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A CRITICAL REVIEW

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**ABSTRACT**

We examine the measurement of tax expenditures, as well as review issues concerning the classification of tax expenditures generally. We use calculations from NBER's TAXSIM to illustrate some of the problems with the current methodology for estimating tax expenditures. Unlike most previous work on the topic, we focus on how features of the current tax system including the alternative minimum tax and sunset rules complicate and compromise the value of information provided by the tax expenditure budget.

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## INTRODUCTION

To most tax policy analysts, the term “tax expenditure” means a special provision of the tax system that results in reduced tax liability for certain subsets of taxpayers. Moreover, for many in the tax policy community, the term suggests tax breaks for limited constituencies that result in a narrow tax base and higher marginal tax rates. Some are blunter: tax expenditures are loopholes that need to be closed. We leave it to other authors to examine the legitimacy of tax expenditure provisions from tax policy or economic efficiency perspectives. Instead, the present analysis examines the measurement of tax expenditures and details some of the complications and challenges associated with interpreting and applying its results.

The technical definition of tax expenditure is found in the *Congressional Budget and Impoundment Act of 1974* (“Budget Act”), which established the modern Congressional budget-making process.<sup>1</sup> The Budget Act requires annual publication of a list of tax expenditures in order to improve the transparency of the federal government budget and account for proxy spending programs governed by the nation’s tax code. The Budget Act formally defines a tax expenditure as:

“Revenue losses attributable to provisions of Federal income 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.”

As is well known, this definition is open to considerable interpretation. The legislative history for the Budget Act indicates that tax expenditures are to be determined in reference to “normal income tax law.” While not codified, legislative history can provide guidance for implementing the law. However, determining what is “normal” is an open question and almost certainly a normative exercise.

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<sup>1</sup> [Public Law](#) 93-344.

Interestingly, by the time the Budget Act was enacted both the Congressional Joint Committee on Taxation (JCT) and the Department of the Treasury Office of Tax Analysis (OTA) had been producing tax expenditure analysis for years. The term “tax expenditure” is attributed to Assistant Secretary of the Treasury (Tax Policy) Stanley Surrey.<sup>2</sup> In 1967 Surrey instructed his staff to compile a list of preferences and concessions in the income tax that were similar to expenditure programs. While Surrey’s stated motivation was to improve the budget process, he was also interested in drawing attention to subsidies in the tax code in hopes of building momentum for base-broadening tax reform.

Surrey’s efforts resulted in Treasury’s first tax expenditure budget report in 1968. Classifying certain provisions of the Internal Revenue Code as deviations from a comprehensive, progressive income tax, the Department of the Treasury reported tax expenditures for the individual and corporate income tax systems, a process that has continued to the present.<sup>3</sup> While the first tax expenditure lists from Treasury were not included in the official budget, the Budget Act mandated that tax expenditures be reported as part of the Administration budget. The Budget Act required no distributional or other economic analysis beyond an estimate of the magnitude of the cost in terms of lost revenue of each listed tax expenditure.

Reflecting reconsiderations in the concept and presentation of tax expenditures, the Treasury presentation has evolved over time. Starting with the Fiscal Year (FY) 1983 Budget, Treasury introduced an additional tax baseline to classify and estimate tax expenditures. The new baseline, called the “reference” tax baseline, is closer to present law than the normal tax baseline and results in a more narrow definition of tax expenditures. Beginning with the FY 1984 Budget

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<sup>2</sup> As Shaviro (2003) notes, the tax expenditure concept seems to have been invented twice, or at the very least, earlier elsewhere. As early as 1954, writers in Germany had noticed the equivalence between special tax deductions, credits, and other allowances and government subsidies. As a result, in 1959, the German government began reporting on subsidies in the federal budget, including those supplied through the tax system. Budgetary reports on tax subsidies that were classified as indirect spending were being made regularly by 1967.

<sup>3</sup> Until 2003, Treasury also included a list of tax expenditures against a transfer-tax baseline (estate and gift taxes). Tax expenditures for other taxes, such as excise taxes, are not reported. As always, there are limited exceptions. For example, both JCT and Treasury have reported the reduction in excise tax receipts that result from the alcohol fuel and biodiesel credits.

and until recently, Treasury presented outlay equivalent estimates for tax expenditures in addition to the traditional revenue-based estimates.<sup>4</sup> The goal of this approach is to provide estimates that more closely correspond to estimates of direct outlay programs.<sup>5</sup> Starting with the FY 1995 Budget, Treasury has reported present-value calculations of tax expenditures that involve either the deferral of tax payments into future periods or other long-term effects.

Recently, the Administration has expressed concern with the arbitrary tax base used to calculate tax expenditures. The FY 2002 Budget states that “(B)ecause of the breadth of this arbitrary tax base, the Administration believes that the concept of ‘tax expenditure’ is uncertain (OMB 2002, p. 61).” The FY 2003 Budget describes a Treasury Department effort to reconsider and revise the tax expenditure presentation and notes that “(D)ue, in part, to the degree of arbitrariness in the tax expenditure baseline, the Administration believes the meaningfulness of tax expenditure estimates is uncertain (OMB 2003, p.95).” To address these concerns, the Administration began estimating tax expenditure estimates against a comprehensive income tax baseline and a consumption tax baseline in its FY 2004 Budget. In addition, the FY 2004 Budget introduced a number of innovations including changes in the accelerated depreciation baseline, the inclusion of or identification of negative tax expenditures, an estimate of the tax expenditure for net imputed rent for owner-occupied housing, and an estimate of the (negative) tax expenditure for the double-taxation of corporate income against a comprehensive income tax.

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<sup>4</sup> The Administration explains in its FY 2008 Budget that outlay equivalents are no longer included “because they were often the same as the normal tax expenditure estimates, and the criteria for applying the concepts as to when they should differ were often judgmental and hard to apply with consistency across time and across tax expenditure items (OMB 2008, p. 286).”

<sup>5</sup> While the linkage of tax expenditures to direct spending programs has conceptual merit, there are numerous analytical complications that hinder reporting comparable numbers for these two classes of government fiscal policy. Although government accounting is not perfect, auditors and policymakers know with reasonable confidence what resources the federal government dedicates to various spending programs. The same cannot be said of all tax expenditures because of various information asymmetries. The government has access to its spending records. It does not necessarily have access to tax expenditure data. To take just one example, income exclusions that involve no information reporting (e.g. enterprise zone capital gain provisions) cannot be estimated with IRS data. Thus, such tax expenditure estimates rely on the educated guesses of government economists rather than the tabulation of reports by accountants.

The JCT began to estimate tax expenditures in 1972. In contrast to the Treasury analysis, the JCT presentation had remained relatively constant, usefully allowing analysts to make intertemporal comparisons. However, recently JCT announced planned changes to its methods of presentation and measurement of tax expenditures (see JCT 2008). The most significant change involves a revision of the classification of tax expenditures. JCT announced it will identify tax expenditures as either “Tax Subsidies” (tax law provisions that are deliberately inconsistent with an identifiable general rule of present law) or “Tax-Induced Structural Distortions” (structural elements that materially affect economic decisions in a manner that imposes substantial economic efficiency costs).<sup>6</sup> Further, JCT has announced that it will now include negative tax expenditures in its analysis. Finally, the revision will use a reference baseline for estimation purposes. This last change reflects an acknowledgement of the limits of defining tax expenditures relative to a normal income tax baseline. The JCT has indicated that it will publish more details of its proposed changes later in 2008.

The evolution of the Treasury and JCT tax expenditure reports reflect, at least in part, the concerns of analysts writing on the subject from within and outside of government agencies (both in the United States and abroad).<sup>7</sup> Legal scholars and economists have wrestled with the tax expenditure concept since Surrey developed the idea.<sup>8</sup> A growing literature debates the usefulness of tax expenditure analysis for expenditure control, social and economic policy, and tax reform.<sup>9</sup> And recommendations to improve tax expenditure reporting by providing more

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<sup>6</sup> JCT will further divide tax expenditures labeled as Tax Subsidies as Tax Transfers (payments made to taxpayers with regard to tax liability; e.g. child tax credit), Social Spending (policies intended to subsidize or induce behavior; e.g. deduction for charitable giving), or Business Synthetic Spending (provisions intended to subsidize or induce behavior directly related to the production of business or investment income, excluding Tax Subsidies related to labor supply; e.g. section 199 deduction).

<sup>7</sup> The literature on tax expenditures is too extensive to list here. For review of tax expenditure practices in other countries see Polackova et. al. (2004).

<sup>8</sup> See Bittker (1969), Andrews (1972), Surrey (1973), Fiekowsky (1980), Surrey and McDaniel (1985), Thuronyi (1988) and Shaviro (2003), for example.

<sup>9</sup> See, for example, Toder (2002), Burman (2003), and Toder (2005).

detail have recently been put forward by the Century Foundation Working Group on Tax Expenditures (Century Foundation Press 2002).<sup>10</sup>

In this paper, we address the methodology of tax expenditure estimation to illustrate some of the problems with the current methodology.<sup>11</sup> Unlike most previous work on the topic, we focus on features of the current tax system that were not in place when Surrey introduced the expenditure concept, such as the alternative minimum tax (AMT) and sunset rules, and how these features complicate and compromise the value of information provided by the tax expenditure reporting. We begin in the next section with a discussion of the issues that arise in defining the “normal” income tax structure. We review how this definition has been implemented by the JCT and Treasury and illustrate some of the consequences of the choice of the normal tax structure using estimates from NBER’s TAXSIM model. The third section reviews the basics of tax expenditure estimation, explores how “scoring” conventions affect the information provided by estimates, and considers the distributional analysis of tax expenditures. In both the second and third sections, we consider the additional information provided from hypothetical tax expenditures calculated using TAXSIM. The final section concludes.

## **WHAT’S NORMAL?**

A tax expenditure estimate shows the change in Federal income tax revenues due to the hypothetical elimination of a provision of the Internal Revenue Code. To qualify as a tax expenditure, the provision must be classified as a divergence from the defined normal income tax system. As noted above, the Budget Act does not define the reference normal tax. Hence, building a list of tax expenditures requires analysts to first define what constitutes the normal

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<sup>10</sup> Among other proposals, the Century Foundation recommended: (1) combined tax expenditure estimates for groups of tax expenditures to account for interaction effects; (2) historical reporting of tax expenditures using comparable methods; and (3) distributional tax expenditure reporting for major provisions.

<sup>11</sup> In a companion paper, Altshuler and Dietz (2008), we offer recommendations for reform of tax expenditure reporting.

income tax. Baseline tax revenues for the estimation exercise can then be generated in reference to this “normal” tax.<sup>12</sup>

### *Defining the normal income tax*

Defining the baseline tax structure is inherently a subjective exercise since it assumes some parts of existing law are “normal,” while others are intentional policy deviations. At a basic level, defining the normal income tax requires analysts to specify the tax base, the rate structure, and the tax unit.<sup>13</sup> The staffs of the JCT and OTA define the normal structure of the income tax as one personal exemption for each taxpayer, one exemption for each dependent, the standard deduction, the prevailing rate structure for the individual income tax, a separate corporate income tax with one marginal tax rate, and deductions for expenses related to earning income. Consistent with the tax code, tax brackets differ based on marital status. Thus, the tax unit is the individual taxpaying unit for the individual tax and the corporation for the corporate tax.

The staff of the JCT defends the inclusion of the personal exemption and the standard deduction by asserting that these provisions implicitly define a “zero bracket”; the OTA cites tax administration as a possible reason to include these provisions in the normal tax base (see JCT 2007 and OMB 2008). Neither reason is entirely compelling using basic tax policy principles.<sup>14</sup> One could argue that all provisions that make up the tax liability threshold, or the income level at which a family begins to pay positive tax, should be part of the normal tax. Under this scenario, the child credit and earned income tax credit (EITC), for example, would not be tax expenditures because they constitute part of the zero bracket. Alternatively, one could treat the personal

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<sup>12</sup> The revenue baseline is generated using projections of Federal receipts either from the Congressional Budget Office, for the JCT estimates, or the Office of the Management and Budget, for the Treasury Department estimates.

<sup>13</sup> As the paper by Carroll, Joulfaian and Mackie (2008) in this volume makes clear, a provision that is a tax expenditure under one tax base (a comprehensive income tax, for example) may not be classified as an expenditure under an alternative base (a consumption tax, for example).

<sup>14</sup> Including the standard deduction for tax administration reasons is justified on tax administration grounds. It is unclear whether this argument applies to the personal exemption.



exemption and standard deduction as tax expenditures, which they would be, for example, if the normal income tax was structured as the current alternative minimum tax (AMT).

More fundamentally, these uneven distinctions between what is a tax expenditure and what is part of the normal income tax reveal differences that may be meaningful within a tax law context but not within an economic context. As in the case of the EITC, a credit is almost by definition a tax expenditure. However, one could imagine a set of deductions and credits that generates the equivalent tax liabilities for lower-income taxpayers as the prevailing set of marginal tax rates. Under existing practice, the set of deductions and credits is a tax expenditure (for income support) and the set of rates is part of the normal tax system. This discussion serves to illustrate the subjective nature of tax expenditure estimation and classification.

Present practice is not even entirely consistent with respect to rates of tax. While the progressive tax structure in the individual tax is considered normal, the graduated corporate rates that are part of the corporate income tax are treated as a tax expenditure.<sup>15</sup> Furthermore, the reduced rates of tax on long-term capital gains and dividends enacted with the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) are classified as tax expenditures by the staff of the JCT but not by the staff of the OTA. As of 2007, these special rates represent the largest single tax expenditure in the JCT tax expenditure list (JCT 2007).<sup>16</sup>

### ***The normal income tax versus a comprehensive income tax***

The Administration budget presentation includes a detailed discussion of how the normal tax structure differs from a comprehensive income tax (see also Carroll, Joulfaian, and Mackie

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<sup>15</sup> The staff of the JCT includes the lower rates as a tax expenditure arguing that they provide a tax benefit for small businesses.

<sup>16</sup> OTA has included the reduced rates on dividends and capital gains as part of the normal tax since 2005. The Budget document explains that “In a gradual transition to a more economically neutral tax system under which all income is taxed no more than once, the lower tax rates on dividends and capital gains on corporate equity under current law have not been considered tax preferences since 2005 (OMB 2007, page 299).” As a result, the OTA tax expenditure estimates for the lower rates on capital, step-up in bases, and inside build-up on tax-preferred assets are limited to capital gains from sources other than corporate equity.

2008). We briefly highlight the main differences in this section. As mentioned above, the normal tax structure used by JCT and OTA includes a separate corporate income tax. Under a comprehensive income tax, the two systems would presumably be integrated so that all income would be subject to taxation once at the recipient's personal tax rate. Although the normal structure does include a foreign tax credit and dividends received deduction to prevent double taxation at the corporate level, the present concept does not include any provision to mitigate the double taxation of income that results from having both corporate and individual tax systems. As mentioned in the introduction, the staff of the OTA includes an appendix to the tax expenditure section of the Budget that reports the "double tax on corporate profit" as a negative tax expenditure. The estimate is negative since the "provision" raises rather than loses revenue relative to the baseline tax system.

Another major departure from a comprehensive income tax base involves the timing of taxes. While a comprehensive income tax would tax all income as it is earned, the normal structure taxes capital gains only upon realization. Thus, deferral of tax on capital gains is not considered a tax expenditure under the normal tax structure.<sup>17</sup>

A comprehensive income tax would levy tax on real as opposed to nominal gains in capital asset or debt values. But present law fails to provide any indexing of the bases of capital assets or debt. Both the JCT and OTA follow present law in their normal tax definition.

A comprehensive income base would include accrued and imputed income such as imputed rent from housing and imputed services from consumer durable goods. Until 2006, the revenue loss from the exclusion of imputed rent was not reported in either the JCT or OTA tax expenditure exercises. Starting with the FY 2006 Budget, the Treasury began estimating the tax expenditure for the exclusion of implicit rental income of homeowners net of depreciation, interest and taxes. The present treatment creates an inconsistency, however. The OTA estimate

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<sup>17</sup> It is interesting to note that some provisions in the tax code that allow deferral of taxation are identified as such. For example, the deferral of gain on like-kind exchanges and interest on savings bonds are tax expenditures.

for net imputed rent appears in the regular listing of tax expenditures. But if imputed rent is treated as a tax expenditure, then the mortgage interest deduction and deduction for taxes on owner-occupied homes should not be reported as tax expenditures. OTA lists all these provisions as tax expenditures, which results in double counting. Moreover, the OTA does not report similar, although smaller, imputed-rent tax expenditures for other durable goods, such as vehicles.

