	30	150
19	Tax credit and deduction for clean-fuel burning vehicles	70	90	70	40	–10	–70	–70	–40
20	Exclusion from income of conservation subsidies provided by public utilities	80	80	80	80	80	80	80	400
	Natural Resources and Environment								
21	Expensing of exploration and development costs, nonfuel minerals	30	30	30	30	30	40	40	170
22	Excess of percentage over cost depletion, nonfuel minerals	260	260	270	280	290	290	300	1,430
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	450	480	540	580	610	650	680	3,060
24	Capital gains treatment of certain timber income	100	110	110	120	120	130	140	620
25	Expensing of multiperiod timber growing costs	360	370	380	380	400	410	410	1,980
26	Tax incentives for preservation of historic structures	200	210	230	240	250	260	280	1,260
	Agriculture								
27	Expensing of certain capital outlays	170	180	170	170	170	170	190	870
28	Expensing of certain multiperiod production costs	130	130	120	120	120	120	120	600
29	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	1,010	1,060	1,120	1,180	1,250	1,310	1,380	6,240
31	Income averaging for farmers	70	70	80	80	80	90	90	420
32	Deferral of gain on sale of farm refiners	10	10	10	10	10	10	20	60
	Commerce and Housing								
	Financial institutions and insurance:								
33	Exemption of credit union income	1,020	1,090	1,160	1,240	1,320	1,410	1,510	6,640
34	Excess bad debt reserves of financial institutions	0	0	0	0	0	0	0	0
35	Exclusion of interest on life insurance savings	17,690	19,130	20,740	22,470	24,390	26,350	28,310	122,260
36	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	210	220	240	250	270	280	290	1,330
38	Small life insurance company deduction	100	100	100	100	100	100	100	500
	Housing:								
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	870	960	1,050	1,140	1,210	1,270	1,360	6,030
40	Exclusion of interest on rental housing bonds	180	200	220	240	250	260	280	1,250
41	Deductibility of mortgage interest on owner-occupied homes	63,590	65,540	68,440	71,870	74,790	78,160	82,650	375,910
42	Deductibility of State and local property tax on owner-occupied homes	21,760	22,320	22,160	19,750	16,240	14,580	13,580	86,310
43	Deferral of income from post 1987 installment sales	1,050	1,080	1,100	1,120	1,140	1,160	1,190	5,710
44	Capital gains exclusion on home sales	19,670	20,260	20,860	21,490	22,140	22,800	23,480	110,770
45	Exception from passive loss rules for $25,000 of rental loss	5,690	5,270	4,920	4,600	4,290	4,020	3,790	21,620
46	Credit for low-income housing investments	3,290	3,450	3,640	3,820	3,990	4,160	4,360	19,970
47	Accelerated depreciation on rental housing (normal tax method)	1,590	1,080	310	–520	–1,770	–3,310	–4,570	–9,860
	Commerce:								
48	Cancellation of indebtedness	0	10	30	50	60	60	50	250
49	Exceptions from imputed interest rules	50	50	50	50	50	50	50	250
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	56,060	55,010	53,930	54,550	49,870	49,760	51,450	259,560
51	Capital gains exclusion of small corporation stock	100	130	160	210	250	300	350	1,270
52	Step-up basis of capital gains at death	26,890	27,390	28,500	29,630	30,490	31,370	32,390	152,380
53	Carryover basis of capital gains on gifts	640	640	450	540	640	650	630	2,910
54	Ordinary income treatment of loss from small business corporation stock sale	40	40	50	50	50	50	50	250
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	–1,800	–2,530	–1,980	–6,520	–9,200	–12,360	–15,820	–45,880
56	Accelerated depreciation of machinery and equipment (normal tax method)	47,770	31,110	16,670	–39,310	–35,260	–33,260	–31,570	–122,730
57	Expensing of certain small investments (normal tax method)	–360	–110	370	1,570	1,830	1,510	1,380	6,660
58	Amortization of start-up costs (normal tax method)	110	130	150	160	160	170	170	810

Table 6–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(In millions of dollars)

		Total from corporations and individuals							
		2002	2003	2004	2005	2006	2007	2008	2004–2008
59	Graduated corporation income tax rate (normal tax method)	4,870	5,380	5,700	5,880	6,100	6,350	6,640	30,670
60	Exclusion of interest on small issue bonds	330	360	400	430	450	470	510	2,260
	Transportation								
61	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
62	Exclusion of reimbursed employee parking expenses	2,070	2,180	2,290	2,410	2,540	2,680	2,810	12,730
63	Exclusion for employer-provided transit passes	250	320	380	450	530	600	670	2,630
	Community and Regional Development								
64	Investment credit for rehabilitation of structures (other than historic)	30	30	30	30	30	30	30	150
65	Exclusion of interest for airport, dock, and similar bonds	690	750	830	890	950	1,000	1,060	4,730
66	Exemption of certain mutuals' and cooperatives' income	60	60	60	70	70	70	70	340
67	Empowerment zones, Enterprise communities, and Renewal communities	730	1,130	1,170	1,280	1,410	1,580	1,750	7,190
68	New markets tax credit	90	190	290	430	610	830	870	3,030
69	Expensing of environmental remediation costs	80	80	20	–10	–10	–10	–10	–20
	Education, Training, Employment, and Social Services								
	Education:								
70	Exclusion of scholarship and fellowship income (normal tax method)	1,270	1,260	1,260	1,340	1,400	1,410	1,420	6,830
71	HOPE tax credit	4,110	3,520	2,880	2,930	2,730	2,900	2,790	14,230
72	Lifetime Learning tax credit	2,180	2,250	2,980	2,840	2,610	2,820	2,860	14,110
73	Education Individual Retirement Accounts	50	100	160	240	330	440	560	1,730
74	Deductibility of student-loan interest	450	640	660	680	700	720	720	3,480
75	Deduction for higher education expenses	420	2,230	2,880	3,620	2,940	0	0	9,440
76	State prepaid tuition plans	270	340	400	470	560	660	750	2,840
77	Exclusion of interest on student-loan bonds	240	260	290	310	340	350	370	1,660
78	Exclusion of interest on bonds for private nonprofit educational facilities	580	640	700	760	810	850	900	4,020
79	Credit for holders of zone academy bonds	50	80	90	100	100	100	100	490
80	Exclusion of interest on savings bonds redeemed to finance educational expenses	10	10	10	10	10	20	20	70
81	Parental personal exemption for students age 19 or over	2,480	3,310	3,230	2,690	2,020	1,670	1,470	11,080
82	Deductibility of charitable contributions (education)	4,020	4,140	4,350	4,640	4,820	4,970	5,230	24,010
83	Exclusion of employer-provided educational assistance	400	490	520	550	580	610	650	2,910
	Training, employment, and social services:								
84	Work opportunity tax credit	380	560	430	190	80	40	20	760
85	Welfare-to-work tax credit	80	70	80	60	40	20	10	210
86	Employer provided child care exclusion	690	720	760	810	850	890	940	4,250
87	Employer-provided child care credit	40	90	130	140	150	160	170	750
88	Assistance for adopted foster children	220	250	290	330	380	430	480	1,910
89	Adoption credit and exclusion	140	220	450	500	540	560	570	2,620
90	Exclusion of employee meals and lodging (other than military)	740	780	810	850	890	930	970	4,450
91	Child credit [2]	22,170	21,440	21,310	22,480	24,280	23,940	23,660	115,670
92	Credit for child and dependent care expenses	2,750	2,910	3,230	2,860	2,380	2,190	2,050	12,710
93	Credit for disabled access expenditures	50	50	50	60	60	60	60	290
94	Deductibility of charitable contributions, other than education and health	30,860	32,100	33,990	35,710	37,360	38,780	41,160	187,000
95	Exclusion of certain foster care payments	450	430	430	440	450	460	470	2,250
96	Exclusion of parsonage allowances	350	380	400	420	450	480	510	2,260
	Health								
97	Exclusion of employer contributions for medical insurance premiums and medical care	99,060	108,500	120,160	132,240	144,710	157,180	170,230	724,520
98	Self-employed medical insurance premiums	1,760	2,500	3,690	3,940	4,220	4,520	4,980	21,350
99	Workers' compensation insurance premiums	5,280	5,770	6,190	6,630	7,020	7,490	8,000	35,330
100	Medical Savings Accounts	20	30	30	30	30	30	20	140
101	Deductibility of medical expenses	5,710	6,060	6,340	6,490	6,610	6,980	7,380	33,800
102	Exclusion of interest on hospital construction bonds	1,200	1,320	1,440	1,560	1,660	1,740	1,850	8,250
103	Deductibility of charitable contributions (health)	4,240	4,360	4,580	4,900	5,070	5,220	5,490	25,260
104	Tax credit for orphan drug research	140	160	180	200	220	250	280	1,130
105	Special Blue Cross/Blue Shield deduction	300	340	310	300	270	300	250	1,430
106	Tax credit for health insurance purchased by certain displaced and retired individuals	0	0	60	30	40	50	60	240
	Income Security								
107	Exclusion of railroad retirement system benefits	390	400	400	400	400	400	400	2,000
108	Exclusion of workers' compensation benefits	5,750	6,100	6,460	6,850	7,270	7,710	8,190	36,480
109	Exclusion of public assistance benefits (normal tax method)	380	400	410	430	450	470	440	2,200
110	Exclusion of special benefits for disabled coal miners	70	60	60	50	50	50	40	250
111	Exclusion of military disability pensions	110	110	120	120	130	130	140	640
	Net exclusion of pension contributions and earnings:	0	0	0	0	0	0	0	0
112	Employer plans	51,260	63,480	67,870	70,540	73,200	67,500	61,440	340,550
113	401(k) plans	50,830	52,920	55,290	57,830	61,490	65,060	68,030	307,700
114	Individual Retirement Accounts	19,080	20,840	23,130	22,400	22,380	20,540	19,800	108,250
115	Low and moderate income savers credit	850	2,050	1,860	1,670	1,510	850	0	5,890
116	Keogh plans	7,000	7,282	7,616	7,904	8,166	8,402	9,196	41,284
	Exclusion of other employee benefits:	0	0	0	0	0	0	0	0
117	Premiums on group term life insurance	1,780	1,800	1,830	1,860	1,890	1,920	1,950	9,450

Table 6–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(In millions of dollars)

		Total from corporations and individuals							
		2002	2003	2004	2005	2006	2007	2008	2004–2008
118	Premiums on accident and disability insurance	220	230	240	250	260	270	280	1,300
119	Small business retirement plan credit	10	20	40	50	50	60	60	260
120	Income of trusts to finance supplementary unemployment benefits	20	30	30	30	30	30	30	150
121	Special ESOP rules	1,630	1,710	1,790	1,890	1,990	2,090	2,200	9,960
122	Additional deduction for the blind	40	40	40	40	40	40	40	200
123	Additional deduction for the elderly	1,890	1,950	2,050	2,120	2,180	2,110	2,030	10,490
124	Tax credit for the elderly and disabled	20	20	20	20	10	10	10	70
125	Deductibility of casualty losses	280	400	420	440	460	500	540	2,360
126	Earned income tax credit [3]	4,450	4,930	5,090	5,280	5,410	5,580	5,790	27,150
	Social Security								
	Exclusion of social security benefits:								
127	Social Security benefits for retired workers	18,340	18,560	18,930	19,210	20,000	21,100	21,550	100,790
128	Social Security benefits for disabled	2,910	3,210	3,570	3,950	4,360	4,870	4,390	21,140
129	Social Security benefits for dependents and survivors	3,730	3,910	4,140	4,360	4,590	4,920	4,820	22,830
	Veterans Benefits and Services								
130	Exclusion of veterans death benefits and disability compensation	3,160	3,230	3,400	3,590	3,780	3,980	4,190	18,940
131	Exclusion of veterans pensions	70	80	80	90	90	90	100	450
132	Exclusion of GI bill benefits	90	90	90	100	100	110	110	510
133	Exclusion of interest on veterans housing bonds	40	40	50	50	50	60	60	270
	General Purpose Fiscal Assistance								
134	Exclusion of interest on public purpose State and local bonds	25,250	26,780	27,310	27,720	27,810	27,530	28,360	138,730
135	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	47,430	50,520	50,910	47,770	40,480	37,190	36,080	212,430
136	Tax credit for corporations receiving income from doing business in U.S. possessions	2,240	2,240	2,240	2,200	1,300	0	0	5,740
	Interest								
137	Deferral of interest on U.S. savings bonds	510	590	670	750	840	920	1,050	4,230
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	21,760	22,320	22,160	19,750	16,240	14,580	13,580	86,310
	Nonbusiness State and local taxes other than on owner-occupied homes	47,430	50,520	50,910	47,770	40,480	37,190	36,080	212,430
	Exclusion of interest on State and local bonds for:								
	Public purposes	25,250	26,780	27,310	27,720	27,810	27,530	28,360	138,730
	Energy facilities	110	120	130	140	140	150	160	720
	Water, sewage, and hazardous waste disposal facilities	450	480	540	580	610	650	680	3,060
	Small-issues	330	360	400	430	450	470	510	2,260
	Owner-occupied mortgage subsidies	870	960	1,050	1,140	1,210	1,270	1,360	6,030
	Rental housing	180	200	220	240	250	260	280	1,250
	Airports, docks, and similar facilities	690	750	830	890	950	1,000	1,060	4,730
	Student loans	240	260	290	310	340	350	370	1,660
	Private nonprofit educational facilities	580	640	700	760	810	850	900	4,020
	Hospital construction	1,200	1,320	1,440	1,560	1,660	1,740	1,850	8,250
	Veterans' housing	40	40	50	50	50	60	60	270
	Credit for holders of zone academy bonds	50	80	90	100	100	100	100	490

[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: 2002 $1,070; 2003 $1,140; 2004 $1,230; 2005 $1,320; 2006 $1,370; 2007 $1,400; and 2008 $1,430.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2002 $5,060; 2003 $5,870; 2004 $5,860; 2005 $5,700; 2006 $7,630; 2007 $7,630; and 2008 $7,500

[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2002 $27,830; 2003 $30,610; 2004 $31,380; 2005 $32,090; 2006 $33,450; 2007 $34,480; and 2008 $35,380.

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 $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Table 6–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES

(In millions of dollars)

		Corporations								Individuals							
		2002	2003	2004	2005	2006	2007	2008	2004–2008	2002	2003	2004	2005	2006	2007	2008	2004–2008
	National Defense																
1	Exclusion of benefits and allowances to armed forces personnel	...	...	...	...	...	...	...	...	2,190	2,210	2,240	2,260	2,290	2,310	2,330	11,430
	International Affairs																
2	Exclusion of income earned abroad by U.S. citizens	...	...	...	...	...	...	...	...	2,740	2,620	2,680	2,750	2,810	2,940	3,100	14,280
3	Exclusion of certain allowances for Federal employees abroad	...	...	...	...	...	...	...	...	760	800	840	880	930	980	1,030	4,660
4	Extraterritorial income exclusion	4,820	5,150	5,510	5,890	6,290	6,730	7,200	31,620	...	...	...	...	...	...	...	...
5	Inventory property sales source rules exception	1,470	1,540	1,620	1,700	1,790	1,880	1,980	8,970	...	...	...	...	...	...	...	...
6	Deferral of income from controlled foreign corporations (normal tax method)	7,000	7,450	7,900	8,400	8,930	9,550	10,210	44,990	...	...	...	...	...	...	...	...
7	Deferred taxes for financial firms on certain income earned overseas	1,950	2,050	2,130	2,190	2,260	960	0	7,540	...	...	...	...	...	...	...	...
	General Science, Space, and Technology																
8	Expensing of research and experimentation expenditures (normal tax method)	1,630	2,160	2,710	3,320	3,910	4,190	4,300	18,430	30	40	50	70	80	80	80	360
9	Credit for increasing research activities	6,810	5,590	4,950	2,890	1,240	520	170	9,770	60	50	40	20	0	0	0	60
	Energy																
10	Expensing of exploration and development costs, fuels	130	150	130	70	50	40	30	320	20	20	20	10	10	0	0	40
11	Excess of percentage over cost depletion, fuels	510	550	530	500	510	530	540	2,610	100	120	120	110	110	110	110	560
12	Alternative fuel production credit	1,500	900	500	500	500	500	200	2,200	60	40	20	20	20	20	10	90
13	Exception from passive loss limitation for working interests in oil and gas properties	...	...	...	...	...	...	...	...	10	10	10	10	10	10	10	50
14	Capital gains treatment of royalties on coal	...	...	...	...	...	...	...	...	100	110	110	120	120	130	140	620
15	Exclusion of interest on energy facility bonds	30	30	30	30	30	30	30	150	80	90	100	110	110	120	130	570
16	Enhanced oil recovery credit	300	310	320	330	330	340	350	1,670	30	30	30	30	30	30	40	160
17	New technology credit	100	180	250	270	270	270	270	1,330	0	0	0	0	0	0	0	0
18	Alcohol fuel credits [1]	20	20	20	20	20	20	20	100	10	10	10	10	10	10	10	50
19	Tax credit and deduction for clean-fuel burning vehicles	50	60	40	20	–10	–60	–60	–70	20	30	30	20	0	–10	–10	30
20	Exclusion from income of conservation subsidies provided by public utilities	...	...	...	...	...	...	...	...	80	80	80	80	80	80	80	400
	Natural Resources and Environment																
21	Expensing of exploration and development costs, nonfuel minerals	30	30	30	30	30	40	40	170	0	0	0	0	0	0	0	0
22	Excess of percentage over cost depletion, nonfuel minerals	240	240	250	260	270	270	280	1,330	20	20	20	20	20	20	20	100
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	110	110	120	120	120	130	130	620	340	370	420	460	490	520	550	2,440
24	Capital gains treatment of certain timber income	...	...	...	...	...	...	...	...	100	110	110	120	120	130	140	620
25	Expensing of multiperiod timber growing costs	240	250	260	260	270	280	280	1,350	120	120	120	120	130	130	130	630
26	Tax incentives for preservation of historic structures	160	170	180	190	200	210	220	1,000	40	40	50	50	50	50	60	260
	Agriculture																
27	Expensing of certain capital outlays	20	20	20	20	20	20	30	110	150	160	150	150	150	150	160	760
28	Expensing of certain multiperiod production costs	20	20	20	20	20	20	20	100	110	110	100	100	100	100	100	500
29	Treatment of loans forgiven for solvent farmers	...	...	...	...	...	...	...	...	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	...	...	...	...	...	...	...	...	1,010	1,060	1,120	1,180	1,250	1,310	1,380	6,240
31	Income averaging for farmers	...	...	...	...	...	...	...	...	70	70	80	80	80	90	90	420
32	Deferral of gain on sale of farm refiners	10	10	10	10	10	10	20	60	...	...	...	...	...	...	...	...
	Commerce and Housing																
	Financial institutions and insurance:																
33	Exemption of credit union income	1,020	1,090	1,160	1,240	1,320	1,410	1,510	6,640	...	...	...	...	...	...	...	...
34	Excess bad debt reserves of financial institutions	0	0	0	0	0	0	0	0	...	...	...	...	...	...	...	...
35	Exclusion of interest on life insurance savings	1,770	1,800	1,830	1,860	1,890	1,920	1,950	9,450	15,920	17,330	18,910	20,610	22,500	24,430	26,360	112,810
36	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50	...	...	...	...	...	...	...	...
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	210	220	240	250	270	280	290	1,330	...	...	...	...	...	...	...	...
38	Small life insurance company deduction	100	100	100	100	100	100	100	500	...	...	...	...	...	...	...	...
	Housing:																
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	210	220	230	230	240	250	260	1,210	660	740	820	910	970	1,020	1,100	4,820
40	Exclusion of interest on rental housing bonds	40	50	50	50	50	50	50	250	140	150	170	190	200	210	230	1,000
41	Deductibility of mortgage interest on owner-occupied homes	...	...	...	...	...	...	...	...	63,590	65,540	68,440	71,870	74,790	78,160	82,650	375,910
42	Deductibility of State and local property tax on owner-occupied homes	...	...	...	...	...	...	...	...	21,760	22,320	22,160	19,750	16,240	14,580	13,580	86,310

