IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES HOUSE OF REPRESENTATIVES, Plaintiff, v. SYLVIA MATHEWS BURWELL, in her official capacity as Secretary of the United States Department of Health and Human Services, et al., Defendants.	)	Case No. 14-cv-01967-RMC

EXHIBIT U

113th Congress
2d Session } **COMMITTEE PRINT** { S. PRT. 113–32

TAX EXPENDITURES

Compendium of Background Material on Individual Provisions

COMMITTEE ON THE BUDGET

UNITED STATES SENATE

DECEMBER 2014

PREPARED BY THE

CONGRESSIONAL RESEARCH SERVICE

Prepared for the use of the Committee on the Budget by the Congressional Research Service. This document has not been officially approved by the Committee and may not reflect the views of its members.

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COMMITTEE ON THE BUDGET

PATTY MURRAY, Washington, *Chairman*

LETTER OF TRANSMITTAL

December 23, 2014

UNITED STATES SENATE
COMMITTEE ON THE BUDGET
WASHINGTON, DC

To the Members of the Committee on the Budget:

The Congressional Budget and Impoundment Control Act of 1974 (as amended) requires the Budget Committees to examine tax expenditures as they develop the Congressional Budget Resolution. Section 3(3) of the Budget Act of 1974 defines tax expenditures as those revenue losses attributable to provisions of the federal tax laws which allow a special exclusion, exemption, or deduction from gross income or provide a special credit, a preferential rate of tax, or a deferral of tax liability.

Tax expenditures are often enacted as permanent legislation and can be compared to direct spending on entitlement programs. There are over 200 separate tax expenditures in current law, costing the Treasury more than $1 trillion each year. Given the nation's unsustainable long-term budget outlook, all forms of spending -- including spending through the tax code -- deserve increased scrutiny. This print was prepared by the Congressional Research Service (CRS) and was coordinated by Alex Brosseau and Jill Harrelson of the Senate Budget Committee staff. All tax code changes through December 19, 2014 are included.

The CRS has produced an extraordinarily useful document which incorporates not only a description of each provision and an estimate of its revenue cost, but also a discussion of its impact, a review of its underlying rationale, an assessment which addresses the arguments for and against the provision, and a set of bibliographic references. Nothing in this print should be interpreted as representing the views or recommendations of the Senate Budget Committee or any of its members.

Patty Murray
Chairman

LETTER OF SUBMITTAL

CONGRESSIONAL RESEARCH SERVICE
THE LIBRARY OF CONGRESS
Washington, D.C., December 19, 2014

Honorable Patty Murray
Chairman, Committee on the Budget
U.S. Senate
Washington, DC 20510

Dear Madame Chairman:

I am pleased to submit a revision of the December 2012 Committee Print on Tax Expenditures.

As in earlier versions, each entry includes an estimate of each tax expenditure's revenue cost, its legal authorization, a description of the tax provision and its impact, the rationale at the time of adoption, an assessment, and bibliographic citations. The impact section includes quantitative data on the distribution of tax expenditures across income classes where such data are relevant and available. The rationale section contains some detail about the historical development of each provision. The assessment section summarizes major issues surrounding each tax expenditure.

The revision was written under the general direction of Jane Gravelle, Senior Specialist in Economic Policy, Steven Maguire, Section Research Manager, and Donald Marples, Specialist in Public Finance. Contributors of individual entries include Andrew Austin, James Bickley, Margo Crandall-Hollick, Jane Gravelle, Gary Guenther, Mark Keightley, Mindy Levit, Sean Lowry, Steven Maguire, Donald Marples, and Molly Sherlock of the Government and Finance Division; Alexandra Hegji and Scott Syzmendera of the Domestic Social Policy Division; Don Jansen of the Foreign Affairs, Defense and Trade Division; and Jennifer Teefy of the Knowledge Services Group. Khalil Williams and Sandra Edwards provided editorial review and prepared the document for publication.

Mary B. Mazanec
Director

Table of Contents

Introduction

This compendium gathers basic information concerning approximately 225 federal tax provisions currently treated as tax expenditures. They include those listed in Tax Expenditure Budgets prepared for fiscal years 2014-2018 by the Joint Committee on Taxation (JCT),[1] although certain separate items that are closely related and are within a major budget function may be combined. The JCT also lists 24 additional tax expenditures with de minimis revenue losses (i.e., less than $50 million over 5 years), that are not included in this compendium. Other provisions that have expired, are not in the JCT list, but may be extended, and are included in this compendium. On December 16, 2014, the Senate adopted and sent to the President for his signature The Tax Increase Prevention Act of 2014 (H.R. 5771) which extended through 2014 a number of provisions that had expired at the end of 2013. The revenue effects of this change are in notes to revenue tables in the relevant sections.

