Selected Recently Expired Individual Tax Provisions (“Extenders”): In Brief

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Summary

The Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act (S. 2260), which would extend a set of expired tax provisions through the end of 2015, was reported on April 28, and subsequently became an amendment to H.R. 3474. The bill did not advance in the Senate, as a motion to end debate on H.R. 3474, the legislative vehicle for the tax extenders package, was voted down on May 15, 2014.

These and other temporary tax provisions that are regularly extended for one or two years are often referred to as "tax extenders." This report briefly summarizes and discusses items categorized as individual tax provisions. It does not include housing and charitable provisions that are reviewed in other CRS reports. These reports include CRS Report R43517, *Recently Expired Charitable Tax Provisions ("Tax Extenders"): In Brief*, by Jane G. Gravelle and Molly F. Sherlock; CRS Report R43510, *Selected Recently Expired Business Tax Provisions ("Tax Extenders")*, by Jane G. Gravelle, Donald J. Marples, and Molly F. Sherlock; CRS Report R43449, *Recently Expired Housing Related Tax Provisions ("Tax Extenders"): In Brief*, by Mark P. Keightley; and CRS Report R43541, *Recently Expired Community Assistance Related Tax Provisions ("Tax Extenders"): In Brief*, by Sean Lowry.

The five provisions discussed, with their revenue costs for a two-year extension, are

- Above-the-Line Deduction for Certain Expenses of Elementary and Secondary School Teachers,
- Deduction for State and Local Sales Taxes,
- Above-the-Line Deduction for Qualified Tuition and Related Expenses,
- Parity for Exclusion for Employer-Provided Mass Transit and Parking Benefits, and
- Credit for Health Insurance Costs of Eligible Individuals.

In terms of revenue, the most significant provision is the optional deduction for sales taxes, which is estimated to cost $6.5 billion if extended for two years. The next largest is the deduction for tuition expenses at $0.6 billion, followed by the classroom expense deduction at $0.4 billion, the mass transit provision at $0.2 billion, and the health credit at $0.1 billion.

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Introduction

The Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act (S. 2260), which would extend a set of expired tax provisions through the end of 2015, was reported on April 28, and subsequently became an amendment to H.R. 3474. The bill did not advance in the Senate, as a motion to end debate on H.R. 3474, the legislative vehicle for the tax extenders package, was voted down on May 15, 2014.

Most of the provisions proposed for extension in the Senate expired at the end of 2013. The House has proposed making selected provisions permanent, but none of the provisions discussed in this report are among them.

These and other temporary tax provisions that are regularly extended for one or two years are often referred to as "tax extenders."[1] This report briefly summarizes and discusses items categorized as individual tax provisions.[2] The report does not include housing and charitable provisions that are reviewed in other CRS reports.[3]

The five provisions discussed, with their revenue costs for a two year extension,[4] are

- Above-the-Line Deduction for Certain Expenses of Elementary and Secondary School Teachers ($0.4 billions),
- Deduction for State and Local Sales Taxes ($6.5 billion),
- Above-the-Line Deduction for Qualified Tuition and Related Expenses ($0.5 billion),
- Parity for Exclusion for Employer-Provided Mass Transit and Parking Benefits ($0.2 billion), and
- Credit for Health Insurance Costs of Eligible Individuals ($0.1 billion).

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[1] An overview of all extenders can be found at CRS Report R43124, *Expired and Expiring Temporary Tax Provisions ("Tax Extenders")*, by Molly F. Sherlock.

[2] Nine provisions are categorized as individual extenders, which include the five discussed in this report, two housing-related provisions, and two charitable provisions. See Joint Committee on Taxation's revenue estimates for the list, in JCX-51-14, May 15, 2014, at https://www.jct.gov/publications.html?func=startdown&id=4601https://www.jct.gov/publications.html?func=startdown&id=4577.

