

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 tax 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 crucially on the baseline tax system against which the actual tax system is compared. The tax expenditure estimates presented in this document are 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.

An important assumption underlying each tax expenditure estimate reported below is that other parts of the Tax Code remain unchanged. The estimates would be different if tax expenditures were changed simultaneously because of potential interactions among provisions. For that reason, this document does not present a grand total for the estimated tax expenditures.

Tax expenditures relating to the individual and corporate income taxes are estimated for fiscal years 2022–2032 using two methods of accounting: current tax receipt effects and present value effects. The present value approach provides estimates of the receipt effects for tax expenditures that generally involve deferrals of tax payments into the future.

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

All tax expenditure estimates and descriptions presented here are based upon current tax law enacted as of July 31, 2022, and reflect the economic assumptions from the Midsession Review of the Fiscal Year 2023 Budget. In some cases, expired or repealed provisions are listed if their tax receipt effects occur in fiscal year 2022 or later.

The total receipt effects for tax expenditures for fiscal years 2022–2032 are displayed according to the Budget’s functional categories in Table 1. Descriptions of the specific tax expenditure provisions follow the discussion of general features of the tax expenditure concept.

Two baseline concepts—the normal tax baseline and the reference tax law baseline—are used to identify and estimate tax expenditures.¹ 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 receipt effects for these items are zero using the reference tax law. The alternative baseline concepts are discussed in detail below.

Tables 2A and 2B report separately the respective portions of the total receipt effects that arise under the individual and corporate income taxes. 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 form of tax liability that the various provisions affect. The ultimate beneficiaries of corporate tax expenditures could be shareholders, employees, customers, or other providers of capital, depending on economic forces.

Table 3 ranks the major tax expenditures by the size of their 2023–2032 receipt effect. The first column provides the number of the provision in order to cross reference this table to Tables 1, 2A, and 2B, as well as to the descriptions below.

Interpreting Tax Expenditure Estimates

The estimates shown for individual tax expenditures in Tables 1 through 3 do not necessarily equal the increase in Federal receipts (or the change in the budget balance) that would result from repealing these special provisions, for the following reasons.

First, eliminating a tax expenditure may have incentive effects that alter economic behavior. These incentives can affect the resulting magnitudes of the activity, or the consequences of other tax provisions or Government programs. For example, if capital gains were taxed at higher ordinary income tax rates, capital gain realizations would be expected to decline, which could

¹ These baseline concepts are thoroughly discussed in Special Analysis G of the 1985 Budget, where the former is referred to as the pre-1983 method and the latter the post-1982 method.

result in lower tax receipts depending on the elasticity of the capital gains tax rates. Such behavioral effects are not reflected in the estimates.

Second, tax expenditures are interdependent even without incentive effects. Repeal of a tax expenditure provision can increase or decrease the tax receipts associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the receipt costs from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the receipt 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 1 are the totals of individual and corporate income tax receipt effects reported in Tables 2A and 2B, and do not reflect any possible interactions between individual and corporate income tax receipts. For this reason, the estimates in Table 1 should be regarded as approximations.

Present-Value Estimates

The annual value of tax expenditures for tax deferrals is reported on a cash basis in all tables except Table 4. Cash-based estimates reflect the difference between taxes deferred in the current year and incoming receipts 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 over time, 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 have a real cost to the Government (i.e., taxpayers). 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.

Discounted present-value estimates of receipt effects are presented in Table 4 for certain provisions that involve tax deferrals or other long-term receipt effects. These estimates complement the cash-based tax expenditure estimates presented in the other tables.

The present-value estimates represent the receipt effects, net of future tax payments that follow from activities undertaken during calendar year 2022 which cause the deferrals or other long-term receipt effects. For instance, a pension contribution in 2022 would cause a deferral of tax payments on wages in 2022 and on pension fund earnings on this contribution (e.g., interest) in later years. In some future year, however, the 2022 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.

Tax Expenditure Baselines

A tax expenditure is an exception to baseline provisions of the tax structure that usually results in a reduction in the amount of tax owed. 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, most of this year's tax expenditure estimates are presented using two baselines: the normal tax baseline and the reference tax law baseline. Tax expenditures may take the form of credits, deductions, special exceptions and allowances.

The normal tax baseline is patterned on a practical variant of 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 deduction of 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. Reference tax law tax expenditures are limited to special exceptions from a generally provided tax rule that serves programmatic functions in a way that is analogous to spending programs. Provisions under the reference tax law baseline are generally tax expenditures under the normal tax baseline, but the reverse is not always true.

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

- Income is taxable only when it is realized in exchange. Thus, the deferral of tax on unrealized capital gains is not regarded as a tax expenditure. Accrued income would be taxed under a comprehensive income tax.
- There is a separate corporate income tax.
- Tax rates on noncorporate business income vary by level of income.
- Individual tax rates, including brackets, standard deduction, and personal exemptions, are allowed to vary with marital status.
- 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 general price level. 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).
- The base erosion and anti-abuse tax (BEAT) for multinational corporations is treated as a minimum tax and considered part of the rate structure.

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

Tax rates. The separate schedules applying to the various taxpaying units and the Alternative Minimum Tax are treated as part of the baseline rate structure under both the reference tax law 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. Under the reference tax law, gross income does not include gifts defined as receipts of money or property that are not consideration in an exchange nor does gross income include most transfer payments 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 tax law 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 property is computed using estimates of economic depreciation.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported on in this document follow. These descriptions relate to current law as of July 31, 2022.

National Defense

1. *Exclusion of benefits and allowances to armed forces personnel.*—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income because they represent accretions to wealth that do not materially differ from cash wages. As an example, a rental voucher of \$100 is (approximately) equal in value to \$100 of cash income. In contrast to this treatment, certain housing and meals, in addition to other benefits 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.

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, the pro-rata shares of sales and expense deductions reportable in a year are limited. A passive business activity is defined generally 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.

International Affairs

2. **Exclusion of income earned abroad by U.S. citizens.**—Under the baseline tax system, all compensation received by U.S. citizens and residents is properly included in their taxable income. It makes no difference whether the compensation is a result of working abroad or whether it is labeled as a housing allowance. In contrast to this treatment, U.S. tax law allows U.S. citizens and residents who live abroad, work in the private sector, and satisfy a foreign residency requirement to exclude up to \$80,000, plus adjustments for inflation since 2004, in foreign earned income from U.S. taxes. In addition, if these taxpayers are provided housing by their employers, then they may also exclude the cost of such housing from their income to the extent that it exceeds 16 percent of the earned income exclusion limit. This housing exclusion is capped at 30 percent of the earned income exclusion limit, with geographical adjustments. If taxpayers do not receive a specific allowance for housing expenses, they may deduct housing expenses up to the amount by which foreign earned income exceeds their foreign earned income exclusion.

3. **Exclusion of certain allowances for Federal employees abroad.**—In general, all compensation received by U.S. citizens and residents is properly included in their taxable income. It makes no difference whether the compensation is a result of working abroad or whether it is labeled as an allowance for the high cost of living abroad. In contrast to this treatment, 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 such as rent, education, and the cost of travel to and from the United States.

4. **Reduced tax rate on active income of controlled foreign corporations (normal tax method).**—Under the baseline tax system, worldwide income forms the tax base of U.S. corporations. In contrast, U.S. tax law exempts or preferentially taxes certain portions of this income. Prior to the passage of the Tax Cuts and Jobs Act TCJA (effective January 1, 2018), active foreign income was generally taxed only upon repatriation. TCJA changed these rules, so that certain active income (called “global intangible low tax income” or “GILTI”) is taxed currently, even if it is not distributed. However, U.S. corporations generally receive a 50 percent deduction from U.S. tax on their GILTI (the deduction decreases to 37.5 percent in 2026), resulting in a substantially reduced rate of tax. In addition, some active income is excluded from tax, and distributions out of active income are no longer taxed upon repatriation. These reductions and exemptions from U.S. taxation are considered tax expenditures. However, U.S. shareholders of specified foreign corporations must include their pro rata share of accumulated post-1986 deferred foreign income (as of the last taxable year before January 1, 2018) in U.S. taxable income, and this inclusion acts as an offset to the reduced tax rate on CFC income in the years in which the payments are received.

5. **Deduction for foreign-derived intangible income derived from trade or business within the United States.**—Under the baseline tax system, the United States taxes income earned by U.S. corporations from serving foreign markets (e.g., exports and royalties) at the full U.S. rate. After the passage of TCJA, domestic corporations are allowed a deduction equal to 37.5 percent of “foreign-derived intangible income,” which is essentially income from serving foreign markets (defined on a formulaic basis). The deduction falls to 21.875 percent in 2026.

6. **Interest Charge Domestic International Sales Corporations (IC-DISCs).**—Under the baseline tax system, taxpayer earnings are subject to tax using the regular tax rates applied to all taxpayers. In contrast, IC-DISCs allow a portion of income from exports to be taxed at the qualified dividend rate which is no higher than 20 percent (plus a 3.8 percent surtax for high-income taxpayers).

General Science, Space, and Technology

7. **Expensing of research and experimentation expenditures (normal tax method).**—The baseline tax system allows a deduction for the cost of producing income. It requires taxpayers to capitalize the costs associated with investments over time to better match the streams of income and associated costs. 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. Because of this ambiguity, the reference tax law baseline system would allow expensing of R&E expenditures. In contrast, 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. Current law requires R&E expenditures paid or incurred in taxable years beginning after December 31, 2021, to be capitalized and amortized over 5 years, while allowing R&E expenditures paid or incurred in prior taxable years to be expensed.