The individual AMT and passive loss rules create their own complexities with respect to tax expenditure classification. A comprehensive income tax would (presumably) not include an AMT and would allow for the full deduction of losses generated from passive activities. The annual JCT tax expenditure pamphlet explains that the AMT and the passive activity loss rules are not part of the normal income tax. Instead, they are viewed as provisions that reduce the magnitude of the tax expenditures to which they apply. Exceptions to the AMT and the passive loss rules are therefore not classified as tax expenditures by the staff of the JCT because the effects of the exceptions are already incorporated in the estimates of related tax expenditures. The OTA lists the AMT and passive loss rules as part of the normal tax system.

Like the individual AMT, the corporate AMT is part of the normal tax structure for the OTA but not for the JCT. Both agencies consider the prevailing rules providing for carrybacks and carryforwards of business net operating losses as a part of the normal tax structure. Under a comprehensive income tax, however, losses would be fully and immediately deductible. Another difficult issue for any tax system involves the tax treatment of the recovery of capital costs. Analysts must specify the “normal” treatment of depreciation for tax purposes. A comprehensive income tax would provide inflation adjusted allowances for economic depreciation. The OTA follows this treatment and uses estimates of real, inflation adjusted, economic depreciation in its normal tax baseline. In contrast, the JCT treats capital cost recovery allowances that are more

generous than those provided under section 168(g), which allows straight-line depreciation over a period that is longer than under the current law accelerated system, as tax expenditures.<sup>18</sup>

### ***Differences in normal tax baseline across institutions***

As should be clear, the definition of the normal tax is not obvious. The normal tax is not analogous to a comprehensive income tax or the current tax system and changes over time. Further, JCT and OTA employ slightly different definitions. In addition, as mentioned in the introduction, the staff of the OTA currently uses two baselines: a normal tax baseline and a reference tax baseline with the latter being closer to existing tax law.

Table 1 shows the differences between the JCT and OTA definitions of “normal tax” as well as the difference between the OTA “normal” and “reference” tax baselines. As the table demonstrates, the JCT methodology uses a somewhat broader definition of the normal income tax base. Accordingly, the JCT list of tax expenditures includes some provisions that are not contained in the Treasury list.<sup>19</sup> The most striking differences, in terms of the magnitudes of the estimates, are the omissions from the OTA tax expenditure list of reduced rates on dividends and capital gains, cash accounting, and the exclusion of the value of Medicare Part A (hospital insurance), Part B (supplementary medical insurance), and Part D (prescription drug insurance) in excess of premiums.

### ***The normal tax structure and tax expenditure estimates***

Tax policy proposals that change the normal tax structure by definition change the magnitude of tax expenditure estimates. A decrease in marginal tax rates or an increase in the

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<sup>18</sup> Prior to 2004, OTA used the JCT methodology.

<sup>19</sup> Nonetheless, there are tax expenditures reported by OTA that are not reported by the JCT. Until 2007, the JCT pamphlet has included a list of tax expenditures that are scored by the JCT but not by Treasury (and vice-versa). An interesting difference in particulars but not to the general rule is that Treasury counts a credit against excise taxes that has no effect on income tax liabilities, the alternative fuel and fuel mixture tax credit, as a tax expenditure. JCT provides an estimate for an income tax credit provided for the carrying of excise taxes paid on distilled spirits in wholesale inventories.

standard deduction, for example, will decrease the tax expenditure for the mortgage interest deduction. As a result, both the size and distribution of tax expenditures can be affected by intentional as well as unintentional policy changes.

### *Consequences of the standard deduction*

Including the standard deduction in the normal tax structure has an important impact on the tax expenditures for itemized deductions. As explained further in the next section, the procedure for estimating tax expenditures essentially consists of running taxpayers through a tax calculator under the baseline normal tax structure with and without the tax provision and comparing tax revenues. A taxpayer that would not itemize in the absence of a particular itemized deduction is assumed to claim the standard deduction (this is sometimes called “tax form behavior”). As a result, the standard deduction reduces the estimate of some tax expenditures arising from itemized deductions. Some examples of the effect of the standard deduction on the tax expenditure estimates are shown in Table 2.

The hypothetical taxpayer in Table 2 itemizes and claims a total of \$13,100 in itemized deductions for state and local income taxes, real estate taxes, home mortgage interest, and charitable contributions. The standard deduction is assumed to be \$10,000 and the taxpayer is assumed to face a marginal tax rate of 20 percent regardless if s/he itemizes. We ignore complications related to the AMT for now. The first column shows the base case; the next four columns show the tax expenditure estimates for each of the itemized deductions.

Note first that although the deductions this taxpayer claims for state and local income taxes and for real estate taxes are different, the tax expenditure estimates are identical. This is shown in columns (2) and (3). Both the itemized deduction for state and local income taxes and for real estate taxes are large enough that if either were removed, the taxpayer would claim the standard deduction. The increase in taxable income is simply the difference between the

taxpayer's itemized deductions (\$13,000) and the standard deduction (\$10,000). Thus, the revenue gain from eliminating either deduction is 20 percent of \$3,100 or \$620.

Now consider what happens if the mortgage interest deduction is disallowed. In this case the tax expenditure estimate is based on the full amount of this taxpayer's mortgage interest payments and the standard deduction has no effect on the estimate (see column 4). Our example also shows how tax expenditure estimates vary with the magnitude of the standard deduction. For example, increasing the standard deduction by \$2,000 makes all of this taxpayer's itemized deductions "marginal" in the sense that the taxpayer takes the standard deduction in the absence of any one of their itemized deductions. As a result, the tax expenditure is the same for all four deductions.

The last row of table 2 shows clearly that the tax expenditure estimate of an itemized deduction does not reflect how revenues would change if the itemized deduction were an "above the line" deduction or a statutory adjustment. Of course, this is not the exercise that tax expenditure estimates were meant to address but is one that can be of interest to policy analysts.

Our example ignored the phase-out of itemized deductions under current law which is part of the normal tax baseline (and has been since the so-called Pease provision was put in place in 1990). The phase-out reduces expenditure estimates of itemized deductions for taxpayers over certain income thresholds under the regular tax but not under the AMT leading to complicated interactions between the standard deduction, itemized deductions, and the AMT. Barthold et. al. (1998) show how these phase-outs, phase-ins, and other income tests with respect to certain tax provisions can create conditions under which a taxpayer's effective tax rate can exceed their statutory marginal tax rate, with additional complications for revenue and tax expenditure estimation.

### *Consequences of the AMT*

The AMT reduces the value of tax preferences by “recapturing” them. The AMT also affects the value of certain tax preferences by changing effective marginal tax rates.<sup>20</sup> To demonstrate the importance of the AMT, we use TAXSIM to calculate how a set of tax expenditures estimates vary across different AMT policy scenarios. TAXSIM is the individual income tax simulation model operated by the NBER.<sup>21</sup> Like the models used by JCT, OTA, and some think tanks (the Tax Policy Center, notably), TAXSIM is essentially a large Turbo-Tax-style calculator aggregating tax form results over thousands of simulated, statistically-weighted taxpayers.<sup>22</sup> The underlying data for TAXSIM is the IRS Statistics of Income (SOI) public-use file. JCT and OTA have access to the set of confidential IRS taxpayer data, which is both larger in terms of sample size and more detailed with respect to tax variables reported.

We calculate tax expenditures for the years 2000-2011 under three AMT scenarios: (i) current law, (ii) current law with no AMT, and (iii) current law in the absence of a patch for the AMT. By “current law” we mean the law in place in the year of the estimate so that the 2004 tax expenditure for the child credit, for example, uses the Internal Revenue Code in place (and thus the normal tax structure) for 2004. The “patch” refers to recent annual adjustments to the AMT exemption amounts for inflation to prevent a large increase in the number of taxpayers who would otherwise pay AMT. By “no AMT patch” we mean that the patch applied in 2001 to the AMT is no longer indexed.<sup>23</sup> The TAXSIM estimates are reported in our appendix table.

Figure 1 shows the tax expenditure for the mortgage interest deduction, the state and local income tax deduction, and the property tax deductions available to itemizers from 2000 to

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<sup>20</sup> For example, mortgage interest paid, with the exception of home equity loan interest not used for home improvement, may be deducted under the regular income tax and the AMT. Moving from the income tax paying-status to AMT-paying status implies changing the applicable marginal tax rate and thus the value of the tax expenditure.

<sup>21</sup> We thank Daniel Feenberg for his exceptional efforts in employing TAXSIM for this project.

<sup>22</sup> As discussed further in the next section, tax expenditure estimates do not allow for any taxpayer behavior. Revenue estimates produced by JCT and OTA allow for microeconomic behavior while holding the size of the economy constant. As a result, information beyond what is produced by a tax calculator is required for revenue estimates.

<sup>23</sup> The TAXSIM estimates are available upon request from the authors.

2007 under our three AMT scenarios. We focus on the period through 2007 because from 2008 onward the “current law” and “current law with no AMT patch” scenarios are the same. The decline in the tax expenditure estimates for all three deductions between 2001 and 2003 is a result of the decrease in rates enacted with the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).

Note that the tax expenditure for the property tax and state and local income tax deduction would have remained near the 2003 level if the AMT exemption levels had not been “patched.” This is because these itemized deductions are preferences under the AMT. Figure 1 shows that the AMT has had a substantial effect on these tax expenditures. With no AMT, both tax expenditures would have increased substantially between 2003 and 2007: from \$43.4 billion to \$60 billion for the state and local income tax deduction and from \$23.8 billion to \$32.7 billion for the property tax deduction.

The effect of the AMT on the mortgage interest deduction is much different. Because most mortgage interest expenses may be deducted under the AMT, the TAXSIM estimates for the “current law” and “current law with no AMT” scenario are almost the same. Whether the AMT is patched, however, has a substantial impact on the expenditure estimate. It turns out that the tax expenditure for the mortgage interest deduction is higher when the AMT is *not* patched than under current law with the patch (see also Burman et al). With no patch, more taxpayers end up on the AMT. Because there is no standard deduction under the AMT, there is no carve-back to decrease the tax expenditure of the provision. In addition, under the AMT there is no phase-out for itemized deductions, which again increases the expenditure estimate. Finally, the rate at which mortgage interest (and other itemized deductions) are deducted under the AMT and under the regular tax differ. Using TAXSIM, Feenberg and Poterba (2004) calculate that the weighted average marginal tax rate for the mortgage interest deduction is about two percentage points greater under the AMT than without the AMT in 2007, for example.



The AMT affects a wide range of tax expenditures. Figure 2 shows the impact of the AMT on the itemized deductions examined above for 2007 as well as on three additional tax provisions: the reduced rates for dividends and capital gains, the child tax credit and the Lifetime and Hope education credits. We chose these provisions for illustrative purposes.

The reduced rates on dividends and capital gains apply under the AMT, but due to an interaction with the AMT exemption amount, the benefits of the rates can be reduced (see Leiserson 2007 for a detailed example). When a taxpayer realizes capital gains, s/he increases AMT taxable income which in turn decreases the AMT exemption through the exemption phase-out. The phase-out raises the effective rate on capital gains and dividends.

According to our TAXSIM calculations, the 2007 tax expenditure for the reduced rates on dividends and capital gains is \$88.9 billion. With no AMT to carve back the provision, the tax expenditure increases to \$92 billion; a not inconsiderable difference. With no patch of the AMT exemption amounts, the tax expenditure is slightly higher than the current law estimate and lies between these two estimates at \$89.1 billion because of the reduced ability of the AMT to recapture the benefits of the reduced rates.

The treatment of tax credits under the AMT has changed recently. For taxable years beginning before 2007, nonrefundable individual credits were allowed against both the regular tax and AMT. Starting in 2007, these credits are effectively disallowed --- they may only be claimed to the extent that the individual's regular income tax liability exceeds the individual's minimum tax liability (see JCT 2007 for details). The adoption credit, child credit, and saver's credit, however, are exceptions to this rule and may be claimed against both the regular tax (reduced by other nonrefundable personal credits) and the AMT.

Figure 2 shows clearly that the AMT has an important and uneven impact on tax expenditures. Much has been written concerning the uncertainty created by the AMT (see Ackerman and Altshuler 2006, for example). This uncertainty spills over to tax expenditure estimates that are presented only for present tax law baselines and not alternative scenarios that

may be more realistic such as an extension of the AMT patch. An open question that we address later is whether tax expenditures should be calculated under a variety of AMT scenarios.

### *Hypothetical tax expenditures*

We have noted that what is considered “normal” is subject to judgment. In this section, for illustrative purposes, we consider some hypothetical tax expenditures that would arise under different definitions of the normal tax. These “new” expenditure estimates provide information regarding the cost of the structure of the prevailing tax system.

Suppose first that the standard deduction and personal exemptions were classified as tax expenditures (listed as income support policies, for example). Using the TAXSIM model, we find that the personal exemption estimate is \$129 billion in 2007 and represents 12.8 percent of baseline revenues. Clearly, this deviation from a pure income tax with no deductions or exclusions is large relative to other policy divergences in the tax code.

The standard deduction is more difficult to estimate using TAXSIM since it requires imputations for itemized deductions for taxpayers that do not itemize under present law. If we assume that in the absence of the standard deduction there exists a floor on the itemized deductions equal to the current standard deduction, then the hypothetical tax expenditure for the standard deduction is \$75 billion for 2007, a value that clearly rivals other major existing tax expenditures.

Similarly, the progressive structure is a set of preferred tax rates, and special rates are considered a tax expenditure under the Budget Act. Therefore, an argument can be made that this system is itself a tax expenditure. In fact, as noted earlier, one could construct a set of deductions/credits under a pure flat tax that generates the same tax liabilities as the progressive rates create under present law. The set of deductions/credits would be tax expenditures; the set of progressive rates would not. Nonetheless, most tax analysts would agree that the ability-to-pay principle, and thus the progressive system of rates, is an important element of the existing income

tax. However, if one were to report a tax expenditure for this component, it would be similar to the following exercise.

Assume that for the purposes of this hypothetical tax expenditure, the maximum statutory marginal income tax rate in a given year (35 percent for our purposes) is the “normal” rate. All other rates under present law are therefore preferential rates, assigned on the basis of income type (e.g. wages or capital gains) or other criteria (adjusted gross income of the taxpayer). These preferred rates are tax expenditures.

We estimate tax expenditures for each of the rates using 2005 SOI data.<sup>24</sup> Figure 3 shows our expenditure estimates for the 2005 individual tax brackets. The tax expenditure for the 10 percent bracket (the estimate for taxing income in this class at 10 percent rather than 35 percent) is equal to \$244.7 billion, a number that substantially exceeds most existing tax expenditures. The estimate for the 15 percent rate is \$344 billion, for the 25 percent rate is \$72.1 billion, and for the 28 percent rate is \$17 billion. In total, the hypothetical tax expenditure for “income support for the progressive system of rates” is \$827.4 billion per year, an estimate that exceeds almost all official tax expenditures.

Combined with the estimates for the standard deduction and the personal exemptions, these calculations provide information regarding the amounts that are dedicated in tax expenditure terms to the progressive system of rates and reveal the relative size of this important policy element to other, existing tax expenditures. As with other tax expenditures, the distributional aspects of this hypothetical tax expenditure are revealing. Appendix Figure 1 shows that the benefit of the progressive system of rates accrues roughly to middle-income taxpayers.

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<sup>24</sup> One could imagine other methods of calculating these tax expenditures. Instead of using the maximum statutory rate as the baseline rate, one could use the average marginal rate or the average effective tax rate. However, doing so would require reporting negative tax expenditures for income taxed at above average rates, which presents its own conceptual issues that are discussed in more detail below. Alternatively, one could use the lowest rate as the base, and calculate negative tax expenditures, or use the revenue neutral rate.

### *Comparing estimates over time*

Many researchers have studied how tax expenditures have changed over time.<sup>25</sup> But, as noted above, the baseline “normal” tax changes when tax policy changes alter any provisions of the prevailing tax structure. Hence, Congress implicitly changes policy towards tax-favored activities when it changes tax rates, the standard deduction, the AMT, or any other part of the normal tax structure. To demonstrate how policy changes affect tax expenditure estimates, we use TAXSIM to calculate a set of tax expenditures under present law in place in each year and under pre-2001 law (we call this “constant” law since it holds constant the provisions in place prior to EGTRRA). In our discussion, we focus on the mortgage interest, state and local income tax, and property tax deductions.

