

SCOPE OF TAX EXPENDITURES

Some of the special tax provisions cause revenue to be lost to the Government forever because the current tax base or the tax rates are reduced without any offsetting increase later. Such tax expenditures correspond closely to direct expenditures.

Other special tax provisions serve to defer the time when the taxes will be paid. For a particular taxpayer, transaction, or asset, the special provision may really represent a deferral of tax. However, for stable or growing businesses with an indefinite life, for the Government, and for the entire economy, the deferral of taxes continues forever under most of these provisions; furthermore, in an expanding economy the aggregate amount of deferred taxes tends to grow year after year. Examples of special tax provisions which cause deferral of taxes include: Deduction of employer and self-employed contributions to private pension plans and exemption of investment income of such plans; accelerated depreciation deductions on buildings; net income reinvested in ship construction and renovation by certain shipping companies; expensing of capital costs in agriculture and natural resource industries; and exclusion of nonrepatriated earnings of foreign subsidiaries.

Special tax provisions, which serve to defer but not forgive tax payments, might be compared to net lending in budget terminology. These special tax provisions are generally open-ended, with the extent and duration of their use largely at the taxpayers' option. For these reasons, the tax expenditure classifications in this analysis do not separate the special provisions which reduce taxes from those which defer taxes.

This analysis does not attempt a complete listing of all the special tax provisions. Various items have been excluded for one or more of several reasons:

(a) Some items were excluded because there is insufficient information available on which to base a sound estimate. For example, in the case of depreciation on machinery and equipment, accelerated tax methods may provide an allowance beyond that appropriate to the measurement of net income but it is difficult to measure that difference because the true economic deterioration or obsolescence factor cannot be readily determined.

(b) Some items were excluded where the case for their inclusion in the income base stands on relatively technical or theoretical tax arguments. The imputed rent on owner-occupied homes, for example, involves not only a conceptual problem but difficult practical problems of measurement.

(c) Some items were omitted because of their relatively small quantitative importance.

Other features of our income tax system are considered not as variations from the generally accepted measure of net income or as tax preferences but as a part of the structure of an income tax system based on ability to pay. Such features include personal exemptions and the rate schedules under the individual income tax.

It must be recognized that the exclusions from the listing are to some extent arbitrary. The objective of this analysis is to provide a list of items that would be generally recognized as an intended use of the tax system to achieve results which are now, or could be, achieved through direct Government expenditures. The design of this list seems best served by constructing a minimum list rather than including highly complicated or controversial items that would becloud the utility of this analysis.

TAX EXPENDITURES BY FUNCTIONAL CATEGORY

The tax expenditures resulting from the various special tax provisions are classified under the functional categories used in the budget. In most cases, particular special tax provisions which affect more than one budget category have been classified in the one where the effect is most important. In a few cases where the amount is large and the allocation relatively clear, the tax expenditures are divided between two functions.

No significant tax expenditures are made in three budget categories, space, interest, and general government and others. Two classes of tax expenditures (aid to State and local governments and capital gains—individual) which involve large amounts have not been assigned to specific functional categories for the reasons given in those sections of the analysis.