8. **Credit for increasing research activities.**—The baseline tax system would uniformly tax all returns to investments and not allow credits for particular activities, investments, or industries. In contrast, the Tax Code allows an R&E credit of up to 20 percent of qualified research expenditures in excess of a base amount. The base amount of the credit 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

can elect the alternative simplified credit regime, which equals 14 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years.

Energy

9. **Expensing of exploration and development costs, oil and gas.**—Under the baseline tax system, the costs of exploring and developing oil and gas wells would be capitalized and then amortized (or depreciated) over an estimate of the economic life of the property. This insures that the net income from the well or mine is measured appropriately each year. In contrast to this treatment, current law allows immediate deduction, i.e., expensing, of intangible drilling costs for successful investments in domestic oil and gas wells (such as wages, the cost of using machinery for grading and drilling, and the cost of unsalvageable materials used in constructing wells). Because expensing allows recovery of costs sooner, it is more advantageous to the taxpayer than amortization. Expensing provisions for exploration expenditures apply only to properties for which a deduction for percentage depletion is allowable. For oil and gas wells, integrated oil companies may expense only 70 percent of intangible drilling costs and must amortize the remaining 30 percent over five years. Non-integrated oil companies may expense all such costs.

10. **Expensing of exploration and development costs, coal.**— This is similar to the above provision but limited to coal. Current law allows immediate deduction of eligible exploration and development costs for domestic coal mines and other natural fuel deposits.

11. **Excess of percentage over cost depletion, oil and gas.**—The baseline tax system would allow recovery of the costs of developing certain oil and gas properties using cost depletion. Cost depletion is similar in concept to depreciation, in that the costs of developing or acquiring the asset are capitalized and then gradually reduced over an estimate of the asset's economic life, as is appropriate for measuring net income. In contrast, the Tax Code generally allows independent fuel producers and royalty owners to take percentage depletion deductions rather than cost depletion on limited quantities of output. Under percentage depletion, taxpayers deduct a percentage of gross income from fossil fuel production. In certain cases the deduction is limited to a fraction of the asset's net income. Over the life of an investment, percentage depletion deductions can exceed the cost of the investment. Consequently, percentage depletion may provide more advantageous tax treatment than would cost depletion, which limits deductions to an investment's cost.

12. **Excess of percentage over cost depletion, coal.**—This is similar to the above provision but limited to coal.

13. **Exception from passive loss limitation for working interests in oil and gas properties.**—The baseline tax system accepts current law's general rule limiting taxpayers' ability to deduct losses from passive activities against nonpassive income (e.g., wages, interest, and dividends). Passive activities generally are defined as those in which the taxpayer does not materially participate, though there are numerous additional considerations brought to bear on the determination of which activities are passive for a given taxpayer. Losses are limited in an attempt to limit tax sheltering activities. Passive losses that are unused may be carried forward and applied against future passive income. An exception from the passive loss limitation is provided for a working interest in an oil or gas property that the taxpayer holds directly or through an entity that does not limit the liability of the taxpayer with respect to the interest. Thus, taxpayers can deduct losses from such working interests against nonpassive income without regard to whether they materially participate in the activity.

14. **Capital gains treatment of royalties on coal.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low tax rates to apply to certain types or sources of income. Current law allows capital gains realized by individuals to be taxed at a preferentially low rate that is no higher than 20 percent (plus the 3.8 percent surtax). Certain sales of coal under royalty contracts qualify for taxation as capital gains rather than ordinary income.

15. **Exclusion of interest on energy facility bonds.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows interest earned on State and local bonds used to finance construction of certain energy facilities to be exempt from tax. 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 enhanced oil recovery on U.S. projects. The credit is reduced in proportion to the ratio of the reference price of oil for the previous calendar year minus \$28 (adjusted for inflation from 1990) to \$6.

17. **Energy production credit.**—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code provides a credit for certain electricity produced from wind energy, biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, or qualified hydropower and sold to an unrelated party. Wind facilities must have begun construction before January 1, 2022. Facilities that begin construction in 2017 receive 80 percent of the credit, facilities that begin construction in 2018 receive 60 percent of the credit, facilities that begin construction in 2019 receive 40 percent of the credit, and facilities that begin construction in 2020-2021 receive 60 percent of the credit. Qualified facilities producing electricity from sources other than wind must begin construction before January 1, 2022. In addition to the electricity production credit, a ten-year income tax credit is allowed for the production of refined coal for facilities placed in service before January 1, 2012. The

Tax Code also provided an income tax credit for Indian coal facilities. The Indian coal facilities credit expired on December 31, 2021.

18. **Marginal wells credit.**—A credit is provided for crude oil and natural gas produced from a qualified marginal well. A marginal well is one that does not produce more than 1,095 barrel-of-oil equivalents per year, with this limit adjusted proportionately for the number of days the well is in production. The credit is no more than \$3.00 per barrel of qualified crude oil production and \$0.50 per thousand cubic feet of qualified natural gas production. The credit for natural gas is reduced in proportion to the amount by which the reference price of natural gas at the wellhead for the previous calendar year exceeds \$1.67 per thousand cubic feet and is zero for a reference price that exceeds \$2.00. The credit for crude oil is reduced in proportion to the amount by which the reference price of oil for the previous calendar year exceeds \$15.00 per barrel and is zero for a reference price that exceeds \$18.00. All dollar amounts are adjusted for inflation from 2004.

19. **Energy investment credit.**—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. However, the Tax Code provides credits for investments in solar and geothermal energy property, qualified fuel cell power plants, stationary micro-turbine power plants, geothermal heat pumps, waste energy recovery property, small wind property, offshore wind, and combined heat and power property. The credit is 30 percent for property that begins construction before 2020, 26 percent for property that begins construction in 2020-2022, and 22 percent for property that begins construction in 2023 and in all cases that is placed in service before January 1, 2026. The credit for offshore wind is 30 percent for facilities placed in service before January 1, 2026. A 10 percent credit is available for geothermal or qualified solar property placed in service after December 31, 2025. Owners of renewable power facilities that qualify for the energy production credit may instead elect to take an energy investment credit at a rate specified by law.

20. **Alcohol fuel credits.**—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code provides an income tax credit for qualified cellulosic biofuel production which was renamed the Second generation biofuel producer credit. This provision expired on December 31, 2021.

21. **Bio-diesel and small agri-biodiesel producer tax credits.**—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. However, the Tax Code allows an income tax credit for biodiesel and for Bio-diesel derived from virgin sources. In lieu of the Bio-diesel credit, the taxpayer can claim a refundable excise tax credit. In addition, small agri-biodiesel producers are eligible for a separate income tax credit for biodiesel production, and a separate credit is available for qualified renewable diesel fuel mixtures. This provision expires on December 31, 2022.

22. **Tax credits for clean-fuel burning vehicles and refueling property.**—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code allows credits for plug-in electric-drive motor vehicles, alternative fuel vehicle refueling property, two-wheeled plug-in electric vehicles, and fuel cell motor vehicles. These provisions, except for the plug-in electric-drive motor vehicle credit, expired after December 31, 2017.

23. **Exclusion of utility conservation subsidies.**—The baseline tax system generally takes a comprehensive view of taxable income that includes a wide variety of (measurable) accretions to wealth. In certain circumstances, public utilities offer rate subsidies to non-business customers who invest in energy conservation measures. These rate subsidies are equivalent to payments from the utility to its customer, and so represent accretions to wealth, income that would be taxable to the customer under the baseline tax system. In contrast, the Tax Code exempts these subsidies from the non-business customer's gross income.

24. **Credit for holding clean renewable energy bonds.**—The baseline tax system would uniformly tax all returns to investments and not allow credits for particular activities, investments, or industries. In contrast, the Tax Code provides for the issuance of Clean Renewable Energy Bonds that entitle the bond holder to a Federal income tax credit in lieu of interest. As of March 2010, issuers of the unused authorization of such bonds could opt to receive direct payment with the yield becoming fully taxable.

25. **Credit for investment in clean coal facilities.**—The baseline tax system would uniformly tax all returns to investments and not allow credits for particular activities, investments, or industries. In contrast, the Tax Code provides investment tax credits for clean coal facilities producing electricity and for industrial gasification combined cycle projects.

26. **Amortize all geological and geophysical expenditures over two years.**—The baseline tax system allows taxpayers to deduct the decline in the economic value of an investment over its economic life. However, the Tax Code allows geological and geophysical expenditures incurred in connection with oil and gas exploration in the United States to be amortized over two years for non-integrated oil companies, a span of time that is generally shorter than the economic life of the assets.

27. **Allowance of deduction for certain energy efficient commercial building property.**—The baseline tax system would not allow deductions in lieu of normal depreciation allowances for particular investments in particular industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code allows a deduction for certain energy efficient commercial building property. The basis of such property is reduced by the amount of the deduction. Starting in 2021, the maximum deduction amount per square foot will be increased by a cost-of-living adjustment.

28. **Credit for construction of new energy efficient homes.**—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. However, the Tax Code allowed contractors a tax credit of \$2,000 for the construction of a qualified new energy-efficient home that had an annual level of heating and cooling energy consumption at least 50 percent below the annual consumption under the 2006 International Energy Conservation Code. The credit equaled \$1,000 in the case of a new manufactured home that met a 30 percent standard or requirements for EPA’s Energy Star homes. This provision expired on December 31, 2017.

29. **Credit for energy efficiency improvements to existing homes.**—The baseline tax system would not allow credits for particular activities, investments, or industries. However, the Tax Code provided an investment tax credit for expenditures made on insulation, exterior windows, and doors that improved the energy efficiency of homes and met certain standards. The Tax Code also provided a credit for purchases of advanced main air circulating fans, natural gas, propane, or oil furnaces or hot water boilers, and other qualified energy efficient property. This provision expired on December 31, 2017, but legislation enacted in 2020 allowed taxpayers to claim tax credits retroactively for three years.

