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

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Summary

The Protecting Americans From Tax Hikes (PATH) Act, considered as an amendment to the Military Construction and Veterans Affairs and Related Agencies Appropriations Act, 2016 (P.L. 114-113), was signed into law on December 18, 2015. That legislation made some tax provisions that had expired at the end of 2014 permanent, and extended others through the 2016 tax year. This report briefly summarizes and discusses selected items categorized as individual tax provisions. These and other temporary tax provisions that have been regularly extended for one or two years are often referred to as "tax extenders." Other bills in the 114th Congress would make provisions discussed in this report permanent, including the deduction for state and local sales taxes (H.R. 622) and the deduction for teacher's expenses (H.R. 2692 and H.R. 2940), both discussed in this report.

Additional information on other extender provisions may be found 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 four provisions discussed are

- Above-the-Line Deduction for Certain Expenses of Elementary and Secondary School Teachers, which the PATH Act modifies and makes permanent;
- Deduction for State and Local Sales Taxes, which the PATH act makes permanent;
- Above-the-Line Deduction for Qualified Tuition and Related Expenses, which the PATH Act extends through 2016; and
- Parity for Exclusion for Employer-Provided Mass Transit and Parking Benefits, which the PATH Act makes permanent.

In terms of revenue, the most significant provision is the optional deduction for sales taxes, which is estimated to cost $42.4 billion over 10 years. The next largest is the classroom expense deduction at $2.9 billion, followed by the mass transit provision at $1.8 billion. The two-year extension for the deduction for tuition expenses is estimated to cost $0.6 billion.

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Introduction

The Protecting Americans From Tax Hikes (PATH) Act, considered as an amendment to the Military Construction and Veterans Affairs and Related Agencies Appropriations Act, 2016 (P.L. 114-113), was signed into law on December 18, 2015. That legislation made some tax provisions that had expired at the end of 2014 permanent, and extended others through the 2016 tax year. This report briefly summarizes and discusses four items categorized as individual tax provisions.[1] These and other temporary tax provisions that are regularly extended for one or two years are often referred to as *tax extenders*.[2]

In total, the extensions of tax provisions included PATH Act is estimated to increase the deficit by $628.8 billion from FY2016 to FY2025. Of this cost, $47.7 billion is attributable to the four individual provisions discussed in this report (not accounting for any potential macroeconomic effects).

The three extender provisions discussed in this report that were made permanent by the PATH Act, along with their 10-year revenue costs,[3] are

- Above-the-Line Deduction for Certain Expenses of Elementary and Secondary School Teachers ($2.9 billion over ten years), which was modified by the PATH Act,
- Deduction for State and Local Sales Taxes ($42.4 billion over 10 years), and
- Parity for Exclusion for Employer-Provided Mass Transit and Parking Benefits ($1.8 billion over 10 years).

The PATH Act also extends one provision discussed in this report through 2016. That provision, along with its two-year revenue cost, is

- Above-the-Line Deduction for Qualified Tuition and Related Expenses ($0.6 billion over two years).

Above-the-Line Deduction for Certain Expenses of Elementary and Secondary School Teachers[4]

The deduction for certain expenses of elementary and secondary school teachers was made permanent by the PATH Act. Teachers and other eligible educators are allowed a deduction for

[1] Eight provisions are categorized as individual extenders, which include the four discussed in this report, two housing-related provisions, and two charitable provisions. For information about other individual provisions, 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. See the Joint Committee on Taxation's revenue estimates for the list, in JCX -107-14R, *Estimated Revenue Effects of H.R. 5771, the "Tax Increase Prevention Act of 2014," Scheduled for Consideration by the House of Representatives on December 3, 2014*, December 3, 2014, https://www.jct.gov/publications.html?func=startdown&id=4677.

[2] An overview of all extenders can be found at CRS Report R43898, *Tax Provisions that Expired in 2014 ("Tax Extenders")*, by Molly F. Sherlock.

[3] Revenue estimates from the Joint Committee on Taxation, *Estimated Revenue Budget Effects of Division Q of Amendment #2 to the Senate Amendment to H.R. 2029 (Rules Committee Print 114-40), the "Protecting Americans From Tax Hikes Act of 2015"*, 114th Congress, December 16, 2015, JCX-143-15.

[4] Section 62 of the Internal Revenue Code.

certain classroom expenses under this provision. The deduction is "above-the-line," that is, it is not restricted to tax filers who itemize deductions. The cap for this deduction was $250 in 2014; the PATH Act indexed that limit for inflation, rounded to the nearest $50, beginning in tax year 2016.

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. The PATH Act modified this provision to include professional development costs as qualifying expenses starting in 2016. Other qualified expenses already eligible for the deduction 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.[5]

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).[6] 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 114th Congress, legislation has been introduced that would make the deduction permanent (H.R. 2692), make the provision permanent and index it for inflation (H.R. 2940), and allow a deduction for qualified home-school expenses (S. 100).

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 deductions are taken by tax filing units with adjusted gross incomes over $50,000. These tax units

[5] 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.

[6] In 2013, less than 15% of total tax returns were filed by households with incomes over $100,000, while over 40% of itemized deductions were filed by such households. Source: Internal Revenue Service, *Statistics of Income*, Table 2.1, 2013, http://www.irs.gov/uac/SOI-Tax-Stats-Individual-Statistical-Tables-by-Tax-Rate-and-Income-Percentile.

[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] Source: Internal Revenue Service, *Statistics of Income*, Table 3.4, 2013, http://www.irs.gov/uac/SOI-Tax-Stats-Individual-Statistical-Tables-by-Tax-Rate-and-Income-Percentile.