Figure 4 shows the effect of tax policy changes enacted from 2001 onward on the growth of the tax expenditure estimate for the mortgage interest deduction. Our calculations indicate that this tax preference to housing increased by 14 percent between 2000 and 2007. In the absence of the 2001 and 2003 tax policy changes (under “constant law”), the tax expenditure estimate would have increased by 26 percent. Note that between 2008 and 2010, the tax expenditure estimates are quite similar. This is due to the AMT which is not patched under current law for those years, and, as we have seen, actually increases the tax expenditure for this itemized deduction.

The evolution of the tax expenditure for state and local income taxes under constant (pre-2001) law and current law is shown in Figure 5 and is striking. Between 2000 and 2007, this expenditure decreased by about 1 percent under current law but would have increased by 36 percent under constant law. The noticeable decrease from 2007 to 2008 is due to recapture effects from the AMT, which is not patched for 2008 under our present law baseline. The difference in the benefits for the property tax deduction under actual law and the constant law baseline, shown in Figure 6, is also dramatic. The tax expenditure increases by 24 percent

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<sup>25</sup> See, for example, US GAO (2005), Neubig and Joulfaian (1988), Toder (1998), and Steuerle (2004).

between 2000 and 2007. Under constant law this expenditure would have grown by 72 percent. This exercise illustrates clearly how tax policy changes can effect the growth of tax expenditures.

### *Sunsets, budget windows and timing issues*

Tax expenditure analysis treats sunsets as permanent features, which is consistent with revenue estimation practice. This approach is consistent with treating tax expenditures as reporting the effects of present law, rather than analyzing policy proposals. For example, many major and minor elements of the tax code are scheduled to sunset in the near future. In fact, most of the major 2001 and 2003 tax cuts are scheduled to expire on January 1, 2011, a date some observers have called “tax policy doomsday.” The scheduled sunsets lead to some interesting patterns of tax expenditure estimates as we have already seen in Figures 4, 5, and 6. Reading a tax expenditure table across time requires fairly sophisticated knowledge of U.S. tax policy and is a bit like reading tea leaves. Consider the tax expenditure estimate for the state and local income tax deduction under current law. The estimates for 2000-2011 assume that the AMT is not patched for 2008-2011 and the 2001 and 2003 tax cuts expire as scheduled.<sup>26</sup> It is hard to think of this pattern of tax benefits as being equivalent to an expenditure program outlay given how it fluctuates with tax rules.<sup>27</sup>

Sunsets can also give rise to negative tax expenditures. For example, the 2007 JCT tax expenditure publication reports negative tax expenditure estimates for the tax code section 198 brownfield expensing provision for individual taxpayers (i.e. pass-through entities and small businesses) for fiscal years 2009 through 2011. This is due to the fact that the provision expires under present law at the end of 2008. Expensing accelerates qualified brownfield remediation cost deductions. The acceleration generates a positive tax expenditure in the year of expensing

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<sup>26</sup> In particular, the marginal income tax rate cuts, including the creation of the 10% bracket and the reduction of the maximum rate from 39.6% to 35%.

<sup>27</sup> Nonetheless, expenditure programs have their own quirks with respect to reporting, including the annual appropriation process and some baseline issues.

with a corresponding set of negative tax expenditures due to the loss of deductions in future years. An expensing provision with no sunset would not typically reveal these negative tax expenditures because the expensing behavior in each fiscal year would exceed the loss of the otherwise permitted expense deductions.<sup>28</sup> Negative tax expenditures that arise in this manner appear for other provisions, including section 179 small business expensing, GO-Zone bonus depreciation, and Indian reservation accelerated depreciation.

Another class of examples of negative values appearing on tax expenditure tables is the set of expiring business tax credits, such as the credit for fuel cell and microturbine power plant installation in OTA's 2008 tax expenditure listing. Here, the provision provides a credit to the qualifying taxpayer, but the credit also requires a corresponding reduction in basis of the asset. This consequently reduces future depreciation deductions and raises gains taxation, if applicable, in future years. Beyond the sunset of the credit, this gives rise to larger tax receipts than in the baseline and therefore a negative tax expenditure.

Nonetheless, as a general rule, negative tax expenditures are not presently reported as a matter of convention.<sup>29</sup> In the examples noted above, these negative estimates arise only within a few or even single years.<sup>30</sup> Over the full reporting period for the tax expenditure, in general no negative tax expenditures are currently estimated and reported in tax expenditure budgets produced by either the JCT or OTA.<sup>31</sup>

This raises a fundamental question: what is a negative tax expenditure? For many, a negative tax expenditure represents a disproportional statutory tax burden on a particular kind of income or economic activity. As an outlay equivalent, it may be thought of as a fee or transfer

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<sup>28</sup> However, the original rules for the brownfield expensing provision was limited to certain locations. If all such locations were redeveloped, then even a permanent version of the original rules would have exhibited negative tax expenditures for individual years. We thank Tom Barthold for noting this point to us.

<sup>29</sup> JCT (2008) announced that they will report negative tax expenditures in the future.

<sup>30</sup> However, this raises the question of whether a negative tax expenditure should continue to be reported for an expired provision that has only a negative tax expenditure for the budget window.

<sup>31</sup> One exception illustrates the previous explanation of temporary provisions giving rise to negative tax expenditures. The 2007 OTA report provides a negative tax expenditure over the reporting period (2008-2012) for the deferral of gain allocable to disposition of electrical transmission property due to FERC-mandated restructuring.

payment from the taxpayer to the Treasury. However, for others, a negative tax expenditure is simply a tax and thus no special accounting is necessary. Indeed, the Budget Act does not refer to negative tax expenditures. Nonetheless, a certain respect for symmetry requires that more thought and analysis be given to negative tax expenditure reporting.<sup>32</sup>

OTA lists several examples of tax rules that may be considered negative tax expenditures under a comprehensive income tax. These include the passive loss rules, the restrictions on carrybacks and carryforwards for net operating losses, and restrictions on the deductibility of capital losses. For example, owners of a personal residence are not permitted to deduct a loss from the sale of the property. The gain exclusion for principal residences is reported as a positive tax expenditure, but the corresponding restriction on loss deductions is not. There are other theoretical negative tax expenditures that are worth considering. For example, the double taxation of corporate income may be considered a tax expenditure. And, in fact, beginning in 2004, the OTA has been reporting the double taxation of corporate profits as a negative tax expenditure in an appendix to the tax expenditure presentation in the budget. As another example, the taxation of gains due to inflation might be considered a negative tax expenditure.

### ***Alternative baselines***

As this section has made clear, different “normal” tax structures will generate different tax expenditure estimates. The staff of the OTA has studied how the expenditure budget would change under a comprehensive income or consumption tax base using the current rate structure (see OMB 2008 and Carroll, Joulfaian and Mackie 2008). It is also interesting to consider the impact of the current progressive rate structure on expenditure estimates. One way to explore this issue is to use a flat tax structure to estimate tax expenditures. We ran some experiments with TAXSIM replacing the normal marginal tax rates (and special rates on dividends and capital

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<sup>32</sup> Indeed, the JCT has indicated that in the future it will report estimates for some negative tax expenditures (JCT 2008).

gains) with a flat rate of 19 percent, the rate that most closely corresponds to a revenue neutral rate according to TAXSIM for 2008.

Again, for expository purposes, we focus on the tax expenditures for the mortgage interest, state and local income tax, and property tax deductions. In addition to current law and pre-EGTRRA law estimates, Figures 4, 5, and 6 include series showing estimates for our flat rate experiment. The growth of the mortgage interest deduction over the period, shown in Figure 4, is similar under current law and current law with the flat rate because of its relative lack of interaction with the AMT. The estimates plotted in Figures 5 and 6 reveal the more significant interactions between the AMT and the state and local income tax and real property tax deductions. The flat rate experiment shows a relatively smooth pattern over the time period while the current law experiment illustrates the significant carve-back of these deductions by the AMT. Also interesting is the fact that the flat rate estimate exceeds the 2010 and 2011 estimates for pre-EGTRRA law due to the relatively lower marginal rates faced by taxpayers deducting property taxes.

### ***Summary***

It is clear from the preceding discussion that tax expenditure reporting involves numerous definitional and interactive complications that distinguish it from outlay or government expenditure accounting for which tax expenditures are intended to be comparable. Debates regarding the appropriate “normal” income tax structure, timing issues, interactions with the AMT and standard deduction, as well as more fundamental issues regarding the correct income definition suggest that tax expenditure reporting must be examined within the context of certain standing and generally accepted assumptions regarding tax policy. Nonetheless, as the following section illustrates, even the more mechanical estimation process, done under a given set of such assumptions, is complicated by common misunderstandings regarding the methodology used to generate estimates of tax expenditures.



## SCORING TAX EXPENDITURES

### *Estimating Considerations*

The economists of the JCT and the OTA employ certain standing assumptions when they calculate tax expenditure estimates. First and most importantly, unlike official revenue estimates, tax expenditure estimates do not incorporate any change in taxpayers' economic behavior. Revenue estimates include forecasts of behavior that will change, including consumption, investment and other economic actions. These modeled micro-dynamic responses allow taxpayers to respond to changes in after-tax prices and other tax-related incentives. However, as is well known, revenue estimation does not allow macroeconomic feedback or changes in national income in response to changes in tax policy.

In contrast, tax expenditure estimates include neither the micro-dynamic response nor macroeconomic feedback. As discussed in the previous section, a tax expenditure is simply the change to the existing baseline or forecast of a particular line item of tax revenue. This tax expenditure methodology is thus intended to include the induced or ex post effects of the tax expenditure provision. This analysis is presented as a state-of-the-world as it currently exists, rather than incorporating expected behavior effects from a future change in policy. Consequently, it is important to note, as some analysts fail to do, that a tax expenditure estimate is not a revenue estimate. In part this confusion exists because revenue estimates are not reported side-by-side with tax expenditure estimates.<sup>33</sup>

For example, the tax expenditure for the mortgage interest deduction is calculated by summing for all itemizing taxpayers the amount of mortgage interest paid times the applicable marginal income tax rate applied against itemized deduction amounts. As noted earlier, there is an interaction with the standard deduction due to the itemization decision. However, the tax

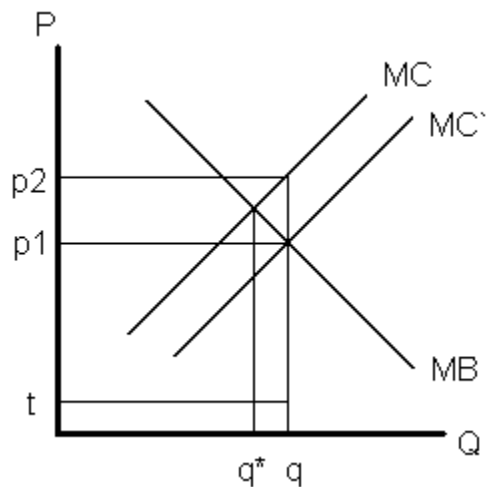
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<sup>33</sup> However, the staff of the JCT has recently indicated that "where helpful and feasible" the staff will report accompanying revenue estimates. (see JCT 2008). The CBO currently presents many revenue options of large scale tax policy proposals in its biannual Budget Options report.

expenditure estimate does not allow the taxpayer to modify the own-rent decision regarding housing, nor does it allow the taxpayer to change debt and investment allocation decisions. It is reasonable to assume that if Congress were to eliminate the mortgage interest deduction, many taxpayers would reduce their holdings of low-yield assets to reduce mortgage debt holdings due to the change in after-tax mortgage interest rates.<sup>34</sup> While a revenue estimate would reflect these actions, the tax expenditure estimate does not. For most cases, the tax expenditure estimate tends to be larger than the corresponding revenue estimate because of this assumption.

As another example, the tax expenditure estimate for the Hope credit for student expenses does not allow taxpayers to change education decisions in order for the taxpayer to qualify for other tax incentives. There are numerous education incentives in the Internal Revenue Code, some with overlapping qualifying criteria. The interaction of these incentives is discussed more below.

To examine the difference between a revenue estimate and a tax expenditure estimate, consider the following partial equilibrium example for an economic action,  $Q$ , with price,  $P$ .



Suppose that the marginal cost curve (MC) includes a broad-based tax,  $t$ . The marginal cost and marginal benefit cost curve yield the after-tax partial equilibrium. Further suppose that there

<sup>34</sup> Poterba and Sinai (2008) examine this tax expenditure in detail.

exists a separate tax provision that provides a tax expenditure targeted directly to this market. The tax expenditure takes the form of a per-unit subsidy in the amount of  $p_2$  minus  $p_1$ , thereby shifting the applicable marginal cost curve to  $MC'$ . The tax expenditure increases the amount of the activity undertaken from  $q^*$  to  $q$ . Under the prevailing tax rules, the tax expenditure induced quantity,  $q$ , is the baseline quantity for tax expenditure analysis purposes.

The tax expenditure estimate of the incentive is equal to  $(p_2 - p_1)q$ .<sup>35</sup> However, the revenue estimate of repealing this tax expenditure is equal to  $(p_2 - p_1)q - t(q - q^*)$ . The revenue estimate is lower because it includes a revenue loss associated with the microdynamic response: a reduction in the amount of the activity undertaken by the taxpayer from  $q$  to  $q^*$ .

It is difficult to provide an example of a set of official estimates illustrating the difference between a revenue and tax expenditure estimates, typically because tax expenditure estimates are calculated for large provisions or bundles of small, related provisions of the tax code. Revenue estimates typically are issued for smaller, more detailed policy changes associated with these provisions. For example, in 2005 the JCT published a revenue estimate for repealing the deduction for home equity loan interest paid (JCT 2005). With respect to this provision, only the total tax expenditure for the mortgage interest deduction is publicly available. In contrast, the repeal would have affected only a portion of the mortgage interest deduction, so a direct comparison between the tax expenditure and the revenue estimate cannot be made. Despite these data limitations, it is certainly the case that the 2005 revenue estimate included a number of behavioral responses to the proposed policy change and was therefore lower than its hypothetical tax expenditure.

An example that can be used to illustrate this point is the tax exclusion for employer-paid life insurance. The JCT reports that the tax expenditure for this provision in years 2009, 2010 and 2011 is approximately equal to \$2.7 billion. However, in the 2007 CBO Budget Options

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<sup>35</sup> We assume here that the tax expenditure does not take the form of an itemized deduction to abstract from any interaction with the standard deduction.

report, the JCT reported that the revenue estimate for this provision is only equal to \$2.1 billion in 2009, \$2.2 billion in 2010, and \$2.3 billion in 2011. The smaller revenue estimate is consistent with what theory would predict. The tax incentive for employer-provided life insurance increases its use, and repealing that tax expenditure would not result in a full capture of the benefit because of shifting of taxpayer behavior. Therefore the revenue estimate should be lower than the tax expenditure.

As noted earlier, there is one notable exception to the general rule that tax expenditure estimates do not incorporate taxpayer behavior: tax form behavior. In this sense, tax expenditure estimates automatically include a realistic accounting of most tax form interactions, including whether to itemize or not. This tax form behavior creates the possibility of changing the relative sizes of various tax expenditures, as our earlier example from Table 2 illustrated. In general, tax expenditures of large provisions generate relatively higher estimates than tax expenditures of relatively smaller provisions because of the itemization decision. Given that tax expenditures are often compared to one another, this biasing of tax expenditures in terms of size may be problematic for tax policy analysts. On the other hand, the recapture produced by the standard deduction is clearly an important component of the revenue estimate and thus this estimate may in fact be more realistic.

However, there are tax incentives that have overlapping qualifying criteria for which only one tax incentive may be claimed as a matter of law. How should such provisions be estimated for tax expenditure analysis? Because the qualifying criteria are similar, the taxpayer may qualify for another tax expenditure with no change in economic behavior, if the one claimed under current law were to be eliminated. However, this type of tax form behavior is not likely to be automatically captured by an Individual Tax Model (ITM), and thus can lead to differing estimates.