Table 6–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(In millions of dollars)

		Corporations								Individuals							
		2002	2003	2004	2005	2006	2007	2008	2004–2008	2002	2003	2004	2005	2006	2007	2008	2004–2008
43	Deferral of income from post 1987 installment sales	270	280	290	290	300	300	310	1,490	780	800	810	830	840	860	880	4,220
44	Capital gains exclusion on home sales	...	...	...	...	...	...	...	...	19,670	20,260	20,860	21,490	22,140	22,800	23,480	110,770
45	Exception from passive loss rules for $25,000 of rental loss	...	...	...	...	...	...	...	...	5,690	5,270	4,920	4,600	4,290	4,020	3,790	21,620
46	Credit for low-income housing investments	2,630	2,760	2,910	3,060	3,190	3,330	3,490	15,980	660	690	730	760	800	830	870	3,990
47	Accelerated depreciation on rental housing (normal tax method)	70	30	–20	–80	–160	–260	–330	–850	1,520	1,050	330	–440	–1,610	–3,050	–4,240	–9,010
	Commerce:																
48	Cancellation of indebtedness	...	...	...	...	...	...	...	...	0	10	30	50	60	60	50	250
49	Exceptions from imputed interest rules	...	...	...	...	...	...	...	...	50	50	50	50	50	50	50	250
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	...	...	...	...	...	...	...	...	56,060	55,010	53,930	54,550	49,870	49,760	51,450	259,560
51	Capital gains exclusion of small corporation stock	...	...	...	...	...	...	...	...	100	130	160	210	250	300	350	1,270
52	Step-up basis of capital gains at death	...	...	...	...	...	...	...	...	26,890	27,390	28,500	29,630	30,490	31,370	32,390	152,380
53	Carryover basis of capital gains on gifts	...	...	...	...	...	...	...	...	640	640	450	540	640	650	630	2,910
54	Ordinary income treatment of loss from small business corporation stock sale	...	...	...	...	...	...	...	...	40	40	50	50	50	50	50	250
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	–1,710	–2,250	–1,470	–5,280	–7,440	–9,980	–12,820	–36,990	–90	–280	–510	–1,240	–1,760	–2,380	–3,000	–8,890
56	Accelerated depreciation of machinery and equipment (normal tax method)	40,670	26,390	14,140	–33,390	–29,330	–26,960	–25,000	–100,540	7,100	4,720	2,530	–5,920	–5,930	–6,300	–6,570	–22,190
57	Expensing of certain small investments (normal tax method)	–140	–80	130	560	720	580	520	2,510	–220	–30	240	1,010	1,110	930	860	4,150
58	Amortization of start-up costs (normal tax method)	90	110	120	130	130	140	140	660	20	20	30	30	30	30	30	150
59	Graduated corporation income tax rate (normal tax method)	4,870	5,380	5,700	5,880	6,100	6,350	6,640	30,670	...	...	...	...	...	...	...	...
60	Exclusion of interest on small issue bonds	80	80	90	90	90	90	100	460	250	280	310	340	360	380	410	1,800
	Transportation																
61	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100	...	...	...	...	...	...	...	...
62	Exclusion of reimbursed employee parking expenses	...	...	...	...	...	...	...	...	2,070	2,180	2,290	2,410	2,540	2,680	2,810	12,730
63	Exclusion for employer-provided transit passes	...	...	...	...	...	...	...	...	250	320	380	450	530	600	670	2,630
	Community and Regional Development																
64	Investment credit for rehabilitation of structures (other than historic)	20	20	20	20	20	20	20	100	10	10	10	10	10	10	10	50
65	Exclusion of interest for airport, dock, and similar bonds	170	170	180	180	190	200	200	950	520	580	650	710	760	800	860	3,780
66	Exemption of certain mutuals' and cooperatives' income	60	60	60	70	70	70	70	340	...	...	...	...	...	...	...	...
67	Empowerment zones, Enterprise communities, and Renewal communities	220	300	300	320	350	390	420	1,780	510	830	870	960	1,060	1,190	1,330	5,410
68	New markets tax credit	20	50	70	110	150	210	220	760	70	140	220	320	460	620	650	2,270
69	Expensing of environmental remediation costs	70	70	20	–10	–10	–10	–10	–20	10	10	0	0	0	0	0	0
	Education, Training, Employment, and Social Services																
	Education:																
70	Exclusion of scholarship and fellowship income (normal tax method)	...	...	...	...	...	...	...	...	1,270	1,260	1,260	1,340	1,400	1,410	1,420	6,830
71	HOPE tax credit	...	...	...	...	...	...	...	...	4,110	3,520	2,880	2,930	2,730	2,900	2,790	14,230
72	Lifetime Learning tax credit	...	...	...	...	...	...	...	...	2,180	2,250	2,980	2,840	2,610	2,820	2,860	14,110
73	Education Individual Retirement Accounts	...	...	...	...	...	...	...	...	50	100	160	240	330	440	560	1,730
74	Deductibility of student-loan interest	...	...	...	...	...	...	...	...	450	640	660	680	700	720	720	3,480
75	Deduction for higher education expenses	...	...	...	...	...	...	...	...	420	2,230	2,880	3,620	2,940	0	0	9,440
76	State prepaid tuition plans	...	...	...	...	...	...	...	...	270	340	400	470	560	660	750	2,840
77	Exclusion of interest on student-loan bonds	60	60	60	60	70	70	70	330	180	200	230	250	270	280	300	1,330
78	Exclusion of interest on bonds for private nonprofit educational facilities	140	150	150	160	160	170	170	810	440	490	550	600	650	680	730	3,210
79	Credit for holders of zone academy bonds	50	80	90	100	100	100	100	490	...	...	...	...	...	...	...	...
80	Exclusion of interest on savings bonds redeemed to finance educational expenses	...	...	...	...	...	...	...	...	10	10	10	10	10	20	20	70
81	Parental personal exemption for students age 19 or over	...	...	...	...	...	...	...	...	2,480	3,310	3,230	2,690	2,020	1,670	1,470	11,080
82	Deductibility of charitable contributions (education)	720	700	710	830	820	810	810	3,980	3,300	3,440	3,640	3,810	4,000	4,160	4,420	20,030
83	Exclusion of employer-provided educational assistance	...	...	...	...	...	...	...	...	400	490	520	550	580	610	650	2,910
	Training, employment, and social services:																
84	Work opportunity tax credit	350	490	360	160	70	30	10	630	30	70	70	30	10	10	10	130
85	Welfare-to-work tax credit	70	60	70	50	30	20	10	180	10	10	10	10	10	0	0	30

Table 6–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(In millions of dollars)

		Corporations								Individuals							
		2002	2003	2004	2005	2006	2007	2008	2004–2008	2002	2003	2004	2005	2006	2007	2008	2004–2008
86	Employer provided child care exclusion	.....	.....	.....	.....	.....	.....	.....	.....	690	720	760	810	850	890	940	4,250
87	Employer-provided child care credit	.....	.....	.....	.....	.....	.....	.....	.....	40	90	130	140	150	160	170	750
88	Assistance for adopted foster children	.....	.....	.....	.....	.....	.....	.....	.....	220	250	290	330	380	430	480	1,910
89	Adoption credit and exclusion	.....	.....	.....	.....	.....	.....	.....	.....	140	220	450	500	540	560	570	2,620
90	Exclusion of employee meals and lodging (other than military)	.....	.....	.....	.....	.....	.....	.....	.....	740	780	810	850	890	930	970	4,450
91	Child credit [2]	.....	.....	.....	.....	.....	.....	.....	.....	22,170	21,440	21,310	22,480	24,280	23,940	23,660	115,670
92	Credit for child and dependent care expenses	.....	.....	.....	.....	.....	.....	.....	.....	2,750	2,910	3,230	2,860	2,380	2,190	2,050	12,710
93	Credit for disabled access expenditures	10	10	10	20	20	20	20	90	40	40	40	40	40	40	40	200
94	Deductibility of charitable contributions, other than education and health	890	870	880	1,040	1,010	1,010	1,010	4,950	29,970	31,230	33,110	34,670	36,350	37,770	40,150	182,050
95	Exclusion of certain foster care payments	.....	.....	.....	.....	.....	.....	.....	.....	450	430	430	440	450	460	470	2,250
96	Exclusion of parsonage allowances	.....	.....	.....	.....	.....	.....	.....	.....	350	380	400	420	450	480	510	2,260
	Health																
97	Exclusion of employer contributions for medical insurance premiums and medical care	.....	.....	.....	.....	.....	.....	.....	.....	99,060	108,500	120,160	132,240	144,710	157,180	170,230	724,520
98	Self-employed medical insurance premiums	.....	.....	.....	.....	.....	.....	.....	.....	1,760	2,500	3,690	3,940	4,220	4,520	4,980	21,350
99	Workers' compensation insurance premiums	.....	.....	.....	.....	.....	.....	.....	.....	5280	5770	6190	6630	7020	7490	8000	35,330
100	Medical Savings Accounts	.....	.....	.....	.....	.....	.....	.....	.....	20	30	30	30	30	30	20	140
101	Deductibility of medical expenses	.....	.....	.....	.....	.....	.....	.....	.....	5,710	6,060	6,340	6,490	6,610	6,980	7,380	33,800
102	Exclusion of interest on hospital construction bonds	290	300	310	320	330	340	350	1,650	910	1,020	1,130	1,240	1,330	1,400	1,500	6,600
103	Deductibility of charitable contributions (health)	870	850	860	1,010	990	980	980	4,820	3,370	3,510	3,720	3,890	4,080	4,240	4,510	20,440
104	Tax credit for orphan drug research	140	160	180	200	220	250	280	1,130	.....	.....	.....	.....	.....	.....	.....	.....
105	Special Blue Cross/Blue Shield deduction	300	340	310	300	270	300	250	1,430	.....	.....	.....	.....	.....	.....	.....	.....
106	Tax credit for health insurance purchased by certain displaced and retired individuals	.....	.....	.....	.....	.....	.....	.....	.....	0	0	60	30	40	50	60	240
	Income Security																
107	Exclusion of railroad retirement system benefits	.....	.....	.....	.....	.....	.....	.....	.....	390	400	400	400	400	400	400	2,000
108	Exclusion of workers' compensation benefits	.....	.....	.....	.....	.....	.....	.....	.....	5,750	6,100	6,460	6,850	7,270	7,710	8,190	36,480
109	Exclusion of public assistance benefits (normal tax method)	.....	.....	.....	.....	.....	.....	.....	.....	380	400	410	430	450	470	440	2,200
110	Exclusion of special benefits for disabled coal miners	.....	.....	.....	.....	.....	.....	.....	.....	70	60	60	50	50	50	40	250
111	Exclusion of military disability pensions	.....	.....	.....	.....	.....	.....	.....	.....	110	110	120	120	130	130	140	640
	Net exclusion of pension contributions and earnings:																
112	Employer plans	.....	.....	.....	.....	.....	.....	.....	.....	51,260	63,480	67,870	70,540	73,200	67,500	61,440	340,550
113	401(k) plans	.....	.....	.....	.....	.....	.....	.....	.....	50,830	52,920	55,290	57,830	61,490	65060	68030	307,700
114	Individual Retirement Accounts	.....	.....	.....	.....	.....	.....	.....	.....	19,080	20,840	23,130	22,400	22,380	20,540	19,800	108,250
115	Low and moderate income savers credit	.....	.....	.....	.....	.....	.....	.....	.....	850	2,050	1,860	1,670	1,510	850	0	5,890
116	Keogh plans	.....	.....	.....	.....	.....	.....	.....	.....	7,000	7,282	7,616	7,904	8,166	8,402	9,196	41,284
	Exclusion of other employee benefits:																
117	Premiums on group term life insurance	.....	.....	.....	.....	.....	.....	.....	.....	1,780	1,800	1,830	1,860	1,890	1,920	1,950	9,450
118	Premiums on accident and disability insurance	.....	.....	.....	.....	.....	.....	.....	.....	220	230	240	250	260	270	280	1,300
119	Small business retirement plan credit	.....	.....	.....	.....	.....	.....	.....	.....	10	20	40	50	50	60	60	260
120	Income of trusts to finance supplementary unemployment benefits	20	30	30	30	30	30	30	150								
121	Special ESOP rules	1330	1400	1470	1550	1640	1720	1810	8,190	300	310	320	340	350	370	390	1,770
122	Additional deduction for the blind	.....	.....	.....	.....	.....	.....	.....	.....	40	40	40	40	40	40	40	200
123	Additional deduction for the elderly	.....	.....	.....	.....	.....	.....	.....	.....	1,890	1,950	2,050	2,120	2,180	2,110	2,030	10,490
124	Tax credit for the elderly and disabled	.....	.....	.....	.....	.....	.....	.....	.....	20	20	20	20	10	10	10	70
125	Deductibility of casualty losses	.....	.....	.....	.....	.....	.....	.....	.....	280	400	420	440	460	500	540	2,360
126	Earned income tax credit [3]	.....	.....	.....	.....	.....	.....	.....	.....	4,450	4,930	5,090	5,280	5,410	5,580	5,790	27,150
	Social Security																
	Exclusion of social security benefits:																
127	Social Security benefits for retired workers	.....	.....	.....	.....	.....	.....	.....	.....	18,340	18,560	18,930	19,210	20,000	21,100	21,550	100,790
128	Social Security benefits for disabled	.....	.....	.....	.....	.....	.....	.....	.....	2,910	3,210	3,570	3,950	4,360	4,870	4,390	21,140
129	Social Security benefits for dependents and survivors	.....	.....	.....	.....	.....	.....	.....	.....	3,730	3,910	4,140	4,360	4,590	4,920	4,820	22,830
	Veterans Benefits and Services																
130	Exclusion of veterans death benefits and disability compensation	.....	.....	.....	.....	.....	.....	.....	.....	3,160	3,230	3,400	3,590	3,780	3,980	4,190	18,940
131	Exclusion of veterans pensions	.....	.....	.....	.....	.....	.....	.....	.....	70	80	80	90	90	90	100	450
132	Exclusion of GI bill benefits	.....	.....	.....	.....	.....	.....	.....	.....	90	90	90	100	100	110	110	510
133	Exclusion of interest on veterans housing bonds	10	10	10	10	10	10	10	50	30	30	40	40	40	50	50	220
	General Purpose Fiscal Assistance																
134	Exclusion of interest on public purpose State and local bonds	6,170	6,360	6,550	6,750	6,950	7,160	7,370	34,780	19,080	20,420	20,760	20,970	20,860	20,370	20,990	103,950
135	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	.....	47,430	50,520	50,910	47,770	40,480	37,190	36,080	212,430

Table 6–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(In millions of dollars)

		Corporations								Individuals							
		2002	2003	2004	2005	2006	2007	2008	2004–2008	2002	2003	2004	2005	2006	2007	2008	2004–2008
136	Tax credit for corporations receiving income from doing business in U.S. possessions	2,240	2,240	2,240	2,200	1,300	0	0	5,740	.....	.....	.....	.....	.....	.....	.....	.....
	Interest																
137	Deferral of interest on U.S. savings bonds	.....	.....	.....	.....	.....	.....	.....	.....	510	590	670	750	840	920	1,050	4,230
	Addendum: Aid to State and local governments:																
	Deductibility of:																
	Property taxes on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	.....	21,760	22,320	22,160	19,750	16,240	14,580	13,580	86,310
	Nonbusiness State and local taxes other than on owner-occupied homes	.....	.....	.....	.....	.....	.....	.....	.....	47,430	50,520	50,910	47,770	40,480	37,190	36,080	212,430
	Exclusion of interest on State and local bonds for:																
	Public purposes	6,170	6,360	6,550	6,750	6,950	7,160	7,370	34,780	19,080	20,420	20,760	20,970	20,860	20,370	20,990	103,950
	Energy facilities	30	30	30	30	30	30	30	150	80	90	100	110	110	120	130	570
	Water, sewage, and hazardous waste disposal facilities	110	110	120	120	120	130	130	620	340	370	420	460	490	520	550	2,440
	Small-issues	80	80	90	90	90	90	100	460	250	280	310	340	360	380	410	1,800
	Owner-occupied mortgage subsidies	210	220	230	230	240	250	260	1,210	660	740	820	910	970	1,020	1,100	4,820
	Rental housing	40	50	50	50	50	50	50	250	140	150	170	190	200	210	230	1,000
	Airports, docks, and similar facilities	170	170	180	180	190	200	200	950	520	580	650	710	760	800	860	3,780
	Student loans	60	60	60	60	70	70	70	330	180	200	230	250	270	280	300	1,330
	Private nonprofit educational facilities	140	150	150	160	160	170	170	810	440	490	550	600	650	680	730	3,210
	Hospital construction	290	300	310	320	330	340	350	1,650	910	1,020	1,130	1,240	1,330	1,400	1,500	6,600
	Veterans' housing	10	10	10	10	10	10	10	50	30	30	40	40	40	50	50	220
	Credit for holders of zone academy bonds	50	80	90	100	100	100	100	490	.....	.....	.....	.....	.....	.....	.....	.....