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

Table 1. Distribution by Income Class of the Deduction for Classroom Expenses, 2013

Income Class ($ in the thousands)	Percentage Distribution of Returns	Percentage Distribution of Deduction
Below $10	16.8	1.6
$10 to $20	16.4	3.4
$20 to $30	12.9	4.4
$30 to $40	9.8	8.0
$40 to $50	7.7	9.6
$50 to $75	13.0	19.8
$75 to $100	8.5	17.6
$100 to $200	11.1	31.3
$200 and over	3.8	4.3

Source: Based on Internal Revenue Service, Statistics of Income, 2013, Table 1.4, 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 such spending, and may encourage other educators to purchase supplies who otherwise would not have done so. 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 change their behavior.

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, and thereby reducing their own income. Under this view, capping the deduction will prevent teachers who spend above the cap from being fully refunded for the contribution.

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]

The PATH Act made permanent the option to deduct state and local sales taxes. Although state and local 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. Before the PATH Act only income and property taxes were deductible on a permanent basis. The deduction for general sales taxes was disallowed by the Tax Reform Act of 1986 (P.L. 99-514). The deduction for *sales*

[9] Section 164 of the Internal Revenue Code.

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 was extended several times.[10]

Under this provision, individuals who itemize deductions may take a deduction for state and local sales taxes in lieu of taking a deduction for state and local income taxes. Taxpayers may keep individual receipts or may use an Internal Revenue Service (IRS) look-up table.[11] 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.[12]

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**, about half of the deductions are taken by those in the $100,000 or more income class, who account for about 15% 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.[13]

Table 2. Distribution by Income Class of the Deduction for State and Local Sales Taxes, 2013

Income Class ($ in the thousands)	Percentage Distribution of Returns	Percentage Distribution of Deductions
Below $10	16.8	1.4
$10 to $20	16.4	3.2
$20 to $30	12.9	4.9
$30 to $40	9.8	6.1
$40 to $50	7.7	6.4
$50 to $75	13.0	15.2
$75 to $100	8.5	13.8
$100 to $200	11.1	29.1
$200 and over	3.8	19.8

Source: Based on Internal Revenue Service, Statistics of Income, 2013, Table 1.4 and Table 2.1, 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, as it would offer filers in states that do not impose an income tax (or which have a low income tax rate) an alternative means of reducing their federal tax liability. 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 has neither an income nor a sales tax,

[10] Permanent extension of the sales tax deduction was proposed in several bills in the 113th Congress. In the 114th Congress, H.R. 622, which passed the House April 16, 2015, would make the deduction permanent.

[11] More information about the look-up table is available at the "Sales Tax Deduction Calculator," Internal Revenues Service: https://www.irs.gov/Individuals/Sales-Tax-Deduction-Calculator.

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

[13] 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.

and received a higher than average benefit from federal tax deductions in analysis of 2004 activity.[14]

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.[15] These concerns also apply to an optional sales tax deduction.

Above-the-Line Deduction for Qualified Tuition and Related Expenses[16]

The PATH Act extended the above-the-line deduction for qualified tuition and related expenses through the 2016 tax year. This provision allows taxpayers to deduct qualified tuition and related expenses for postsecondary education from their adjusted gross income. Expenses that qualify for this deduction include tuition payments or any fees required for enrollment at an eligible institution. Payments made with borrowed funds are eligible for the deduction: the year of eligibility is determined by the date payment is made to the institution and not when the loan is repaid. 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 could be claimed as dependents, married persons filing separately, and nonresident aliens who do not elect to be treated as resident aliens do not qualify for the deduction, in part to avoid multiple claims on a single set of expenses. 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.

[14] States without an income tax have a higher share of taxes deductible, 70%, compared with 58% for states with an income tax (data taken from CRS Report RL32781, *Federal Deductibility of State and Local Taxes*, by Steven Maguire and Jeffrey M. Stupak). 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, part 2, June 2011, p. 574.

[15] 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.

[16] Section 222 of the Internal Revenue Code.

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.[17]

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 formerly temporary provision that was made permanent by the PATH Act. 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).[18] 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 $55,000 for 2015.

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 confusion about the education benefits may have caused taxpayers to fail to choose the optimal education benefit.[19]

Table 3. Distribution by Income Class of the Qualified Tuition Deduction, 2013

Income Class ($ in the thousands)	Percentage Distribution of Returns	Percentage Distribution of Deduction
Below $10	16.8	31.6
$10 to $20	16.4	9.6
$20 to $30	12.9	6.3
$30 to $40	9.8	5.3
$40 to $50	7.7	4.7

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

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

[19] The lack of optimal choices with education preferences is also discussed by GAO. See *Improved Tax Information Could Help Families Pay for College*, GAO-12-560, May 18, 2012, http://www.gao.gov/products/GAO-12-560; and *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.

Income Class ($ in the thousands)	Percentage Distribution of Returns	Percentage Distribution of Deduction
$50 to $75	13.0	13.4
$75 to $100	8.5	5.7
$100 to $200	11.1	23.3
$200 and over	3.8	0.0

Source: Based on Internal Revenue Service, Statistics of Income, 2013, Table 1.4, http://www.irs.gov/uac/SOI-Tax-Stats—Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income.

Parity for Exclusion for Employer-Provided Mass Transit and Parking Benefits[20]

The exclusion for employer-provided mass transit and parking benefits was made permanent by the PATH Act. 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 2015. The excludable amounts are adjusted for inflation. This provision would increase the limit for mass transit, currently $130, to the $250 allowed for parking.[21]

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.

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

[21] These limits are indexed for inflation; IRS announced the limits for 2015 in Rev. Proc. 2014-61, https://www.irs.gov/pub/irs-drop/rp-14-61.pdf.

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