30. **Credit for residential energy efficient property.**—The baseline tax system would uniformly tax all returns to investments and not allow credits for particular activities, investments, or industries. However, the Tax Code provides a credit for the purchase of a qualified photovoltaic property and solar water heating property, as well as for fuel cell power plants, geothermal heat pumps, and small wind property used in or placed on a residence. The credit is 30 percent for property placed in service before January 1, 2020, 26 percent for property placed in service in 2020- 2022, and 22 percent for property placed in service in 2023.

31. **Credit for qualified energy conservation bonds.**—The baseline tax system would uniformly tax all returns to investments and not allow credits for particular activities, investments, or industries. However, the Tax Code provides for the issuance of energy conservation bonds which entitle the bond holder to a Federal income tax credit in lieu of interest. As of March 2010, issuers of the unused authorization of such bonds could opt to receive direct payment with the yield becoming fully taxable.

32. **Advanced energy property credit.**—The baseline tax system would not allow credits for particular activities, investments, or industries. However, the Tax Code provides a 30 percent investment credit for property used in a qualified advanced energy manufacturing project. The Treasury Department may award up to \$2.3 billion in tax credits for qualified investments.

33. **Advanced nuclear power facilities production credit.**—The baseline tax system would not allow credits or deductions for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code allows a tax credit equal to 1.8 cents times the number of kilowatt hours of electricity produced at a qualifying advanced nuclear power facility. A taxpayer may claim no more than \$125 million per 1,000 megawatts of capacity. The Treasury Department may allocate up to 6,000 megawatts of credit-eligible capacity. Any unutilized national capacity limitation shall be allocated after December 31, 2020, according to prioritization rules set forth by statute.

34. **Reduced tax rate for nuclear decommissioning funds.**—The baseline tax system would uniformly tax all returns to investments and not allow special rates for particular activities, investments, or industries. In contrast, the Tax Code provides a special 20 percent tax rate for investments made by Nuclear Decommissioning Reserve Funds.

Natural Resources and Environment

35. **Expensing of exploration and development costs, nonfuel minerals.**—The baseline tax system allows the taxpayer to deduct the depreciation of an asset according to the decline in its economic value over time. However, certain capital outlays associated with exploration and development of nonfuel minerals may be expensed rather than depreciated over the life of the asset.

36. **Excess of percentage over cost depletion, nonfuel minerals.**—The baseline tax system allows the taxpayer to deduct the decline in the economic value of an investment over time. Under current law, however, most nonfuel mineral extractors may use percentage depletion (whereby the deduction is fixed as a percentage of receipts) rather than cost depletion, with percentage depletion rates ranging from 22 percent for sulfur to 5 percent for sand and gravel. Over the life of an investment, percentage depletion deductions can exceed the cost of the investment. Consequently, percentage depletion may provide more advantageous tax treatment than would cost depletion, which limits deductions to an investment’s cost.

37. **Exclusion of interest on bonds for water, sewage, and hazardous waste facilities.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows interest earned on State and local bonds used to finance construction of sewage, water, or hazardous waste facilities to be exempt from tax. These bonds are generally subject to the State private-activity bond annual volume cap.

38. **Capital gains treatment of certain timber income.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low tax rates to apply to certain types or sources of income. However, under current law certain timber sales can be treated as a capital gain rather than ordinary income and therefore subject to

the lower capital-gains tax rate. Current law allows capital gains to be taxed at a preferentially low rate that is no higher than 20 percent (plus the 3.8 percent surtax).

39. **Expensing of multiperiod timber growing costs.**—The baseline tax system requires the taxpayer to capitalize costs associated with investment property. However, most of the production costs of growing timber may be expensed under current law rather than capitalized and deducted when the timber is sold, thereby accelerating cost recovery.

40. **Tax incentives for preservation of historic structures.**—The baseline tax system would not allow credits for particular activities, investments, or industries. However, expenditures to preserve and restore certified historic structures qualify for an investment tax credit of 20 percent for certified rehabilitation activities. The taxpayer's recoverable basis must be reduced by the amount of the credit. The credit must be claimed ratably over the five years after the property is placed in service, for property placed in service after December 31, 2017.

41. **Carbon oxide sequestration credit.**—The baseline tax system would uniformly tax all returns to investments and not allow credits for particular activities, investments, or industries. In contrast, the Tax Code allows a credit for qualified carbon oxide captured at a qualified facility and disposed of in secure geological storage. In addition, the provision allows a credit for qualified carbon oxide that is captured at a qualified facility and used as a tertiary injectant in a qualified enhanced oil or natural gas recovery project. The credit differs according to whether the carbon was captured using equipment which was originally placed in service before February 9, 2018, or thereafter.

42. **Deduction for endangered species recovery expenditures.**—The baseline tax system would not allow deductions in addition to normal depreciation allowances for particular investments in particular industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, under current law farmers can deduct up to 25 percent of their gross income for expenses incurred as a result of site and habitat improvement activities that will benefit endangered species on their farm land, in accordance with site specific management actions included in species recovery plans approved pursuant to the Endangered Species Act of 1973.

Agriculture

43. **Expensing of certain capital outlays.**—The baseline tax system requires the taxpayer to capitalize costs associated with investment property. However, farmers may expense certain expenditures for feed and fertilizer, for soil and water conservation measures, and certain other capital improvements under current law.

44. **Expensing of certain multiperiod production costs.**—The baseline tax system requires the taxpayer to capitalize costs associated with an investment over time. However, the production of livestock and crops with a production period greater than two years is exempt from the uniform cost capitalization rules (e.g., for costs for establishing orchards or structure improvements), thereby accelerating cost recovery.

45. **Treatment of loans forgiven for solvent farmers.**—Because loan forgiveness increases a debtors net worth the baseline tax system requires debtors to include the amount of loan forgiveness as income or else reduce their recoverable basis in the property related to the loan. If the amount of forgiveness exceeds the basis, the excess forgiveness is taxable if the taxpayer is not insolvent. For bankrupt debtors, the amount of loan forgiveness reduces carryover losses, unused credits, and then basis, with the remainder of the forgiven debt excluded from taxation. Qualified farm debt that is forgiven, however, is excluded from income even when the taxpayer is solvent.

46. **Capital gains treatment of certain agriculture income.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low tax rates to apply to certain types or sources of income. In contrast, current law allows capital gains to be taxed at a preferentially low rate that is no higher than 20 percent (plus the 3.8 percent surtax). Certain agricultural income, such as unharvested crops, qualify for taxation as capital gains rather than ordinary income, and so benefit from the preferentially low 20 percent maximum tax rate on capital gains (plus the 3.8 percent surtax).

47. **Income averaging for farmers.**—The baseline tax system generally taxes all earned income each year at the rate determined by the income tax. However, taxpayers may average their taxable income from farming and fishing over the previous three years.

48. **Deferral of gain on sale of farm refiners.**—The baseline tax system generally subjects capital gains to taxes the year that they are realized. However, the Tax Code allows a taxpayer who sells stock in a farm refiner to a farmers' cooperative to defer recognition of the gain if the proceeds are re-invested in a qualified replacement property.

49. **Expensing of reforestation expenditures.**—The baseline tax system requires the taxpayer to capitalize costs associated with an investment over time. In contrast, the Tax Code provides for the expensing of the first \$10,000 in reforestation expenditures with 7-year amortization of the remaining expenses.

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.

50. **Exemption of credit union income.**—Under the baseline tax system, corporations pay taxes on their profits under the regular tax rate schedule. However, in the Tax Code the earnings of credit unions not distributed to members as interest or dividends are exempt from the income tax.

51. **Exclusion of life insurance death benefits.**—Under the baseline tax system, individuals and corporations would pay taxes on their income when it is (actually or constructively) received or accrued. Nevertheless, current law generally excludes from tax amounts received under life insurance contracts if such amounts are paid by reason of the death of the insured.

52. **Exemption or special alternative tax for small property and casualty insurance companies.**—The baseline tax system would require corporations to pay taxes on their profits under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. Under current law, however, stock non-life insurance companies are generally exempt from tax if their gross receipts for the taxable year do not exceed \$600,000 and more than 50 percent of such gross receipts consist of premiums. Mutual non-life insurance companies are generally tax-exempt if their annual gross receipts do not exceed \$150,000 and more than 35 percent of gross receipts consist of premiums. Also, non-life insurance companies with no more than a specified level of annual net written premiums generally may elect to pay tax only on their taxable investment income provided certain ownership diversification requirements are met. The underwriting income (premiums, less insurance losses and expenses) of electing companies is excluded from tax. The specified premium limit is indexed for inflation; for 2022, the premium limit is \$2.45 million.

53. **Tax exemption of insurance income earned by tax-exempt organizations.**—Under the baseline tax system, corporations pay taxes on their profits under the regular tax rate schedule. The baseline tax system would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. Generally the income generated by life and property and casualty insurance companies is subject to tax, albeit under special rules. However, income from insurance operations conducted by certain tax-exempt organizations, such as fraternal societies, voluntary employee benefit associations, and others are exempt from tax.

54. **Exclusion of interest spread of financial institutions.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. Consumers pay for some deposit-linked services, such as check cashing, by accepting a below-market interest rate on their demand deposits. If they received a market rate of interest on those deposits and paid explicit fees for the associated services, they would pay taxes on the full market rate and (unlike businesses) could not deduct the fees. The Government thus foregoes tax on the difference between the risk-free market interest rate and below-market interest rates on demand deposits, which under competitive conditions should equal the value of deposit services.