With respect to each tax expenditure, this compendium provides:

> The estimated federal revenue loss associated with the provision for individual and corporate taxpayers, for fiscal years 2014-2018, as estimated by the Joint Committee on Taxation;
>
> The legal authorization for the provision (e.g., Internal Revenue Code section, Treasury Department regulation, or Treasury ruling);
>
> A description of the tax expenditure, including an example of its operation where this is useful;
>
> A brief analysis of the impact of the provision, including information on the distribution of benefits where data are available;
>
> A brief statement of the rationale for the adoption of the tax expenditure where it is known, including relevant legislative history;

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[1] U.S. Congress, Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2014-2018*, August 5, 2014 (JCX-97-14).

An assessment, which addresses the arguments for and against the provision; and

Selected bibliography.

The information presented for each tax expenditure is not intended to be exhaustive or definitive. Rather, it is intended to provide an introductory understanding of the nature, effect, and background of each provision. Useful starting points for further research are listed in the selected bibliography following each provision.

On December 16, 2014, the Senate adopted and sent to the President for his signature The Tax Increase Prevention Act of 2014 (H.R. 5771) which extended through 2014 a number of provisions that had expired at the end of 2013. The revenue effects of this change are in notes to revenue tables in the relevant sections.

Defining Tax Expenditures

Tax expenditures are revenue losses resulting from tax provisions that grant special tax relief designed to encourage certain kinds of behavior by taxpayers or to aid taxpayers in special circumstances. These provisions may, in effect, be viewed as spending programs channeled through the tax system. They are, in fact, classified in the same functional categories as the U.S. budget.

Section 3(3) of the Congressional Budget and Impoundment Control Act of 1974 specifically defines tax expenditures as:

> ... those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability;

In the legislative history of the Congressional Budget Act, provisions classified as tax expenditures are contrasted with those provisions which are part of the "normal structure" of the individual and corporate income tax necessary to collect government revenues.

The listing of a provision as a tax expenditure in no way implies any judgment about its desirability or effectiveness relative to other tax or non-tax provisions that provide benefits to specific classes of individuals and corporations. Rather, the listing of tax expenditures, taken in conjunction with the listing of direct spending programs, is intended to allow Congress to scrutinize all federal programs relating to the same goals—both non-tax and tax—when developing its annual budget. Only when tax expenditures are considered will congressional budget decisions take into account the full spectrum of federal programs.

Because any qualified taxpayer may reduce tax liability through use of a tax expenditure, such provisions are comparable to entitlement programs under which benefits are paid to all eligible persons. Since tax expenditures are often enacted as permanent legislation, it is important that, as entitlement programs, they be given thorough periodic consideration to see whether they are efficiently meeting the national needs and goals for which they were established.

Tax expenditure budgets which list the estimated annual revenue losses associated with each tax expenditure first were required to be published in 1975 as part of the Administration's budget for fiscal year 1976, and have been required to be published by the Budget Committees since 1976. The tax expenditure concept is still being refined, and therefore the classification of certain provisions as tax expenditures continues to be discussed. Nevertheless, there has been widespread agreement for the treatment as tax expenditures of most of the provisions included in this compendium.[2]

As defined in the Congressional Budget Act, the concept of tax expenditure refers to the corporate and individual income taxes. Other parts of the Internal Revenue Code—excise taxes, employment taxes, estate and gift taxes—also have exceptions, exclusions, refunds and credits (such as a gasoline tax exemption for non-highway uses) which are not included here because they are not parts of the income taxes.

Administration Fiscal Year 2015 Expenditure Budget

There are several differences between the tax expenditures shown in this publication and the tax expenditure budget found in the Administration's FY2015 budget document. In some cases tax expenditures are combined in

[2] For a discussion of the conceptual problems involved in defining tax expenditures and some of the differences between the Administration's and Joint Committee on Taxation's approaches, see *The Budget of the United States Government, Fiscal Year 2015, Analytical Perspectives*, "Tax Expenditures," pp. 203-239. See also Linda Sugin, "What Is Happening to the Tax Expenditure Budget?" *Tax Notes*, August 16, 2004, pp. 763-766; and Thomas L. Hungerford, "Tax Expenditures: Good, Bad, or Ugly?" *Tax Notes*, October 23, 2006, pp. 325-334.

one list, but listed separately in the other. In other cases, changes in economic conditions (such as forecast growth in GDP) result in differences in the magnitude of the tax expenditure estimates.