As an example of the differences in scoring conventions for this situation, consider the JCT and OTA tax expenditure estimates for the tax credits for post-secondary education (HOPE

credit and the lifetime learning credit).<sup>36</sup> The credits have differing but similar qualifying criteria, such that if one credit were repealed, then some taxpayers could claim the other credit. The differences in the JCT and OTA estimates for these provisions demonstrate that they indeed use different conventions for this estimate. The fiscal year 2008 estimate from JCT for both credits is \$4.4 billion. The OTA estimate is broken out for each credit, with \$3.4 billion for the HOPE credit and \$2.2 billion for the lifetime learning credit. It is clear that the JCT economists are allowing taxpayers to substitute between the two credits, when the taxpayers are otherwise qualified and one credit is hypothetically repealed for tax expenditure estimation purposes. This produces some recapture, through increased use of another tax incentive, and a smaller tax expenditure estimate. In contrast, the OTA estimates examine the credits in isolation and do not include such tax form behavior. Nonetheless, for both estimates, it is important to note that this tax form behavior does not equate to change in economic behavior. There is no increase or decrease in the underlying qualifying activity of higher education expenditures by the taxpayer.<sup>37</sup> The JCT approach in this regard is justified as being similar to tax form behavior used to determine whether a taxpayer, for tax expenditure purposes, itemizes their deductions.

There are many other overlapping provisions in the tax code. For example, the major savings incentives, traditional and Roth IRAs and 401(k)-style accounts, reward a similar underlying economic behavior: saving. The report of the President's 2005 Advisory Panel for Federal Tax Reform notes that there are at least a dozen tax-preferred options in the current code.

The interaction of tax expenditures raises a known issue that is routinely ignored with respect to the reporting of bundles of tax expenditures. Tax expenditures cannot be summed. Because of the previously identified issues concerning itemization and other tax form behavior, summing of tax expenditure estimates often results in double counting and biased estimates. For

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<sup>36</sup> Another interesting example of overlapping provisions involves the treatment of export income. Prior to the Jobs Act, U.S. multinational corporations received favorable treatment of income from sales abroad through the export source rules and the foreign sales corporation provisions.

<sup>37</sup> There may be other interactions in this example with the tuition and fees deduction that may be claimed on the front of the 1040 individual tax form.

example, Hungerford (2006) performed a simulation in which twelve selected tax expenditures were eliminated in isolation and then simultaneously. Hungerford finds that the sum of the individual tax expenditure estimates was 17.5 percent higher than the tax expenditure calculation for simultaneous repeal of the twelve provisions. The Government Accountability Office asked OTA to conduct a similar exercise with five major itemized deductions (U.S. General Accountability Office 2005).<sup>38</sup> The analysts at OTA found a 25 percent difference between the simultaneous estimate and the sum of the individual tax expenditures. Despite this, researchers have produced reviews of tax expenditures that rely on summing tax expenditures to present an aggregate picture of the role tax expenditures play in the federal government's budget.<sup>39</sup>

Using TAXSIM, we calculated the tax expenditure for two bundles of tax expenditures. For 2007, TAXSIM reports a tax expenditure for the mortgage interest deduction of \$82.4 billion and \$25.8 billion for property taxes for owner-occupied homes. Summing these two tax expenditures yields \$108.2 billion. However, the tax expenditure estimated simultaneously for these two provisions generates an estimate of \$99.1 billion, a decline of 8.4 percent. As a second and somewhat different example, the 2007 tax expenditure for the state and local income tax deduction is \$47.4 billion. Summing with the tax expenditure for the property tax deduction yields \$73.2 billion for 2008. The simultaneous estimate of these tax expenditures produces \$74.8 billion, representing an increase of 2.1 percent. This unusual case, where the simultaneous repeal of two tax expenditures yields a larger estimate than the sum of their individual tax expenditures is due to the AMT. As noted earlier, the AMT can also produce interaction effects, particularly given the combined effect of lower tax rates and unindexed AMT exemption amounts, which is forecasted to increase the number of AMT-payers for future tax years. In the absence of the AMT, the 2007 tax expenditure for the state and local income tax deduction is \$60

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<sup>38</sup> The five itemized deductions include charitable contributions, home mortgage interest expenses, state and local income taxes, state and local property taxes, and medical expenses.

<sup>39</sup> See, for example, Neubig and Joulfaian (1988), Toder 1998, Steuerle (2004), and GAO (2005), and most recently Weiner (2008).

billion and the tax expenditure for the property tax deduction is \$32.7 billion. The simultaneous estimate of these tax expenditures is \$95.5 billion, representing a decrease of 3.7 percent from the sum of the two tax expenditures (\$92.8 billion).

Putting aside the complexities caused by the AMT, these examples suggest that the interaction effects among tax expenditures, particularly for large tax provisions, can be significant. Given these estimates, there would be certain transparency benefits for JCT and OTA reporting of bundles of policy-related or issue-related tax expenditures. For example, an estimate could be reported for all housing-related tax expenditure or other similarly-related bundles of tax incentives, thereby yielding more accurate estimates of common bundles of tax expenditures.

Alternatively, as estimated by Burman, Geissler and Toder (2008), bundles of tax expenditures could be grouped by their tax-form character (exclusions, itemized deductions, refundable credits, special rates, etc.). For 2007 estimates, Burman et. al. find that the tax expenditure for the sum of income exclusions (life insurance contributions, retirement benefits, and other exclusions) is six percent higher than the sum of the individual tax expenditures. They attribute this effect to the progressive character of the income tax rates. When tax exclusions are considered simultaneously (or “stacked” in the ITM jargon), the effective marginal income tax rate of the taxpayer increases due to greater amounts of taxable income or AMT-paying status. For a bundle of itemized deductions (mortgage interest, state and local taxes, charitable contributions, medical expenses and casualty losses), they find the opposite effect. The tax expenditure of the set is 15 percent smaller than the sum of the individual tax expenditures because of the recapture effect produced by the standard deduction.

We consider an experiment that bundles the top tax expenditures. The idea is to use a variant of tax expenditure estimation (a bundled estimate) to gauge the revenue gains from base broadening. We are able to estimate thirteen major expenditures with TAXSIM including the mortgage interest deduction (\$82.4 billion), the deduction for unreimbursed medical and dental expenses (\$8.3 billion), the deduction for state and local income taxes (\$47.4 billion), the

deduction for property taxes on owner-occupied homes (\$25.8 billion), the deduction for charitable contributions (\$42.7 billion), the earned income tax credit (\$41.4 billion), the refundable child tax credit (\$46.2 billion), the lifetime earning and Hope credits (\$6.6 billion), the child and dependent care credit (\$2.6 billion), the tax-exemption on municipal bonds (\$17.6 billion), the preferred tax rates on capital gains and dividends (\$88.9 billion), the tax preferences for IRAs and Keogh plans (\$4.0 billion), and the exclusion for certain pensions and annuities (\$17.6 billion).<sup>40</sup> Summing these tax expenditure yields \$431.4 billion. Simultaneously estimating the repeal of these provisions produces a 2007 estimate of \$387.7 billion, a difference of 10.1 percent.

It is worth noting the size of this estimate. In 2007, TAXSIM forecasts a total of \$1.02 trillion in individual income tax receipts. Hence, these 13 items represent about 38 percent of this total. As these are tax expenditure estimates, without actual revenue estimates it cannot be calculated the extent to which income tax rates could be reduced if these provisions were eliminated. Nonetheless, these expenditures represent a considerable amount of tax base narrowing. And without the AMT to carve back the benefits of many of these expenditures, the TAXSIM forecast for the 13 items increases to \$453.4 billion or 46 percent of tax revenues. It is also interesting to compare how the size of the revenue loss due to this group of expenditures has evolved over time. Under our current law scenario, the share of revenues accounted for by the top 13 individual tax expenditures has increased from about 33 percent in 2000 to 38 percent in 2007. Using our constant law scenario, or pre-EGTRRA rules, the percentage increases by only one percentage point to 34 percent in 2007. With no AMT, the percentage goes from about 35 percent in 2000 to 41 percent in 2007.

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<sup>40</sup> Pensions and annuities not included in AGI includes only has social security benefits due to data limitations on the SOI Public Use File.



### ***Tax Expenditures Distributional Considerations***

As with any appropriation item of the federal budget, the distributional aspects of tax expenditures are important, particularly for tax provisions attempting to achieve a policy objective beyond raising revenue for the government.<sup>41</sup> The best source of information regarding the distribution of government tax expenditure estimates is the JCT tax expenditure publication.<sup>42</sup> In each edition, the JCT presents the distribution of major tax expenditures: mortgage interest deduction, student loan interest, education credits, child tax credit, untaxed social security and railroad retirement benefits, child care credit, earned income credit, charitable contribution deduction, state and local tax deduction (income, sales and personal property), medical expense deduction and the owner-occupied home property tax deduction.<sup>43</sup>

As with other forms of distributional analysis, selection of an income classifier is important. JCT uses an expanded income classifier which is equal to adjusted gross income (AGI) plus the following items: tax-exempt interest, employer contributions for health and life insurance, employer share of payroll taxes, workers' compensation, nontaxable Social Security

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<sup>41</sup> See Joint Committee on Taxation (1993) for an extensive discussion of the methodological issues involved in producing distributional analysis. See Cronin (1999) for a discussion of the OTA distribution methodology.

<sup>42</sup> Congressional Budget Office reports are another source of distributional information for tax expenditures. The most recent example is a February 2008 report on the deductibility of state and local taxes (CBO 2008). Outside of the government, the Tax Policy Center (TPC) uses their ITM to distribute a variety of individual tax expenditures including, among others, the child tax credit, earned income tax credit, tax benefits for health insurance, and special rates for capital gains and dividends. While the TPC methodology follows the JCT approach, there are some differences. The TPC use a measure of cash income that differs somewhat from the JCT expanded income detailed above. Cash income is AGI minus taxable state and local tax refunds, plus total deductions from AGI, non-taxable pension income, tax-exempt interest, non-taxable social security benefits, cash transfers, worker's compensation, employer's contribution to tax deferred retirement savings plans, employer's share of payroll taxes and corporate tax liability. The inclusion of the employer share of payroll taxes and corporate taxes puts income on a pretax basis. Another difference from JCT is that the TPC examines the impact of tax expenditures on after-tax income, as well as the share of the tax benefit received and the size of the tax benefit.

<sup>43</sup> In addition to being relatively large, these provisions have the benefit that the data requirements necessary to confidently estimate the distributional aspects of the tax expenditures are available in the confidential SOI data. For other large tax expenditures, the data and off-ITM model estimations provide less reliable methods of determining distributions.

benefits, the insurance value of Medicare benefits, alternative minimum tax preference items, and excluded income of U.S. citizens living abroad.

Beyond the income classifier concept itself, it is also important to note that the JCT distributional methodology uses the unit of analysis provided by the SOI data: the tax unit. With the possibility of multiple tax returns being filed by households or families, as these concepts are defined in Census data for example, there is some difficulty in using this analysis to make comparisons to other kinds of distributional analysis. This is particularly true for married taxpayers filing separate returns. Furthermore, there can be a difference between the statutory incidence of a tax expenditure and the economic incidence of the tax provision. For example, the mortgage interest deduction is claimed on an individual tax form, but the underlying deduction represents expense allocable to investment for a household.

We use the SOI Public Use File for 2004 and TAXSIM to illustrate simple distributional analysis of the state and local income tax deduction, some grouped expenditures, and a major expenditure that is not distributed by JCT, the special rates on dividends and capital gains. As before, we consider three scenarios: current law, current law with no AMT and current law with no AMT patch. We use a modified version of cash income that can be calculated using information from TAXSIM as an income classifier.<sup>44</sup> To simplify the presentation, we show results only for 2004 and by income decile (instead of also by income class).<sup>45</sup> One goal of this exercise is to demonstrate how incremental changes in presentation can increase available information regarding tax expenditure. To this end, we follow the JCT approach and calculate

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<sup>44</sup> Cash income is AGI minus state and local tax refunds, plus tax-exempt interest, non-taxable Social Security benefits, deductions for IRA contributions, student loan interest, alimony paid, tuition & fees, Health Savings Accounts, one-half of the self-employment tax, self-employed health insurance, self-employed SEP, SIMPLE and qualified plans, and penalties on the early withdrawal of saving, minus other income. The Public Use File does not report other income. To calculate other income, we took the difference between reported AGI and the signed sum of the reported components of AGI. The difference includes moving expenses, foreign earned income, and net operating losses from previous years as well as errors due to censoring and rounding. Returns of dependents are excluded from the analysis.

<sup>45</sup> See the notes to Table 7 for decile breakpoints.

the distribution of benefits and not some other possible distributional measures such as the effect of the expenditure(s) on after-tax income.

We begin by showing the distribution of tax liability in Table 7. As is well-known, tax liability is concentrated in the top decile. Somewhat surprisingly, the distribution of tax liability changes little under the two alternative AMT scenarios. Table 8 shows the distribution of the tax expenditure for the state and local income tax deduction. The first column shows the distribution of those taxpayers that claim an itemized deduction for state and local income taxes across income deciles. The second column reports the average deduction. The results are not surprising given what is known about the distribution of this expenditure from the JCT distribution tables, for example. The benefits are highly concentrated at the top of the distribution (as is tax liability and the group of taxpayers that itemize their returns).

Our analysis both complements the JCT analysis by showing information by income deciles (with detail on the top decile) and adds to the analysis by considering how the distribution changes under alternate AMT scenarios. Without the AMT, the benefit of this itemized deduction is skewed even more to the top of the distribution. Without an AMT patch, on the other hand, the benefits are somewhat less skewed across the income deciles. However, the benefits do become more concentrated within the top one percent to returns.

Table 9 shows the distribution of the special rates on dividends and capital gains. Given the concentration of this income in the top decile, this distribution of benefits is not surprising. Nevertheless, it is striking that 99 percent of the benefit goes to taxpayers in the top five percent of the distribution. Moreover, the distribution of this tax expenditure is less progressive than the others reported in this paper.

Table 10 shows the distribution of our hypothetical tax expenditure that bundles the top thirteen tax expenditures in TAXSIM. Taxpayers across all deciles benefit from this group of tax expenditures, with the earned income tax credit and child credit most important in the bottom deciles. Table 11 shows how the distribution of the top expenditures is affected by these two

credits by removing them from the analysis. While only about one half of the top thirteen expenditures in TAXSIM go to the top ten percent of tax units, once we eliminate the EITC and child credit, almost 70 percent of the top expenditures are claimed by this group. The average expenditure in each of the bottom five deciles falls significantly and the total benefit received by the bottom half falls from 20.5 percent to 4.5 percent.

Burman et al. find that eliminating most major tax expenditures simultaneously would make the tax system less progressive as tax expenditures constitute a larger percentage of lower-income taxpayer's AGI than higher-income taxpayers. The analysis in our paper generally confirms these results, as can be seen by comparing the distribution of liability in Table 7 to, for example, the distributions reported in Tables 10 and 11.

In theory, the distributional consequences of tax expenditures are not limited to income concepts. For example, unlike almost all revenue estimates, JCT and OTA report tax expenditures estimates by taxpayer type: corporate or individual. While this additional information is useful, it can also be misleading. Many business sectors are dominated by pass-through entities that report tax liability on individual income tax forms. This conflates individual income tax data with business tax data and can thus be misused in certain contexts. Furthermore, like other tax variables, there may be uneven allocation of tax expenditure benefits across geographic space. Unfortunately, OTA and JCT do not report spatial analyses of tax provisions and proposals.<sup>46</sup>

## CONCLUSION

Despite the challenges associated with tax expenditure classification and estimation, the annual reporting of tax expenditure estimates is an important source of information for economists and tax law observers. We have reviewed the evolution of the tax expenditure

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<sup>46</sup> For a recent examples of the spatial estimation of housing-related tax expenditures, see Gyourko and Sinai (2004) and Dietz (2006). For recent information regarding the deductibility of state and local taxes, see CBO (2008).

reporting process and identified examples of inconsistencies between present and theoretically ideal practice. Using NBER's TAXSIM, we have demonstrated the complications produced by the AMT, the standard deduction, the grouping of tax expenditures, expiring provisions, and interactive effects in the estimation process. A fuller understanding and appreciation of the complications associated with tax expenditure classification, estimation, and reporting will enable tax analysts to more efficiently use these tools to better understand the present-law tax system, as well as possible, future reforms.