[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: 2002 $1,070; 2003 $1,140; 2004 $1,230; 2005 $1,320; 2006 $1,370; 2007 $1,400; and 2008 $1,430.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2002 $5,060; 2003 $5,870; 2004 $5,860; 2005 $5,700; 2006 $7,630; 2007 $7,630; and 2008 $7,500

[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2002 $27,830; 2003 $30,610; 2004 $31,380; 2005 $32,090; 2006 $33,450; 2007 $34,480; and 2008 $35,380.

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 $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Table 6–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2004–2008 PROJECTED REVENUE EFFECT

(In millions of dollars)

Provision	2004	2004–2008
Exclusion of employer contributions for medical insurance premiums and medical care	120,160	724,520
Deductibility of mortgage interest on owner-occupied homes	68,440	375,910
Net exclusion of pension contributions and earnings: Employer plans	67,870	340,550
Net exclusion of pension contributions and earnings: 401(k) plans	55,290	307,700
Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	53,930	259,560
Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	50,910	212,430
Deductibility of charitable contributions, other than education and health	33,990	187,000
Step-up basis of capital gains at death	28,500	152,380
Exclusion of interest on public purpose State and local bonds	27,310	138,730
Exclusion of interest on life insurance savings	20,740	122,260
Child credit	21,310	115,670
Capital gains exclusion on home sales	20,860	110,770
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	23,130	108,250
Social Security benefits for retired workers	18,930	100,790
Deductibility of State and local property tax on owner-occupied homes	22,160	86,310
Deferral of income from controlled foreign corporations (normal tax method)	7,900	44,990
Net exclusion of pension contributions and earnings: Keough Plans	7,616	41,284
Exclusion of workers' compensation benefits	6,460	36,480
Workers' compensation insurance premiums	6,190	35,330
Deductibility of medical expenses	6,340	33,800
Extraterritorial income exclusion	5,510	31,620
Graduated corporation income tax rate (normal tax method)	5,700	30,670
Earned income tax credit	5,090	27,150
Deductibility of charitable contributions (health)	4,580	25,260
Deductibility of charitable contributions (education)	4,350	24,010
Social Security benefits for dependents and survivors	4,140	22,830
Exception from passive loss rules for $25,000 of rental loss	4,920	21,620
Self-employed medical insurance premiums	3,690	21,350
Social Security benefits for disabled	3,570	21,140
Credit for low-income housing investments	3,640	19,970
Exclusion of veterans death benefits and disability compensation	3,400	18,940
Expensing of research and experimentation expenditures (normal tax method)	2,760	18,790
Exclusion of income earned abroad by U.S. citizens	2,680	14,280
HOPE tax credit	2,880	14,230
Lifetime Learning tax credit	2,980	14,110
Exclusion of reimbursed employee parking expenses	2,290	12,730
Credit for child and dependent care expenses	3,230	12,710
Exclusion of benefits and allowances to armed forces personnel	2,240	11,430
Parental personal exemption for students age 19 or over	3,230	11,080
Additional deduction for the elderly	2,050	10,490
Special ESOP rules	1,790	9,960
Credit for increasing research activities	4,990	9,830
Premiums on group term life insurance	1,830	9,450
Deduction for higher education expenses	2,880	9,440
Inventory property sales source rules exception	1,620	8,970
Exclusion of interest on hospital construction bonds	1,440	8,250
Deferred taxes for financial firms on certain income earned overseas	2,130	7,540
Empowerment zones, Enterprise communities, and Renewal communities	1,170	7,190
Exclusion of scholarship and fellowship income (normal tax method)	1,260	6,830
Expensing of certain small investments (normal tax method)	370	6,660
Exemption of credit union income	1,160	6,640
Capital gains treatment of certain income	1,120	6,240
Exclusion of interest on owner-occupied mortgage subsidy bonds	1,050	6,030
Low and moderate income savers credit	1,860	5,890
Tax credit for corporations receiving income from doing business in U.S. possessions	2,240	5,740
Deferral of income from post 1987 installment sales	1,100	5,710
Exclusion of interest for airport, dock, and similar bonds	830	4,730
Exclusion of certain allowances for Federal employees abroad	840	4,660
Exclusion of employee meals and lodging (other than military)	810	4,450
Employer provided child care exclusion	760	4,250
Exclusion of interest on bonds for private nonprofit educational facilities	700	4,020
Deferral of interest on U.S. savings bonds	670	4,230
Deductibility of student-loan interest	660	3,480
Excess of percentage over cost depletion, fuels	650	3,170
Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	540	3,060
New markets tax credit	290	3,030
Exclusion of employer-provided educational assistance	520	2,910
Carryover basis of capital gains on gifts	450	2,910
State prepaid tuition plans	400	2,840

Table 6–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2004–2008 PROJECTED REVENUE EFFECT—Continued

(In millions of dollars)

Provision	2004	2004–2008
Exclusion for employer-provided transit passes	380	2,630
Adoption credit and exclusion	450	2,620
Deductibility of casualty losses	420	2,360
Alternative fuel production credit	520	2,290
Exclusion of interest on small issue bonds	400	2,260
Exclusion of parsonage allowances	400	2,260
Exclusion of certain foster care payments	430	2,250
Exclusion of public assistance benefits (normal tax method)	410	2,200
Exclusion of railroad retirement system benefits	400	2,000
Expensing of multiperiod timber growing costs	380	1,980
Assistance for adopted foster children	290	1,910
Enhanced oil recovery credit	350	1,830
Education Individual Retirement Accounts	160	1,730
Exclusion of interest on student-loan bonds	290	1,660
Special Blue Cross/Blue Shield deduction	310	1,430
Excess of percentage over cost depletion, nonfuel minerals	270	1,430
New technology credit	250	1,330
Tax exemption of certain insurance companies owned by tax-exempt organizations	240	1,330
Premiums on accident and disability insurance	240	1,300
Capital gains exclusion of small corporation stock	160	1,270
Tax incentives for preservation of historic structures	230	1,260
Exclusion of interest on rental housing bonds	220	1,250
Tax credit for orphan drug research	180	1,130
Expensing of certain capital outlays	170	870
Amortization of start-up costs (normal tax method)	150	810
Work opportunity tax credit	430	760
Employer-provided child care credit	130	750
Exclusion of interest on energy facility bonds	130	720
Exclusion of military disability pensions	120	640
Capital gains treatment of royalties on coal	110	620
Capital gains treatment of certain timber income	110	620
Expensing of certain multiperiod production costs	120	600
Exclusion of GI bill benefits	90	510
Small life insurance company deduction	100	500
Credit for holders of zone academy bonds	90	490
Exclusion of veterans pensions	80	450
Income averaging for farmers	80	420
Exclusion from income of conservation subsidies provided by public utilities	80	400
Expensing of exploration and development costs, fuels	150	360
Exemption of certain mutuals' and cooperatives' income	60	340
Credit for disabled access expenditures	50	290
Exclusion of interest on veterans housing bonds	50	270
Small business retirement plan credit	40	260
Exclusion of special benefits for disabled coal miners	60	250
Exceptions from imputed interest rules	50	250
Ordinary income treatment of loss from small business corporation stock sale	50	250
Cancellation of indebtedness	30	250
Tax credit for health insurance purchased by certain displaced and retired individuals	60	240
Welfare-to-work tax credit	80	210
Additional deduction for the blind	40	200
Expensing of exploration and development costs, nonfuel minerals	30	170
Alcohol fuel credits 1/	30	150
Income of trusts to finance supplementary unemployment benefits	30	150
Investment credit for rehabilitation of structures (other than historic)	30	150
Medical Savings Accounts	30	140
Deferral of tax on shipping companies	20	100
Tax credit for the elderly and disabled	20	70
Exclusion of interest on savings bonds redeemed to finance educational expenses	10	70
Deferral of gain on sale of farm refiners	10	60
Exception from passive loss limitation for working interests in oil and gas properties	10	50
Treatment of loans forgiven for solvent farmers	10	50
Special alternative tax on small property and casualty insurance companies	10	50
Expensing of environmental remediation costs	20	–20
Tax credit and deduction for clean-fuel burning vehicles	70	–40
Accelerated depreciation on rental housing (normal tax method)	1,080	–4,570
Accelerated depreciation of buildings other than rental housing (normal tax method)	–2,530	–15,820
Accelerated depreciation of machinery and equipment (normal tax method)	31,110	–31,570

Table 6–4. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 2002

(In millions of dollars)

	Provision	Present Value of Revenue Loss
1	Deferral of income from controlled foreign corporations (normal tax method)	7,180
2	Deferred taxes for financial firms on income earned overseas	1,740
3	Expensing of research and experimentation expenditures (normal tax method)	1,800
4	Expensing of exploration and development costs—fuels	140
5	Expensing of exploration and development costs—nonfuels	10
6	Expensing of multiperiod timber growing costs	210
7	Expensing of certain multiperiod production costs—agriculture	240
8	Expensing of certain capital outlays—agriculture	270
9	Deferral of income on life insurance and annuity contracts	24,210
10	Expensing of certain small investments (normal tax method)	700
11	Amortization of start-up costs (normal tax method)	30
12	Deferral of tax on shipping companies	20
13	Credit for holders of zone academy bonds	120
14	Credit for low-income housing investments	3,580
15	Deferral for state prepaid tuition plans	590
16	Exclusion of pension contributions—employer plans	90,570
17	Exclusion of 401(k) contributions	81,000
18	Exclusion of IRA contributions and earnings	10,650
19	Exclusion of contributions and earnings for Keogh plans	9,290
20	Exclusion of interest on public-purpose bonds	23,560
21	Exclusion of interest on non-public purpose bonds	6,070
22	Deferral of interest on U.S. savings bonds	470

Outlay Equivalents

The concept of "outlay equivalents" is another theoretical measure of the budget effect of tax expenditures. It is the amount of budget outlays that would be required to provide the taxpayer the same after-tax income as would be received through the tax provision. The outlay-equivalent measure allows the cost of a tax expenditure to be compared with a direct Federal outlay on a more even footing. Outlay equivalents are reported in Table 6–5.

Table 6–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES

(In millions of dollars)

		Outlay Equivalents							
		2002	2003	2004	2005	2006	2007	2008	2004–2008
	National Defense								
1	Exclusion of benefits and allowances to armed forces personnel	2,540	2,570	2,600	2,620	2,650	2,680	2,710	13,260
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	3,810	3,470	3,530	3,640	3,700	3,880	4,100	18,850
3	Exclusion of certain allowances for Federal employees abroad	1,000	1,060	1,110	1,170	1,220	1,290	1,360	6,150
4	Extraterritorial income exclusion	7,410	7,920	8,480	9,060	9,680	10,350	11,080	48,650
5	Inventory property sales solurce rules exception	2,260	2,370	2,490	2,620	2,750	2,890	3,050	13,800
6	Deferral of income from controlled foreign corporations (normal tax method)	7,000	7,450	7,900	8,400	8,930	9,550	10,210	44,990
7	Deferred taxes for financial firms on certain income earned overseas	1,950	2,050	2,130	2,190	2,260	960	0	7,540
	General Science, Space, and Technology								
8	Expensing of research and experimentation expenditures (normal tax method)	1,660	2,200	2,760	3,390	3,990	4,270	4,380	18,790
9	Credit for increasing research activities	10,560	8,670	7,680	4,470	1,910	800	260	15,120
	Energy								
10	Expensing of exploration and development costs, fuels	170	180	150	80	60	50	40	380
11	Excess of percentage over cost depletion, fuels	850	930	810	790	840	850	850	4,140
12	Alternative fuel production credit	2,100	1,260	700	700	700	700	280	3,080
13	Exception from passive loss limitation for working interests in oil and gas properties	0							
14	Capital gains treatment of royalties on coal	130	140	150	160	170	170	180	830
15	Exclusion of interest on energy facility bonds	160	170	180	200	200	210	230	1,020
16	Enhanced oil recovery credit	540	560	570	590	600	620	630	3,010
17	New technology credit	140	240	330	350	360	360	370	1,770
18	Alcohol fuel credits [1]	30	30	30	30	30	30	30	150
19	Tax credit and deduction for clean-fuel burning vehicles	100	120	100	60	–10	–90	–100	–40
20	Exclusion from income of conservation subsidies provided by public utilities	100	110	110	110	110	100	100	530
	Natural Resources and Environment								