Major Types of Tax Expenditures

Tax expenditures may take any of the following forms:

(1) exclusions, exemptions, and deductions, which reduce taxable income;

(2) preferential tax rates, which apply lower rates to part or all of a taxpayer's income;

(3) credits, which are subtracted from taxes as ordinarily computed; and

(4) deferrals of tax, which result from delayed recognition of income or from allowing deductions in the current year that are properly attributable to a future year.

The amount of tax relief per dollar of each exclusion, exemption, and deduction increases with the taxpayer's tax rate. A tax credit is subtracted directly from the tax liability that would otherwise be due; thus the amount of tax reduction is the amount of the credit—which does not depend on the marginal tax rate. (See Appendix A for further explanation.)

Largest Tax Expenditures

While JCT lists and estimates about 225 items in their tax expenditure publication, relatively few account for most of the aggregate cost. The following two tables list the top individual and corporate tax expenditures. The first table lists the 10 largest tax expenditures (in terms of revenue lost) directed to individuals. In several instances, one item in the table includes two or more items listed by JCT. The 10 items listed here account for 14 separate items in JCT's list. Overall, these 10 items account for almost 66 percent of the total dollars of tax expenditures directed to individuals.

10 Largest Tax Expenditures, 2014: Individuals

[In billions of dollars]

Tax Expenditure	Amount
Exclusion of employer contributions for health care	143.0
Reduced rates of tax on dividends and long-term capital gains	96.5
Exclusion of contributions and earnings to retirement plans	88.8
Earned income tax credit	69.2
Deduction for mortgage interest	67.8
Child tax credit	57.3
Deduction of state and local taxes	56.5
Exclusion of untaxed Social Security and railroad retirement benefits	37.4
Deduction for charitable contributions	34.8
Exclusion of benefits provided under cafeteria plans	34.5

The next table reports the 10 largest tax expenditures (in terms of revenue lost) directed to corporations. Again, some of the JCT tax expenditure items have been combined into a single item (such as the exclusion of contribution and earnings to retirement plans). Overall, these 10 tax expenditure items account for slightly over 80 percent of the total dollars of tax expenditures directed to corporations, excluding bonus depreciation.

10 Largest Tax Expenditures, 2014: Corporations

[In billions of dollars]

Tax Expenditure	Amount
Deferral for active income of controlled-foreign corporations	83.4
Depreciation of equipment in excess of the alternative depreciation system, excluding bonus depreciation	24.0
Deduction of income attributable to domestic production activities	12.2
Deferral of gains on like-kind exchanges	11.7
Exclusion of interest on public purpose state and local government bonds	9.3
Deferral of gain on non-dealer installment sales	6.9
Credit for low income housing	6.8
Credit for increasing research activities	4.6
Reduced rates on first $10,000,000 of corporate taxable income	3.8
Inventory property sales source rule exception	3.0

Note : Depreciation of equipment with bonus depreciation included is a negative tax expenditure of $24 billion. See discussion in entry on depreciation of equipment, p. 431.

Order of Presentation

The tax expenditures are presented in an order which generally parallels the budget functional categories used in the congressional budget, i.e., tax expenditures related to "national defense" are listed first, and those related to "international affairs" are listed next. In a few instances, two or three closely related tax expenditures derived from the same Internal Revenue Code provision have been combined in a single summary to avoid repetitive references even though the tax expenditures are related to different functional categories. This parallel format is consistent with the requirement of section 301(d)(6) of the Budget Act, which requires the tax expenditure budgets published by the Budget Committees as parts of their April 15 reports to present the estimated levels of tax expenditures "by major functional categories."

CREDITS AND SUBSIDIES FOR PARTICIPATION IN EXCHANGES

Estimated Revenue Loss

[In billions of dollars]

Fiscal year	Individuals	Corporations	Total
2014	15.5	-	15.5
2015	35.8	-	35.8
2016	74.3	-	74.3
2017	92.4	-	92.4
2018	100.1	-	100.1

Authorization

Section 36B.

Description

Beginning in 2014, the Patient Protection and Affordable Care Act of 2010 (PPACA) imposes a penalty for individuals and families without health insurance and establishes exchanges which limit premium differences for purchase of individual health insurance by those not covered by employer plans. PPACA includes a refundable tax credit to reduce the cost of health insurance premiums purchased through exchanges.