[3] See CRS Report R43449, *Recently Expired Housing Related Tax Provisions ("Tax Extenders"): In Brief*, by Mark P. Keightley, and CRS Report R43517, *Recently Expired Charitable Tax Provisions ("Tax Extenders"): In Brief*, by Jane G. Gravelle and Molly F. Sherlock.

[4] Revenue estimates from the Joint Committee on Taxation's JCX-51-14, May 15, 2014, at https://www.jct.gov/publications.html?func=startdown&id=4601https://www.jct.gov/publications.html?func=startdown&id=4577.

Above-the-Line Deduction for Certain Expenses of Elementary and Secondary School Teachers[5]

Teachers and other eligible educators are allowed a deduction for up to $250 of certain classroom expenses under this provision. The deduction is "above-the-line," that is, it is not restricted to tax filers who itemize deductions. Eligible educators include any elementary or secondary school teacher, instructor, counselor, principal, or aide in a school for a minimum of 900 hours in a school year. Qualified expenses must be associated with the purchase of books, supplies (other than nonathletic supplies for health or physical education courses), computer equipment, software and services, other equipment, and supplementary materials.[6]

The tax code allows a deduction of expenses for trade or business in general, but that deduction is an itemized deduction (generally benefitting higher income individuals). Further, the trade and business deduction is allowed only when miscellaneous itemized deductions are above 2% of income. These miscellaneous itemized deductions include other employee expenses (such as union dues), as well as investment costs and tax preparation costs, which might permit a taxpayer who itemizes to exceed the 2% threshold and make this deduction more attractive. Teachers who donate to the school (for example, books for the school library) can take a charitable deduction if they itemize.

According to a study by the National School Supply and Equipment Association, a trade association for educational product companies, teachers spent $1.6 billion on classroom supplies during the 2012-2013 school year. On average, unreimbursed spending on classroom supplies is estimated at $485 per teacher per year.[7]

The classroom deduction was enacted for two years (2002 and 2003) as part of the Job Creation and Worker Assistance Act of 2002 (P.L. 107-147). It was extended several times, often retroactively. In the 113th Congress, legislation has been introduced that would extend and expand the deduction, make the deduction permanent, and allow the deduction for qualified home-school expenses.

A deduction tends to benefit higher-income individuals more than lower-income individuals because its value depends on the marginal tax rate. For example, at the 15% tax rate, the value of a $250 deduction is $37.50. At the 10% rate, the value of the same $250 deduction is $25. Tax statistics indicate that more than 70% of taxpayers pay at the 15% rate or below.[8] Even at a 35% tax rate, the value is less than $100 ($87.50). Also, as shown in **Table 1**, deductions themselves are more concentrated in higher-income classes. Almost three-quarters of the total value of

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[5] Section 62 of the Internal Revenue Code.

[6] Educators must reduce the total amount they deduct on eligible items by any interest earned or received from an Education Savings Bond or distribution from a Qualified Tuition (Section 529) Program or Coverdell Education Savings Account that was excluded from income. In other words, if educators or members of their tax filing units use earnings from these savings vehicles to pay tuition and other qualified educational expenses, only those classroom expenses that exceed the value of these income exclusions are deductible.

[7] David Nagel, K-12 Teachers Out of Pocket $1.6 Billion on Classroom, *The Journal*, July 1, 2013, http://thejournal.com/articles/2013/07/01/k12-teachers-out-of-pocket-1-point-6-billion-on-classroom-tools.aspx.

[8] Internal Revenue Service, Statistics of Income, Table 3.4, 2011, http://www.irs.gov/uac/SOI-Tax-Stats-Individual-Statistical-Tables-by-Tax-Rate-and-Income-Percentile.

deductions are taken by tax filing units with adjusted gross incomes over $50,000. These tax units accounted for about a third of tax filing units. A third of the total value of the deductions is taken by those with incomes over $100,000, less than 15% of tax filing units.