55. **Exclusion of interest on owner-occupied mortgage subsidy bonds.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows interest earned on State and local bonds used to finance homes purchased by first-time, low-to-moderate-income buyers to be exempt from tax. These bonds are generally subject to the State private-activity-bond annual volume cap.

56. **Exclusion of interest on rental housing bonds.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows interest earned on State and local government bonds used to finance multifamily rental housing projects to be tax-exempt.

57. **Deductibility of mortgage interest expense on owner-occupied residences.**—Under the baseline tax system, expenses incurred in earning income would be deductible. However, such expenses would not be deductible when the income or the return on an investment is not taxed. In contrast, the Tax Code allows an exclusion from a taxpayer's taxable income for the value of owner-occupied housing services and also allows the owner-occupant to deduct mortgage interest paid on his or her primary residence and one secondary residence as an itemized non-business deduction. In general, the mortgage interest deduction is limited to interest on debt no greater than the owner's basis in the residence, and is also limited to interest on debt of 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 total debt does not exceed the fair market value of the residence. As an alternative to the deduction, holders of qualified Mortgage Credit Certificates issued by State or local governmental units or agencies may claim a tax credit equal to a proportion of their interest expense. In the case of taxable years beginning after December 31, 2017, and before January 1, 2026, (1) the \$1 million limit is reduced to \$750,000 for indebtedness incurred after December 15, 2017, and (2) the deduction for interest on home equity indebtedness is disallowed.

58. **Deductibility of State and local property tax on owner-occupied homes.**—Under the baseline tax system, expenses incurred in earning income would be deductible. However, such expenses would not be deductible when the income or the return on an investment is not taxed. In contrast, the Tax Code allows an exclusion from a taxpayer’s taxable income for the value of owner-occupied housing services and also allows the owner-occupant to deduct property taxes paid on real property. In the case of taxable years beginning after December 31, 2017, and before January 1, 2026, (1) the deduction for foreign real property taxes paid is disallowed and (2) the deduction for taxes paid in any taxable year, which includes the deduction for property taxes on real property, is limited to \$10,000 (\$5,000 in the case of a married individual filing a separate return).

59. **Deferral of income from installment sales.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates, or deferral of tax, to apply to certain types or sources of income. 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.

60. **Capital gains exclusion on home sales.**—The baseline tax system would not allow deductions and exemptions for certain types of income. In contrast, the Tax Code allows homeowners to exclude from gross income up to \$250,000 (\$500,000 in the case of a married couple filing a joint return) of the capital gains from the sale of a principal residence. To qualify, the taxpayer must have owned and used the property as the taxpayer’s principal residence for a total of at least two of the five years preceding the date of sale. In addition, the exclusion may not be used more than once every two years.

61. **Exclusion of net imputed rental income.**—Under the baseline tax system, the taxable income of a taxpayer who is an owner-occupant would include the implicit value of gross rental income on housing services earned on the investment in owner-occupied housing and would allow a deduction for expenses, such as interest, depreciation, property taxes, and other costs, associated with earning such rental income. In contrast, the Tax Code allows an exclusion from taxable income for the implicit gross rental income on housing services, while in certain circumstances allows a deduction for some costs associated with such income, such as for mortgage interest and property taxes.

62. **Exception from passive loss rules for \$25,000 of rental loss.**—The baseline tax system accepts current law’s general rule limiting taxpayers’ ability to deduct losses from passive activities against nonpassive income (e.g., wages, interest, and dividends). Passive activities generally are defined as those in which the taxpayer does not materially participate, and there are numerous additional considerations brought to bear on the determination of which activities are passive for a given taxpayer. Losses are limited in an attempt to limit tax sheltering activities. Passive losses that are unused may be carried forward and applied against future passive income. In contrast to the general restrictions on passive losses, the Tax Code exempts certain owners of rental real estate activities from “passive income” limitations. The exemption is limited to \$25,000 in losses and phases out for taxpayers with income between \$100,000 and \$150,000.

63. **Credit for low-income housing investments.**—The baseline tax system would uniformly tax all returns to investments and not allow credits for particular activities, investments, or industries. However, under current law 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 at least 70 percent of the building’s qualified basis 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 can exceed these levels in certain statutorily defined and State designated areas where project development costs are higher. The credit is allowed in equal amounts over 10 years and is generally subject to a volume cap.

64. **Accelerated depreciation on rental housing (normal tax method).**—Under a comprehensive economic income tax, the costs of acquiring a building are capitalized and depreciated over time in accordance with the decline in the property’s economic value due to wear and tear or obsolescence. This insures that the net income from the rental property is measured appropriately each year. Current law allows depreciation that is accelerated relative to economic depreciation. However, the depreciation provisions of the Tax Code are part of the reference tax law, and thus do not give rise to tax expenditures under reference tax law. Under normal tax baseline, in contrast, depreciation allowances reflect estimates of economic depreciation.

65. **Discharge of mortgage indebtedness.**—Under the baseline tax system, all income would generally be taxed under the regular tax rate schedule. The baseline tax system would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows an exclusion from a taxpayer’s taxable income for any discharge of indebtedness of up to \$750,000 (\$375,000 in the case of a married individual filing a separate return) from a qualified principal residence. The provision applies to debt discharged after December 31, 2020, and before January 1, 2026.

66. **Premiums for mortgage insurance deductible as interest.**—Under the baseline tax system, expenses incurred in earning income would be deductible, but such expenses would not be deductible when the income or the return on an investment is not taxed. Because imputed rental income is not subject to tax, mortgage insurance premiums do not represent expenses incurred in earning income. In contrast, the Tax Code allows mortgage insurance premiums to be treated as deductible mortgage interest expenses. The provision applies to premiums paid in 2021.

67. **Discharge of business indebtedness.**—Under the baseline tax system, all income would generally be taxed under the regular tax rate schedule. The baseline tax system would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows an exclusion from a taxpayer's taxable income for any discharge of qualified real property business indebtedness by taxpayers other than a C corporation. If the canceled debt is not reported as current income, however, the basis of the underlying property must be reduced by the amount canceled.

68. **Exceptions from imputed interest rules.**—Under the baseline tax system, holders (issuers) of debt instruments are generally required to report interest earned (paid) in the period it accrues, not when received. 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. But under current law, any debt associated with the sale of property worth less than \$250,000 is exempted from the general interest accounting rules. This general \$250,000 exception is not a tax expenditure under reference tax law but is under normal tax baseline. Current law also includes exceptions for certain property worth more than \$250,000. These are tax expenditure under reference tax law and normal tax baselines. These exceptions include, sales of personal residences worth more than \$250,000, and sales of farms and small businesses worth between \$250,000 and \$1 million.

69. **Treatment of qualified dividends.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low tax rates to apply to certain types or sources of income. For individuals, tax rates on regular income vary from 10 percent to 39.6 percent in the budget window (plus a 3.8 percent surtax on high income taxpayers), depending on the taxpayer's income. In contrast, under current law, qualified dividends are taxed at a preferentially low rate that is no higher than 20 percent (plus the 3.8 percent surtax).

70. **Capital gains (except agriculture, timber, iron ore, and coal).**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low tax rates to apply to certain types or sources of income. Under current law, capital gains on assets held for more than one year are taxed at a preferentially low rate that is no higher than 20 percent (plus the 3.8 percent surtax).

71. **Capital gains exclusion of small corporation stock.**—The baseline tax system would not allow deductions and exemptions or provide preferential treatment of certain sources of income or types of activities. In contrast, the Tax Code provided an exclusion of 50 percent, applied to ordinary rates with a maximum of a 28 percent tax rate, for capital gains from qualified small business stock held by individuals for more than 5 years; 75 percent for stock issued after February 17, 2009 and before September 28, 2010; and 100 percent for stock issued after September 27, 2010. A qualified small business is a corporation whose gross assets do not exceed \$50 million as of the date of issuance of the stock.

72. **Step-up basis of capital gains at death.**—Under the baseline tax system, unrealized capital gains would be taxed when assets are transferred at death. It would not allow for exempting gains upon transfer of the underlying assets to the heirs. In contrast, capital gains on assets held at the owner's death are not subject to capital gains tax under current law. The cost basis of the appreciated assets is adjusted to the market value at the owner's date of death which becomes the basis for the heirs.

73. **Carryover basis of capital gains on gifts.**—Under the baseline tax system, unrealized capital gains would be taxed when assets are transferred by gift. In contrast, when a gift of appreciated asset is made under current law, 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.

74. **Ordinary income treatment of loss from small business corporation stock sale.**—The baseline tax system limits to \$3,000 the write-off of losses from capital assets, with carryover of the excess to future years. In contrast, the Tax Code allows up to \$100,000 in losses from the sale of small business corporate stock (capitalization less than \$1 million) to be treated as ordinary losses and fully deducted.

75. **Deferral of capital gains from like-kind exchanges.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates, or deferral of tax, to apply to certain types or sources of income. In contrast, current law allows the deferral of accrued gains on assets transferred in qualified like-kind exchanges.

76. **Depreciation of buildings other than rental housing (normal tax method).**—Under a comprehensive economic income tax, the costs of acquiring a building are capitalized and depreciated over time in accordance with the decline in the property's economic value due to wear and tear or obsolescence. This insures that the net income from the property is measured appropriately each year. Current law allows depreciation deductions that differ from those under economic depreciation. However, the depreciation provisions of the Tax Code are part of the reference tax law, and thus do not give rise to tax expenditures under reference tax law. Under normal tax baseline, in contrast, depreciation allowances reflect estimates of economic depreciation.