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**Table 1  
A Comparison of Baselines**

| <b>JCT Normal Tax</b>  | <b>Treasury Normal Tax</b>  | <b>Treasury Reference Tax</b>  |
|--|---|--|
| <p><b>Individual tax</b></p> <ul style="list-style-type: none"> <li>• One personal exemption for each taxpayer and dependent</li> <li>• Standard deduction</li> <li>• Includes all cash transfer payments from the Government</li> <li>• Deductions for investment and employee business expenses</li> <li>• Prevailing tax rate schedule and tax brackets</li> <li>• Capital gains taxed upon realization</li> <li>• All employee compensation subject to tax currently               <ul style="list-style-type: none"> <li>◦ Employee stock options taxed at regular rate when options exercised (with corresponding deduction for employees). Income is difference between purchase price of stock and the market price on the day the option exercised.</li> </ul> </li> <li>• All other income and transfers subject to tax               <ul style="list-style-type: none"> <li>◦ Social security income excluded only for the portion of retirement benefits that represent a return of payroll taxes paid during working years; Medicare benefits excluded only for the portion of HI tax contributions; public assistance benefits (food stamps, Medicaid, public housing) subject to tax; gifts excluded</li> </ul> </li> <li>• Imputed income from owner-occupied homes excluded (but not classified as tax expenditure due to administrative necessity)</li> <li>• Income tax levied on nominal not real gains in asset values (no indexing)</li> <li>• Foreign tax credit</li> </ul> | <p>JCT normal tax with the following exceptions</p> <ul style="list-style-type: none"> <li>• Includes prevailing rates on capital gains on corporate equity and dividends (since 2005 Budget)</li> <li>• Includes AMT and passive loss rules as part of the baseline</li> <li>• Includes net imputed rental income</li> </ul> | <p>Treasury normal tax with the following exception</p> <ul style="list-style-type: none"> <li>• Gross income does not include transfer payments</li> </ul>  |
| <p><b>Business income taxation</b></p> <ul style="list-style-type: none"> <li>• Treatment of capital costs               <ul style="list-style-type: none"> <li>◦ Cost recovery allowances more favorable than straight-line recovery</li> <li>◦ No indexing</li> </ul> </li> <li>• Accounting standards               <ul style="list-style-type: none"> <li>◦ Accrual method of accounting, standard of “economic performance” used to determine whether liabilities are deductible, and general concept of matching income and expenses. Tax provisions that do not satisfy all three are viewed as tax expenditures.</li> </ul> </li> <li>• Prevailing carryback and carryforward periods for net operating losses</li> <li>• Top statutory rate on corporate income (no graduated rates)</li> <li>• Special tax rules for pass-through entities and nonprofit corporations exempting them from corporate income tax</li> <li>• Controlled foreign corporations (CFCs) not considered separate entities from controlling U.S. shareholders</li> <li>• Foreign tax credit</li> </ul>  | <p>JCT normal tax with the following exceptions</p> <ul style="list-style-type: none"> <li>• Includes corporate AMT</li> <li>• Includes cash method of accounting for certain businesses</li> <li>• Uses economic depreciation in baseline</li> </ul>   | <p>Treasury normal tax with the following exceptions</p> <ul style="list-style-type: none"> <li>• Includes prevailing graduated corporate rates</li> <li>• Includes accelerated depreciation</li> <li>• CFCs are considered separate entities (except for tax haven activities)</li> </ul> |

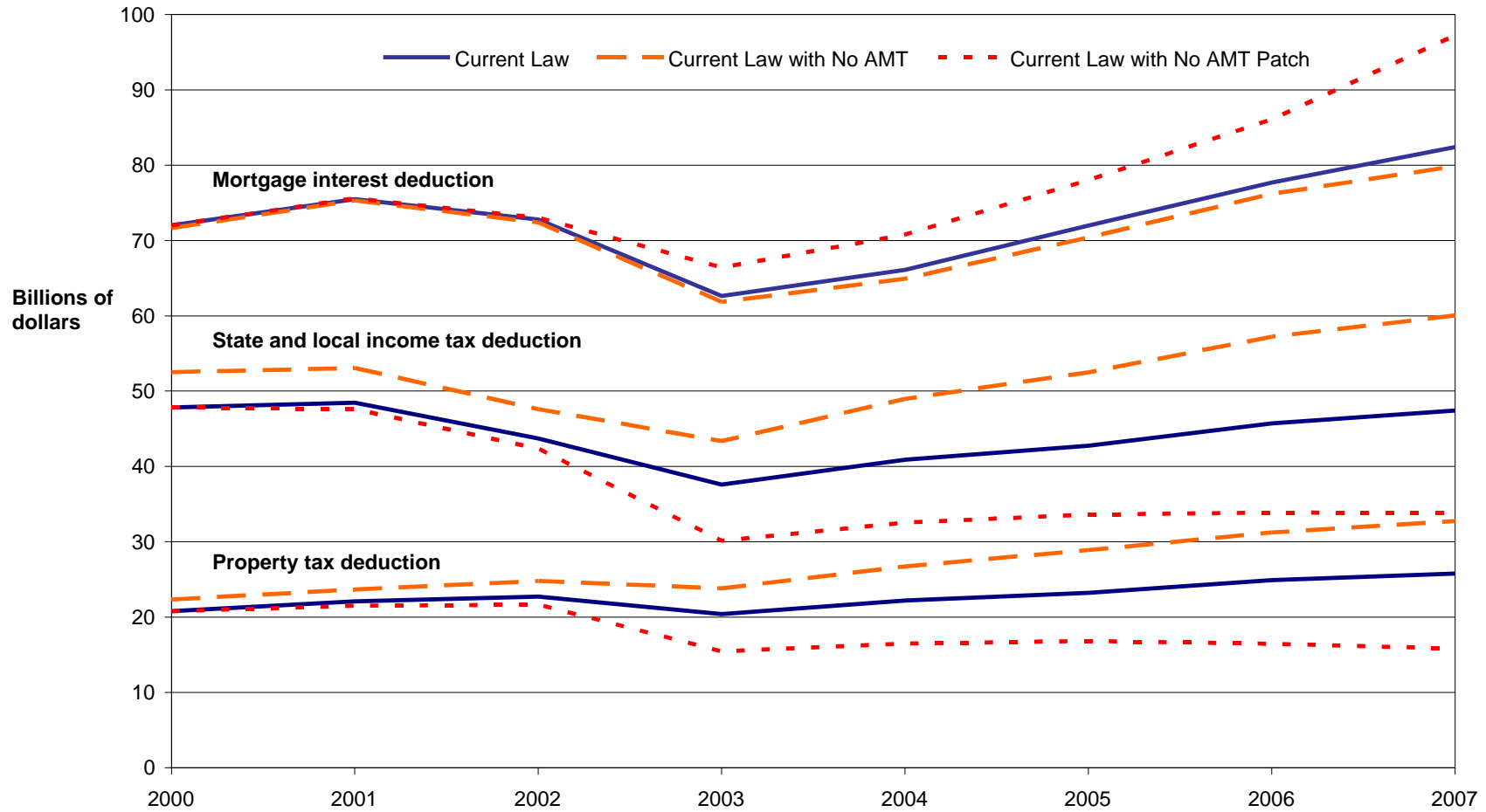
Notes: See JCT (2007) and OMB (2008) for further details

**Table 2**  
**Tax Expenditure Estimates for a Hypothetical Taxpayer**

|   | Base case (1) | Eliminate state and local deduction (2) | Eliminate real estate deduction (3) | Eliminate home mortgage interest deduction (4) | Eliminate charitable contributions deduction (5) |
|---|---------------|---|-------------------------------------|--|--|
| <b>Itemized deductions:</b>   |               |   |                                     |  |  |
| State and local income taxes  | \$6,500       | \$0                                     | \$6,500                             | \$6,500  | \$6,500  |
| Real estate taxes   | 3,500         | 3,500                                   | 0                                   | 3,500  | 3,500  |
| Home mortgage interest deduction  | 1,100         | 1,100                                   | 1,100                               | 0  | 1,100  |
| Charitable contributions  | 2,000         | 2,000                                   | 2,000                               | 2,000  | 0  |
| Sum of itemized deductions  | 13,100        | 6,600                                   | 9,600                               | 12,000   | 11,100   |
| <b>Standard deduction</b>   | 10,000        | 10,000                                  | 10,000                              | 10,000   | 10,000   |
| <b>Taxpayer itemizes?</b>   | Yes           | No                                      | No                                  | Yes  | Yes  |
| <b>Itemized deductions claimed by taxpayer</b>  | 13,100        | 10,000                                  | 10,000                              | 12,000   | 11,100   |
| <b>Tax expenditure estimate for eliminated itemized deduction(s)</b>                    |               | 620                                     | 620                                 | 220  | 400  |
| Tax expenditure if standard deduction raised to \$12,000                                |               | 220                                     | 220                                 | 220  | 220  |
| Tax expenditure if itemized deduction were an above the line deduction or an adjustment |               | 1,300                                   | 700                                 | 220  | 400  |

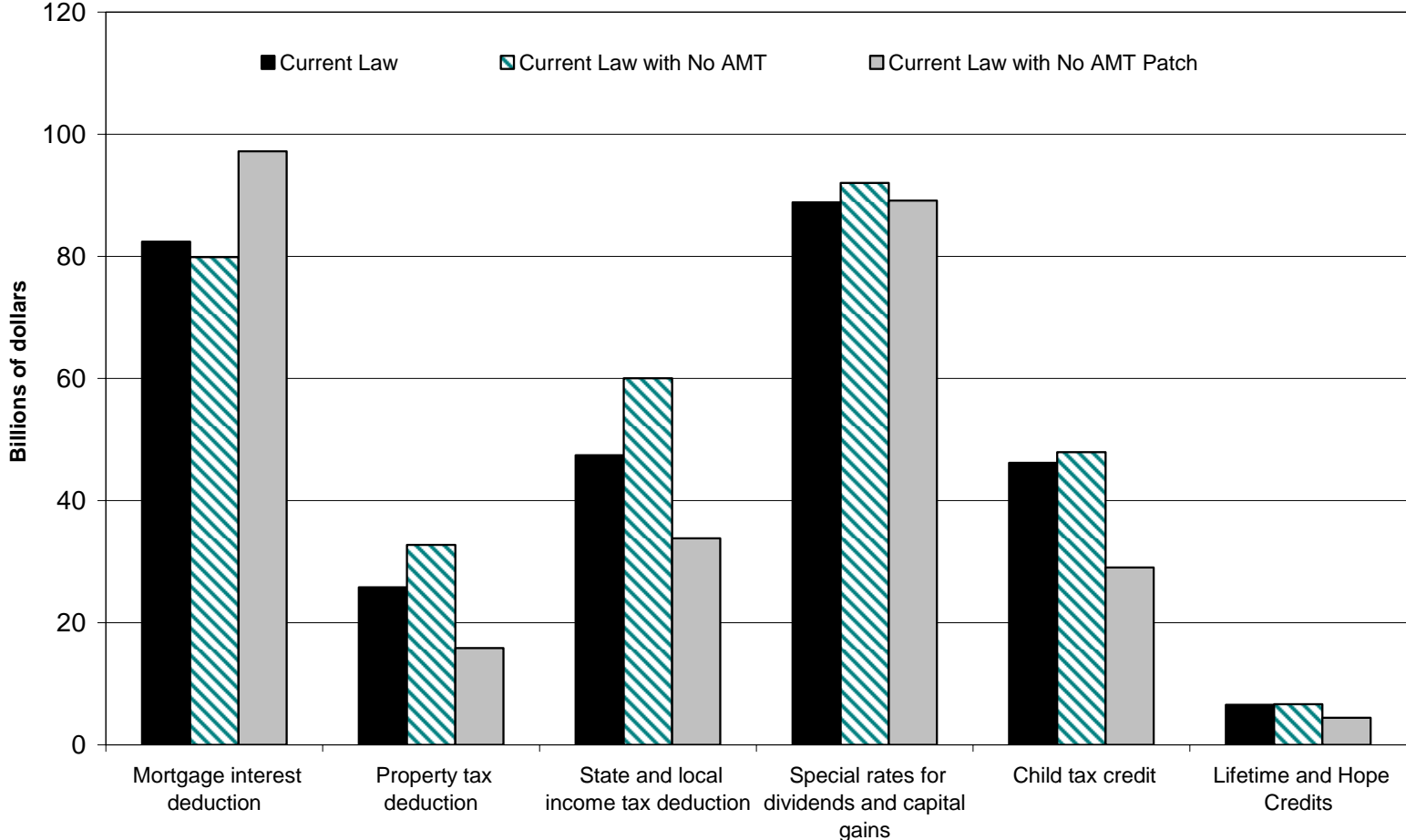
Note: Assumes a flat marginal tax rate of 20 percent.

**Figure 1**  
**Effect of AMT on Select Tax Expenditure Estimates, 2000-2007**



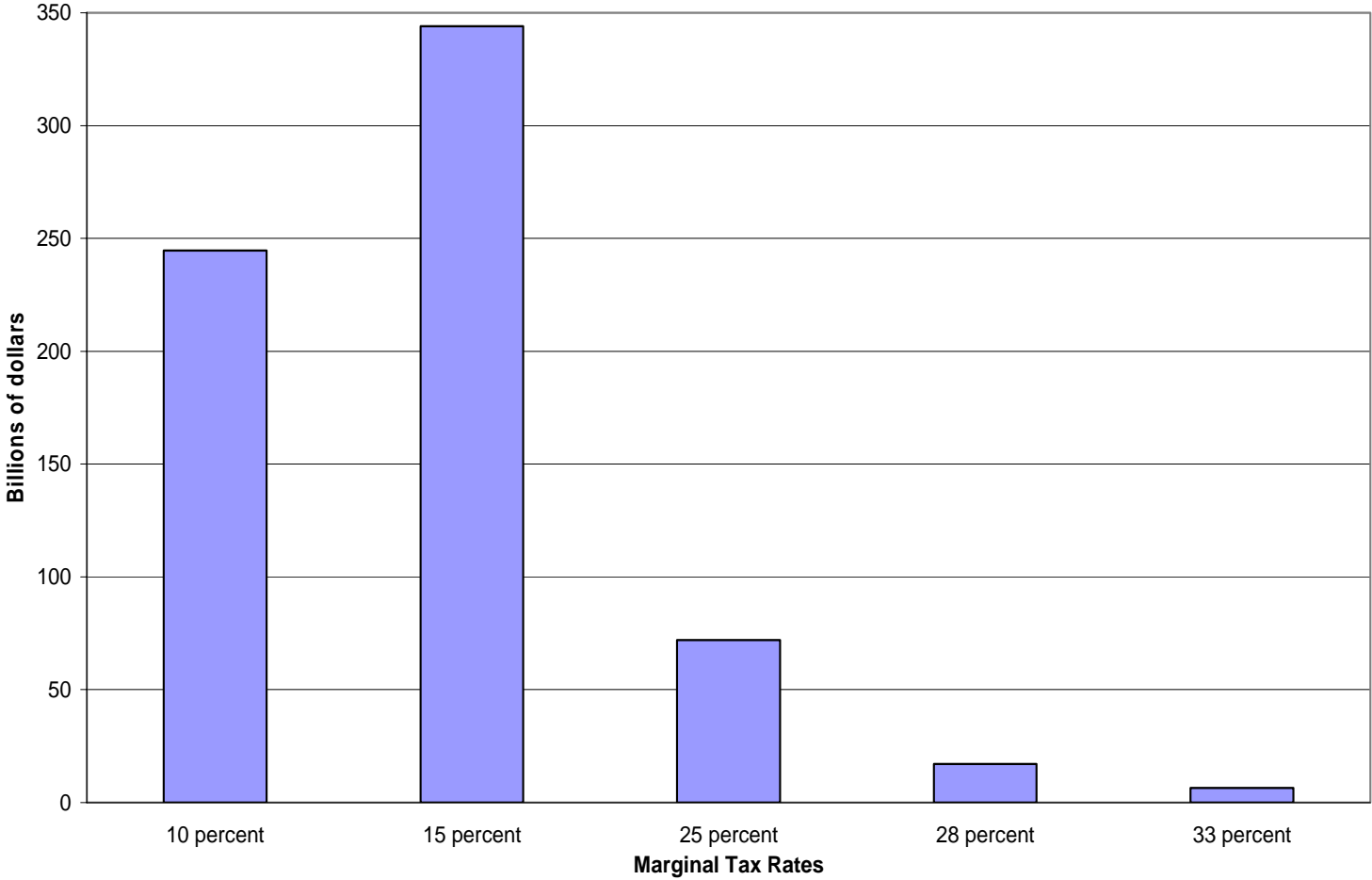
Notes: Authors' calculations using NBER TAXSIM. See text for further details.