Table 1. Distribution by Income Class of the Deduction for Classroom Expenses, 2011

Income Class ($ in the thousands)	Percentage Distribution of Returns	Percentage Distribution of Deduction
Below $10	15.9	1.2
$10 to $20	17.1	3.3
$20 to $30	13.2	4.5
$30 to $40	10.0	7.7
$40 to $50	7.6	9.5
$50 to $75	13.0	20.8
$75 to $100	8.2	19.1
$100 to $200	10.2	30.2
$200 and over	3.2	3.7

Source: Based on Internal Revenue Service, Statistics of Income, 2011, Table 1.42, http://www.irs.gov/uac/SOI-Tax-Stats—Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income.

If intended as an incentive, the classroom expense deduction may encourage educators already purchasing supplies to increase the amount spent and may encourage other educators to purchase supplies. However, a deduction that is capped at a small amount may not be very effective, because many teachers are already spending at least $250. Generally, benefits with caps are expected to be less effective, per dollar of revenue lost, in increasing the spending objective, because those whose contributions are above the cap without the deduction have no marginal incentive to increase it.

Rather than being viewed as an incentive, the provision might, instead, be seen as increasing equity in the tax system. Teachers are providing a contribution to their students, which reduces their own income.

The provision adds to complexity, not only by requiring an additional line on the tax form, but also because a deduction for classroom expenses could potentially provide more benefit by including it in the itemized deduction for employee expenses, which is subject to a floor and conditional on the taxpayer itemizing deductions, but does not have a ceiling. Taxpayers might need to compute taxes twice to determine which deduction results in a lower tax liability.

Deduction for State and Local Sales Taxes[9]

Although taxes have been deductible since the initiation of the income tax in 1913, deductions of certain taxes (such as excise taxes) have been disallowed over the years. Currently only income

[9] Section 164 of the Internal Revenue Code.

and property taxes are deductible. The deduction for general sales taxes was disallowed by the Tax Reform Act of 1986 (P.L. 99-514). The deduction for *sales taxes* was temporarily reinstated in 2004 with enactment of the American Jobs Creation Act of 2004 (P.L. 108-357). Unlike the pre-TRA 1986 deduction, the current version allows for a deduction for sales taxes *in lieu of* income taxes. It has been extended several times.[10]

Under this tax extender individuals who itemize deductions may take a deduction for sales taxes *in lieu* of income taxes. Taxpayers may keep individual receipts or may use an Internal Revenue Service (IRS) look-up table. The IRS table amounts, however, do not include the sales taxes paid for cars, motorcycles, boats, aircraft, or a home, or local sales taxes, which are added.[11]

The value of a given dollar amount of deduction is higher for taxpayers with higher marginal tax rates. In addition, as an itemized deduction, the deduction tends to be concentrated in the higher-income classes that itemize deductions. As shown in **Table 2**, 44% of the deductions are taken by those in the $100,000 or more income class, who account for 13% of returns. Itemizing taxpayers in the seven states without a general income tax but with a general sales tax typically benefit the most from the optional sales tax deduction.[12]

Table 2. Distribution by Income Class of the Deduction for State and Local Sales Taxes, 2011

Income Class ($ in the thousands)	Percentage Distribution of Returns	Percentage Distribution of Deductions
Below $10	15.9	1.8
$10 to $20	17.1	4.2
$20 to $30	13.2	5.5
$30 to $40	10.0	6.6
$40 to $50	7.6	6.9
$50 to $75	13.0	16.9
$75 to $100	8.2	14.9
$100 to $200	10.2	26.1
$200 and over	3.2	17.7

Source: Based on Internal Revenue Service, Statistics of Income, 2011, **Table 2**, http://www.irs.gov/uac/SOI-Tax-Stats—Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income.