77. **Accelerated depreciation of machinery and equipment (normal tax method).**—Under a comprehensive economic income tax, the costs of acquiring machinery and equipment are capitalized and depreciated over time in accordance with the decline in the property's economic value due to wear and tear or obsolescence. This insures that the net income from the property is measured appropriately each year. Current law allows depreciation deductions that are accelerated relative to economic depreciation. In particular, through 2022, 100 percent of the purchase cost of qualified property is eligible to be expensed immediately; this percentage phases out to zero through 2027. The depreciation provisions of the Tax Code are part of the refer-

ence tax law, and thus do not give rise to tax expenditures under reference tax law. Under the normal tax baseline, in contrast, depreciation allowances reflect estimates of economic depreciation.

78. **Expensing of certain small investments (normal tax method).**—Under the reference tax law baseline, the costs of acquiring tangible property and computer software would be depreciated using the Tax Code’s depreciation provisions. Under the normal tax baseline, depreciation allowances are estimates of economic depreciation. However, subject to investment limitations, the Tax Code allows up to \$1 million (indexed for inflation) in qualifying investments in tangible property and certain computer software to be expensed rather than depreciated over time.

79. **Exclusion of interest on small issue bonds.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows interest earned on small issue industrial development bonds (IDBs) issued by State and local governments to finance manufacturing facilities to be 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.

80. **Special rules for certain film and TV production.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow deductions and exemptions or preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allowed taxpayers to deduct up to \$15 million per production (\$20 million in certain distressed areas) in non-capital expenditures incurred during the year. This provision is scheduled to expire at the end of 2025.

81. **Allow 20-percent deduction to certain pass-through income.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow deductions and exemptions or preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, for tax years 2018 to 2025, the Tax Code allows for a deduction equal to up to 20 percent of income attributable to domestic pass-through businesses, subject to certain limitations.

Transportation

82. **Tonnage tax.**—The baseline tax system generally would tax all profits and income under the regular tax rate schedule. U.S. shipping companies may choose to be subject to a tonnage tax based on gross shipping weight in lieu of an income tax, in which case profits would not be subject to tax under the regular tax rate schedule.

83. **Deferral of tax on shipping companies.**—The baseline tax system generally would tax all profits and income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows certain companies that operate U.S. flag vessels to defer income taxes on that portion of their income used for shipping purposes (e.g., primarily construction, modernization and major repairs to ships, and repayment of loans to finance these investments).

84. **Exclusion of reimbursed employee parking expenses.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, would be included in taxable income. Dedicated payments and in-kind benefits represent accretions to wealth that do not differ materially from cash wages. In contrast, the Tax Code allows an exclusion from taxable income for employee parking expenses that are paid for by the employer or that are received by the employee in lieu of wages. In 2022, the maximum amount of the parking exclusion is \$280 per month. The tax expenditure estimate does not include any subsidy provided through employer-owned parking facilities. However, beginning in 2018, parking expenses are no longer deductible to for-profit employers and treated as unrelated business income for nonprofit employers..

85. **Exclusion for employer-provided transit passes.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, would be included in taxable income. Dedicated payments and in-kind benefits represent accretions to wealth that do not differ materially from cash wages. In contrast, the Tax Code allows an exclusion from a taxpayer’s taxable income for passes, tokens, fare cards, and vanpool expenses that are paid for by an employer or that are received by the employee in lieu of wages to defray an employee’s commuting costs. Due to a parity to parking provision, the maximum amount of the transit exclusion is \$280 per month in 2022. However, beginning in 2018, transit expenses are no longer deductible to employers (except government).

86. **Tax credit for certain expenditures for maintaining railroad tracks.**—The baseline tax system would not allow credits for particular activities, investments, or industries. However, the Tax Code allowed eligible taxpayers to claim a credit equal to the lesser of 50 percent of maintenance expenditures and the product of \$3,500 and the number of miles of railroad track owned or leased. This provision applies to maintenance expenditures in taxable years beginning before January 1, 2017.

87. **Exclusion of interest on bonds for Highway Projects and rail-truck transfer facilities.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code provides for \$15 billion of tax-exempt bond authority to finance qualified highway or surface freight transfer facilities.

Community and Regional Development

88. **Exclusion of interest for airport, dock, and similar bonds.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows 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 to be tax-exempt. These bonds are not subject to a volume cap.

89. **Exemption of certain mutuals' and cooperatives' income.**—Under the baseline tax system, corporations pay taxes on their profits under the regular tax rate schedule. In contrast, the Tax Code provides for the incomes of mutual and cooperative telephone and electric companies to be exempt from tax if at least 85 percent of their receipts are derived from patron service charges.

90. **Empowerment zones.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low tax rates to apply to certain types or sources of income, tax credits, and write-offs faster than economic depreciation. In contrast, the Tax Code allows qualifying businesses in designated economically depressed areas to receive tax benefits such as an employment credit and special tax-exempt financing. A taxpayer's ability to accrue new tax benefits for empowerment zones expires on December 31, 2025.

91. **New markets tax credit.**—The baseline tax system would not allow credits for particular activities, investments, or industries. However, the Tax Code allows taxpayers who make qualified equity investments in a community development entity (CDE), which then make qualified investments in low-income communities, to be eligible for a tax credit that is received over 7 years. The total equity investment available for the credit across all CDEs is generally \$5 billion for each calendar year 2020 through 2025, the last year for which credit allocations are authorized.

92. **Credit to holders of Gulf and Midwest Tax Credit Bonds.**—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, under current law taxpayers that own Gulf and Midwest Tax Credit bonds receive a non-refundable tax credit rather than interest. The credit is included in gross income.

93. **Recovery Zone Bonds.**—The baseline tax system would not allow credits for particular activities, investments, or industries. In addition, it would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allowed local governments to issue up to \$10 billion in taxable Recovery Zone Economic Development Bonds in 2009 and 2010 and receive a direct payment from Treasury equal to 45 percent of interest expenses. In addition, local governments could issue up to \$15 billion in tax exempt Recovery Zone Facility Bonds. These bonds financed certain kinds of business development in areas of economic distress.

94. **Tribal Economic Development Bonds.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code was modified in 2009 to allow Indian tribal governments to issue tax exempt "tribal economic development bonds." There is a national bond limitation of \$2 billion on such bonds.

95. **Opportunity Zones.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow deferral or exclusion from income for investments made within certain geographic regions. In contrast, the Tax Code allows the temporary deferral of the recognition of capital gain if reinvested prior to December 31, 2026, in a qualifying opportunity fund which in turn invests in qualifying low-income communities designated as opportunity zones. For qualifying investments held at least 5 years, 10 percent of the deferred gain is excluded from income; this exclusion increases to 15 percent for investments held for at least 7 years. In addition, capital gains from the sale or exchange of an investment in a qualified opportunity fund held for at least 10 years are excluded from gross income.

96. **Disaster Employee Retention Credit.**—The baseline tax system would not allow credits for particular activities, investments, or industries. In contrast, the Tax Code provides employers located in certain presidentially declared disaster areas during the years 2017 through 2020 a 40 percent credit for up to \$6,000 in wages paid to each eligible employee while the business was inoperable as a result of the disaster. Only wages paid after the disaster occurred and within 150 days of the last day of the incident period are eligible for the credit. Employers must reduce their deduction for wages paid by the amount of the credit claimed.

Education, Training, Employment, and Social Services

97. **Exclusion of scholarship and fellowship income (normal tax method).**—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 baseline tax system of the reference tax 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.)

98. **Tax credits for post-secondary education expenses.**—The baseline tax system would not allow credits for particular activities, investments, or industries. Under current law in 2022, however, there are two credits for certain post-secondary education expenses. The American Opportunity Tax Credit (AOTC) allows a partially refundable credit of up to \$2,500 per eligible student for qualified tuition and related expenses paid. The AOTC may be claimed during each of the first four years of the student's post-secondary education. The Lifetime Learning Credit (LLC) allows a non-refundable credit for 20 percent of an eligible student's qualified tuition and fees, up to a maximum credit of \$2,000 per return. The LLC may be claimed during any year of the student's post-secondary education. Only one credit may be claimed per student per year. The combined credits are phased out for taxpayers with modified adjusted gross income between \$160,000 and \$180,000 if married filing jointly (\$80,000 and \$90,000 for other taxpayers), not indexed. Married individuals filing separate returns cannot claim either credit.

99. **Deductibility of student loan interest.**—The baseline tax system accepts current law's general rule limiting taxpayers' ability to deduct non-business interest expenses. In contrast, taxpayers may claim an above-the-line deduction of up to \$2,500 on interest paid on an education loan. In 2022, the maximum deduction is phased down ratably for taxpayers with modified AGI between \$140,000 and \$170,000 if married filing jointly (\$70,000 and \$85,000 for other taxpayers). Married individuals filing separate returns cannot claim the deduction.

100. **Qualified tuition programs (includes Education IRA).**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. Some States have adopted prepaid tuition plans, prepaid room and board plans, and college savings plans, which allow persons to pay in advance or save for college expenses for designated beneficiaries. Under current law, investment income, or the return on prepayments, is not taxed when earned, and is tax-exempt when withdrawn to pay for qualified expenses. Beginning in 2018, the definition of a qualified expense was expanded to include up to \$10,000 per child per year of expenses for primary or secondary education, including tuition at religious schools.

101. **Exclusion of interest on student-loan bonds.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, interest earned on State and local bonds issued to finance student loans is tax-exempt under current law. The volume of all such private activity bonds that each State may issue annually is limited.