**Figure 2**  
**Effect of AMT on Selected Tax Expenditure Estimates, 2007**



Notes: Authors' calculations using NBER TAXSIM. See text for further details.

**Figure 3**  
**Tax Expenditure Estimate for Graduated Individual Marginal Tax Rates, 2005**



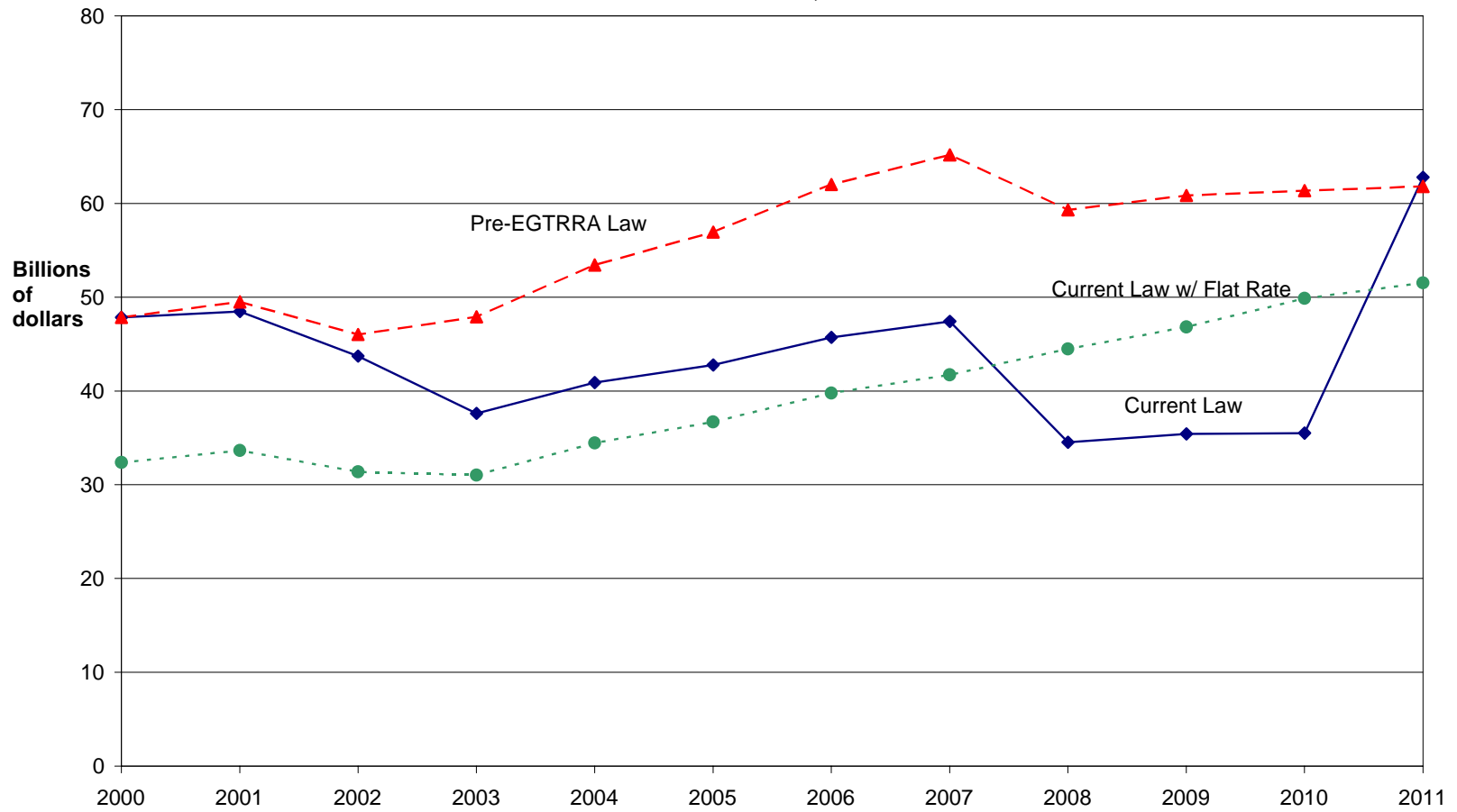
*Notes:* Authors' calculation from SOI data. See text for details.

**Figure 4**  
**Tax Expenditure Estimate for Mortgage Interest Deduction, 2000-2011**



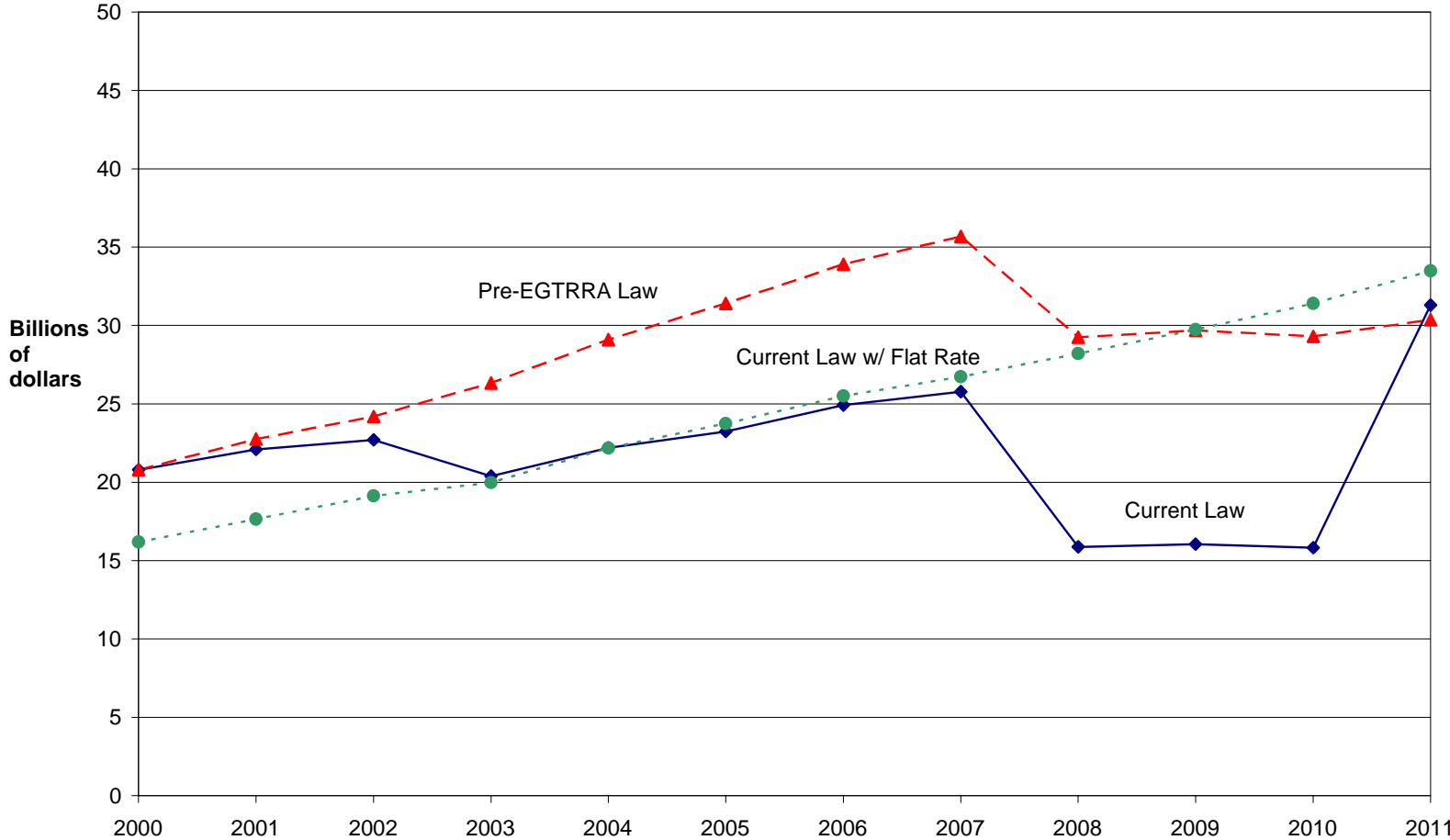
Notes: Authors' calculations using NBER TAXSIM. See text for further details.

**Figure 5**  
**Tax Expenditure Estimate for State and Local Income**  
**Tax Deduction, 2000-2011**



Notes: Authors' calculations using NBER TAXSIM. See text for further details.

**Figure 6**  
**Tax Expenditure Estimate for Property Tax Deduction, 2000-2011**



Notes: Authors' calculations using NBER TAXSIM. See text for further details.



**Table 7**  
**Distribution of Individual Income Tax Revenues under three AMT Scenarios**  
(in millions of dollars)

| Income decile               | Tax liability under 2004 law |                         |                 |                         |                       |                         |
|-----------------------------|------------------------------|-------------------------|-----------------|-------------------------|-----------------------|-------------------------|
|                             | Assuming 2004 AMT            | Percentage of liability | Assuming no AMT | Percentage of liability | Assuming no AMT patch | Percentage of liability |
| Bottom                      | 0                            | -0.8                    | -54             | -0.8                    | 1                     | -0.8                    |
| 2nd                         | -6,286                       | -1.6                    | -6,294          | -1.6                    | -6,282                | -1.5                    |
| 3rd                         | -12,671                      | -1.0                    | -12,684         | -1.0                    | -12,671               | -1.0                    |
| 4th                         | -8,114                       | 0.0                     | -8,127          | 0.0                     | -8,114                | 0.0                     |
| 5th                         | -28                          | 1.8                     | -33             | 1.8                     | -26                   | 1.8                     |
| 6th                         | 14,445                       | 3.3                     | 14,405          | 3.4                     | 14,460                | 3.3                     |
| 7th                         | 26,985                       | 5.4                     | 26,965          | 5.5                     | 27,058                | 5.3                     |
| 8th                         | 43,264                       | 8.0                     | 43,211          | 8.2                     | 43,440                | 7.9                     |
| 9th                         | 64,898                       | 13.0                    | 64,750          | 13.2                    | 65,444                | 13.1                    |
| Top                         | 104,805                      | 71.8                    | 104,409         | 71.4                    | 108,416               | 72.0                    |
| <b>Detail on top decile</b> |                              |                         |                 |                         |                       |                         |
| Top 5%                      | 484,370                      | 60.0                    | 471,885         | 59.5                    | 494,337               | 59.8                    |
| Top 1%                      | 311,965                      | 38.7                    | 305,602         | 38.5                    | 312,482               | 37.8                    |
| <b>Total</b>                | <b>806,894</b>               | <b>100.0</b>            | <b>792,973</b>  | <b>100.0</b>            | <b>826,335</b>        | <b>100.0</b>            |

*Notes:* Calculations from NBER TAXSIM using 2004 Statistics of Income Public Use File. The income concept used to place tax returns into income classes is adjusted gross income (AGI) minus state and local tax refunds, plus tax-exempt interest, non-taxable Social Security benefits, deductions for IRA contributions, student loan interest, alimony paid, tuition & fees, Health Savings Accounts, one-half of the self-employment tax, self-employed health insurance, self-employed SEP, SIMPLE and qualified plans, and penalties on the early withdrawal of saving, minus other income. The Public Use File does not report other income. To calculate other income, we took the difference between reported AGI and the signed sum of the reported components of AGI. The difference includes moving expenses, foreign earned income, and net operating losses from previous years as well as errors due to censoring and rounding. Returns of dependents are excluded from the analysis. Returns with negative income are excluded from lowest income group but included in totals. Decile breakpoints are, respectively, \$8,425, \$14,618, \$20,370, \$27,310, \$35,280, \$44,876, \$57,070, \$73,865, and \$104,687 (\$145,801 for top 5% and \$360,419 for top 1%).

**Table 8**  
**Distribution of the Tax Expenditure for the State and Local Income Tax Deduction under three AMT Scenarios, 2004**  
 Money amounts in millions of dollars, returns in thousands

| Income decile               | Under 2004 law                               |                   |                                       | Under 2004 law with no AMT                   |                   |                                       | Under 2004 law with no AMT patch             |                   |                                       |
|-----------------------------|--|-------------------|---------------------------------------|--|-------------------|---------------------------------------|--|-------------------|---------------------------------------|
|                             | Percentage of all returns claiming deduction | Average deduction | Percentage of total deduction claimed | Percentage of all returns claiming deduction | Average deduction | Percentage of total deduction claimed | Percentage of all returns claiming deduction | Average deduction | Percentage of total deduction claimed |
| Bottom                      | 0.0  | 19                | 0.0                                   | 0.0  | 19                | 0.0                                   | 0.0  | 19                | 0.0                                   |
| 2nd                         | 0.3  | 56                | 0.0                                   | 0.3  | 56                | 0.0                                   | 0.4  | 56                | 0.0                                   |
| 3rd                         | 1.0  | 86                | 0.1                                   | 1.0  | 86                | 0.1                                   | 1.1  | 86                | 0.1                                   |
| 4th                         | 2.6  | 125               | 0.2                                   | 2.5  | 125               | 0.2                                   | 2.9  | 125               | 0.3                                   |
| 5th                         | 5.7  | 172               | 0.8                                   | 5.6  | 172               | 0.6                                   | 6.4  | 172               | 0.9                                   |
| 6th                         | 9.4  | 269               | 1.9                                   | 9.2  | 269               | 1.6                                   | 10.4   | 269               | 2.4                                   |
| 7th                         | 12.7   | 395               | 3.8                                   | 12.5   | 395               | 3.2                                   | 14.0   | 391               | 4.7                                   |
| 8th                         | 17.2   | 490               | 6.4                                   | 16.9   | 492               | 5.4                                   | 18.8   | 488               | 7.9                                   |
| 9th                         | 23.7   | 803               | 14.5                                  | 23.4   | 813               | 12.4                                  | 23.8   | 794               | 16.2                                  |
| Top                         | 27.4   | 3,450             | 72.2                                  | 28.5   | 4,117             | 76.4                                  | 22.2   | 3,546             | 67.5                                  |
| <b>Detail on top decile</b> |  |                   |                                       |  |                   |                                       |  |                   |                                       |
| Top 5%                      | 13.7   | 5,526             | 57.9                                  | 14.8   | 6,604             | 63.8                                  | 10.8   | 6,177             | 57.2                                  |
| Top 1%                      | 2.8  | 18,429            | 38.7                                  | 3.0  | 20,166            | 39.8                                  | 3.0  | 18,757            | 47.7                                  |
| <b>Total</b>                | <b>100.0</b>                                 | <b>1,309</b>      | <b>100.0</b>                          | <b>100.0</b>                                 | <b>1,535</b>      | <b>100.0</b>                          | <b>100.0</b>                                 | <b>1,167</b>      | <b>100.0</b>                          |

See notes to table 7.