Table 6–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

		Outlay Equivalents							
		2002	2003	2004	2005	2006	2007	2008	2004–2008
21	Expensing of exploration and development costs, nonfuel minerals	40	40	40	40	50	50	50	230
22	Excess of percentage over cost depletion, nonfuel minerals	330	340	350	360	370	380	390	1,850
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	640	690	780	840	880	930	980	4,410
24	Capital gains treatment of certain timber income	130	140	150	160	170	170	180	830
25	Expensing of multiperiod timber growing costs	470	480	490	510	520	530	540	2,590
26	Tax incentives for preservation of historic structures	200	210	220	240	250	260	270	1,240
	Agriculture								
27	Expensing of certain capital outlays	220	230	210	210	210	210	230	1,070
28	Expensing of certain multiperiod production costs	160	160	150	150	140	140	140	720
29	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	1,350	1,420	1,500	1,580	1,660	1,750	1,840	8,330
31	Income averaging for farmers	90	90	100	100	100	100	110	510
32	Deferral of gain on sale of farm refiners	10	10	10	10	10	10	20	60
	Commerce and Housing								
	Financial institutions and insurance:								
33	Exemption of credit union income	1,300	1,380	1,480	1,580	1,690	1,800	1,920	8,470
34	Excess bad debt reserves of financial institutions	0	0	0	0	0	0	0	0
35	Exclusion of interest on life insurance savings	19,630	21,230	23,010	24,940	27,060	29,250	31,420	135,680
36	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	290	310	330	350	370	390	400	1,840
38	Small life insurance company deduction	120	120	120	120	120	120	120	600
	Housing:								
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	1,250	1,380	1,510	1,640	1,730	1,830	1,950	8,660
40	Exclusion of interest on rental housing bonds	260	290	320	350	360	370	400	1,800
41	Deductibility of mortgage interest on owner-occupied homes	63,590	65,540	68,440	71,870	74,790	78,160	82,650	375,910
42	Deductibility of State and local property tax on owner-occupied homes	21,760	22,320	22,160	19,750	16,240	14,580	13,580	86,310
43	Deferral of income from post 1987 installment sales	1,040	1,060	1,080	1,100	1,120	1,140	1,170	5,610
44	Capital gains exclusion on home sales	24,580	25,320	26,080	26,860	27,670	28,500	29,350	138,460
45	Exception from passive loss rules for $25,000 of rental loss	5,690	5,270	4,920	4,600	4,290	4,020	3,790	21,620
46	Credit for low-income housing investments	4,450	4,670	4,920	5,170	5,390	5,620	5,900	27,000
47	Accelerated depreciation on rental housing (normal tax method)	1,590	1,080	310	–510	–1,770	–3,310	–4,570	–9,860
	Commerce:								
48	Cancellation of indebtedness	0	10	30	50	60	60	50	250
49	Exceptions from imputed interest rules	50	50	50	50	50	50	50	250
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	74,750	73,350	71,910	72,730	66,490	66,340	68,590	346,060
51	Capital gains exclusion of small corporation stock	130	170	220	270	340	400	460	1,690
52	Step-up basis of capital gains at death	35,850	36,520	38,000	39,500	40,650	41,830	43,190	203,170
53	Carryover basis of capital gains on gifts	640	640	450	540	640	650	630	2,910
54	Ordinary income treatment of loss from small business corporation stock sale	50	50	60	60	60	60	60	300
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	–1,800	–2,530	–1,980	–6,520	–9,200	–12,360	–15,820	–45,880
56	Accelerated depreciation of machinery and equipment (normal tax method)	47,770	31,110	16,670	–39,310	–35,260	–33,260	–31,570	–122,730
57	Expensing of certain small investments (normal tax method)	–360	–110	370	1,570	1,830	1,510	1,380	6,660
58	Amortization of start-up costs (normal tax method)	110	130	150	160	160	170	170	810
59	Graduated corporation income tax rate (normal tax method)	7,490	8,280	8,770	9,040	9,380	9,770	10,210	47,170
60	Exclusion of interest on small issue bonds	470	520	570	610	640	670	730	3,220
	Transportation								
61	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
62	Exclusion of reimbursed employee parking expenses	2,710	2,860	3,020	3,190	3,360	3,550	3,730	16,850
63	Exclusion for employer-provided transit passes	310	400	480	560	660	750	840	3,290
	Community and Regional Development								
64	Investment credit for rehabilitation of structures (other than historic)	30	30	30	30	30	30	30	150
65	Exclusion of interest for airport, dock, and similar bonds	30	30	30	30	30	30	30	150
66	Exemption of certain mutuals' and cooperatives' income	60	60	60	70	70	70	70	340
67	Empowerment zones, Enterprise communities and Renewal communities	730	1,120	1,170	1,280	1,410	1,580	1,750	7,190
68	New markets tax credit	90	190	300	420	610	830	870	3,030
69	Expensing of environmental remediation costs	110	110	40	–20	–10	–10	–10	–10
	Education, Training, Employment, and Social Services								
	Education:								
70	Exclusion of scholarship and fellowship income (normal tax method)	1,390	1,390	1,380	1,480	1,540	1,550	1,560	7,510
71	HOPE tax credit	5,270	4,510	3,690	3,760	3,500	3,720	3,580	18,250
72	Lifetime Learning tax credit	2,790	2,880	3,820	3,640	3,340	3,610	3,660	18,070
73	Education Individual Retirement Accounts	60	120	190	280	390	520	660	2,040
74	Deductibility of student-loan interest	540	760	790	820	840	850	860	4,160
75	Deduction for higher education expenses	540	2,860	3,700	4,640	3,760	0	0	12,100
76	State prepaid tuition plans	270	340	400	470	560	660	750	2,840

Table 6–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

		Outlay Equivalents							
		2002	2003	2004	2005	2006	2007	2008	2004–2008
77	Exclusion of interest on student-loan bonds	340	370	410	440	490	510	530	2,380
78	Exclusion of interest on bonds for private nonprofit educational facilities	830	920	1,010	1,090	1,160	1,220	1,300	5,780
79	Credit for holders of zone academy bonds	70	110	130	140	150	150	150	720
80	Exclusion of interest on savings bonds redeemed to finance educational expenses	20	20	20	20	20	20	20	100
81	Parental personal exemption for students age 19 or over	2,750	3,670	3,570	2,980	2,240	1,850	1,630	12,270
82	Deductibility of charitable contributions (education)	5,670	5,830	6,130	6,560	6,800	7,000	7,380	33,870
83	Exclusion of employer-provided educational assistance	500	610	650	680	720	760	800	3,610
	Training, employment, and social services:.								
84	Work opportunity tax credit	380	560	430	190	80	40	20	760
85	Welfare-to-work tax credit	80	70	80	60	40	20	10	210
86	Exclusion of employer provided child care	920	960	1,010	1,080	1,130	1,190	1,250	5,660
87	Employer-provided child care	60	120	170	190	200	220	230	840
88	Assistance for adopted foster children	250	280	330	370	420	480	540	2,140
89	Adoption credit and exclusion	180	280	570	640	690	710	730	3,340
90	Exclusion of employee meals and lodging (other than military)	910	950	990	1030	1080	1130	1180	5,410
91	Child credit [2]	29,560	28,590	28,410	29,970	32,370	31,920	31,550	154,220
92	Credit for child and dependent care expenses	3,670	3,880	4,310	3,810	3,170	2,920	2,730	16,940
93	Credit for disabled access expenditures	60	70	70	70	80	80	80	380
94	Deductibility of charitable contributions, other than education and health	42,840	44,510	47,190	49,550	51,910	53,760	57,280	259,690
95	Exclusion of certain foster care payments	520	490	500	510	520	530	540	2,600
96	Exclusion of parsonage allowances	430	460	490	520	550	580	620	2,760
	Health								
97	Exclusion of employer contributions for medical insurance premiums and medical care	128,510	140,330	155,930	172,140	188,900	205,820	223,620	946,410
98	Self-employed medical insurance premiums	2,200	3,110	4,590	4,870	5,200	5,560	6,150	26,370
99	Workers' compensation insurance premiums	6,580	7,200	7,710	8,250	8,720	9,300	9,950	43,930
100	Medical Savings Accounts	30	30	40	40	40	40	30	190
101	Deductibility of medical expenses	6,210	6,600	6,910	7,050	7,160	7,560	7,990	36,670
102	Exclusion of interest on hospital construction bonds	1,720	1,900	2,070	2,240	2,390	2,500	2,660	11,860
103	Deductibility of charitable contributions (health)	5,990	6,160	6,470	6,940	7,180	7,380	7,770	35,740
104	Tax credit for orphan drug research	210	240	270	300	330	370	420	1,690
105	Special Blue Cross/Blue Shield deduction	400	450	410	400	360	400	330	1,900
106	Tax credit for health insurance purchased by certain displaced and retired individuals	0	0	70	40	50	60	70	290
	Income Security								
107	Exclusion of railroad retirement system benefits	390	400	400	400	400	400	400	2,000
108	Exclusion of workers' compensation benefits	5,750	6,100	6,460	6,850	7,270	7,710	8,190	36,480
109	Exclusion of public assistance benefits (normal tax method)	380	400	410	430	450	470	440	2,200
110	Exclusion of special benefits for disabled coal miners	70	60	60	50	50	50	40	250
111	Exclusion of military disability pensions	110	110	120	120	130	130	140	640
	Net exclusion of pension contributions and earnings:.								
112	Employer plans	63,280	77,890	82,770	86,020	89,270	82,320	74,930	415,310
113	401(k) plans	62,750	64,930	67,430	70,520	74,990	79,340	82,960	375,240
114	Individual Retirement Accounts	25,790	28,010	30,690	29,930	29,420	27,630	26,730	144,400
115	Low and moderate income savers credit	20	30	30	30	30	30	30	150
116	Keogh plans	8,943	9,272	9,661	9,976	10,259	10,521	11,516	51,933
	Exclusion of other employee benefits:.								
117	Premiums on group term life insurance	2360	2400	2440	2480	2520	2560	2610	12,610
118	Premiums on accident and disability insurance	290	310	320	330	350	360	370	1,730
119	Small business retirement plan credit	10	20	40	50	50	60	60	260
120	Income of trusts to finance supplementary unemployment benefits	20	30	30	30	30	30	30	150
121	Special ESOP rules	2,220	2,340	2,450	2,580	2,720	2,860	2,990	13,600
122	Additional deduction for the blind	40	50	50	50	50	50	50	250
123	Additional deduction for the elderly	2,290	2,360	2,480	2,570	2,630	2,550	2,460	12,690
124	Tax credit for the elderly and disabled	30	20	20	20	20	20	10	90
125	Deductibility of casualty losses	310	440	460	480	510	500	540	2,490
126	Earned income tax credit [3]	4,930	5,470	5,660	5,860	6,010	6,200	6,430	30,160
	Social Security								
	Exclusion of social security benefits:.								
127	Social Security benefits for retired workers	18,340	18,560	18,930	19,210	20,000	21,100	21,550	100,790
128	Social Security benefits for disabled	2,910	3,210	3,570	3,950	4,360	4,870	4,390	21,140
129	Social Security benefits for dependents and survivors	3,730	3,910	4,140	4,360	4,590	4,920	4,820	22,830
	Veterans Benefits and Services.								
130	Exclusion of veterans death benefits and disability compensation	3,160	3,230	3,400	3,590	3,780	3,980	4,190	18,940
131	Exclusion of veterans pensions	70	80	80	90	90	90	100	450
132	Exclusion of GI bill benefits	90	90	90	100	100	110	110	510
133	Exclusion of interest on veterans housing bonds	50	50	70	70	70	80	80	370

Table 6–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

		Outlay Equivalents							
		2002	2003	2004	2005	2006	2007	2008	2004–2008
	General Purpose Fiscal Assistance								
134	Exclusion of interest on public purpose State and local bonds	36,190	38,400	39,160	39,740	39,850	39,430	40,630	198,810
135	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	47,430	50,520	50,910	47,770	40,480	37,190	36,080	212,430
136	Tax credit for corporations receiving income from doing business in U.S. possessions	3,190	3,190	3,190	3,140	1,860	0	0	8,190
	Interest								
137	Deferral of interest on U.S. savings bonds	510	590	670	750	840	920	1,050	4,230
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	21,760	22,320	22,160	19,750	16,240	14,580	13,580	86,310
	Nonbusiness State and local taxes other than on owner-occupied homes	47,430	50,520	50,910	47,770	40,480	37,190	36,080	212,430
	Exclusion of interest on State and local bonds for:								
	Public purposes	36,190	38,400	39,160	39,740	39,850	39,430	40,630	198,810
	Energy facilities	160	170	180	200	200	210	230	1,020
	Water, sewage, and hazardous waste disposal facilities	640	690	780	840	880	930	980	4,410
	Small-issues	470	520	570	610	640	670	730	3,220
	Owner-occupied mortgage subsidies	1,250	1,380	1,510	1,640	1,730	1,830	1,950	8,660
	Rental housing	260	290	320	350	360	370	400	1,800
	Airports, docks, and similar facilities	30	30	30	30	30	30	30	150
	Student loans	340	370	410	440	490	510	530	2,380
	Private nonprofit educational facilities	830	920	1,010	1,090	1,160	1,220	1,300	5,780
	Hospital construction	1,720	1,900	2,070	2,240	2,390	2,500	2,660	11,860
	Veterans' housing	50	50	70	70	70	80	80	370
	Credit for holders of zone academy bonds	70	110	130	140	150	150	150	720

[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: 2002 $1,070; 2003 $1,140; 2004 $1,230; 2005 $1,320; 2006 $1,370; 2007 $1,400; and 2008 $1,430.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2001 $980; 2002 $5,060 2003 $5,870; 2004 $5,860; 2005 $5,700; 2006 $7,630; 2007 $7,630; and 2008 $7,500

[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2002 $27,830; 2003 $30,610; 2004 $31,380; 2005 $32,090; 2006 $33,450; 2007 $34,480; and 2008 $35,380.

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 $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Tax Expenditure Baselines

A tax expenditure is an exception to baseline provisions of the tax structure. The 1974 Congressional Budget Act, which mandated the tax expenditure budget, did not specify the baseline provisions of the tax law. As noted previously, deciding whether provisions are exceptions, therefore, is a matter of judgment. As in prior years, this year's tax expenditure estimates are presented using two baselines: the normal tax baseline and the reference tax law baseline.

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 it is closer to existing law. Tax expenditures under the reference law baseline are always tax expenditures under the normal tax baseline, but 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 only when it is 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. Imputed income would be taxed under a comprehensive income tax, and all income would be taxed as it accrued.
- 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. (This budget proposes to eliminate the double taxation of corporate income.)
- Values of assets and debt are not generally 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).

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

(1) *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.

(2) *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.[1] 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.[2]

(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 property is computed using estimates of economic depreciation. The latter represents a change in the calculation of the tax expenditure under normal law in the 2004 Budget. The Appendix provides further details on the new methodology and how it differs from the prior methodology.

(4) *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

The Government Performance and Results Act of 1993 (GPRA) directs Federal agencies to develop annual and strategic plans for their programs and activities. These plans set out performance objectives to be achieved over a specific time period. Most of these objectives will be achieved through direct expenditure programs. Tax expenditures, however, may also contribute to achieving these goals. The report of the Senate Governmental Affairs Committee on GPRA[3] calls on the Executive branch to undertake a series of analyses to assess the effect of specific tax expenditures on the achievement of agencies' performance objectives.

The Executive Branch is continuing to focus on the availability of data needed to assess the effects of the tax expenditures designed to increase savings. Treasury's Office of Tax Analysis and Statistics of Income Division (IRS) have developed a new sample of individual income tax filers as one part of this effort. This new "panel" sample will follow the same taxpayers over a period of at least ten years. The first year of this panel sample was drawn from tax returns filed in 2000 for tax year 1999. The sample will capture the changing demographic and economic circumstances of individuals and the effects of changes in tax law over an extended period of time. Data from the sample will therefore permit more extensive, and better, analyses of many tax provisions than can be performed using only annual ("cross-section") data. In particular, data from this panel sample will enhance our ability to analyze the effect of tax expenditures designed to increase savings. Other efforts by OMB, Treasury, and other agencies to improve data available for the analysis of tax expenditures will continue over the next several years.

Comparison of tax expenditure, spending, and regulatory policies. Tax expenditures by definition work through the tax system and, particularly, the in-

[1] Gross income does, however, include transfer payments associated with past employment, such as Social Security benefits.

[2] 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. In addition, costs of earning income may be limited under the alternative minimum tax.

[3] Committee on Government Affairs, United States Senate, "Government Performance and Results Act of 1993" (Report 103-58, 1993).

come 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.[4] 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 cases. In addition, some tax expenditures actually simplify the tax system, (for example, the exclusion for up to $500,000 of capital gains on home sales).

Tax expenditures also have important limitations. In many cases they add to the complexity of the tax system, which raises both administrative and compliance costs. For example, targeting personal exemptions and credits can complicate filing and decisionmaking. The income tax system may have little or no contact with persons who have no or very low incomes, and does not require information on certain characteristics of individuals used in some spending programs, such as wealth. Verifying eligibility criteria can be costly. The tax system also operates on the basis of annual income and it may be poorly targeted when taxpayer characteristics change within the course of a year. 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 activities to be addressed with specific resources in a way that is difficult to emulate with tax expenditures. Tax expenditures may not receive the same level of scrutiny afforded to other programs.

Outlay programs 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 tax return. Outlay programs may also receive more year-to-year oversight and fine tuning, through the legislative and executive budget process. In addition, many different 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—provide flexibility for policy design. On the other hand, 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 require resources to be raised via taxes, user charges, or government borrowing, which can impose further costs by diverting resources from their most efficient uses, but tax expenditures can have similar effects by requiring government to make up for lost revenue. Finally, spending programs, particularly on the discretionary side, may respond less readily to changing activity levels and economic conditions than tax expenditures.

Regulations have more direct and immediate effects than outlay and tax-expenditure programs because regulations apply directly and immediately to the regulated party (i.e., the intended actor)—generally in the private sector. Regulations can also be fine-tuned more quickly than tax expenditures, because they can generally be changed by the executive branch without legislation. Like tax expenditures, regulations often rely largely 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. This reliance can diminish their economic efficiency, although this feature can also promote full compliance where (as in certain safety-related cases) policymakers believe that trade-offs with economic considerations are not of paramount importance. Also, regulations generally do not directly affect Federal outlays or receipts. Thus, like tax expenditures, they may escape the type of scrutiny that outlay programs receive. However, most regulations are subjected to a formal benefit-cost analysis that goes well beyond the analysis required for outlays and tax-expenditures. To some extent, the GPRA requirement for performance evaluation will address this lack of formal analysis.

Some policy objectives are achieved using multiple approaches. For example, minimum wage legislation, the earned income tax credit, and the food stamp program are regulatory, tax expenditure, and direct outlay programs, respectively, all having the objective of improving the economic welfare of low-wage workers.

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., the exclusion for up to $500,000 of capital gains on home sales); 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, accelerated depreciation may encourage investment. 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 revenue effect. Outputs are quantitative or qualitative measures

[4] Although this section focuses upon tax expenditures under the income tax, tax expenditures also arise under the unified transfer, payroll, and excise tax systems. Such provisions can be useful when they relate to the base of those taxes, such as an excise tax exemption for certain types of consumption deemed meritorious.

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). Effects on the incomes of members of particular groups 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 provisions. In addition, such assessments can raise significant challenges in economic modeling.

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 goals such as tax neutrality. These include the exclusion for income earned abroad by nongovernmental employees and exclusions for income of U.S.-controlled foreign corporations. Measuring the effectiveness of these provisions raises challenging issues.