102. **Exclusion of interest on bonds for private nonprofit educational facilities.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, under current law interest earned on State and local Government bonds issued to finance the construction of facilities used by private nonprofit educational institutions is not taxed.

103. **Credit for holders of zone academy bonds.**—The baseline tax system would not allow credits for particular activities, investments, or industries. Under current law, however, 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 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 was limited to \$1.4 billion in 2009 and 2010. As of March 2010, issuers of the unused authorization of such bonds could opt to receive direct payment with the yield becoming fully taxable. An additional \$0.4 billion of these bonds with a tax credit was authorized to be issued each year in 2011 through 2016.

104. **Exclusion of interest on savings bonds redeemed to finance educational expenses.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. Under current law, however, 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 \$128,650 and \$156,650 if married filing jointly (\$83,200 and \$98,200 for other taxpayers) in 2022.

105. **Parental personal exemption for students age 19 or over.**—Under the baseline tax system, a personal exemption would be allowed for the taxpayer, as well as for the taxpayer's spouse and dependents who do not claim a personal exemption on their own tax returns. These exemptions are repealed for taxable years beginning after December 31, 2017, and before January 1, 2026. However, the definitions regarding eligibility for dependent exemptions for children (and qualifying relatives), which determine eligibility for a number of family-related provisions, remain in place. These provisions include the new \$500 credit for dependents other than qualifying children (Other Dependent Credit, or ODP). In general, to be considered a dependent child, a child would have to be under age 19. In contrast, the Tax Code allows taxpayers to consider their children aged 19 to 23 as dependents, as long as the children are full-time students and reside with the taxpayer for over half the year (with exceptions for temporary absences from home, such as for school attendance). Absent this provision, children over 18 would need to meet the more stringent rules for qualified relatives in order to qualify the taxpayer for certain benefits, including the ODP.

106. **Deductibility of charitable contributions (education).**—The baseline tax system would not allow a deduction for personal expenditures. In contrast, the Tax Code provides taxpayers a deduction for contributions to nonprofit educational institutions that are similar to personal expenditures. Moreover, taxpayers who donate capital assets to educational institutions can deduct the asset's current value without being taxed on any appreciation in value. An individual's total charitable contribution

generally may not exceed 50 percent (60 percent for tax years 2018 through 2025) of adjusted gross income; a corporation's total charitable contributions generally may not exceed 10 percent of pre-tax income.

107. **Exclusion of employer-provided educational assistance.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income because it represents accretions to wealth that do not materially differ from cash wages. Under current law, however, 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. The maximum exclusion is \$5,250 per taxpayer. From March 27, 2020 through December 31, 2025 employer-provided student loan payments are considered eligible educational assistance.

108. **Special deduction for teacher expenses.**—The baseline tax system would not allow a deduction for personal expenditures. In contrast, the Tax Code allowed educators in both public and private elementary and secondary schools, who worked at least 900 hours during a school year as a teacher, instructor, counselor, principal or aide, to subtract up to \$250 of qualified expenses, indexed to 2014, when determining their adjusted gross income (AGI).

109. **Discharge of student loan indebtedness.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, the Tax Code allows certain professionals who perform in underserved areas or specific fields, and as a consequence have their student loans discharged, not to recognize such discharge as income.

110. **Qualified school construction bonds.**—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code was modified in 2009 to provide a tax credit in lieu of interest to holders of qualified school construction bonds. The national volume limit is \$22.4 billion over 2009 and 2010. As of March 2010, issuers of such bonds could opt to receive direct payment with the yield becoming fully taxable.

111. **Work opportunity tax credit.**—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code provides employers with a tax credit for qualified wages paid to individuals. The credit applies to employees who began work on or before December 31, 2025 and who are certified as members of various targeted groups. The amount of the credit that can be claimed is 25 percent of qualified wages for employment less than 400 hours and 40 percent for employment of 400 hours or more. Generally, 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. However, the credit for long-term welfare recipients can be claimed on second year wages as well and has a \$9,000 maximum. Also, certain categories of veterans are eligible for a higher maximum credit of up to \$9,600. Employers must reduce their deduction for wages paid by the amount of the credit claimed.

112. **Employer-provided child care exclusion.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, current law allows up to \$5,000 of employer-provided child care to be excluded from an employee's gross income even though the employer's costs for the child care are a deductible business expense. The amount was temporarily increased to \$10,500 for 2021.

113. **Employer-provided child care credit.**—The baseline tax system would not allow credits for particular activities, investments, or industries. In contrast, current law provides a credit 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.

114. **Assistance for adopted foster children.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. 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; special needs adoptions receive the maximum benefit even if that amount is not spent. These payments are excluded from gross income under current law.

115. **Adoption credit and exclusion.**—The baseline tax system would not allow credits for particular activities. In contrast, taxpayers can receive a tax credit for qualified adoption expenses under current law. Taxpayers may also exclude qualified adoption expenses provided or reimbursed by an employer 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.

116. **Exclusion of employee meals and lodging (other than military).**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. Furthermore, all compensation would generally be deductible by the employer. In contrast, under current law employer-provided meals and lodging are excluded from an employee's gross income. Additionally, beginning in 2018, employers are allowed a deduction for only 50 percent of the expenses of employer-provided meals, except that in 2021 and 2022, employers are eligible for a full deduction on restaurant meals provided to employees. Employer-provided lodging is fully deductible by the employer, in general.

117. **Credit for child and dependent care expenses.**—The baseline tax system would not allow credits for particular activities or targeted at specific groups. In contrast, the Tax Code provides a tax credit to parents who work or attend school and who have child and dependent care expenses. In taxable year 2022, expenditures up to a maximum \$3,000 for one dependent and

\$6,000 for two or more dependents are eligible for a nonrefundable credit. The credit is equal to 35 percent of qualified expenditures for taxpayers with incomes of up to \$15,000. The credit is reduced to a minimum of 20 percent by one percentage point for each \$2,000 of income in excess of \$15,000.

118. **Credit for disabled access expenditures.**—The baseline tax system would not allow credits for particular activities, investments, or industries. In contrast, the Tax Code provides small businesses (less than \$1 million in gross receipts or fewer than 31 full-time employees) a 50 percent credit for expenditures in excess of \$250 to remove access barriers for disabled persons. The credit is limited to \$5,000.

119. **Deductibility of charitable contributions, other than education and health.**—The baseline tax system would not allow a deduction for personal expenditures including charitable contributions. In contrast, the Tax Code provides taxpayers a deduction for 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 (60 percent between 2018 and 2025) of adjusted gross income; a corporation's total charitable contributions generally may not exceed 10 percent of pre-tax income.

120. **Exclusion of certain foster care payments.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. Foster parents provide a home and care for children who are wards of the State, under contract with the State. Under current law, compensation received for this service is excluded from the gross incomes of foster parents; the expenses they incur are nondeductible.

121. **Exclusion of parsonage allowances.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, would be included in taxable income. Dedicated payments and in-kind benefits represent accretions to wealth that do not differ materially from cash wages. In contrast, the Tax Code allows an exclusion from a clergyman's taxable income for the value of the clergyman's housing allowance or the rental value of the clergyman's parsonage.

122. **Indian employment credit.**—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code provides employers with a tax credit for qualified wages paid to employees who are enrolled members of Indian tribes. The amount of the credit that could be claimed is 20 percent of the excess of qualified wages and health insurance costs paid by the employer in the current tax year over the amount of such wages and costs paid by the employer in 1993. Qualified wages and health insurance costs with respect to any employee for the taxable year could not exceed \$20,000. Employees have to live on or near the reservation where they work to be eligible for the credit. Employers must reduce their deduction for wages paid by the amount of the credit claimed. The credit does not apply to taxable years beginning after December 31, 2021.

Health

123. **Exclusion of employer contributions for medical insurance premiums and medical care.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, under current law, employer-paid health insurance premiums and other medical expenses (including long-term care or Health Reimbursement Accounts) are not included in employee gross income even though they are deducted as a business expense by the employee.

124. **Self-employed medical insurance premiums.**—Under the baseline tax system, all compensation and remuneration, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, under current law self-employed taxpayers may deduct their family health insurance premiums. Taxpayers without self-employment income are not eligible for this special deduction. The deduction is not available for any month in which the self-employed individual is eligible to participate in an employer-subsidized health plan and the deduction may not exceed the self-employed individual's earned income from self-employment.

125. **Medical Savings Accounts and Health Savings Accounts.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. Also, the baseline tax system would not allow a deduction for personal expenditures and generally would tax investment earnings. In contrast, individual contributions to Archer Medical Savings Accounts (Archer MSAs) and Health Savings Accounts (HSAs) are allowed as a deduction in determining adjusted gross income whether or not the individual itemizes deductions. Employer contributions to Archer MSAs and HSAs are excluded from income and employment taxes. Archer MSAs and HSAs require that the individual have coverage by a qualifying high deductible health plan. Earnings from the accounts are excluded from taxable income. Distributions from the accounts used for medical expenses are not taxable. The rules for HSAs are generally more flexible than for Archer MSAs and the deductible contribution amounts are greater (in 2019, \$3,500 for taxpayers with individual coverage and \$7,000 for taxpayers with family coverage). Thus, HSAs have largely replaced MSAs.

126. **Deductibility of medical expenses.**—The baseline tax system would not allow a deduction for personal expenditures. In contrast, under current law personal expenditures for medical care (including the costs of prescription drugs) exceeding 7.5 percent of the taxpayer's adjusted gross income are deductible. For tax years beginning after 2012, only medical expenditures

exceeding 10 percent of the taxpayer's adjusted gross income are deductible. However, for the years 2013, 2014, 2015 and 2016, if either the taxpayer or the taxpayer's spouse turned 65 before the end of the taxable year, the threshold remained at 7.5 percent of adjusted income. Beginning in 2017, the 10 percent threshold applied to all taxpayers, including those over 65.