**Table 9**  
**Distribution of Hypothetical Tax Expenditure for Special Rates on Dividends and Capital Gains under three AMT Scenarios**  
 Money amounts in millions of dollars, returns in thousands

| Income decile               | Under 2004 law                               |                   |                                       | Under 2004 law with no AMT                   |                   |                                       | Under 2004 law with no AMT patch             |                   |                                       |
|-----------------------------|--|-------------------|---------------------------------------|--|-------------------|---------------------------------------|--|-------------------|---------------------------------------|
|                             | Percentage of all returns claiming deduction | Average deduction | Percentage of total deduction claimed | Percentage of all returns claiming deduction | Average deduction | Percentage of total deduction claimed | Percentage of all returns claiming deduction | Average deduction | Percentage of total deduction claimed |
| Bottom                      | 0.0  | 0                 | 0.0                                   | 0.0  | 0                 | 0.0                                   | 0.0  | 0                 | 0.0                                   |
| 2nd                         | 0.0  | 0                 | 0.0                                   | 0.0  | 0                 | 0.0                                   | 0.0  | 0                 | 0.0                                   |
| 3rd                         | 0.0  | 46                | 0.0                                   | 0.0  | 46                | 0.0                                   | 0.0  | 46                | 0.0                                   |
| 4th                         | 0.0  | 244               | 0.0                                   | 0.0  | 244               | 0.0                                   | 0.0  | 244               | 0.0                                   |
| 5th                         | 0.1  | 56                | 0.0                                   | 0.1  | 56                | 0.0                                   | 0.1  | 56                | 0.0                                   |
| 6th                         | 0.7  | 596               | 0.0                                   | 0.7  | 603               | 0.0                                   | 0.7  | 603               | 0.0                                   |
| 7th                         | 1.3  | 685               | 0.0                                   | 1.4  | 685               | 0.0                                   | 1.3  | 686               | 0.0                                   |
| 8th                         | 3.8  | 868               | 0.1                                   | 3.7  | 845               | 0.1                                   | 4.0  | 981               | 0.1                                   |
| 9th                         | 10.8   | 1,221             | 0.4                                   | 10.8   | 1,183             | 0.4                                   | 10.8   | 1,369             | 0.5                                   |
| Top                         | 83.2   | 39,777            | 99.5                                  | 83.3   | 41,160            | 99.5                                  | 83.0   | 39,777            | 99.4                                  |
| <b>Detail on top decile</b> |  |                   |                                       |  |                   |                                       |  |                   |                                       |
| Top 5%                      | 72.1   | 45,549            | 98.7                                  | 72.3   | 47,121            | 98.9                                  | 71.9   | 45,508            | 98.5                                  |
| Top 1%                      | 27.2   | 109,377           | 89.5                                  | 27.3   | 113,418           | 90.0                                  | 27.1   | 109,346           | 89.3                                  |
| <b>Total</b>                | <b>100.0</b>                                 | <b>33,273</b>     | <b>100.0</b>                          | <b>100.0</b>                                 | <b>34,452</b>     | <b>100.0</b>                          | <b>100.0</b>                                 | <b>33,225</b>     | <b>100.0</b>                          |

See notes to table 7.

**Table 10**  
**Distribution of Hypothetical Tax Expenditure Combining the Top 13 TAXSIM Tax Expenditures under three AMT Scenarios**  
 Money amounts in millions of dollars, returns in thousands

| Income decile               | Under 2004 law                     |              |                             | Under 2004 law with no AMT         |              |                             | Under 2004 law with no AMT patch   |              |                             |
|-----------------------------|------------------------------------|--------------|-----------------------------|------------------------------------|--------------|-----------------------------|------------------------------------|--------------|-----------------------------|
|                             | Percentage of all returns claiming | Average      | Percentage of total claimed | Percentage of all returns claiming | Average      | Percentage of total claimed | Percentage of all returns claiming | Average      | Percentage of total claimed |
| Bottom                      | 6.8                                | 1,087        | 2.0                         | 6.8                                | 1,087        | 1.9                         | 6.8                                | 1,087        | 2.0                         |
| 2nd                         | 7.9                                | 2,185        | 4.7                         | 7.9                                | 2,184        | 4.6                         | 7.9                                | 2,185        | 4.7                         |
| 3rd                         | 7.3                                | 2,442        | 4.8                         | 7.3                                | 2,442        | 4.7                         | 7.3                                | 2,442        | 4.8                         |
| 4th                         | 8.5                                | 2,119        | 4.9                         | 8.5                                | 2,119        | 4.8                         | 8.5                                | 2,119        | 4.9                         |
| 5th                         | 9.0                                | 1,696        | 4.1                         | 9.0                                | 1,696        | 4.0                         | 9.0                                | 1,696        | 4.1                         |
| 6th                         | 10.3                               | 1,720        | 4.8                         | 10.3                               | 1,720        | 4.6                         | 10.3                               | 1,722        | 4.8                         |
| 7th                         | 11.2                               | 1,994        | 6.0                         | 11.2                               | 1,994        | 5.9                         | 11.2                               | 1,997        | 6.0                         |
| 8th                         | 12.2                               | 2,218        | 7.3                         | 12.2                               | 2,218        | 7.1                         | 12.2                               | 2,240        | 7.4                         |
| 9th                         | 12.9                               | 2,942        | 10.3                        | 12.9                               | 2,948        | 10.0                        | 12.9                               | 3,155        | 11.0                        |
| Top                         | 13.8                               | 13,762       | 51.1                        | 13.8                               | 14,484       | 52.4                        | 13.8                               | 13,609       | 50.4                        |
| <b>Detail on top decile</b> |                                    |              |                             |                                    |              |                             |                                    |              |                             |
| Top 5%                      | 7.0                                | 23,079       | 43.4                        | 7.0                                | 24,472       | 44.8                        | 7.0                                | 22,824       | 42.8                        |
| Top 1%                      | 1.4                                | 81,163       | 30.7                        | 1.4                                | 85,142       | 31.3                        | 1.4                                | 80,804       | 30.5                        |
| <b>Total</b>                | <b>100.0</b>                       | <b>3,705</b> | <b>100.0</b>                | <b>100.0</b>                       | <b>3,805</b> | <b>100.0</b>                | <b>100.0</b>                       | <b>3,715</b> | <b>100.0</b>                |

See notes to table 7.

**Table 11**  
**Distribution of Hypothetical Tax Expenditure Combining 11 TAXSIM Tax Expenditures under three AMT Scenarios**  
 Money amounts in millions of dollars, returns in thousands

| Income decile               | Under 2004 law                     |              |                             | Under 2004 law with no AMT         |              |                             | Under 2004 law with no AMT patch   |              |                             |
|-----------------------------|------------------------------------|--------------|-----------------------------|------------------------------------|--------------|-----------------------------|------------------------------------|--------------|-----------------------------|
|                             | Percentage of all returns claiming | Average      | Percentage of total claimed | Percentage of all returns claiming | Average      | Percentage of total claimed | Percentage of all returns claiming | Average      | Percentage of total claimed |
| Bottom                      | 0.1                                | 84           | 0.0                         | 0.1                                | 88           | 0.0                         | 0.1                                | 84           | 0.0                         |
| 2nd                         | 2.2                                | 272          | 0.2                         | 2.2                                | 272          | 0.2                         | 2.2                                | 272          | 0.2                         |
| 3rd                         | 4.0                                | 552          | 0.6                         | 4.0                                | 552          | 0.6                         | 4.0                                | 552          | 0.6                         |
| 4th                         | 6.4                                | 762          | 1.3                         | 6.4                                | 762          | 1.2                         | 6.4                                | 762          | 1.3                         |
| 5th                         | 8.9                                | 1,026        | 2.4                         | 8.9                                | 1,025        | 2.3                         | 8.9                                | 1,026        | 2.4                         |
| 6th                         | 11.8                               | 1,275        | 3.9                         | 11.8                               | 1,275        | 3.8                         | 11.8                               | 1,279        | 3.9                         |
| 7th                         | 13.8                               | 1,557        | 5.6                         | 13.8                               | 1,557        | 5.4                         | 13.8                               | 1,562        | 5.6                         |
| 8th                         | 15.6                               | 1,656        | 6.7                         | 15.6                               | 1,655        | 6.5                         | 15.6                               | 1,682        | 6.8                         |
| 9th                         | 17.6                               | 2,322        | 10.6                        | 17.6                               | 2,329        | 10.2                        | 17.6                               | 2,548        | 11.6                        |
| Top                         | 19.5                               | 13,624       | 68.9                        | 19.5                               | 14,355       | 70.0                        | 19.5                               | 13,478       | 67.8                        |
| <b>Detail on top decile</b> |                                    |              |                             |                                    |              |                             |                                    |              |                             |
| Top 5%                      | 10.0                               | 23,072       | 59.5                        | 10.0                               | 24,468       | 60.9                        | 10.0                               | 22,818       | 58.7                        |
| Top 1%                      | 2.0                                | 81,175       | 42.2                        | 2.0                                | 85,176       | 42.6                        | 2.0                                | 80,817       | 41.9                        |
| <b>Total</b>                | <b>100.0</b>                       | <b>3,860</b> | <b>100.0</b>                | <b>100.0</b>                       | <b>4,003</b> | <b>100.0</b>                | <b>100.0</b>                       | <b>3,876</b> | <b>100.0</b>                |

See notes to table 7.

**APPENDIX TABLE**  
**Estimates of Selected Tax Expenditures, 2000-2011**  
(Billions of dollars)

**1. Individual income tax revenues**

|      | Current Law | Current Law<br>with No AMT | Current Law<br>with No AMT<br>Patch | Pre-EGTRRA<br>Law | Current law<br>with flat rate of<br>19% |
|------|-------------|----------------------------|-------------------------------------|-------------------|---|
| 2000 | 959.9       | 944.7                      | 959.9                               | 959.9             | 865.1                                   |
| 2001 | 829.4       | 821.3                      | 830.9                               | 873.1             | 812.1                                   |
| 2002 | 764.5       | 756.9                      | 766.8                               | 817.0             | 780.0                                   |
| 2003 | 705.6       | 695.6                      | 721.1                               | 846.9             | 799.0                                   |
| 2004 | 810.0       | 795.9                      | 829.4                               | 967.7             | 891.4                                   |
| 2005 | 896.6       | 879.4                      | 921.2                               | 1059.1            | 975.1                                   |
| 2006 | 964.8       | 950.3                      | 1001.1                              | 1139.5            | 1048.7                                  |
| 2007 | 1017.3      | 994.4                      | 1086.3                              | 1199.3            | 1092.9                                  |
| 2008 | 1151.6      | 1044.7                     | 1151.6                              | 1279.6            | 1139.6                                  |
| 2009 | 1227.0      | 1104.6                     | 1227.0                              | 1354.8            | 1196.1                                  |
| 2010 | 1318.9      | 1172.5                     | 1318.9                              | 1447.1            | 1268.4                                  |
| 2011 | 1520.1      | 1469.0                     | 1520.1                              | 1513.5            | 1303.9                                  |

**2. Tax expenditure for mortgage interest deduction**

|      | Current Law | Current Law<br>with No AMT | Current Law<br>with No AMT<br>Patch | Pre-EGTRRA<br>Law | Current law<br>with flat rate of<br>19% |
|------|-------------|----------------------------|-------------------------------------|-------------------|---|
| 2000 | 72.0        | 71.7                       | 72.0                                | 72.0              | 51.1                                    |
| 2001 | 75.5        | 75.3                       | 75.6                                | 76.7              | 55.4                                    |
| 2002 | 72.8        | 72.4                       | 73.0                                | 75.0              | 55.3                                    |
| 2003 | 62.6        | 61.9                       | 66.4                                | 74.1              | 51.9                                    |
| 2004 | 66.1        | 64.9                       | 70.8                                | 77.5              | 54.0                                    |
| 2005 | 72.0        | 70.4                       | 78.0                                | 79.7              | 58.0                                    |
| 2006 | 77.7        | 76.2                       | 86.1                                | 86.3              | 62.5                                    |
| 2007 | 82.4        | 79.9                       | 97.2                                | 90.9              | 65.5                                    |
| 2008 | 104.0       | 85.2                       | 104.0                               | 101.8             | 69.2                                    |
| 2009 | 111.3       | 90.3                       | 111.3                               | 108.7             | 73.1                                    |
| 2010 | 118.8       | 95.8                       | 118.8                               | 115.9             | 77.3                                    |
| 2011 | 124.5       | 117.9                      | 124.5                               | 124.5             | 84.5                                    |

**3. Tax expenditure for medical expenses deduction**

|      | Current Law | Current Law with No AMT | Current Law with No AMT Patch | Pre-EGTRRA Law | Current law with flat rate of 19% |
|------|-------------|-------------------------|-------------------------------|----------------|-----------------------------------|
| 2000 | 5.1         | 5.1                     | 5.1                           | 5.1            | 5.0                               |
| 2001 | 5.3         | 5.4                     | 5.3                           | 5.6            | 5.7                               |
| 2002 | 5.7         | 5.8                     | 5.7                           | 6.1            | 6.2                               |
| 2003 | 5.6         | 5.6                     | 5.5                           | 6.7            | 6.4                               |
| 2004 | 6.7         | 6.8                     | 6.6                           | 8.0            | 7.6                               |
| 2005 | 7.3         | 7.4                     | 7.2                           | 8.3            | 8.1                               |
| 2006 | 7.9         | 8.0                     | 7.7                           | 9.0            | 8.7                               |
| 2007 | 8.3         | 8.4                     | 8.3                           | 9.5            | 9.2                               |
| 2008 | 8.9         | 9.0                     | 8.9                           | 9.9            | 9.7                               |
| 2009 | 9.6         | 9.6                     | 9.6                           | 10.5           | 10.3                              |
| 2010 | 10.2        | 10.1                    | 10.2                          | 11.1           | 10.8                              |
| 2011 | 12.2        | 12.7                    | 12.2                          | 12.0           | 11.9                              |

**4. Tax expenditure for property tax deduction**

|      | Current Law | Current Law with No AMT | Current Law with No AMT Patch | Pre-EGTRRA Law | Current law with flat rate of 19% |
|------|-------------|-------------------------|-------------------------------|----------------|-----------------------------------|
| 2000 | 20.8        | 22.4                    | 20.8                          | 20.8           | 16.2                              |
| 2001 | 22.1        | 23.7                    | 21.5                          | 22.8           | 17.7                              |
| 2002 | 22.7        | 24.8                    | 21.7                          | 24.2           | 19.1                              |
| 2003 | 20.4        | 23.8                    | 15.5                          | 26.3           | 20.0                              |
| 2004 | 22.2        | 26.8                    | 16.5                          | 29.1           | 22.2                              |
| 2005 | 23.2        | 28.9                    | 16.8                          | 31.4           | 23.8                              |
| 2006 | 24.9        | 31.2                    | 16.5                          | 33.9           | 25.5                              |
| 2007 | 25.8        | 32.7                    | 15.9                          | 35.7           | 26.7                              |
| 2008 | 15.9        | 34.9                    | 15.9                          | 29.3           | 28.2                              |
| 2009 | 16.1        | 36.9                    | 16.1                          | 29.7           | 29.8                              |
| 2010 | 15.8        | 39.1                    | 15.8                          | 29.3           | 31.4                              |
| 2011 | 31.3        | 47.1                    | 31.3                          | 30.4           | 33.5                              |

**5. Tax expenditure for state and local income tax deduction**

|      | Current Law | Current Law with No AMT | Current Law with No AMT Patch | Pre-EGTRRA Law | Current law with flat rate of 19% |
|------|-------------|-------------------------|-------------------------------|----------------|-----------------------------------|
| 2000 | 47.9        | 52.5                    | 47.9                          | 47.9           | 32.4                              |
| 2001 | 48.5        | 53.1                    | 47.6                          | 49.5           | 33.7                              |
| 2002 | 43.7        | 47.6                    | 42.4                          | 46.0           | 31.4                              |
| 2003 | 37.6        | 43.4                    | 30.2                          | 47.9           | 31.0                              |
| 2004 | 40.9        | 49.0                    | 32.5                          | 53.4           | 34.4                              |
| 2005 | 42.8        | 52.5                    | 33.6                          | 56.9           | 36.7                              |
| 2006 | 45.7        | 57.2                    | 33.9                          | 62.0           | 39.8                              |
| 2007 | 47.4        | 60.0                    | 33.8                          | 65.2           | 41.7                              |
| 2008 | 34.6        | 64.5                    | 34.6                          | 59.3           | 44.5                              |
| 2009 | 35.4        | 68.1                    | 35.4                          | 60.9           | 46.8                              |
| 2010 | 35.5        | 72.8                    | 35.5                          | 61.4           | 49.9                              |
| 2011 | 62.8        | 84.3                    | 62.8                          | 61.8           | 51.5                              |

**6. Tax expenditure for charitable contributions deductions**

|      | Current Law | Current Law with No AMT | Current Law with No AMT Patch | Pre-EGTRRA Law | Current law with flat rate of 19% |
|------|-------------|-------------------------|-------------------------------|----------------|-----------------------------------|
| 2000 | 34.6        | 34.6                    | 34.6                          | 34.6           | 23.1                              |
| 2001 | 33.2        | 33.2                    | 33.2                          | 33.7           | 23.0                              |
| 2002 | 32.5        | 32.4                    | 32.5                          | 33.4           | 23.3                              |
| 2003 | 30.5        | 30.3                    | 31.5                          | 35.2           | 23.7                              |
| 2004 | 34.8        | 34.5                    | 36.1                          | 40.0           | 26.5                              |
| 2005 | 37.7        | 37.2                    | 39.3                          | 42.2           | 28.4                              |
| 2006 | 40.5        | 40.1                    | 42.7                          | 45.5           | 30.5                              |
| 2007 | 42.7        | 42.1                    | 46.8                          | 47.8           | 32.0                              |
| 2008 | 49.7        | 44.7                    | 49.7                          | 51.7           | 33.8                              |
| 2009 | 52.8        | 47.2                    | 52.8                          | 54.7           | 35.5                              |
| 2010 | 56.1        | 50.1                    | 56.1                          | 58.0           | 37.6                              |
| 2011 | 60.6        | 59.5                    | 60.6                          | 60.7           | 39.5                              |