One reason to retain the sales tax option is to provide equity across the states. Equity across states is an elusive concept in general, however. Benefits to states depend on the level as well as type of tax and on the level and distribution of income. For example, New Hampshire with neither an

[10] Permanent extension of the sales tax deduction has been proposed several bills in the 113th Congress. The following bills would make the deduction permanent: H.R. 2854 (Rep. Hastings), H.R. 4789 (Rep. Fincher), S. 41 (Sen. Cantwell), and S. 127 (Sen. Heller). H.R. 3942 (Rep. Grayson) would extend the sales tax deduction for one year.

[11] See CRS Report RL32781, *Federal Deductibility of State and Local Taxes*, by Steven Maguire for a more extensive discussion of state and local tax deductions.

[12] These states are Florida, Nevada, South Dakota, Tennessee, Texas, Washington and Wyoming. Alaska does not have a state sales tax but cities can impose sales taxes.

income nor a sales tax had a higher than average benefit from federal tax deductions in a 2004 study.[13]

One reason that the sales tax became a target for elimination in 1986 was that most taxpayers looked the tax up in a table and the deduction did not reflect their actual sales tax paid. Taxpayers could also rely on their own receipts but that was a burden on both taxpayers and tax administrators. There were also concerns that other selective sales taxes or taxes imposed at other than the retail level were not deductible.[14] These concerns also apply to an optional sales tax deduction.

Above-the-Line Deduction for Qualified Tuition and Related Expenses[15]

This provision allows taxpayers to deduct qualified tuition and related expenses for postsecondary education from their adjusted gross income. The deduction is "above-the-line," that is, it is not restricted to itemizers. The deduction can be taken for qualified expenses paid for taxpayers and their spouses and dependents. Individuals who may be claimed as dependents on another taxpayer's return, married persons filing separately, and nonresident aliens who do not elect to be treated as resident aliens cannot take the deduction. The deduction is reduced by any grants, scholarships, Pell Grants, employer-provided educational assistance, veterans' educational assistance, and any other nontaxable income (other than gifts and inheritances). Qualified expenses being deducted also must be reduced if paid with tax-free interest from Education Savings Bonds, tax-free distributions from Coverdell Education Savings Accounts, and tax-free earnings withdrawn from Qualified Tuition Plans.

The maximum deduction per return is $4,000 for taxpayers with modified adjusted gross income that does not exceed $65,000 ($130,000 on joint returns). The deduction is phased out at higher income levels. Taxpayers with incomes above $65,000 ($130,000 for joint returns) but not above $80,000 ($160,000 for joint returns) can deduct some fraction of $2,000 in qualified expenses. Taxpayers with incomes above $80,000 ($160,000 for joint returns) cannot claim a deduction. These income limits are not adjusted for inflation.

One criticism of education tax benefits is that the taxpayer is faced with a confusing choice of deductions and credits and tax favored education savings plans, and that these benefits should be consolidated. Tax reform proposals have consolidated these benefits into a single education credit in some cases.[16]

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[13] States without an income tax have a higher share of taxes deductible, 66%, compared with 53% for states with an income tax (data provided by Steve Maguire based on Census records for 2010). The tax benefit also depends on the level and distribution of income and the level of taxes. The average benefit from federal tax deductions in the Metcalf study of 2004 returns was 0.4% of income, ranging from a low of 0.1% to a high of 0.7%. States with sales taxes and without income taxes had benefits below the national average in general, but a number of states with income taxes were at the same level or lower. See Gilbert E. Metcalf, "Assessing the Federal Deduction for State and Local Taxes," *National Tax Journal*, Vol. 64, No. 2, Part2, June 2011, p. 574.

[14] See Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986*, May 4, 1987, pp. 47-48. Posted at https://www.jct.gov/publications.html?func=startdown&id=3367.

[15] Section 222 of the Internal Revenue Code.

[16] See, for example, President George W. Bush's Advisory Panel's proposal, *Simple, Fair, and Pro-Growth: Proposals* (continued...)