127. **Exclusion of interest on hospital construction bonds.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, under current law interest earned on State and local government debt issued to finance hospital construction is excluded from income subject to tax.

128. **Refundable Premium Assistance Tax Credit.**—The baseline tax system would not allow credits for particular activities or targeted at specific groups. In contrast, for taxable years ending after 2013, the Tax Code provides a premium assistance credit to any eligible taxpayer for any qualified health insurance purchased through a Health Insurance Exchange. In general, an eligible taxpayer is a taxpayer with annual household income between 100 percent and 400 percent of the federal poverty level for a family of the taxpayer's size and that does not have access to affordable minimum essential health care coverage. The amount of the credit equals the lesser of (1) the actual premiums paid by the taxpayer for such coverage or (2) the difference between the cost of a statutorily-identified benchmark plan offered on the exchange and a required payment by the taxpayer that increases with income. The American Rescue Plan Act of 2021 (P.L. 117-2) temporarily increased the Premium Tax Credit in three ways. For 2021 and 2022, the legislation increased the Premium Tax Credit for currently eligible individuals and families, providing access to free plans for those earning 100 to 150 percent of the federal poverty level, and expanded eligibility to newly include individuals and families with income above 400 percent of the federal poverty level. The legislation also expanded eligibility in 2021 to individuals who receive unemployment insurance for any week in 2021. The legislation also eliminated the requirement for individuals to repay any excess advance payments of the Premium Tax Credit for 2020.

129. **Credit for employee health insurance expenses of small business.**—The baseline tax system would not allow credits for particular activities or targeted at specific groups. In contrast, the Tax Code provides a tax credit to qualified small employers that make a certain level of non-elective contributions towards the purchase of certain health insurance coverage for its employees. To receive a credit, an employer must have fewer than 25 full-time-equivalent employees whose average annual full-time-equivalent wages from the employer are less than \$50,000 (indexed for taxable years after 2013). However, to receive a full credit, an employer must have no more than 10 full-time employees, and the average wage paid to these employees must be no more than \$25,000 (indexed for taxable years after 2013). A qualifying employer may claim the credit for any taxable year beginning in 2010, 2011, 2012, and 2013 and for up to two years for insurance purchased through a Health Insurance Exchange thereafter. For taxable years beginning in 2010, 2011, 2012, and 2013, the maximum credit is 35 percent of premiums paid by qualified taxable employers and 25 percent of premiums paid by qualified tax-exempt organizations. For taxable years beginning in 2014 and later years, the maximum tax credit increases to 50 percent of premiums paid by qualified taxable employers and 35 percent of premiums paid by qualified tax-exempt organizations.

130. **Deductibility of charitable contributions (health).**—The baseline tax system would not allow a deduction for personal expenditures including charitable contributions. In contrast, the Tax Code provides individuals and corporations a deduction for 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.

131. **Tax credit for orphan drug research.**—The baseline tax system would not allow credits for particular activities, investments, or industries. In contrast, under current law drug firms can claim a tax credit of 25 percent of the costs for clinical testing required by the Food and Drug Administration for drugs that treat rare physical conditions or rare diseases.

132. **Special Blue Cross/Blue Shield tax benefits.**—The baseline tax system generally would tax all profits under the regular tax rate schedule using broadly applicable measures of baseline income. It would not allow preferentially low tax rates to apply to certain types or sources of income. In contrast, certain Blue Cross and Blue Shield (BC/BS) health insurance providers and certain other health insurers are provided with special tax benefits, provided that their percentage of total premium revenue expended on reimbursement for clinical services provided to enrollees or for activities that improve health care quality is not less than 85 percent for the taxable year. A qualifying insurer may take as a deduction 100 percent of any net increase in its unearned premium reserves, instead of the 80 percent allowed other insurers. A qualifying insurer is also allowed a special deduction equal to the amount by which 25 percent of its health-claim expenses exceeds its beginning-of-the-year accounting surplus. The deduction is limited to the insurer's taxable income determined without the special deduction.

133. **Distributions from retirement plans for premiums for health and long-term care insurance.**—Under the baseline tax system, all compensation, including dedicated and deferred payments, should be included in taxable income. In contrast, the Tax Code provides for tax-free distributions of up to \$3,000 from governmental retirement plans for premiums for health and long term care premiums of public safety officers.

134. **Credit for family and sick leave taken by self-employed individuals.**—The baseline tax system would not allow credits for particular activities or targeted as specific groups. Under current law, however, self-employed individuals are allowed a refundable credit equal for certain family or sick leave taken. In general, the sick leave credit is equal to 100% of daily self-employment income (equal to self-employment income divided by 260) during a period of qualified sick leave, up to \$511 per day for 10 days. The family leave credit is equal to two thirds of daily self-employment income (but no greater than two thirds of \$200)

during a period of qualified family leave for up to 10 weeks. Under current law, the credit applies to leave taken prior to October 1, 2021.

Income Security

135. **Child tax credit.**—The baseline tax system would not allow credits for particular activities or targeted at specific groups. Under current law, however, taxpayers with children under age 18 can qualify for a child tax credit. In taxable years 2022 through 2025, taxpayers may claim a \$2,000 per child partially refundable child tax credit. Up to \$1,500 per child of unclaimed credit due to insufficient tax liability may be refundable—taxpayers may claim a refund for 15 percent of earnings in excess of a \$2,500 floor, up to the lesser of the amount of unused credit or \$1,500 per child. A taxpayer may also claim a nonrefundable credit of \$500 for each qualifying child not eligible for the \$2,000 credit (those over sixteen and those without SSNs) and for each dependent relative. The total combined child and other dependent credit is phased out for taxpayers at the rate of \$50 per \$1,000 of modified AGI above \$400,000 if married filing jointly (\$200,000 for all other filers). For tax years beginning after December 31, 2025, the credit returns to its pre-TCJA value of \$1,000. At that time, up to the full value of the credit (subject to a phase-in of 15 percent of earnings in excess of \$3,000) will be refundable and the \$500 other dependent credit will expire. The credit will once again phase out at the rate of \$50 per \$1,000 of modified AGI above \$110,000 if married filing jointly (\$75,000 for single or head of household filers and \$55,000 for married taxpayers filing separately).

136. **Exclusion of railroad (Social Security equivalent) benefits.**—Under the baseline tax system, all compensation, including dedicated and deferred payments, should be included in taxable income. In contrast, the Social Security Equivalent Benefit paid to railroad retirees and the disabled is not generally subject to the income tax unless the recipient's modified gross income reaches a certain threshold under current law. See provision number 156, Social Security benefits for retired and disabled workers and spouses, dependents, and survivors, for a discussion of the threshold.

137. **Exclusion of workers' compensation benefits.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. However, workers compensation is not subject to the income tax under current law.

138. **Exclusion of public assistance benefits (normal tax method).**—Under the reference tax law baseline, gifts and transfers are not treated as income to the recipients. In contrast, the normal tax method considers cash transfers from the Government as part of the recipients' income, and thus, treats the exclusion for public assistance benefits under current law as a tax expenditure.

139. **Exclusion of special benefits for disabled coal miners.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. However, 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.

140. **Exclusion of military disability pensions.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, most of the military disability pension income received by current disabled military retirees is excluded from their income subject to tax.

141. **Defined benefit employer plans.**—Under the baseline tax system, all compensation, including deferred and dedicated payments, should be included in taxable income. In addition, investment income would be taxed as earned. In contrast, under current law certain contributions to defined benefit pension plans are excluded from an employee's gross income even though employers can deduct their contributions. In addition, the tax on the investment income earned by defined benefit pension plans is deferred until the money is withdrawn.

142. **Defined contribution employer plans.**—Under the baseline tax system, all compensation, including deferred and dedicated payments, should be included in taxable income. In addition, investment income would be taxed as earned. In contrast, under current law individual taxpayers and employers can make tax-preferred contributions to employer-provided 401(k) and similar plans (e.g. 403(b) plans and the Federal Government's Thrift Savings Plan). In 2022, an employee could exclude up to \$20,500 of wages from AGI under a qualified arrangement with an employer's 401(k) plan. Employees age 50 or over could exclude up to \$27,000 in contributions. The defined contribution plan limit, including both employee and employer contributions, is \$61,000 in 2022. The tax on contributions made by both employees and employers and the investment income earned by these plans is deferred until withdrawn.

143. **Individual Retirement Accounts (IRAs).**—Under the baseline tax system, all compensation, including deferred and dedicated payments, should be included in taxable income. In addition, investment income would be taxed as earned. In contrast, under current law individual taxpayers can take advantage of traditional and Roth IRAs to defer or otherwise reduce the tax on the return to their retirement savings. The IRA contribution limit is \$6,000 in 2022; taxpayers age 50 or over are allowed to make additional "catch-up" contributions of \$1,000. Contributions to a traditional IRA are generally deductible but the deduction is phased out for workers with incomes above certain levels if the workers or their spouses are active participants in an employer-provided retirement plan. Contributions and account earnings are includible in income when withdrawn from traditional IRAs. Roth IRA contributions are not deductible, but earnings and withdrawals are exempt from taxation. Income limits also apply to Roth IRA contributions.