**7. Tax expenditure for municipal bond interest deduction**

|      | Current Law | Current Law<br>with No<br>AMT | Current Law<br>with No AMT<br>Patch | Pre-EGTRRA<br>Law | Current law with<br>flat rate of 19% |
|------|-------------|-------------------------------|-------------------------------------|-------------------|--------------------------------------|
| 2000 | 18.0        | 18.3                          | 18.0                                | 18.0              | 10.6                                 |
| 2001 | 18.0        | 18.1                          | 17.9                                | 18.1              | 10.8                                 |
| 2002 | 16.9        | 17.0                          | 16.8                                | 17.3              | 10.5                                 |
| 2003 | 15.0        | 15.1                          | 15.0                                | 16.8              | 10.2                                 |
| 2004 | 14.8        | 15.0                          | 14.9                                | 16.7              | 10.0                                 |
| 2005 | 15.9        | 16.1                          | 16.0                                | 17.9              | 10.6                                 |
| 2006 | 16.8        | 17.0                          | 16.9                                | 18.9              | 11.2                                 |
| 2007 | 17.6        | 17.8                          | 17.8                                | 19.8              | 11.7                                 |
| 2008 | 18.6        | 18.6                          | 18.6                                | 20.6              | 12.2                                 |
| 2009 | 19.6        | 19.5                          | 19.6                                | 21.6              | 12.8                                 |
| 2010 | 20.5        | 20.4                          | 20.5                                | 22.6              | 13.3                                 |
| 2011 | 24.1        | 24.6                          | 24.1                                | 24.0              | 14.3                                 |

**8. Tax expenditure for special rates for dividends and capital gains**

|      | Current Law | Current Law<br>with No<br>AMT | Current Law<br>with No AMT<br>Patch | Pre-EGTRRA<br>Law |
|------|-------------|-------------------------------|-------------------------------------|-------------------|
| 2000 | 76.2        | 83.6                          | 76.2                                | 76.2              |
| 2001 | 30.6        | 32.0                          | 30.6                                | 39.5              |
| 2002 | 22.6        | 23.4                          | 22.5                                | 29.1              |
| 2003 | 32.3        | 33.0                          | 32.4                                | 36.3              |
| 2004 | 56.5        | 58.0                          | 56.5                                | 61.0              |
| 2005 | 79.3        | 81.5                          | 79.4                                | 83.8              |
| 2006 | 92.3        | 95.6                          | 92.5                                | 97.5              |
| 2007 | 88.9        | 92.0                          | 89.1                                | 94.7              |
| 2008 | 87.4        | 90.9                          | 87.4                                | 92.2              |
| 2009 | 87.1        | 90.7                          | 87.1                                | 92.1              |
| 2010 | 102.8       | 107.8                         | 102.8                               | 108.2             |
| 2011 | 62.9        | 65.5                          | 62.9                                | 66.8              |

**9. Tax expenditure for earned income tax credit**

|      | Current Law | Current Law<br>with No<br>AMT | Current Law<br>with No AMT<br>Patch | Pre-EGTRRA<br>Law |
|------|-------------|-------------------------------|-------------------------------------|-------------------|
| 2000 | 32.2        | 32.2                          | 32.2                                | 32.2              |
| 2001 | 33.1        | 33.1                          | 33.1                                | 33.2              |
| 2002 | 36.9        | 36.9                          | 36.9                                | 36.9              |
| 2003 | 36.4        | 36.4                          | 36.4                                | 36.6              |
| 2004 | 38.6        | 38.6                          | 38.6                                | 38.6              |
| 2005 | 39.6        | 39.6                          | 39.6                                | 39.6              |
| 2006 | 40.5        | 40.5                          | 40.5                                | 40.5              |
| 2007 | 41.4        | 41.4                          | 41.4                                | 41.5              |
| 2008 | 42.5        | 42.5                          | 42.5                                | 42.5              |
| 2009 | 43.5        | 43.5                          | 43.5                                | 43.5              |
| 2010 | 44.5        | 44.5                          | 44.5                                | 44.6              |
| 2011 | 46.0        | 46.0                          | 46.0                                | 46.0              |

**10. Tax expenditure for child tax credit**

|      | Current Law | Current Law<br>with No AMT | Current Law<br>with No AMT<br>Patch | Pre-<br>EGTRRA<br>Law |
|------|-------------|----------------------------|-------------------------------------|-----------------------|
| 2000 | 19.9        | 19.9                       | 19.9                                | 19.9                  |
| 2001 | 27.8        | 27.7                       | 27.8                                | 23.4                  |
| 2002 | 27.9        | 27.9                       | 27.9                                | 23.6                  |
| 2003 | 44.2        | 44.2                       | 44.2                                | 23.8                  |
| 2004 | 47.0        | 47.0                       | 47.0                                | 24.7                  |
| 2005 | 47.4        | 47.4                       | 47.4                                | 24.8                  |
| 2006 | 47.8        | 47.8                       | 47.8                                | 24.9                  |
| 2007 | 46.2        | 48.0                       | 29.1                                | 24.7                  |
| 2008 | 28.3        | 48.2                       | 28.3                                | 18.7                  |
| 2009 | 27.4        | 48.4                       | 27.4                                | 17.9                  |
| 2010 | 26.5        | 48.5                       | 26.5                                | 17.2                  |
| 2011 | 12.0        | 19.8                       | 12.0                                | 11.9                  |

**11. Tax expenditure for Lifetime and Hope Credits**

|      | Current Law | Current Law<br>with No AMT | Current Law<br>with No AMT<br>Patch | Pre-<br>EGTRRA<br>Law |
|------|-------------|----------------------------|-------------------------------------|-----------------------|
| 2000 | 4.8         | 4.8                        | 4.8                                 | 4.8                   |
| 2001 | 4.9         | 4.9                        | 4.9                                 | 5.2                   |
| 2002 | 4.9         | 4.9                        | 4.9                                 | 5.1                   |
| 2003 | 5.8         | 5.8                        | 5.8                                 | 6.2                   |
| 2004 | 6.0         | 6.0                        | 6.0                                 | 6.5                   |
| 2005 | 6.2         | 6.2                        | 6.2                                 | 6.6                   |
| 2006 | 6.6         | 6.6                        | 6.6                                 | 7.1                   |
| 2007 | 6.6         | 6.6                        | 4.4                                 | 7.1                   |
| 2008 | 4.4         | 6.7                        | 4.4                                 | 5.6                   |
| 2009 | 4.3         | 6.7                        | 4.3                                 | 5.4                   |
| 2010 | 4.2         | 6.7                        | 4.2                                 | 5.3                   |
| 2011 | 5.3         | 7.2                        | 5.3                                 | 5.3                   |

**12. Hypothetical tax expenditure: Personal Exemption**

|      | Current Law | Current Law with No AMT | Current Law with No AMT Patch | Pre-EGTRRA Law | Current law with flat rate of 19% |
|------|-------------|-------------------------|-------------------------------|----------------|-----------------------------------|
| 2000 | 121.0       | 122.5                   | 121.0                         | 121.0          | 116.9                             |
| 2001 | 118.5       | 119.9                   | 117.6                         | 126.0          | 122.5                             |
| 2002 | 119.1       | 121.1                   | 117.5                         | 128.6          | 126.7                             |
| 2003 | 106.8       | 109.2                   | 96.5                          | 130.0          | 128.2                             |
| 2004 | 111.2       | 114.3                   | 98.2                          | 134.3          | 131.5                             |
| 2005 | 117.2       | 121.5                   | 100.5                         | 142.1          | 137.7                             |
| 2006 | 125.2       | 130.2                   | 101.2                         | 152.0          | 145.1                             |
| 2007 | 129.0       | 135.8                   | 83.5                          | 159.1          | 151.3                             |
| 2008 | 85.0        | 145.6                   | 85.0                          | 148.1          | 158.7                             |
| 2009 | 83.8        | 152.3                   | 83.8                          | 150.8          | 164.9                             |
| 2010 | 83.0        | 163.0                   | 83.0                          | 154.6          | 173.5                             |
| 2011 | 153.5       | 186.3                   | 153.5                         | 150.2          | 176.3                             |

**13. Hypothetical tax expenditure: Thirteen items**

|      | Current Law | Current Law with No AMT | Current Law with No AMT Patch | Pre-EGTRRA Law | Current law with flat rate of 19% |
|------|-------------|-------------------------|-------------------------------|----------------|-----------------------------------|
| 2000 | 315.9       | 326.0                   | 315.9                         | 315.9          | 122.9                             |
| 2001 | 279.9       | 285.1                   | 279.0                         | 289.1          | 130.3                             |
| 2002 | 268.0       | 272.5                   | 266.8                         | 277.9          | 130.6                             |
| 2003 | 274.2       | 280.3                   | 273.8                         | 290.5          | 125.8                             |
| 2004 | 316.4       | 325.0                   | 317.2                         | 334.5          | 135.8                             |
| 2005 | 352.5       | 362.9                   | 355.4                         | 363.4          | 144.2                             |
| 2006 | 383.4       | 396.5                   | 387.9                         | 398.5          | 155.9                             |
| 2007 | 387.7       | 403.3                   | 375.2                         | 407.4          | 162.7                             |
| 2008 | 389.3       | 420.8                   | 389.3                         | 408.4          | 173.5                             |
| 2009 | 403.1       | 434.5                   | 403.1                         | 421.5          | 182.3                             |
| 2010 | 436.6       | 471.7                   | 436.6                         | 455.7          | 194.6                             |
| 2011 | 416.9       | 445.1                   | 416.9                         | 419.7          | 205.0                             |

Notes: The thirteen items are the top thirteen expenditures in terms of tax revenues lost that can be estimated using the TAXSIM model. These items include the mortgage interest deduction, deduction for medical and dental expenses, deduction for state and local income taxes, deduction for property taxes on owner-occupied homes, deduction for charitable contributions, the EITC, the child tax credit, the Lifetime and Hope credits, the child and dependent care credit, the tax exemption on municipal bonds, the special rates on capital gains and dividends, the tax preferences for IRAs and Keogh plans, and the exclusion for certain pensions and annuities. See text for further details.

**14. Hypothetical tax expenditure: Eleven items**

|      | Current Law | Current Law with No AMT | Current Law with No AMT Patch | Pre-EGTRRA Law | Current law with flat rate of 19% |
|------|-------------|-------------------------|-------------------------------|----------------|-----------------------------------|
| 2000 | 263.8       | 274.0                   | 263.8                         | 263.8          | 122.9                             |
| 2001 | 219.0       | 224.2                   | 218.1                         | 232.6          | 130.3                             |
| 2002 | 203.2       | 207.6                   | 201.9                         | 217.4          | 130.6                             |
| 2003 | 192.6       | 198.7                   | 192.2                         | 229.7          | 125.8                             |
| 2004 | 230.5       | 239.1                   | 231.2                         | 271.1          | 135.8                             |
| 2005 | 265.1       | 275.5                   | 268.0                         | 298.9          | 144.2                             |
| 2006 | 294.8       | 307.9                   | 299.3                         | 333.1          | 155.9                             |
| 2007 | 300.1       | 313.5                   | 308.1                         | 341.1          | 162.7                             |
| 2008 | 322.0       | 329.7                   | 322.0                         | 348.9          | 173.5                             |
| 2009 | 335.6       | 342.3                   | 335.6                         | 361.9          | 182.3                             |
| 2010 | 368.9       | 378.4                   | 368.9                         | 396.0          | 194.6                             |
| 2011 | 359.9       | 378.7                   | 359.9                         | 362.9          | 205.0                             |

Notes: The eleven items consist of all of the expenditures included in the "13 items" above with the exception of the EITC and child care credits. See text for further details.

**15. Hypothetical tax expenditure: Standard deduction**

|      | Current Law | Current Law with No AMT | Current Law with No AMT Patch | Pre-EGTRRA Law | Current law with flat rate of 19% |
|------|-------------|-------------------------|-------------------------------|----------------|-----------------------------------|
| 2000 | 65.6        | 65.7                    | 65.6                          | 65.6           | 71.6                              |
| 2001 | 60.0        | 59.9                    | 59.9                          | 65.9           | 72.5                              |
| 2002 | 59.1        | 59.1                    | 59.0                          | 65.6           | 73.2                              |
| 2003 | 62.0        | 62.0                    | 60.5                          | 69.2           | 83.2                              |
| 2004 | 63.5        | 63.6                    | 61.5                          | 70.3           | 83.8                              |
| 2005 | 67.7        | 67.8                    | 64.4                          | 80.6           | 87.8                              |
| 2006 | 71.8        | 71.9                    | 66.5                          | 85.4           | 92.0                              |
| 2007 | 75.2        | 75.7                    | 63.6                          | 90.3           | 96.8                              |
| 2008 | 65.6        | 80.0                    | 65.6                          | 89.2           | 100.8                             |
| 2009 | 66.7        | 83.9                    | 66.7                          | 92.3           | 104.9                             |
| 2010 | 67.7        | 88.0                    | 67.7                          | 95.3           | 109.2                             |
| 2011 | 90.9        | 98.2                    | 90.9                          | 89.7           | 105.6                             |

**16. Hypothetical tax expenditure: Property tax and mortgage interest deductions**

|      | Current Law | Current Law with No AMT | Current Law with No AMT Patch | Pre-EGTRRA Law | Current law with flat rate of 19% |
|------|-------------|-------------------------|-------------------------------|----------------|-----------------------------------|
| 2000 | 86.5        | 87.6                    | 86.5                          | 86.5           | 61.4                              |
| 2001 | 91.1        | 92.5                    | 90.6                          | 92.8           | 66.9                              |
| 2002 | 88.6        | 90.3                    | 87.8                          | 92.0           | 67.7                              |
| 2003 | 75.5        | 78.4                    | 75.6                          | 93.1           | 64.2                              |
| 2004 | 80.4        | 84.1                    | 81.2                          | 99.0           | 68.2                              |
| 2005 | 86.8        | 91.1                    | 88.9                          | 101.6          | 73.3                              |
| 2006 | 93.9        | 99.0                    | 97.1                          | 110.4          | 79.2                              |
| 2007 | 99.1        | 103.7                   | 108.5                         | 116.2          | 82.9                              |
| 2008 | 115.4       | 110.9                   | 115.4                         | 121.8          | 87.9                              |
| 2009 | 123.1       | 117.7                   | 123.1                         | 129.1          | 92.9                              |
| 2010 | 130.8       | 125.2                   | 130.8                         | 136.2          | 98.5                              |
| 2011 | 147.8       | 154.5                   | 147.8                         | 147.1          | 108.4                             |

**17. Hypothetical tax expenditure: Property tax deduction and State and local income tax deduction**

|      | Current Law | Current Law with No AMT | Current Law with No AMT Patch | Pre-EGTRRA Law | Current law with flat rate of 19% |
|------|-------------|-------------------------|-------------------------------|----------------|-----------------------------------|
| 2000 | 67.3        | 72.5                    | 67.3                          | 67.3           | 46.7                              |
| 2001 | 69.3        | 74.4                    | 68.3                          | 70.8           | 49.5                              |
| 2002 | 65.4        | 70.0                    | 63.8                          | 68.6           | 48.5                              |
| 2003 | 57.7        | 64.3                    | 49.0                          | 72.5           | 48.4                              |
| 2004 | 63.3        | 72.5                    | 53.2                          | 80.9           | 53.8                              |
| 2005 | 66.8        | 78.0                    | 55.4                          | 85.1           | 57.5                              |
| 2006 | 71.9        | 85.2                    | 56.0                          | 93.0           | 62.4                              |
| 2007 | 74.8        | 89.4                    | 55.8                          | 97.8           | 65.4                              |
| 2008 | 57.2        | 96.2                    | 57.2                          | 92.6           | 69.8                              |
| 2009 | 58.9        | 101.7                   | 58.9                          | 95.7           | 73.6                              |
| 2010 | 59.2        | 108.9                   | 59.2                          | 97.4           | 78.4                              |
| 2011 | 100.6       | 127.5                   | 100.6                         | 99.0           | 82.1                              |