Taxpayers may use this deduction instead of education tax credits for the same student. These credits include permanent tax credits: the Hope Credit and Lifetime Learning Credit. The Hope Credit has been expanded into the American Opportunity Tax credit, a temporary provision that is scheduled to expire after 2017. The American Opportunity Tax Credit (and the Hope Credit) are directed at undergraduate education and have a limited number of years of coverage (two for the Hope Credit and four for the American Opportunity Tax Credit).[17] The Lifetime Learning Credit (20% of up to $10,000) is not limited in years of coverage. These credits are generally more advantageous than the deduction, except for higher-income taxpayers, in part because the credits are phased out at lower levels of income than the deduction. For example, for single taxpayers, the Lifetime Learning Credit begins phasing out at $53,000 for 2013.

The deduction benefits taxpayers according to their marginal tax rate. Students usually have relatively low incomes, but they may be part of families in higher tax brackets. The maximum amount of deductible expenses limits the tax benefit's impact on individuals attending schools with comparatively high tuition and fees. Because the income limits are not adjusted for inflation, the deduction might be available to fewer taxpayers over time if extended in its current form.

The distribution of the deduction in **Table 3** indicates that some of the benefit is concentrated in the income range where the Lifetime Learning Credit has phased out, but also significant deductions are claimed at lower-income levels. Because the Lifetime Learning Credit is preferable to the deduction at lower-income levels, it seems likely that the confusion among the education benefits may have caused taxpayers to fail to choose the optimal education benefit.[18]

Table 3. Distribution by Income Class of the Qualified Tuition Deduction, 2011

Income Class ($ in the thousands)	Percentage Distribution of Returns	Percentage Distribution of Deduction
Below $10	15.9	31.6
$10 to $20	17.1	9.6
$20 to $30	13.2	7.2
$30 to $40	10.0	3.3
$40 to $50	7.6	5.2
$50 to $75	13.0	13.6
$75 to $100	8.2	5.4
$100 to $200	10.2	24.0
$200 and over	3.2	0.0

Source: Based on Internal Revenue Service, Statistics of Income, 2011, Table3.42, http://www.irs.gov/uac/SOI-Tax-Stats—Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income.

(...continued)

to Fix America's Tax System, November 2005, which can be found at http://www.taxreformpanel.gov/ and the proposal by Chairman Camp of the Ways and Means Committee (The Tax Reform Act of 2014). An explanation of the education provision in this draft legislation can be found at the Joint Committee on Taxation's technical discussion of the individual provisions, JCX-12-14, February 26, 2014, https://www.jct.gov/publications.html?func=startdown&id=4554.

[17] See CRS Report R41967, *Higher Education Tax Benefits: Brief Overview and Budgetary Effects*, by Margot L. Crandall-Hollick.

[18] The lack of optimal choices with education preferences is also discussed by GAO. See *Multiple Higher Education Tax Incentives Create Opportunities for Taxpayers to Make Costly Mistakes*, GAO-08-717T, May 1, 2008, http://www.gao.gov/products/GAO-08-717T.

Parity for Exclusion for Employer-Provided Mass Transit and Parking Benefits[19]

Qualified transportation benefits, such as transit passes, vanpools, and parking, provided by employers are excluded from income within limits. The dollar limit of the exclusion for employer-provided parking is $250 a month for 2014. The excludable amounts are adjusted for inflation. This provision would increase the limit for mass transit, currently $130, to the $250 allowed for parking.

A statutory exclusion for the value of parking was introduced in 1984, along with exclusions for several other fringe benefits. Some employers had provided one or more of these fringe benefits for many years, and employers, employees, and the Internal Revenue Service had not considered those benefits to be taxable income. The Comprehensive Energy Policy Act of 1992 (P.L. 102-486) placed a dollar ceiling on the exclusion from income of parking facilities and introduced the exclusions for mass transit facilities and van pools to encourage mass commuting. The American Recovery and Reinvestment Tax Act of 2009 (P.L. 111-5) increased the exclusion limit on qualified transit benefits to match the level of the parking benefit limit, and the provision was subsequently extended.