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 (e.g., research spending, exploration activity, equipment) might 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 size of tax expenditures. Measures could also indicate the 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. The mortgage interest deduction on personal residences is reported as a tax expenditure because the value of owner-occupied housing services is not included in a taxpayer's taxable income. Taxpayers also may exclude up to $500,000 of the capital gains from the sale of personal residences. Measures of the effectiveness of these provisions could include their effects on increasing the extent of home ownership and the quality of housing.. Similarly, analysis of the extent of accumulated inflationary gains is likely to be relevant to evaluation of the capital gains 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 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 grants 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 pooling of risks. 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. A potentially negative outcome of this tax expenditure is that the subsidy may lead to excessive health care spending for these who are covered.

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). 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 value of benefits funded at the firm level to individuals.

Other provisions principally affect the incomes of members of certain groups, rather than affecting incentives. 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 earned-income tax credit, in contrast, should be evaluated for its effects on labor force participation as well as the income it provides lower-income workers.

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, although broad, is nevertheless incomplete, omitting important details 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. As indicated above, over the next few years the Executive Branch's focus will be on the availability of the data needed to assess the effects of the tax expenditures designed to increase savings.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported upon in this chapter follow. These descriptions relate to current law as of December 31, 2002, and do not reflect proposals made elsewhere in the Budget.

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.***—U.S. citizens who lived abroad, worked in the private sector, and satisfied a foreign residency requirement in 2002 may exclude up to $80,000 in foreign earned income from U.S. taxes.

In addition, if these taxpayers receive a specific allowance for foreign housing from their employers, they may also exclude the value of that allowance. If they do not receive a specific allowance for housing expenses, they may deduct against their U.S. taxes that portion of such expenses that exceeds one-sixth the salary of a civil servant at grade GS-14, step 1 ($67,765 in 2002).

3. ***Exclusion of certain allowances for Federal employees abroad.***—U.S. Federal civilian employees and Peace Corps members who work outside the continental United States are allowed to exclude from U.S. taxable income certain special allowances they receive to compensate them for the relatively high costs associated with living overseas. The allowances supplement wage income and cover expenses like rent, education, and the cost of travel to and from the United States.

4. ***Extraterritorial income exclusion*[5].**—For purposes of calculating U.S. tax liability, a taxpayer may exclude from gross income the qualifying foreign trade income attributable to foreign trading gross receipts. The exclusion generally applies to income from the sale or lease of qualifying foreign trade property and certain types of services income. The FSC Repeal and Extraterritorial Income Exclusion Act of 2000 created the extraterritorial income exclusion to replace the foreign sales corporation provisions, which the Act repealed. The exclusion is generally available for transactions entered into after September 30, 2000.

5. ***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.

6. ***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 considered to be 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.

7. ***Exceptions under subpart F for active financing income.***—Financial firms can defer taxes on income earned overseas in an active business. Taxes on income earned through December 31, 2006 can be deferred.

[5] The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of "income" that is larger in scope than is "income" as defined under general U.S. income tax principles. For that reason, the tax expenditure estimates include, for example, estimates related to the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation.

General Science, Space, and Technology

8. ***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.

9. ***R&E credit.***—The research and experimentation (R&E) 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" by the average amount of the company's gross receipts for the prior four years. The taxpayer's fixed base percentage generally is the ratio of its research expenses to gross receipts for 1984 through 1988. Taxpayers may also elect an alternative credit regime. Under the alternative credit regime the taxpayer is assigned a three-tiered fixed-base percentage that is lower than the fixed-base percentage that would otherwise apply, and the credit rate is reduced (the rates range from 2.65 percent to 3.75 percent). A 20-percent credit with a separate threshold is provided for a taxpayer's payments to universities for basic research. The credit applies to research conducted before July 1, 2004 and extends to research conducted in Puerto Rico and the U.S. possessions.

Energy

10. ***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.

11. ***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.

12. ***Alternative fuel production credit.***—A nontaxable credit of $3 per oil-equivalent barrel of production (in 1979 dollars) 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.

13. ***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.

14. ***Capital gains treatment of royalties on coal.***—Sales of certain coal under royalty contracts can be treated as capital gains rather than ordinary income.

15. ***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.

16. ***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.

17. ***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, biomass, and poultry waste facilities. The renewable resources credit applies only to electricity produced by a facility placed in service on or before December 31, 2004.

18. ***Alcohol fuel credits.***—An income tax credit is provided for ethanol that is derived from renewable sources and used as fuel. The credit equals 53 cents per gallon in 2001 and 2002; 52 cents per gallon in 2003 and 2004; and 51 cents per gallon in 2005, 2006, and 2007. To the extent that ethanol is mixed with taxable motor fuel to create gasohol, taxpayers may claim an exemption of the Federal excise tax rather than the income tax credit. In addition, small ethanol producers are eligible for a separate 10 cents per gallon credit.

19. ***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 2004 through 2007,.

20. ***Exclusion of utility conservation subsidies.***—Non-business customers can exclude from gross income subsidies received from public utilities for expenditures on energy conservation measures.

Natural Resources and Environment

21. ***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.

22. ***Percentage depletion.***—Most nonfuel mineral extractors may use percentage depletion rather than cost depletion, with percentage depletion rates ranging from 22 percent for sulfur to 5 percent for sand and gravel.

23. ***Sewage, water, solid and hazardous waste facility 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 a capital gain 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. ***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

27. ***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.

28. ***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.

29. ***Loans forgiven solvent farmers.***—Farmers are forgiven the tax liability on certain forgiven debt. Normally, a 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 reduces carryover losses, then unused credits, and then basis; any remainder of the forgiven debt is excluded from tax. Farmers with forgiven debt are considered insolvent for tax purposes, and thus qualify for income tax forgiveness.

30. ***Capital gains treatment of certain income.***—Certain agricultural income, such as unharvested crops, can be treated as capital gains rather than ordinary income.

31. ***Income averaging for farmers.***—Taxpayers can lower their tax liability by averaging, over the prior three-year period, their taxable income from farming.

32. ***Deferral of gain on sales of farm refiners.***—A taxpayer who sells stock in a farm refiner to a farmers' cooperative can defer recognition of gain if the taxpayer reinvests the proceeds in qualified replacement property.

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 $2.1 million 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 these and other private activity is limited. The combined volume cap for private activity bonds, including mortgage housing bonds, rental housing bonds, student loan bonds, and industrial development bonds is $62.50 per capita ($187.5 million minimum) per State in 2001, and $75 per capita ($225 million minimum) in 2002. The Community Renewal Tax Relief Act of 2000 accelerated the scheduled increase in the state volume cap and indexed the cap for inflation, beginning in 2003. States may issue mortgage credit certificates (MCCs) in lieu of mortgage revenue 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 value of owner-occupied housing services is not included in a taxpayer's taxable income. The Appendix provides an alternative calculation of the tax expenditure based on the implicit rental income on owner-occupied housing, which is generally viewed as a more accurate measure of the tax expenditure relative to a comprehensive income tax base.

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 who 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 million is, therefore, a tax expenditure.

44. ***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 may not be used more than once every two years.

45. ***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.

46. ***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. State agencies determine who receives the credit; States are limited in the amount of credit they may authorize annually. The Community Renewal Tax Relief Act of 2000 increased the per-resident limit to $1.50 in 2001 and to $1.75 in 2002 and indexed the limit for inflation, beginning in 2003. The Act also created a $2 million minimum annual cap for small States beginning in 2002; the cap is indexed for inflation, beginning in 2003.

47. ***Accelerated depreciation of rental property.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under the reference method. Under the normal tax method, however, economic depreciation is assumed. This calculation is described in more detail in the Appendix.

48. ***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.

49. ***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. 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.

50. ***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 most assets held for more than 1 year, the top capital gains tax rate is 20 percent. For assets acquired after December 31, 2000, the top capital gains tax rate for assets held for more than 5 years is 18 percent. On January 1, 2001, taxpayers were permitted to mark-to-market existing assets to start the 5-year holding period. Losses from the mark-to-market are not recognized. For assets held for more than 1 year by taxpayers in the 15–percent ordinary tax bracket, the top capital gains tax rate is 10 percent. After December 31, 2000, the top capital gains tax rate for assets held by these taxpayers for more than 5 years is 8 percent.

51. ***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.

52. ***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. After repeal of the estate tax under EGTRRA for 2010, the basis for property acquired from a decedent will be the lesser of fair market value or the decedent's basis. Certain types of additions to basis will be allowed so that assets in most estates that are not currently subject to estate tax will not be subject to capital gains tax in the hands of the heirs.

53. ***Carryover basis of capital gains on gifts.***—When a gift is made, the donor's basis in the transferred property (the cost that was incurred when the transferred property was first acquired) carries-over to the donee. The carryover of the donor's basis allows a continued deferral of unrealized capital gains. Even though the estate tax is repealed for 2010 under EGTRRA, the gift tax is retained with a lifetime exemption of $1 million.

54. ***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.

55. ***Accelerated depreciation of non-rental-housing buildings.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under reference law. Under normal law, however, economic depreciation is assumed. This calculation is described in more detail in the Appendix.

56. ***Accelerated depreciation of machinery and equipment.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under reference law. Under the normal tax baseline, this tax depreciation allowance is measured relative to economic depreciation. This calculation is described in more detail in the Appendix.

57. ***Expensing of certain small investments.***—In 2002, qualifying investments in tangible property up to $24,000 can be expensed rather than depreciated over time. The expensing limit increases to $25,000 in 2003. To the extent that qualifying investment during the year exceeds $200,000, the amount eligible for expensing is decreased. In 2002, the amount expensed is completely phased out when qualifying investments exceed $224,000.

58. ***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.

59. ***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 $75,000. 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.

60. ***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

61. ***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.

62. ***Exclusion of employee parking expenses.***—Employee parking expenses that are paid for by the employer or that are received in lieu of wages are excludable from the income of the employee. In 2002, the maximum amount of the parking exclusion is $185 (indexed) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

63. ***Exclusion of employee transit pass expenses.***—Transit passes, tokens, fare cards, and vanpool expenses paid for by an employer or provided in lieu of wages to defray an employee's commuting costs are excludable from the employee's income. In 2002, the maximum amount of the exclusion is $100 (indexed) per month.

Community and Regional Development

64. ***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.

65. ***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.

66. ***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.

67. ***Empowerment zones, enterprise communities, and renewal 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, accelerated depreciation, and certain capital gains incentives. The Job Creation and Worker Assistance Act of 2002 expanded the existing provisions by adding the "New York City Liberty Zone." In addition, certain first-time buyers of a principal residence in the District of Columbia can receive a tax credit on homes purchased on or before December 31, 2003, and investors in certain D.C. property can receive a capital gains break. The Community Renewal Tax Relief Act of 2000 created the renewal communities tax benefits, which begin on January 1, 2002 and expire on December 31, 2009. The Act also created additional empowerment zones, increased the tax benefits for empowerment zones, and extended the expiration date of (1) empowerment zones from December 31, 2004 to December 31, 2009, and (2) the D.C. home-buyer credit from December 31, 2001 to December 31, 2003.

68. ***New markets tax credit.***—Taxpayers who invest in a community development entity (CDE) after December 31, 2000 are eligible for a tax credit. The total equity investment available for the credit across all CDEs is $1.0 billion in 2001, $1.5 billion in 2002 and 2003, $2.0 billion in 2004 and 2005, and $3.5 billion in 2006 and 2007. The amount of the credit equals (1) 5 percent in the year of purchase and the following 2 years, and (2) 6 percent in the following 4 years. A CDE is any domestic firm whose primary mission is to serve or provide investment capital for low-income communities/individuals; a CDE must be accountable to residents of low-income communities. The Community Renewal Tax Relief Act of 2000 created the new markets tax credit.

69. ***Expensing of environmental remediation costs.***—Taxpayers who clean up certain hazardous substances at a qualified site may 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 on or before December 31, 2003. The Community Renewal Tax Relief Act of 2000 extended the expiration date from December 31, 2001 to December 31, 2003. The Act also expanded the number of qualified sites.

Education, Training, Employment, and Social Services

70. ***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).

71. ***HOPE tax credit.***—The non-refundable HOPE tax credit 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. In 2002, the credit is phased out ratably for taxpayers with modified AGI between $82,000 and $102,000 ($41,000 and $51,000 for singles) (indexed beginning in 2002).

72. ***Lifetime Learning tax credit.***—The non-refundable Lifetime Learning tax credit allows a credit for 20 percent of an eligible student's tuition and fees. For tuition and fees paid before January 1, 2003, 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 $82,000 and $102,000 ($41,000 and $51,000 for singles) (indexed beginning in 2002). The credit applies to both undergraduate and graduate students.

73. ***Deduction for Higher Education Expenses.***—The tax code provides a new above-the-line deduction for qualified higher education expenses. The maximum annual deduction is $3,000 beginning in 2002 for taxpayers with adjusted gross income up to $130,000 on a joint return ($65,000 for singles). The maximum deduction increases to $4,000 in 2004. Taxpayers with adjusted gross income up to $160,000 on a joint return ($80,000 for singles) may deduct up to $2,000 beginning in 2004. No deduction is allowed for expenses paid after December 31, 2005.

74. ***Education Individual Retirement Accounts.***—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 is $2,000 and the phase-out range for joint filers is $190,000 through $220,000 of modified AGI, double the range of singles. Elementary and secondary school expenses may also be paid tax-free from such accounts.

75. ***Student-loan interest.***—Taxpayers may claim an above-the-line deduction of up to $2,500 on interest paid on an education loan. Interest may only be deducted for the first five years in which interest payments are required.

76. ***State prepaid tuition plans.***—Some States have adopted prepaid tuition plans and prepaid room and board plans, which allow persons to pay in advance for college expenses for designated beneficiaries. Beginning in 2002, investment income is not taxed when earned, and is tax-exempt when withdrawn to pay for qualified 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.

79. ***Credit for holders of zone academy bonds.***—Financial institutions that own zone academy bonds receive a non-refundable tax credit (at a rate set by the Treasury Department) rather than interest. The credit is included in gross income. Proceeds from zone academy bonds may only be used to renovate, but not construct, qualifying schools and for certain other school purposes. The total amount of zone academy bonds that may be issued is limited to $1.6 billion—$400 million in each year from 1998 to 2003.

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 $86,400 and $116,400 ($57,600 and $72,600 for singles) in 2002.

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. ***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.

83. ***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.

84. ***Work opportunity tax credit.***—Employers can claim a tax credit for qualified wages paid to individuals who begin work on or before December 31, 2004 and who are certified as members of various targeted groups. The amount of the credit that can be claimed is 25 percent for employment of less than 400 hours and 40 percent for employment of 400 hours or more. The maximum credit per employee is $2,400 and can only be claimed on the first year of wages an individual earns from an employer. Employers must reduce their deduction for wages paid by the amount of the credit claimed.

85. ***Welfare-to-work tax credit.***—An employer is eligible for a 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 on or before December 31, 2004.

86. ***Employer-provided child care exclusion.***—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.

87. ***Employer-provided child care credit.***—Employers can deduct expenses for supporting child care or child care resource and referral services. A tax credit to employers for qualified expenses began in 2002. The credit is equal to 25 percent of qualified expenses for employee child care and 10 percent of qualified expenses for child care resource and referral services. Employer deductions for such expenses are reduced by the amount of the credit. The maximum total credit is limited to $150,000 per taxable year.

88. ***Assistance for adopted foster children.***—Taxpayers who adopt eligible children from the public foster care system can receive monthly payments for the children's significant and varied needs and a reimbursement of up to $2,000 for nonrecurring adoption expenses. These payments are excluded from gross income.

89. ***Adoption credit and exclusion.***—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) for 2001. The credit is phased-out ratably for taxpayers with modified AGI between $150,000 and $190,000 in 2002. EGTRRA increased the maximum credit for non-special needs children to $10,000, set a flat credit amount of $10,000 for special needs children, and increased the start point of the phase-out to $150,000 beginning in 2002. The credit amounts and the phase-out thresholds are indexed for inflation beginning in 2003. Unused credits may be carried forward and used during the five subsequent years. Taxpayers may also exclude qualified adoption expenses from income, subject to the same maximum amounts and phase-out as the credit. The same expenses cannot qualify for tax benefits under both programs; however, a taxpayer may use the benefits of the exclusion and the tax credit for different expenses. Stepchild adoptions are not eligible for either benefit. Both the credit and the exclusion were made permanent by EGTRRA.

90. ***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.

91. ***Child credit.***—Taxpayers with children under age 17 can qualify for a $600 refundable per child credit. The maximum credit is increased to $700 in 2005,

$800 in 2009, and $1,000 in 2010. 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).

92. ***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 single parents and by divorced or separated parents who have custody of children. Expenditures up to a maximum $2,400 for one dependent and $4,800 for two or more dependents are eligible for the credit. EGTRRA increased the maximum expenditure limit to $3,000 for one dependent and $6,000 for two or more dependents beginning in 2003. The credit is equal to 30 percent of qualified expenditures (35 percent beginning in 2003) for taxpayers with incomes of $10,000 or less ($15,000 or less beginning in 2003). The credit is reduced to a minimum of 20 percent by one percentage point for each $2,000 of income in excess of $10,000 ($15,000 beginning in 2003).

93. ***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.

94. ***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.

95. ***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.

96. ***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

97. ***Employer-paid medical insurance and expenses.***—Employer-paid health insurance premiums and other medical expenses (including long-term care) are deducted as a business expense by employers, but they are not included in employee gross income. The self-employed also may deduct part of their family health insurance premiums.