144. **Low- and moderate-income savers' credit.**—The baseline tax system would not allow credits for particular activities or targeted at specific groups. In contrast, the Tax Code provides an additional incentive for lower-income taxpayers to save through a nonrefundable credit of up to 50 percent on IRA and other retirement contributions of up to \$2,000. This credit is in addition to any deduction or exclusion. The credit is completely phased out by \$68,000 for joint filers, \$51,000 for head of household filers, and \$34,000 for other filers in 2022.

145. **Self-employed plans.**—Under the baseline tax system, all compensation, including deferred and dedicated payments, should be included in taxable income. In addition, investment income would be taxed as earned. In contrast, under current law self-employed individuals can make deductible contributions to their own retirement plans equal to 25 percent of their income, up to a maximum of \$61,000 in 2022. Total plan contributions are limited to 25 percent of a firm's total wages. The tax on the investment income earned by self-employed SEP, SIMPLE, and qualified plans is deferred until withdrawn.

146. **Premiums on group term life insurance.**—Under the baseline tax system, all compensation, including deferred and dedicated payments, should be included in taxable income. In contrast, under current law employer-provided life insurance benefits are excluded from an employee's gross income (to the extent that the employer's share of the total costs does not exceed the cost of \$50,000 of such insurance) even though the employer's costs for the insurance are a deductible business expense.

147. **Premiums on accident and disability insurance.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, under current law 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.

148. **Exclusion of investment income from Supplementary Unemployment Benefit Trusts.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In addition, investment income would be taxed as earned. Under current law, employers may establish trusts to pay supplemental unemployment benefits to employees separated from employment. Investment income earned by such trusts is exempt from taxation.

149. **Exclusion of investment income from Voluntary Employee Benefit Associations trusts.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. Under current law, employers may establish associations, or VEBAs, to pay employee benefits, which may include health benefit plans, life insurance, and disability insurance, among other employee benefits. Investment income earned by such trusts is exempt from taxation.

150. **Special Employee Stock Ownership Plan (ESOP) rules.**— Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In addition, investment income would be taxed as earned. In contrast, 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. In addition, 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 than other qualified retirement plans; (2) ESOPs may borrow to purchase employer stock, guaranteed by their agreement with the employer that the debt will be serviced by the payment (deductible by firm) 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; (4) dividends paid to ESOP-held stock are deductible by the employer; and (5) earnings are not taxed as they accrue.

151. **Additional deduction for the blind.**—Under the baseline tax system, the standard deduction is allowed. An additional standard deduction for a targeted group within a given filing status would not be allowed. In contrast, the Tax Code allows taxpayers who are blind to claim an additional \$1,750 standard deduction if single or \$1,400 if married in 2022.

152. **Additional deduction for the elderly.**—Under the baseline tax system, the standard deduction is allowed. An additional standard deduction for a targeted group within a given filing status would not be allowed. In contrast, the Tax Code allows taxpayers who are 65 years or older to claim an additional \$1,750 standard deduction if single or \$1,400 if married in 2022.

153. **Deductibility of casualty losses.**—Under the baseline tax system, neither the purchase of property nor insurance premiums to protect the property's value are deductible as costs of earning income. Therefore, reimbursement for insured loss of such property is not included as a part of gross income, and uninsured losses are not deductible. In contrast, the Tax Code provides a deduction for uninsured casualty and theft losses of more than \$100 each, to the extent that total losses during the year exceed 10 percent of the taxpayer's adjusted gross income. In the case of taxable years beginning after December 31, 2017, and before January 1, 2026, personal casualty losses are deductible only to the extent they are attributable to a Federally declared disaster area.

154. **Earned income tax credit (EITC).**—The baseline tax system would not allow credits for particular activities or targeted at specific groups. In contrast, the Tax Code provides an EITC to low-income workers at a maximum rate of 45 percent of income. In 2022, for a family with one qualifying child, the credit is 34 percent of the first \$10,980 of earned income. The credit is 40 percent of the first \$14,950 of income for a family with two qualifying children, and it is 45 percent of the first \$15,410 of income for a family with three or more qualifying children. Low-income workers with no qualifying children are eligible for a 7.65 percent credit on the first \$7,320 of earned income. The credit plateaus and then phases out with the greater of AGI or

earnings at income levels and rates which depend upon how many qualifying children are eligible and marital status. In 2022, the phase-down for married filers begins at incomes \$6,130 greater than for otherwise similar unmarried filers. Earned income tax credits in excess of tax liabilities owed through the individual income tax system are refundable to individuals. Beginning in 2018, the parameters of the EITC are indexed by the chained CPI, which results in a smaller inflation adjustment than previously. This change is permanent.

155. **Recovery rebate credits.**—The baseline tax system would not allow credits for particular activities or targeted at specific groups. In contrast, the Coronavirus Aid, Relief, and Economic Security (CARES) Act provided rebates of \$1,200 (\$2,400 for married couples filing jointly) and 500 per child. The total rebate amount begins phasing out at adjusted gross income over \$75,000 (\$150,000 for married couples filing jointly, \$112,500 for heads of household). This was followed by the Consolidated Appropriations Act which provided rebates of \$600 per eligible taxpayer (\$1,200 for married couples filing jointly) plus an additional \$600 per child, with phase-out features similar to the CARES Act. The American Rescue Plan act provided another rebate credit of \$1,400 (\$2,800 for married couples filing jointly) and \$1,400 per dependent in 2021. The phase out begins at the same thresholds as the CARES Act, but the full credit is phased out proportionately by \$80,000 of AGI (\$160,000 for married couples filing jointly, \$120,000 for heads of household).

Social Security

156. **Social Security benefits for retired and disabled workers and spouses, dependents, and survivors.**—The baseline tax system would tax Social Security benefits to the extent that contributions to Social Security were not previously taxed. Thus, the portion of Social Security benefits that is attributable to employer contributions and to earnings on employer and employee contributions (and not attributable to employee contributions which are taxed at the time of contribution) would be subject to tax. In contrast, the Tax Code may not tax all of the Social Security benefits that exceed the beneficiary's contributions from previously taxed income. Actuarially, previously taxed contributions generally do not exceed 15 percent of benefits, even for retirees receiving the highest levels of benefits. Therefore, up to 85 percent of recipients' Social Security and Railroad Social Security Equivalent retirement benefits are included in (phased into) the income tax base if the recipient's provisional income exceeds certain base amounts. (Provisional income is equal to other items included in adjusted gross income plus foreign or U.S. possession income, tax-exempt interest, and one half of Social Security and Railroad Social Security Equivalent retirement benefits.) The untaxed portion of the benefits received by taxpayers who are below the income amounts at which 85 percent of the benefits are taxable is counted as a tax expenditure. Benefits paid to disabled workers and to spouses, dependents, and survivors are treated in a similar manner. Railroad Social Security Equivalent benefits are treated like Social Security benefits. See also provision number 137, Exclusion of Railroad Social Security Equivalent Benefits.

157. **Credit for certain employer contributions to Social Security.**—Under the baseline tax system, employer contributions to Social Security represent labor cost and are deductible expenses. Under current law, however, certain employers are allowed a tax credit, instead of a deduction, against taxes paid on tips received from customers in connection with the providing, delivering, or serving of food or beverages for consumption. The tip credit equals the full amount of the employer's share of FICA taxes paid on the portion of tips, when added to the employee's non-tip wages, in excess of \$5.15 per hour. The credit is available only with respect to FICA taxes paid on tips.

Veterans Benefits and Services

158. **Exclusion of veterans death benefits and disability compensation.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income because they represent accretions to wealth that do not materially differ from cash wages. In contrast, all compensation due to death or disability paid by the Veterans Administration is excluded from taxable income under current law.

159. **Exclusion of veterans pensions.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income because they represent accretions to wealth that do not materially differ from cash wages. Under current law, however, pension payments made by the Veterans Administration are excluded from gross income.

160. **Exclusion of G.I. Bill benefits.**—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income because they represent accretions to wealth that do not materially differ from cash wages. Under current law, however, G.I. Bill benefits paid by the Veterans Administration are excluded from gross income.

161. **Exclusion of interest on veterans housing bonds.**—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, under current law, interest earned on general obligation bonds issued by State and local governments to finance housing for veterans is excluded from taxable income.

General Government

162. *Exclusion of interest on public purpose State and local bonds.*—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, under current law 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.

163. *Build America Bonds.*—The baseline tax system would not allow credits for particular activities or targeted at specific groups. In contrast, the Tax Code in 2009 allowed State and local governments to issue taxable bonds through 2010 and receive a direct payment from Treasury equal to 35 percent of interest expenses. Alternatively, State and local governments could issue taxable bonds and the private lenders receive the 35 percent credit which is included in taxable income.

164. *Deductibility of nonbusiness State and local taxes other than on owner-occupied homes.*—Under the baseline tax system, a deduction for personal consumption expenditures would not be allowed. In contrast, the Tax Code allows taxpayers who itemize their deductions to claim a deduction for State and local income taxes (or, at the taxpayer's election, State and local sales taxes) and property taxes, even though these taxes primarily pay for services that, if purchased directly by taxpayers, would not be deductible. (The estimates for this tax expenditure do not include the estimates for the deductibility of State and local property tax on owner-occupied homes. See item 56.) In the case of taxable years beginning after December 31, 2017, and before January 1, 2026, (1) the deduction for foreign real property taxes paid is disallowed and (2) the deduction for taxes paid in any taxable year, which includes the deduction for property taxes on real property, is limited to \$10,000 (\$5,000 in the case of a married individual filing a separate return).

Interest

165. *Deferral of interest on U.S. savings bonds.*—The baseline tax system would uniformly tax all returns to investments and not allow an exemption or deferral for particular activities, investments, or industries. In contrast, taxpayers may defer paying tax on interest earned on U.S. savings bonds until the bonds are redeemed.