1.054 INTEREST ON STUDENT LOANS

Internal Revenue Code Section: 221
Oregon Statute: 316.048 (Connection to federal personal taxable income)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1997

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Applicable	$400,000	$400,000
1999–01 Revenue Impact:	Not Applicable	$1,100,000	$1,100,000

DESCRIPTION: A taxpayer may deduct interest on qualified higher education loans. The maximum deduction is $1,000 in 1998, $1,500 in 1999, $2,000 in 2000 and $2,500 in 2001 and succeeding years. The deduction is allowed only with respect to interest paid on a qualified loan during the first five years in which interest payments are required. Months during which the loan is in deferral or forbearance do not count against the five-year period. The deduction is not allowed to individuals who may be claimed as a dependent on another taxpayer's return.

A qualified education loan is any indebtedness incurred to pay for qualified higher education expenses, such as tuition, fees, and room and board. The expenses must be reduced by amounts received from tax-free education benefits. The deduction is phased out for taxpayers with income between $40,000 and $55,000 (if single) or $60,000 and $75,000 (if married). While the maximum deduction amount is not indexed for inflation, the phase out ranges will be indexed for inflation starting in 2003.

PURPOSE: To encourage higher education by reducing the costs.

WHO BENEFITS: Taxpayers who are repaying qualified higher education loans.

EVALUATION: It is too early to determine the impact of this tax expenditure. It should provide incentive for those concerned about loan repayment costs. [*Evaluated by the System of Higher Education.*]

1.055 CHARITABLE CONTRIBUTIONS: EDUCATION

Internal Revenue Code Sections: 170 and 642(c)
Oregon Statutes: 316.695 and 317.013 (Connections to federal personal and corporation deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1917 (personal) and 1935 (corporation)

	Corporation	Personal	Total
1997–99 Revenue Impact:	$5,000,000	$21,700,000	$26,700,000
1999–01 Revenue Impact:	$5,400,000	$23,400,000	$28,800,000

DESCRIPTION: Contributions to educational organizations are allowed as itemized deductions from personal taxable income of amounts up to 50 percent of adjusted gross income. Corporations can deduct from corporate taxable income contributions up to 10 percent of pre-tax income. Taxpayers who donate property may deduct the current market value of the property, up to 30 percent of adjusted gross income, and do not need to pay tax on any capital gains realized on the property.

PURPOSE: To encourage donations to qualifying educational organizations.

WHO BENEFITS: In 1996, roughly 425,000 Oregonians took a deduction for charitable contributions worth a total of nearly $944 million, of which $116 million went to educational organizations. The average total charitable deduction was $2,200.

EVALUATION: This tax expenditure achieves its purpose. Declining public support for public higher education has led to an increasing demand for private support. Public and private institutions of higher education have experienced an increased need for charitable support for their operations to supplement their normal operating revenues in an attempt to control the rate of increase in tuition. Endowments created through such giving enable institutions to develop on-going income to underwrite operating and capital expenses. Individuals often feel a strong sense of identification with a local institution or their alma mater. This tax deduction provides an economic incentive for individuals to act on those feelings and make monetary contributions. It also encourages businesses to make donations because they benefit from a well-educated and appropriately skilled work force. [*Evaluated by the System of Higher Education.*]

1.056 CHARITABLE CONTRIBUTIONS: HEALTH

Internal Revenue Code Sections: 170 and 642(c)
Oregon Statutes: 316.695 and 317.013 (Connections to federal personal and corporation deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1917 (personal) and 1935 (corporation)

	Corporation	Personal	Total
1997–99 Revenue Impact:	$3,800,000	$16,400,000	$20,200,000
1999–01 Revenue Impact:	$4,100,000	$17,700,000	$21,800,000

DESCRIPTION: Contributions to health organizations are allowed as itemized deductions from personal taxable income of amounts up to 50 percent of adjusted gross income. Corporations can deduct from corporate taxable income contributions up to 10 percent of pre-tax income. Taxpayers who donate property may deduct the current market value of the property and do not need to pay tax on any capital gains realized on the property.

PURPOSE: To encourage donations to designated health organizations.

WHO BENEFITS: In 1996, approximately 425,000 Oregonians took a deduction for charitable contributions worth a total of nearly $944 million, of which $87 million went to health organizations. The average total charitable deduction was $2,200.