98. ***Self-employed medical insurance premiums.***—Self-employed taxpayers may deduct a percentage of their family health insurance premiums. Taxpayers without self-employment income are not eligible for the special percentage deduction. The deductible percentage is 60 percent in 2001, 70 percent in 2002, and 100 percent in 2003 and thereafter.

99. ***Workers compensation insurance premiums.***—Workers compensation insurance premiums are paid by employers and deducted as a business expense, but the premiums are not included in employee gross income.

100. ***Medical savings accounts.***—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, 2003.

101. ***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.

102. ***Hospital construction bonds.***—Interest earned on State and local government debt issued to finance hospital construction is excluded from income subject to tax.

103. ***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.

104. ***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.

105. ***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.

106. ***Tax credit for health insurance purchased by ceratin displaced and retired individuals.***—The Trade Act of 2002 provided a refundable tax credit of 65 percent for the purchase of health insurance covergae by individuals eligible for Trade Adjustment Assitance and certain PBGC pension recipients.

Income Security

107. ***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.

108. ***Workers' compensation benefits.***—Workers compensation provides payments to disabled workers. These benefits, although income to the recipients, are not subject to the income tax.

109. ***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.

110. ***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.

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

112. ***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.

113. ***401(k) plans.***—Individual taxpayers can make tax-preferred contributions to certain types of employer-provided 401(k) plans (and 401(k)-type plans like 403(b) plans and the Federal government's Thrift Savings Plan). In 2001, an employee could exclude up to $10,500 (indexed) of wages from AGI under a qualified arrangement with an employer's 401(k) plan. EGTRRA increases the exclusion amount to $11,000 in 2002, $12,000 in 2003, $13,000 in 2004, $14,000 in 2005 and $15,000 in 2006 (indexed thereafter). The tax on the investment income earned by 401(k)-type plans is deferred until withdrawn.

EGTRRA also allows employees to make after-tax contributions to 401(k) and 401(k)-type plans beginning in 2002. These contributions are not excluded from AGI, but the investment income of such after-tax contributions is not taxed when earned or withdrawn.

114. ***Individual Retirement Accounts.***—Individual taxpayers can take advantage of several different Individual Retirement Accounts (IRAs): deductible IRAs, non-deductible IRAs, and Roth IRAs. Employees can make annual contributions to an IRA up to $3,000 (or 100 percent of compensation, if less). The annual contributions limit applies to the total of a taxpayer's deductible, non-deductible, and Roth IRAs contributions. The IRA contribution limit increases to $4,000 in 2005, and $5,000 in 2008 (indexed thereafter) and allows taxpayers over age 50 to make additional "catch-up" contributions of $1,000 (by 2006).

Taxpayers whose AGI is below $54,000 ($34,000 for non-joint filers) in 2002 can claim a deduction for IRA contributions. In 2002, the IRA deduction is phased out for taxpayers with AGI between $54,000 and $64,000 ($34,000 and $44,000 for non-joint). The phase-out range increases annually until it reaches $80,000 to $100,000 in 2007 ($50,000 to $60,000 in 2005 for non-joint filers). Taxpayers whose AGI is above the phase-out range can also claim a deduction for their IRA contributions depending on whether they (or their spouse) are an active participant in an employer-provided retirement plan. The tax on the investment income earned by 401(k) plans, non-deductible IRAs, and deductible IRAs is deferred until the money is withdrawn.

Taxpayers with incomes below $150,000 ($95,000 for nonjoint filers) can make contributions to Roth IRAs. 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). Investment income of a Roth IRA is not taxed when earned nor when withdrawn. Withdrawals from a Roth IRA are penalty 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.

Taxpayers can contribute to a non-deductible IRA regardless of their income and whether they are an active participant in an employer-provided retirement plan. The tax on investment income earned by non-deductible IRAs is deferred until the money is withdrawn.

115. ***Low and moderate income savers' credit.***—EGTRRA provides an additional incentive for lower-income taxpayers to save through a nonrefundable credit of up to 50 percent on IRA contributions. This credit is in addition to any deduction or exclusion. The credit is completely phased out by $50,000 for joint filers and $25,000 for single filers. This temporary credit is in effect from 2002 through 2006.

116. ***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 $40,000 in 2002. The tax on the investment income earned by Keogh plans is deferred until withdrawn.

117. ***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.

118. ***Small business retirement plan credit.***—Businesses with 100 or fewer employees may receive a credit for 50 percent of the qualified startup costs associated with a new qualified retirement plan. The credit is limited to $500 annually and may only be claimed for expenses incurred during the first three years from the start of the qualified plan. Qualified startup expenses include expenses related to the establishment and administration of the plan, and the retirement-related education of employees.

119. ***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.

120. ***Employer-provided supplementary unemployment benefits.***—Employers may establish trusts to pay supplemental unemployment benefits to employees separated from employment. Interest payments to such trusts are exempt from taxation.

121. ***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 corporations 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.

122. ***Additional deduction for the blind.***—Taxpayers who are blind may take an additional $1,150 standard deduction if single, or $900 if married in 2002.

123. ***Additional deduction for the elderly.***—Taxpayers who are 65 years or older may take an additional $1,150 standard deduction if single, or $900 if married in 2002.

124. ***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.

125. ***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.

126. ***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 $7,370 of earned income in 2002. The credit is 40 percent of the first $10,350 of income for a family with two or more qualifying children. The credit is phased out beginning when the taxpayer's income exceeds $13,520 at the rate of 15.98 percent (21.06 percent if two or more qualifying children are present). It is completely phased out when the taxpayer's modified adjusted gross income reaches $29,201 ($33,178 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 2002, the credit is 7.65 percent of the first $4,910 of earned income. When the taxpayer's income exceeds $6,150, the credit is phased out at the rate of 7.65 percent. It is completely phased out at $11,060 of modified adjusted gross income.

For workers with or without children, the income levels at which the credit begins to phase-out and the maximum amounts of income on which the credit can be taken are adjusted for inflation. For married taxpayers filing a joint return, EGTRRA increases the base amount for the phase-out by $1,000 in 2002 through 2004, $2,000 in 2005 through 2007, and $3,000 in 2008 (indexed thereafter).

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

127. ***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.

128. ***Social Security benefits for the disabled.***—Benefit payments from the Social Security Trust Fund, for disability and for dependents and survivors, are partially excluded from a beneficiary's gross incomes.

129. ***Social Security benefits for dependents and survivors.***—Benefit payments from the Social Security

Trust Fund for dependents and survivors are partially excluded from a beneficiary's gross income.

Veterans Benefits and Services

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

131. ***Veterans pension payments.***—Pension payments made by the Veterans Administration are excluded from gross income.

132. ***G.I. Bill benefits.***—G.I. Bill benefits paid by the Veterans Administration are excluded from gross income.

133. ***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

134. ***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), equipment acquisition, and other public purposes is tax-exempt. Interest on bonds issued by Indian tribal governments for essential governmental purposes is also tax-exempt.

135. ***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.

136. ***Business income earned in U.S. possessions.***—U.S. corporations operating in a U.S. possession (e.g., Puerto Rico) can claim a credit against some or all of their U.S. tax liability on possession business income. The credit expires December 31, 2005.

Interest

137. ***U.S. savings bonds.***—Taxpayers may defer paying tax on interest earned on U.S. savings bonds until the bonds are redeemed.

Appendix:
TREASURY REVIEW OF THE TAX EXPENDITURE PRESENTATION

This appendix provides an initial presentation of the Treasury Department review of the tax expenditure budget first described in the 2003 Budget. As previously described, the review focuses in particular on three issues: (1) using comprehensive income as a baseline tax system, (2) using a consumption tax as a baseline tax system, and (3) defining negative tax expenditures (provisions that cause taxpayers to pay too much tax).

The first section of this appendix compares major tax expenditures in the current budget to those implied by a comprehensive income baseline. This comparison includes a discussion of negative tax expenditures. The second section compares the major tax expenditures in the current budget to those implied by a consumption tax baseline, and also discusses negative tax expenditures. The final section addresses concerns that have been raised over the measurement of some current tax expenditures by describing a new estimate of the tax expenditure caused by accelerated depreciation and an alternative estimate of the tax expenditure resulting from the tax exemption of the return earned on owner-occupied housing. The final section also provides an estimate of the negative tax expenditure caused by the double tax on corporate profits.

DIFFERENCES BETWEEN OFFICIAL TAX EXPENDITURES AND THOSE BASED ON COMPREHENSIVE INCOME

As discussed in the main body of this chapter, traditional tax expenditures are measured relative to normal law or reference law baselines that deviate from a comprehensive concept of income. Consequently, tax expenditures identified in the budget can differ from those that would be identified if comprehensive income were chosen as the baseline tax system. This appendix addresses this issue by comparing major tax expenditures listed in the current tax expenditure budget with those implied by a comprehensive income baseline. Most large tax expenditures would continue to be tax expenditures were the baseline taken to be comprehensive income, although some would not. A comprehensive income baseline would also result in a number of additional tax provisions being counted as tax expenditures.

Current budgetary practice excludes from the list of official tax expenditures those provisions that over-tax certain items of income. This exclusion conforms to the view that tax expenditures are substitutes for direct government spending programs. However, it gives a one-sided picture of the ways in which current law deviates from the baseline tax system. Relative to a comprehensive income baseline, a number of current tax provisions would be negative tax expenditures. Some of these might also be negative tax expenditures under the reference law or normal law baselines, expanded to admit negative tax expenditures.

Treatment of Major Tax Expenditures From the Current Budget Under a Comprehensive Income Baseline

Comprehensive income, also called Haig-Simons income, is the real, inflation adjusted, accretion to one's economic power arising between two points in time, e.g., the beginning and ending of the year. It includes all accretions to wealth, whether or not realized, whether or not related to a market transaction, and whether a return to capital or labor. Inflation adjusted capital gains would be included in comprehensive income as they accrue. Business, investment, and casualty losses, including losses caused by depreciation, would be deducted. Implicit returns, such as those accruing to homeowners, also would be included in comprehensive income. While comprehensive income can be defined on the sources side of the consumer's balance sheet, it sometimes is instructive to use the identity between the sources of wealth and the uses of wealth to redefine it as the sum of consumption during the period plus the change in net worth between the beginning and the end of the period.

Comprehensive income is widely held to be the idealized base for an income tax even though it is not a perfectly defined concept.[6] It suffers from conceptual ambiguities, some of which are discussed below, as well as practical problems in measurement and tax administration, e.g., how to implement a practicable deduction for economic depreciation or include in income the return earned on housing or consumer durable goods, including automobiles and major appliances.

Furthermore, comprehensive income represents an ideal tax base only in the tautological sense that the base of an income tax is, or should be, income. Comprehensive income does not necessarily represent the economically most desirable tax base; efficiency or equity might be improved by deviating from comprehensive income as a tax base, e.g., by reducing the taxation of capital income in order to spur economic growth or by subsidizing certain types of activities in order to correct for market failures or to improve the after-tax distribution of income. In addition, some elements of comprehensive income would be difficult or impossible to include in a tax system that is administrable.

Table 1 shows the thirty largest tax expenditures from the 2004 Budget classified according to whether they would be considered a tax expenditure under a comprehensive income tax. Thirteen of the thirty items would be tax expenditures under a comprehensive tax base (those in panel A).[7] Most of these give preferential tax treatment to the return on certain types of savings or investment. They are a result of the explicitly hybrid nature of the existing tax system, and arise out of policy decisions that reflect discomfort with the high tax rate on capital income that would otherwise arise under the current structure of the income tax, especially in consideration of the potential for capital income to be subject to two layers of tax given the absence of integration between the corporate and individual income tax systems.

Panel B deals with items that potentially are tax expenditures, but that raise more difficult conceptual issues or raise inconsistencies. The first of these is the deduction of nonbusiness State and local taxes other than on owner-occupied homes. These taxes include both income taxes and property taxes. The stated justification for this tax expenditure is that "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."[8] The idea is that these taxes represent consumption expenditures, and so are elements of income.

In contrast to the view in the budget, the deduction for State and local taxes might not be a tax expenditure if the baseline were comprehensive income. Properly measured comprehensive income would include the imputed value of State and local government benefits received, but would allow a deduction for State and local taxes paid.[9] Thus, in this sense the deductibility of State and local taxes is consistent with comprehensive income principles; it should not be a tax expenditure. However, imputing the value of State and local services may be difficult and, as a rough correction, the tax system might disallow the deduction for State and local taxes.[10] So, if the value of services from State and local governments is excluded from the tax base, as it generally is under current law, a deduction for taxes might be viewed as a tax expenditure relative to a comprehensive income baseline.[11]

Step-up of basis at death lowers the income tax on capital gains for those who inherit assets below what it would be otherwise. From that perspective it would be a tax expenditure under a comprehensive income baseline. Nonetheless, there are ambiguities. Under a comprehensive income baseline, all gains would be taxed as accrued, so there would be no deferred unrealized gains on assets held at death.

The lack of full taxation of Social Security retirement benefits also is listed in panel B. To the extent that Social Security is viewed as a pension, a comprehensive income tax would include in income all contributions to Social Security retirement funds (payroll taxes) and tax accretions to value as they arise (inside build-up).[12] Benefits paid out of prior contributions and the inside

[6] See, e.g., David F. Bradford, *Untangling the Income Tax* (Cambridge, MA: Harvard University Press, 1986), pp. 15–31, and Richard Goode, "The Economic Definition of Income" in Joseph Pechman, ed., *Comprehensive Income Taxation* (Washington, D.C.: The Brookings Institution, 1977), pp. 1–29.

[7] Not all of the items are properly specified and measured if the intent is to compare current law with a comprehensive income tax. Nonetheless, they all deal with items whose treatment differs fundamentally from that required by a comprehensive income tax.

[8] *Fiscal Year 2003 Budget of the United States Government, Analytical Perspectives* (Washington, D.C.: U.S. Government Printing Office, 2002) p. 127

[9] U.S. Treasury, Blueprints for Basic Tax Reform (Washington, D.C.: U.S. Government Printing Office, 1977) p. 92.

[10] Home mortgage interest and property taxes on owner-occupied housing raise the same ambiguity. Classifying them as probably not tax expenditures arguably is inconsistent. It reflects the judgment that no comprehensive tax is likely to tax the value of State and local services, while it appears somewhat easier to impute and tax the rental income from owner-occupied housing.

[11] Under the normal tax method employed by the Joint Committee on Taxation, the value of some public assistance benefits provided by state governments is included as a tax expenditure, thereby raising a potential double counting issue.

[12] As a practical matter, this may be impossible to do. Valuing claims subject to future contingencies is very difficult, as discussed in Bradford, *Untangling the Income Tax,* pp. 23–24.

build-up, however, would not be included in the tax base because the fall in the value of the individual's Social Security account would be offset by an increase in cash. In contrast, to the extent that Social Security is viewed as a transfer program, all contributions should be deductible from the income tax base and all benefits received should be included in the income tax base.

In contrast to either of these treatments, current law excludes one-half of contributions (employer-paid payroll taxes) from the base of the income tax, makes no attempt to tax accretions, and subjects some, but not all, benefits to taxation. The difference between the current law treatment of Social Security retirement benefits and their treatment under a comprehensive income tax would qualify as a tax expenditure, but such a tax expenditure differs in concept from that included in the current budget.

The tax expenditures in the current budget[13] reflect exemptions for lower income beneficiaries from the tax on 85 percent of Social Security benefits.[14] Historically, payroll taxes paid by the employee represented no more than 15 percent of the expected value of the benefits received by a lower-earnings Social Security beneficiary. The 85 percent inclusion rate is therefore intended to tax the remaining amount of the benefit payment arising from the payroll tax contributions made by employers and the implicit return on the employee and employer contributions. Thus, the tax expenditure conceived and measured in the current budget is not intended to capture the deviation from a comprehensive income baseline, which would additionally account for the deferral of tax on these components (less an inflation adjustment attributable to the employee's payroll tax contributions). Rather, it is intended to approximate the taxation of private pensions with employee contributions made from after-tax income,[15] on the assumption that Social Security is comparable to such pensions. Hence, the official tax expenditure understates the tax advantage accorded Social Security benefits relative to a comprehensive income baseline.

To the extent that the personal and dependent care exemptions and the standard deduction properly remove from taxable income all expenditures that do not yield consumption value, then the child care credit and the earned income tax credit would be tax expenditures. In contrast, a competing perspective views these credits as appropriate modifications that account for differing taxpaying capacity. Since comprehensive income is equal to the sum of consumption and one's change in wealth, expenditures on items that are viewed as not yielding consumption value reduce income, and, hence taxpaying capacity under this interpretation.