To the extent that this exemption induces employees to use mass transportation and to the extent that mass transportation reduces traffic congestion, this exemption lowers commuting costs to all commuters in urban areas. Higher-income individuals are more likely to benefit from the parking exclusion than the mass transit and vanpool subsidies to the extent that the propensity to drive to work is correlated with income. The effective value of the transit benefits rises with the marginal tax rate of a recipient. The value of the exclusion for transit benefits also depends on the location of the employer: the provision is targeted towards the taxpayers working in the highly urbanized areas or other places where transit is available or parking space is limited.

Credit for Health Insurance Costs of Eligible Individuals[20]

The credit is commonly known as the health coverage tax credit (HCTC). Under this provision, eligible taxpayers are allowed a refundable tax credit for 72.5% of the premiums they pay for qualified health insurance for themselves and family members. Eligibility is limited to three groups: (1) individuals who are receiving a Trade Readjustment Assistance (TRA) allowance, or who would be except that their state unemployment benefits are not yet exhausted; (2) individuals who are receiving an Alternative Trade Adjustment Assistance (ATAA) allowance for people age 50 and older; and (3) individuals who are receiving a pension paid in part by the Pension Benefit Guaranty Corporation (PBGC), or who received a lump-sum PBGC payment, and are aged 55 and older. For TRA recipients, eligibility for the HCTC generally does not extend beyond two years, the maximum length of time most can receive TRA allowances or benefits.

[19] Section 132(f) of the Internal Revenue Code.

[20] Section 35 of the Internal Revenue Code.

The HCTC is not available to individuals who are covered under insurance for which an employer or former employer pays 50% or more of the cost; entitled to benefits under Medicare Part A or an armed services health plan; or enrolled in Medicare Part B, Medicaid, the State Children's Health Insurance Program (CHIP), or the federal employees health plan. The Treasury Department makes advance payments of the credit to insurers for eligible taxpayers who choose this option.

The HCTC can be claimed for only 11 types of insurance specified in the statute. Seven require state action to become effective, including coverage through a state high risk pool, coverage under a plan offered to state employees, and, in some limited circumstances, coverage under individual market insurance. As of December 2010, 24 states and the District of Columbia made at least 1 of the 7 types of coverage available; in the remaining 6 states, only 3 automatically qualified types not requiring state action were available, though not necessarily to all individuals eligible for the credit. For example, COBRA continuation coverage is available in all states, but it applies only if the taxpayer had employment-based insurance before losing his job and the employer continues to provide the insurance to the remaining employed workers.

The HCTC was authorized by the Trade Act of 2002 (P.L. 107-210). One impetus for the legislation was to assist workers who had lost their jobs, and consequently their health insurance coverage, because of economic dislocations in the wake of the September 11, 2001 terrorist attacks. Difficulties in reaching consensus on who should be included in this group contributed to the decision to restrict eligibility for the credit primarily to workers adversely affected by international trade (e.g., imported goods contributed importantly to their unemployment, or their companies shifted production to other countries). Extension to taxpayers receiving pensions paid by the PBGC occurred late in the legislative process. The credit was expanded in 2009. The 112th Congress passed and the President signed into law the Trade Adjustment Assistance Extension Act of 2011 (P.L. 112-40), which retroactively changed the subsidy rate to 72.5% (from 65%) for coverage months beginning after February 12, 2011, and terminated the HCTC as of January 1, 2014.

The credit substantially reduces the after tax cost of health insurance. Assessments of the provision have concluded that it is under-utilized with only a fraction of those eligible signing up, possibly because of the requirement to make up-front premium payments or for premium shares that are too large, or because of complexity. The administrative costs have been estimated to be significant per dollar of subsidy delivered.[21]

There is some question about the need for this program now that the Affordable Care Act has provided access to insurance and subsidies.

[21] See CRS Report RL32620, *Health Coverage Tax Credit*, by Bernadette Fernandez.

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