The low-income premium assistance credit provides a tax benefit to limit the cost of premiums to a fixed percentage of income. For individuals and families with income of no more than 133 percent of the federal poverty level (FPL), credits are provided to limit the premium to 2 percent of income. The premium is limited to 3 to 4, 4 to 6.3, 6.3 to 8.05, and 8.05 to 9.5 percent respectively for individuals and families at 133 to 150, 150 to 200, 200 to 250 and 250 to 300 percent of FPL. For incomes that are 300 to 400 percent of FPL, the premium costs are limited to 9.5 percent of income. Eligible participants can choose to either: (a) have the credit paid in advance to their insurance company to lower the cost of monthly premiums, or (b) claim all of the credit when they file a tax return for the year. If the participant chooses to have the credit paid in advance, then they will reconcile the amount paid in advance with the actual credit computed on their tax return. For purposes of the credit, income is adjusted gross income plus excluded income earned abroad (Section 911) and tax-exempt interest.

Participants must provide information from their federal income tax return from the previous year. The individual cannot be eligible for other coverage, including Medicare, Medicaid, the Children's Health Insurance Program (CHIP), military coverage, a grandfathered plan or any other coverage designated by the Secretary of the Treasury. Individuals who are offered minimum essential coverage by employers are also not eligible unless the coverage is unaffordable (employee premiums are more than 9.5 percent of income) or the employer's share is less than 60 percent, and the employee declines the insurance.

The credit can be applied to any plan but is measured as the difference between the cost of a silver plan and the amount of the premium limited by the income level. The credit is payable in advance directly to the insurer. It is not taxable to individuals and families.

Impact

As of April 10, 2014, then-Health and Human Services (HHS) Secretary Kathleen Sebelius testified before the Senate Committee on Finance that 7.5 million people have signed up for coverage through state and federal exchanges since October 1, 2013. According to a June 2014 HHS research brief, 87 percent of 5.4 million federal exchange consumers selected a plan with premium subsidy tax credits during the initial open enrollment period for coverage during 2014. Thus, a large number of families will benefit from the subsidies, which will be concentrated in households with low or moderate income. For example, 400 percent of FPL level for a family of three in 2014 (excluding Alaska and Hawaii) is $78,120.

Rationale

This provision was enacted as part of the Patient Protection and Affordable Care Act (P.L. 111-148), in combination with the Health Care and Education Reconciliation Act of 2010 (P.L. 111-152). The objective of the legislation is to provide near universal health coverage. The premium credit is provided to relieve the financial burden of health insurance premiums on lower and moderate income individuals.

In June 2012, the Supreme Court's ruling in *NFIB v. Sebelius*, found the Act, including the penalties under the individual mandate, to be constitutional.

However, the scope of the premium credit subsidies has been called into question by recent court cases. On July 22, 2014, two appeals courts issued contradictory rulings on the availability of premium tax credits under the Affordable Care Act (ACA). The District of Columbia Circuit in *Halbig v. Burwell* held that ACA "unambiguously restricts" the availability of premium tax credits to health insurance purchased on the 14 state-established exchanges and the District of Columbia, and not on the 36 federally-facilitated exchanges. Hours later, the Court of Appeals for the Fourth Circuit issued its decision in *King v. Burwell*, holding that the relevant statutory language of ACA is ambiguous and subject to multiple interpretations. Because the Fourth Circuit Court concluded that it could not discern what Congress intended with respect to this issue, it found that the IRS regulations enabling enrollees in federally-managed exchanges to be a permissible exercise of the agency's discretion and entitled to judicial deference. As of the publication date of this print, it has been reported that the Department of Justice will petition the D.C. Circuit for a review of the *Halbig* decision by the full appeals court, and that the federal government would continue paying these subsidies on behalf of consumers in the states that use federal exchanges, pending further court review. On November 7, 2014, the Supreme Court of the United States agreed to hear the *King v. Burwell* case during the Court's 2014 session. If the scope of premium credit subsidies are limited to only exchanges managed by the states, then the tax expenditure estimate of this provision could be decreased.

Assessment

The premium assistance credits not only provide relief from the financial burden of health insurance, but also create incentives for lower and moderate income families to purchase health insurance. Although insurance purchase is not mandatory, penalties are imposed if insurance is not purchased. Since the penalties are generally smaller than the cost of insurance for low income families, without premium assistance, some families may find it more feasible to pay the penalty.

As with certain other tax expenditures (such as the earned income credit or the tuition tax credit), the tax system is used as a delivery mechanism to achieve goals of programs (such as education, health and income transfers) that could be provided through other mechanisms. While using the tax system increases the complexity of tax administration, the tax system has some administrative advantages. As compared to an alternative delivery system (where, for example, monthly income is used), tax administration allows subsidies to be based on annual family income. The credit also avoids some of the drawbacks of certain tax benefits, by providing the benefits in advance and directly to the insurer rather than requiring these families to pay and then apply for a refund.

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