The tax expenditures related to workers' compensation benefits raise double counting issues. The official tax expenditure list counts as a tax expenditure both the failure to tax premiums and the failure to tax benefits. This is inappropriate treatment if the baseline is comprehensive income. Under comprehensive income tax principles, if the taxpayer were to buy the insurance himself, he would be able to deduct the premium (since it represents a reduction in net-worth) but should include the benefit when paid (since it represents an increase in net-worth).[16] If the employer paid the premium, the proper treatment would allow the employer a deduction and allow the employee to disregard the premium, but he would take the proceeds, if any, into income. Equivalently, the employee could be required to take the premium into income and ignore the proceeds, on the argument that the premium has the same expected value as the proceeds of the policy, as explained in *Blueprints.*[17] But in no circumstances should the employee be taxed on both the premium and the proceeds. One of the two current tax expenditures would be eliminated if the baseline were comprehensive income.[18]

The next category (panel C) includes items whose treatment under a comprehensive income tax is widely acknowledged to be ambiguous.[19] Consider, for example, the items relating to charitable contributions. Under existing law, charitable contributions are deductible, and this deduction is considered on its face a tax expenditure in the current budget.[20]

The treatment of charitable donations, however, is ambiguous under a comprehensive income tax. If charitable contributions are a consumption item for the giver, then they are properly included in his taxable income; a deduction for contributions would then be a tax expenditure relative to a comprehensive income tax baseline. In contrast, charitable contributions could represent a transfer of purchasing power from the giver to the receiver. As such, they would represent a reduction in the giver's net worth, not an item of consumption, and so properly would be deductible, implying that current law's treatment is not a tax expenditure. At the same time, the value of the charitable benefits received is income to the recipient. Under current law, such income generally is not taxed, and so represents a tax expenditure whose size might be approximated by the size of the donor's contribution.[21]

[13] This includes both the tax expenditure for benefits paid to workers and that for benefits paid to survivors and dependents.

[14] The current budget does not include as a tax expenditure the absence of income taxation on the employer's contributions (payroll taxes) to Social Security retirement at the time these contributions are made.

[15] Private pensions allow the employee to defer tax on all inside build-up. They also allow the employee to defer tax on contributions made by the employer, but not on contributions made directly by the employee. Applying these tax rules to Social Security would require the employee to include in his taxable income benefits paid out of inside build-up and out of the employer's contributions, but would allow the employee to exclude from his taxable income benefits paid out of his own contributions.

[16] Suppose he buys the unemployment insurance policy at the beginning of the year. He exchanges one asset, cash, for another, the policy, so there is no change in net worth. But, at the end of the year, the policy expires and so is worthless, hence he has a reduction in net worth equal to the amount he paid for the policy, which of course is the premium. If the policy pays off (i.e., a work related injury prevents his employment), then he would include the proceeds in his income because they represent an increase in net worth.

[17] U.S. Treasury, *Blueprints for Basic Tax Reform,* pp. 59–61.

[18] This might also be double counting under the normal and reference law baselines.

[19] See, for example, Goode, *The Economic Definition of Income,* pp. 16–17, and Bradford, *Untangling the Income Tax,* pp. 19–21, and pp.30–31.

[20] The item also includes gifts of appreciated property, at least part of which represents a tax expenditure relative to an ideal income tax, even if one assumes that charitable donations are not consumption.

[21] If recipients tend to be in lower tax brackets, then the tax expenditure is smaller than when measured at the donor's tax rates.

Medical expenditures may or may not be an element of income (or consumption), depending on one's point of view. Some argue that medical expenditures don't represent discretionary spending, and so are not consumption. Instead, they are a reduction of net worth and should be excluded from the tax base. Others argue that there is no way to logically distinguish medical care from other consumption items. Moreover, clearly there is choice in health care decisions, e.g., whether to go to the best doctor, whether to have voluntary surgical procedures, and whether to exercise and eat nutritiously so as to improve and maintain one's health and minimize medical expenditures.

The final category (panel D) includes items that probably are not tax expenditures under a comprehensive income tax base. But even these raise some issues. Mortgage interest would be deductible from the base of a comprehensive income tax, because comprehensive income would include implicit rental income on owner-occupied housing. Similarly, property taxes on owner-occupied housing would be deductible, since they represent a reduction in net worth.[22] One could argue, however, that because current law fails to impute rental income, the home mortgage interest deduction and the deduction for property taxes constitute tax expenditures. Alternatively, they might be viewed as proxies for the correct tax expenditure. They are, however, extremely crude proxies for the implicit rental income earned on owner-occupied housing. The interest deduction proxy, for example, ignores implicit rental income earned on a house that is unencumbered by any mortgage.

A comprehensive income tax would assign all income tax liability to individuals. There would be no separate corporation income tax. Hence, the issue of graduated corporate tax rates would not come up.[23] Under some views, graduated individual income tax rates might result in a tax expenditure or in a negative tax expenditure, depending on the decision regarding the general tax rate.

A tax based on comprehensive income would allow all losses to be deducted. Hence, the exception from the passive loss rules would not be a tax expenditure.[24]

Major Tax Expenditures Under a Comprehensive Income Tax That Are Excluded from the Current Budget

While most of the major tax expenditures in the current budget also would be tax expenditures under a comprehensive income base, there also are tax expenditures relative to a comprehensive income base that are not found on the existing tax expenditure list. These additional tax expenditures include the imputed return from consumer durables and owner-occupied housing, the difference between capital gains as they accrue and capital gains as they are realized, private gifts and inheritances received, in-kind benefits from such government programs as food-stamps, Medicaid, and public housing, the value of payouts from insurance policies,[25] and benefits received from private charities. Under some ideas of comprehensive income, the value of leisure and of household production of goods and services also would be included as tax expenditures. The personal exemption and standard deduction also might be considered tax expenditures, although they can be viewed differently, e.g., as elements of the basic tax rate schedule or as necessary expenditures that are not items of voluntary consumption. The foreign tax credit also might be a tax expenditure, since it could be argued that a deduction for foreign taxes, rather than a credit, would seem to measure the income of U.S. residents properly.

Negative Tax Expenditures

Under current budgetary practice, negative tax expenditures, tax provisions that raise rather than lower taxes, are excluded from the official tax expenditure list. This exclusion conforms with the view that tax expenditures are defined to be similar to government spending programs.

If attention is expanded to include any deviation from the baseline tax system, negative tax expenditures would be of interest. Relative to a comprehensive income baseline, there are a number of important negative tax expenditures, some of which also might be viewed as negative tax expenditures under an expanded interpretation of the normal or reference law baseline. Among the more important negative tax expenditures is the corporation income tax, which would be eliminated under a comprehensive income tax applied to individuals as discussed later in the Appendix. The passive loss rules, restrictions on the deductibility of capital losses, and NOL carry-forward requirements each would generate a negative tax expenditure, since a comprehensive income tax would allow full deductibility of losses. If human capital were considered an asset, then its cost (e.g., certain education and training expenses, including perhaps the cost of college and professional school) should be amortizable, but it is not under current law.[26] Some restricted deductions under the individual AMT might be negative tax expenditures as might the phase-out of personal exemptions and of itemized deductions. The inability to deduct consumer interest also might be a negative tax expenditure, as an interest deduction may be required to properly measure income, as seen by the equivalence between borrowing and reduced lending.[27]

Current tax law fails to index for inflation interest receipts, capital gains, depreciation, and inventories. These provisions are negative tax expenditures because

[22] Of course, the value of government services would be included in net income.

[23] As discussed below, the double tax on corporate profits would be a major negative tax expenditure.

[24] In contrast, the passive loss rules themselves, which restrict the deduction of losses, would be a negative tax expenditure when compared to a comprehensive tax base.

[25] To the extent that premiums are deductible.

[26] Current law offers favorable treatment to some education costs, thereby creating (positive) tax expenditures. Current law allows expensing of that part of the cost of education and career training that is related to foregone earnings and this would be a tax expenditure under a comprehensive income baseline. In addition, some education has consumption value, and under a comprehensive income definition would be taxable to that extent, but is not taxable under current law.

[27] See Bradford, *Untangling the Income Tax,* p. 41.

comprehensive income would be indexed for inflation. Current law, however, also fails to index for inflation the deduction for interest payments; this represents a (positive) tax expenditure.

The issue of indexing highlights that even if one wished to focus only on tax policies that are similar to spending programs, accounting for some negative tax expenditures may be required. For example, the net subsidy created by accelerated depreciation is properly measured by the difference between depreciation allowances specified under existing tax law and economic depreciation, which is indexed for inflation.[28]

Tax Expenditures and the Tax Rate Structure

Under some views, the graduated personal income tax rate structure might result in a tax expenditure or in a negative tax expenditure. To the extent that one views a single tax rate as most compatible with a comprehensive income base, tax rates above the appropriate single rate would yield a negative tax expenditure. To the extent that one views a graduated tax rate structure as most desirable, then differences between the appropriate graduated tax rate structure and the actual tax rate structure would lead to tax expenditures or negative tax expenditures.

DIFFERENCES BETWEEN OFFICIAL TAX EXPENDITURES AND TAX EXPENDITURES RELATIVE TO A CONSUMPTION BASE

This section compares tax expenditures listed in the official tax expenditure budget with those implied by a comprehensive consumption baseline. It first discusses some of the difficulties encountered in trying to compare current tax provisions to those that would be observed under a comprehensive consumption tax. Next, it discusses which of the thirty largest official tax expenditures would be tax expenditures under the consumption baseline, concluding that about one-half of the top thirty official tax expenditures would remain tax expenditures under a consumption baseline. Most of those that fall off the list are tax incentives for saving and investment.

The section next discusses some major differences between current law and a comprehensive consumption baseline that are excluded from the current list of tax expenditures. These differences include the consumption value of owner-occupied housing and other consumer durables, benefits from in-kind government transfers, and gifts. It concludes with a discussion of negative tax expenditures relative to a consumption baseline

Ambiguities in Determining Tax Expenditures Relative to a Consumption Baseline

A broad-based consumption tax is a combination of an income tax plus a deduction for net saving. This follows from the definition of comprehensive income as consumption plus the change in net worth. It therefore seems straightforward to say that current law's deviations from a consumption base are the sum of (a) tax expenditures on an income base associated with exemptions and deductions for certain types of income, plus (b) overpayments of tax, or negative tax expenditures, to the extent net saving is not deductible from the tax base. In reality, however, the situation is more complicated. A number of issues arise, some of which also are problems in defining a comprehensive income tax, but seem more severe, or at least more obvious, for the consumption tax baseline.

It is not always clear how to treat certain items under a consumption tax. One problem is determining whether a particular expenditure is an item of consumption. Spending on medical care and charitable donations are two examples. Another problem is related to foreign source income. It is sometimes argued that a credit for foreign income taxes is inappropriate against the base of a consumption tax. Does that mean that the current foreign tax credit is a tax expenditure for a consumption tax base? The classification below includes medical spending and charitable contributions in the definition of consumption, but also considers an alternative view. It makes no judgment about the treatment of foreign taxes, but provides a brief discussion of the issue.

There may be more than one way to treat various items under a consumption tax. For example, a consumption tax might ignore borrowing and lending by excluding from the borrower's tax base the proceeds from loans, denying the borrower a deduction for payments of interest and principal, and excluding interest and principal payments received from the lender's tax base. On the other hand, a consumption tax might include borrowing and lending in the tax base by requiring the borrower to add the proceeds from loans in his tax base, allowing the lender to deduct loans from his tax base, allowing the borrower to deduct payments of principal and interest, and requiring the lender to include receipt of principal and interest payments. In present value terms, the two approaches are equivalent for both the borrower and the lender; in particular both allow the tax base to measure consumption and both impose a zero effective tax rate on interest income. But which approach is taken obviously has different implications (at least on an annual flow basis) for the treatment of many important items of income and expense, such as the home mortgage interest deduction. The classification below suggests that the deduction for home mortgage interest probably should be a tax expenditure, but takes note of alternative views.

[28] Accelerated depreciation can be described as the equivalent of an interest free loan from the government to the taxpayer. Under federal budget accounting principles, such a loan would be treated as an outlay equal to the present value of the foregone interest.

Some exclusions of income are equivalent in many respects to consumption tax treatment that immediately deducts the cost of an investment while taxing the future cash-flow. For example, exempting investment income is equivalent to consumption tax treatment as far as the normal rate of return on new investment is concerned. This is because expensing generates a tax reduction that offsets in present value terms the tax paid on the investment's future normal returns. Expensing gives the income from a marginal investment a zero effective tax rate. However, a yield exemption approach differs from a consumption tax as far as the distribution of income and government revenue is concerned. Pure profits in excess of the normal rate of return would be taxed under a consumption tax, because they are an element of cash-flow, but would not be taxed under a yield exemption tax system. Should exemption of certain kinds of investment income, and certain investment tax credits, be regarded as the equivalent of consumption tax treatment? The classification that follows generally takes a broad view of this equivalence and considers tax provisions that reduce or eliminate the tax on capital income to be consistent with a broad-based consumption tax.

Looking at provisions one at a time can be misleading. The hybrid character of the existing tax system leads to many provisions that might make good sense in the context of a consumption tax, but that generate inefficiencies because of the problem of the "uneven playing field" when evaluated within the context of the existing tax rules. It is not clear how these should be classified. For example, many saving incentives are targeted to specific tax-favored sources of capital income, and so potentially distort economic choices in ways that would not occur under a broad-based consumption tax. As another example, under a consumption value added tax (VAT) based on the destination principle, there would be a rebate of the VAT on exports and a tax on imports. Does this mean that the extraterritorial income exclusion (the successor of the Foreign Sales Corporation provision) is not a tax expenditure? Resolution comes down to judgments about how broad is broad enough to be considered general, or whether it even matters at all that a provision is targeted in some way. The classification that follows generally views savings incentives, even if targeted, as consistent with a broad based consumption tax.

Capital gains would not be a part of a comprehensive consumption tax base. Proceeds from asset sales and sometimes borrowing would be part of the cash-flow tax base, but, for transactions between domestic investors at a flat tax rate, would cancel out in the economy as a whole. How should existing tax expenditures related to capital gains be classified? The classification below generally views available capital gains tax breaks as consistent with a broad-based consumption tax because they lower the tax rate on capital income toward the zero rate that is consistent with a consumption-based tax. By implication, this also means that capital gains taxes paid under a broad-based consumption tax are negative tax expenditures.

Such considerations suggest that trying to compute the current tax's deviations from "the" base of a consumption tax is impossible because deviations cannot be uniquely determined, making it very difficult to do a consistent accounting of the differences between the current tax base and a consumption tax base. Nonetheless, Table 2 attempts a classification based on the criteria outlined above.

Treatment of Major Tax Expenditures Under a Comprehensive Consumption Baseline

As noted above, the major difference between a comprehensive consumption tax and a comprehensive income tax is in the treatment of saving, or in the taxation of capital income. Consequently, many current tax expenditures related to preferential taxation of capital income would not be tax expenditures under a consumption tax. However, preferential treatment of items of income unrelated to fairly broad-based saving incentives would remain tax expenditures under a consumption baseline.

Table 2 shows the thirty largest tax expenditures from the 2004 Budget classified according to whether they would be considered a tax expenditure under a consumption tax. Four of the thirty items clearly would be tax expenditures (those in panel A).

The official tax expenditures for Social Security benefits reflects exceptions for low income taxpayers from the general rule that 85 percent of Social Security benefits are included in the recipient's tax base. The 85 percent inclusion is intended as a simplified mechanism for taxing Social Security benefits as if the Social Security program were a private pension with employee contributions made from after-tax income. Under these tax rules, income earned on contributions made by both employers and employees benefits from tax deferral, but employer contributions also benefit because the employee may exclude them from his taxable income, while the employee's own contributions are included in his taxable income. These tax rules give the equivalent of consumption tax treatment, a zero effective tax rate on the return, to the extent that the original pension contributions are made by the employer, but give less generous treatment to the extent that the original contributions are made by the employee. Income earned on employee contributions is taxed at a low, but positive, effective tax rate. Based on historical calculations, the 85 percent inclusion reflects roughly the outcome of applying these tax rules to a lower-income earner when one-half of the contributions are from the employer and one-half from the employee.

The current tax expenditure measures a tax benefit relative to a baseline that is somewhere between a comprehensive income tax and a consumption tax. The properly measured tax expenditure relative to a consumption tax baseline would include only those Social Security benefits that are accorded treatment more favorable than that implied by a consumption tax, which

would correspond to including 50 percent of Social Security benefits in the recipient's tax base.

Exclusion of workers' compensation benefits allows an exclusion from income that is unrelated to investment, and so should be included in the base of a comprehensive consumption tax.

The credit for increasing research activities gives a negative effective tax rate because the cost of investment in research can be deducted immediately. As discussed above, expensing reduces to zero the effective tax rate on the income from an investment. Giving a tax credit on top of expensing leads to a negative effective tax rate; it gives better than consumption tax treatment to the income earned by the qualifying investment. A tax subsidy for research might be justified to the extent that the full social return from an investment is not captured by the investor, because, e.g., others can freely learn from the results of the research. Nonetheless, such a subsidy is inconsistent with a broad-based consumption tax.

An additional twelve items (panel B) probably would be tax expenditures under a consumption base. Each of these twelve, however, comes with some ambiguity. Several of these items relate to the costs of medical care or to charitable contributions. As discussed in the previous section of the appendix, there is disagreement within the tax policy community over the extent to which medical care and charitable giving represent consumption items. While widely held to be consumption, a competing view is that they represent reductions in net worth that should be excluded from the tax base because they do not yield direct satisfaction to taxpayer who makes the expenditure.

There also is the issue of how to tax employer-provided medical insurance. Under current law, employees do not have to include insurance premiums paid for by employers in their income. The self-employed also may exclude (via a deduction) medical insurance premiums from their taxable income. Assume first that medical spending is consumption. From some perspectives, these premiums should be in the tax base because they appear to represent consumption. Yet an alternative perspective would support excluding the premium from tax as long as the consumption tax base included the value of any medical services paid for by the insurance policy, because the premium equals the expected value of insurance benefits received. But even from this alternative perspective, the official tax expenditure might continue to be a tax expenditure under a consumption tax baseline because current law excludes the value of medical services paid with insurance benefits from the employee's taxable income.

If medical spending is not consumption, one approach to measuring the consumption base would ignore insurance, but allow the consumer to deduct the value of all medical services obtained. An alternative approach would allow a deduction for the premium but include the value of any insurance benefits received, while continuing to allow a deduction for the value of all medical services obtained. In either case, the official tax expenditure for the exclusion of employer provided medical insurance and expenses would not be a tax expenditure relative to a consumption tax baseline.

Ambiguity also surrounds the deductibility of home mortgage interest. A consumption tax seeks to tax the consumption value of housing services consumed no matter how the house is financed. From this perspective, home mortgage interest should not be deductible. However, what governs the proper treatment of interest under a consumption tax is whether financial flows are in or out of the consumption tax base. A result equivalent to disallowing the interest deduction would require that the loan be taken into income and would permit the associated interest and principal payments to be deducted. If the loans are taken into income (as they would be under some types of consumption taxes), then the associated interest and principal payments should be deductible, otherwise not. Without specifying how financial flows are treated, it is unclear how to treat the home mortgage interest deduction. Nonetheless, given that loans are not taken into income under current law, and this treatment's equivalency to disallowing the interest deduction, classifying the deduction of home mortgage interest as a tax expenditure might be reasonable.

Ambiguities arise about the proper treatment of State and local taxes, as they do under an income tax. These taxes are not of themselves consumption items, but might serve as proxies for the value of government services consumed.

The child credit and the earned income tax credit can be viewed as social welfare programs unrelated to measuring and taxing consumption. As such, they would be tax expenditures relative to a consumption baseline. Yet, from another perspective, these credits look similar to a personal or dependent deduction that many would see as appropriate under a broad-based consumption tax.

The extraterritorial income exclusion replaces the previous Foreign Sales Corporation program. It provides an exclusion from income for certain exports. To the extent that the program is viewed as a component of a destination-based VAT it might not be a tax expenditure. In addition, to the extent that the exclusion is an investment subsidy, it might be consistent with consumption tax principles (i.e., a low tax rate on capital income).

The remaining items in the table (panels C and D) are not likely to be tax expenditures under a consumption base. Exemption of workers' compensation insurance premiums would not be a tax expenditure because it represents double counting, given that the exemption of benefits already is a tax expenditure, as discussed in the previous section of the appendix.

Most of the other items that would not be tax expenditures relate to tax provisions that eliminate or reduce the tax on various types of capital income because a zero tax on capital income is consistent with consumption tax principles

The graduated corporate income tax rates would not be a tax expenditure under a comprehensive consumption baseline. A consumption tax would have no tax on corporate income or profits, hence the issue of whether the rate structure on corporate income provides a special benefit to corporations with low income would not arise.

The exception from the passive loss rules probably would not be a tax expenditure because proper measurement of income, and hence of consumption, requires full deduction of losses.

Major Tax Expenditures under a Consumption Tax That Are Excluded from the Current Budget

Several differences between current law and a consumption tax are left off the official tax expenditure list. Additional tax expenditures include the imputed consumption value from consumer durables and owner-occupied housing, private gifts and inheritances received, possibly benefits paid by insurance policies, in-kind benefits from such government programs as food-stamps, Medicaid, and public housing, and benefits received from charities. Under some ideas of a comprehensive consumption tax, the value of leisure and of household production of goods and services would be included as a tax expenditure if they were not imputed to the tax base.

A consumption tax implemented as a tax on cash flows would tax all proceeds from sales of capital assets when consumed, rather than just capital gains; because of expensing, taxpayers effectively would have a zero basis. The proceeds from borrowing would be in the base of a consumption tax that also allowed a deduction for repayment of principal and interest, but are excluded from the current tax base. The deduction of business interest expense might be a tax expenditure, since under some forms of consumption taxation interest is neither deducted from the borrower's tax base nor included in the lender's tax base. The personal exemption and standard deduction also might be considered tax expenditures, although they can be viewed differently, e.g., as elements of the basic tax rate schedule.

The foreign tax credit also might be a tax expenditure relative to a consumption baseline, but the argument for this is not air-tight. From a formalistic perspective, the foreign tax credit would be a tax expenditure because it applies against income tax and there would be no income tax under a consumption baseline. In addition, it is sometimes argued that a deduction for foreign taxes, rather than a credit, is appropriate under a comprehensive consumption tax because the taxpayer's increase in net worth properly is measured after payment of foreign taxes. Nonetheless, simply eliminating the credit for foreign taxes would subject the return earned by U.S. residents on overseas investment to double taxation, and would disfavor foreign investment relative to domestic investment.

Negative Tax Expenditures

Importantly, current law also deviates from a consumption tax norm in ways that increase, rather than decrease, tax liability. These could be called negative tax expenditures. The official budget excludes negative tax expenditures on the theory that tax expenditures are intended to substitute for government spending programs. Yet excluding negative tax expenditures would give a very one-sided look at the differences between the existing tax system and a consumption tax.

A large item on this list would be the inclusion of capital income in the current individual income tax base. The revenue from the corporation income tax also would be a negative tax expenditure. Depreciation allowances, even if accelerated, would be a negative tax expenditure since consumption tax treatment generally would require expensing. Depending on the treatment of loans, the borrower's inability to deduct payments of principal and the lender's inability to deduct loans might be a negative tax expenditure. The passive loss rules, restrictions on the deductibility of capital losses, and NOL carryforward provisions also would generate negative tax expenditures, because the change in net worth requires a deduction for losses. If human capital were considered an asset, then its cost (e.g., certain education and training expenses, including perhaps costs of college and professional school) should be expensed, but it is not under current law. Certain restrictions under the individual AMT as well as the phase-out of personal exemptions and of itemized deductions also might be considered negative tax expenditures.

Tax Expenditures and the Tax Rate Structure

Under some views, the graduated personal income tax rate structure might result in a tax expenditure or in a negative tax expenditure when compared with a consumption tax base. To the extent that one views a single tax rate as most compatible with a consumption tax base, tax rates above the appropriate single rate would yield a negative tax expenditure. To the extent that one views a graduated tax rate structure as most desirable, then differences between the appropriate graduated tax rate structure and the actual tax rate structure would lead to tax expenditures or negative tax expenditures.

REVISED ESTIMATES OF SELECTED TAX EXPENDITURES

Accelerated Depreciation

Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. In the past, official tax expenditure estimates of accelerated depreciation under the normal tax law baseline compared tax allowances based on the historic cost of an asset with allowances calculated using the straight-line method over relatively long recovery periods. Normal law

allowances also were determined by the historical cost of the asset and so did not adjust for inflation, although such an adjustment is required when measuring economic depreciation, the age related fall in the real value of the asset.

In this year's budget, the tax expenditures for accelerated depreciation under the normal law concept have been recalculated using as a baseline depreciation rates and replacement cost indexes from the National Income and Product Accounts.[29] The revised estimates are intended to approximate the degree of acceleration provided by current law over a baseline determined by real, inflation adjusted, economic depreciation. Current law depreciation allowances for machinery and equipment include the benefits of the temporary 30 percent expensing provision.[30] The estimates are shown in tables in the body of the main text, e.g., Table 6–1.

The revised tax expenditure estimates differ substantially from estimates calculated under the old methodology. In general, the new tax expenditure estimates are smaller than the old estimates.[31] In part this is because the new baseline uses depreciation allowances that are faster than those in the old baseline. In addition, the new baseline calculates depreciation on a replacement cost basis rather on the historic cost basis previously used; this translates into larger depreciation allowances to the extent that asset prices rise over time. In many years the new tax expenditures are negative, indicating that current law's tax depreciation allowances are smaller than those implied by economic depreciation. Because these estimates are on a cash flow, rather than a present value, basis, the negative value does not necessarily indicate that tax depreciation is decelerated relative to economic depreciation over the life of an investment. Even when tax depreciation is accelerated over the life of an investment, negative annual cash flow estimates could obtain in the later years of an investment's economic life. This type of vintage effect contributes importantly to the negative tax expenditures calculated for equipment in 2005–2008 because the temporary expensing provision expires in 2004. Calculations that compare the present value of tax depreciation (without 30 percent expensing) with the present value of inflation indexed economic depreciation over each investment's economic life show that for many types of assets tax depreciation is accelerated, but only slightly, assuming a moderate rate of inflation.[32]

[29] See Barbara Fraumeni, "The Measurement of Depreciation in the U.S. National Income and Product Accounts," in Survey of Current Business 77 No. 7 (Washington, D.C.: Department of Commerce, Bureau of Economic Analysis, July, 1997), pp. 7–42, and the *National Income and Product Accounts of the United States,* Table 7.6, "Chain-type Quantity and Price Indexes for Private Fixed Investment by Type," U.S. Department of Commerce, Bureau of Economic Analysis.

[30] The temporary provision allows 30 percent of the cost of a qualifying investment to be deducted immediately rather than capitalized and depreciated over time. It is generally effective for qualifying investments made after September 10, 2001 and before September 11, 2004. Qualifying investments generally are limited to tangible property with depreciation recovery periods of 20 years or less, certain software, and leasehold improvements, but this set of assets corresponds closely to machinery and equipment.

[31] Estimates under the old methodology are no longer shown in the tables.

[32] U.S. Department of the Treasury, *Report to the Congress on Depreciation Recovery Periods and Methods* (Washington, D.C.: U.S. Government Printing Office, July, 2000), p. 32.

Owner-Occupied Housing

A homeowner receives a flow of housing services equal in gross value to the rent that could have been earned had the owner chosen to rent the house to others. Comprehensive income would include in its base the implicit net rental income earned on investment in owner-occupied housing. Current law, however, excludes from its tax base such net rental income. This exclusion is a tax expenditure relative to a comprehensive income base.

In contrast to a comprehensive income baseline, the official list of tax expenditures does not include the exclusion of implicit rental income on owner-occupied housing. Instead, it includes as tax expenditures deductions for home mortgage interest and for property taxes. These are poor proxies for the exclusion of implicit net rental income. To the extent that a homeowner owns his house outright, unencumbered by a mortgage, he would have no home mortgage interest deduction, yet he still would enjoy the benefits of receiving tax free the implicit rental income earned on his house. When measuring the net income from an investment in owner-occupied housing, mortgage interest and property taxes generally would be deductible. The official tax expenditures do not allow for depreciation and other costs incurred by the homeowner that must be deducted in determining his net rental income.

Table 3 shows an estimate of the tax expenditure caused by the exclusion of implicit net rental income from investment in owner-occupied housing. This estimate starts with the NIPA calculated value of gross rent on owner-occupied housing, and subtracts interest, taxes, economic depreciation, and other costs in arriving at an estimate of net-rental income from owner-occupied housing.[33]

The tax expenditure estimate is substantial, growing from $20 billion in 1994 to $31 billion in 2008. Nonetheless, it is only about one-third as large as the official tax expenditure for the deduction of home mortgage interest. In part this discrepancy reflects depreciation and other expenses that must be subtracted from gross rents in arriving at net rental income. In part, it also might reflect homeowners' ability to borrow against their homes to fund other spending, leading to a relatively high debt/equity ratio for housing.

Double Tax on Corporate Profits

A comprehensive income tax would tax all sources of income once at a tax rate appropriate for the particular taxpayer. Taxes would not vary by type or source of income.

In contrast to this benchmark, current law may tax income that shareholders earn on investment in corporate stocks at least twice, and at combined rates that generally are higher than those imposed on other sources of income. Corporate profits are taxed once at the company level under the corporation income tax. They are taxed again at the shareholder level when

[33] *National Income and Production Accounts,* Table 2.4.

received as a dividend or recognized as a capital gain. Corporate profits can be taxed more then twice when they pass through multiple corporations before beings distributed to noncorporate shareholders. Corporate level taxes cascade because corporations and are taxed on capital gains they realize on the sale of stock shares and on some dividend income received. Compared to a comprehensive income tax current law's double (or more) tax on corporate profits is an example of a negative tax expenditure because it subjects income to a larger tax burden than implied by a comprehensive income baseline. The President has proposed in this Budget to remove the double taxation of corporate profits.

Table 3 provides an estimate of the negative tax expenditure caused by the multiple levels of tax on corporate profits. This negative tax expenditure includes the shareholder level tax on dividends paid and capital gains realized out of earnings that have been taxed at the corporate level. It also includes the corporate tax paid on inter-corporate dividends and on corporate capital gains attributable to the sale of stock shares.

The negative tax expenditure is large in magnitude; it grows from $25 billion in 2004 to $33 billion in 2008. It is comparable in size (but opposite in sign) to all but the largest official tax expenditures.

Appendix Table 1. COMPARISON OF CURRENT TAX EXPENDITURES WITH THOSE IMPLIED BY A COMPREHENSIVE INCOME TAX [1]

Description	Revenue Effect (2004)
A. Tax Expenditure Under a Comprehensive Income Tax	
Net exclusion of pension contributions and earnings: Employer plans	67,870
Net exclusion of pension contributions and earnings: 401(k) plans	55,290
Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	53,930
Exclusion of interest on public purpose State and local bonds	27,310
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	23,130
Capital gains exclusion on home sales	20,860
Exclusion of interest on life insurance savings	20,740
Accelerated depreciation of machinery and equipment (normal tax method)	16,670
Deferral of income from controlled foreign corporations (normal tax method)	7,900
Net exclusion of pension contributions and earnings: Keogh plans	7,616
Extraterritorial income exclusion	5,510
Credit for increasing research activities	4,990
Exclusion of Social security benefits of dependents and survivors	4,140
B. Possibly a Tax Expenditure Under a Comprehensive Income Tax, But With Some Qualifications	
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	50,910
Step-up basis of capital gains at death	28,500
Child credit	21,310
Exclusion of Social Security benefits for retired workers	18,930
Exclusion of workers' compensation benefits	6,460
Workers' compensation insurance premiums	6,190
Earned income tax credit	5,090
C. Uncertain	
Exclusion of employer contributions for medical insurance premiums and medical care	120,160
Deductibility of charitable contributions, other than education and health	33,990
Deductibility of medical expenses	6,340
Deductibility of charitable contributions (health)	4,580
Deductibility of charitable contributions (education)	4,350
Deductibility of self-employed medical insurance premiums	3,690
D. Probably Not a Tax Expenditure Under a Comprehensive Income Tax	
Deductibility of mortgage interest on owner-occupied homes	68,440
Deductibility of State and local property tax on owner-occupied homes	22,160
Graduated corporation income tax rate (normal tax method)	5,700
Exception from passive loss rules for $25,000 of rental loss	4,920

[1] The measurement of certain tax expenditures under a comprehensive income tax baseline may differ from the official budget estimate even when the provision would be a tax expenditure under both baselines.

Source: Table 6–2, Tax Expenditure Budget.

Appendix Table 2. COMPARISON OF CURRENT TAX EXPENDITURES WITH THOSE IMPLIED BY A COMPREHENSIVE CONSUMPTION TAX [1]

Description	Revenue Effect (2004)
A. Tax Expenditure Under a Consumption Base	
Exclusion of Social Security benefits for retired workers	18,930
Exclusion of workers' compensation benefits	6,460
Credit for increasing research activities	4,990
Exclusion of Social Security benefits of dependents and survivors	4,140
B. Probably a Tax Expenditure Under a Consumption Base	
Exclusion of employer contributions for medical insurance premiums and medical care	120,160
Deductibility of mortgage interest on owner-occupied homes	68,440
Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	50,910
Deductibility of charitable contributions, other than education and health	33,990
Deductibility of State and local property tax on owner-occupied homes	22,160
Child credit	21,310
Deductibility of medical expenses	6,340
Extraterritorial income exclusion	5,510
Earned income tax credit	5,090
Deductibility of charitable contributions (health)	4,580
Deductibility of charitable contributions (education)	4,350
Deductibility of self-employed medical insurance premiums	3,690
C. Probably Not a Tax Expenditure Under a Consumption Base	
Workers' compensation insurance premiums	6,190
D. Not a Tax Expenditure Under a Consumption Base	
Net exclusion of pension contributions and earnings: Employer plans	67,870
Net exclusion of pension contributions and earnings: 401(k) plans	55,290
Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	53,930
Step-up basis of capital gains at death	28,500
Exclusion of interest on public purpose State and local bonds	27,310
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	23,130
Capital gains exclusion on home sales	20,860
Exclusion of interest on life insurance savings	20,740
Accelerated depreciation of machinery and equipment (normal tax method)	16,663
Deferral of income from controlled foreign corporations (normal tax method)	7,900
Net exclusion of pension contributions and earnings: Keogh plans	7,616
Graduated corporation income tax rate (normal tax method)	5,700
Exception from passive loss rules for $25,000 of rental loss	4,920

[1] The measurement of certain tax expenditures under a consumption tax baseline may differ from the official budget estimate even when the provision would be a tax expenditure under both baselines.

Source: Table 6-2, Tax Expenditure Budget.

Appendix Table 3. POSSIBLE FUTURE ADDITIONS TO TAX EXPENDITURE ESTIMATES [1]

	2004	2005	2006	2007	2008
Imputed Rent On Owner-Occupied Housing	20,517	24,064	25,092	28,052	31,002
Double Tax on Corporate Profits [2]	–25,373	–32,723	–31,590	–32,022	–33,096

[1] Calculations described in the appendix text.

[2] This is a negative tax expenditure, a tax provision that overtaxes income relative to the treatment specified by the baseline tax system.