EVALUATION: This tax expenditure achieves its purpose. Most of the tax advantages are received by those in the higher income ranges because this expenditure is only available to those who itemize deductions. However, given that this tax expenditure is expected to equal $12.7 million dollars for the 1997–99 biennium, it can be expected that a good portion of the donated funds and equipment will provide direct and indirect benefits to all state residents, either in the form of lower costs for health services, or access to services or equipment that previously may not have otherwise been available. [*Evaluated by Oregon Health Plan Policy & Research.*]

1.057 MEDICAL AND DENTAL EXPENSES

Internal Revenue Code Section: 213
Oregon Statute: 316.695 (Connection to federal personal deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1942

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Applicable	$63,300,000	$63,300,000
1999–01 Revenue Impact:	Not Applicable	$67,100,000	$67,100,000

DESCRIPTION: Medical and dental expenses in excess of 7.5 percent of a taxpayer's adjusted gross income are allowed as a deduction from personal taxable income for taxpayers who itemize deductions. The deduction includes amounts paid for health insurance.

PURPOSE: To compensate for large medical expenses that are viewed as involuntary expenses and reduce the ability of the person to pay taxes.

WHO BENEFITS: There were 88,200 Oregonians who took this deduction in 1996 with an average deduction of about $5,070.

EVALUATION: This tax expenditure achieves its purpose. The 7.5 percent threshold limits this deduction to those with unreimbursed medical expenses that are large relative to their level of income. Lower income earners are more likely to qualify than those in higher income brackets; partly because the latter group must incur greater expenses before reaching the 7.5 percent threshold but also because they tend to be covered by employer-provided insurance. [*Evaluated by Oregon Health Plan Policy & Research.*]

1.058 SELF-EMPLOYMENT HEALTH INSURANCE

Internal Revenue Code Section: 162(1)
Oregon Statute: 316.048 (Connection to federal personal taxable income)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1986

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Applicable	$5,700,000	$5,700,000
1999–01 Revenue Impact:	Not Applicable	$6,000,000	$6,000,000

DESCRIPTION: Self-employed individuals may take 45 percent of amounts paid for health insurance in 1998 as an adjustment from personal taxable income. The adjustment increases to 60 percent in 1999, 70 percent in 2002, and 100 percent in 2003 and thereafter. The insurance must be for themselves, their spouses, or their dependents. The adjustment is limited to the taxpayer's earned income.

Effective in 1997, self-employed individuals may also adjust personal income by amounts paid for qualified long-term care insurance. This adjustment is subject to limits of $200 to $2,500 per individual, depending on the age of the insured person.

PURPOSE: To promote the purchase of health insurance by the self-employed and provide some degree of equity between the self-employed and employees covered by employer sponsored health care insurance.

WHO BENEFITS: In 1996, there were approximately 55,300 full-year residents who claimed this adjustment, with an average adjustment amount of $720. The number of claimants increased about six percent from 1995 when 52,100 full-year residents claimed an average adjustment of $710. In 1994, the number of claimants was unusually low because the federal law had Federal Law Sunset Date at the end of 1993. The adjustment was then reinstated in 1995 and made retroactive for 1994.

EVALUATION: While the use of this tax policy has appeared to have declined in recent years (1994 compared to 1993), equity of treatment under the tax code between the self-employed and others engaged in the workforce is an important health policy issue. Maintaining and expanding the percentage of citizens who receive health insurance coverage through the workplace is vital for long-term stability of publicly sponsored health programs and access to necessary medical treatment. Accelerating the percentage of health insurance costs that the self-employed can deduct from personal taxable income, while reducing government revenues, will increase equity of treatment in a rapidly changing workforce and potentially reduce pressure for expanded public health coverage programs. [*Evaluated by Oregon Health Plan Policy & Research.*]

1.059 MEDICAL SAVINGS ACCOUNTS (FEDERAL)

Internal Revenue Code Section: 220
Oregon Statute: 316.048 (Connection to federal personal taxable income)
Federal Law Sunset Date: 12/31/00
Year Enacted in Federal Law: 1996

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Applicable	$400,000	$400,000
1999–01 Revenue Impact:	Not Applicable	$1,100,000	$1,100,000

DESCRIPTION: Individuals' contributions to medical savings accounts are deductible from gross income up to an annual limit of 65 percent of the insurance deductible or earned income, whichever is less. Employer contributions are excluded from the personal taxable income of the employee as well as from the employment taxes of both the employee and employer. Individuals cannot make contributions if their employer does. Earnings on account balances are not taxed. Distributions from medical savings accounts are tax-exempt if used to pay for deductible medical expenses.

Contributions are allowed if individuals are covered by a high-deductible health plan and no other insurance. Plan deductibles must be at least $1,500 (but not more than $2,250) for coverage of one person and at least $3,000 (but not more than $4,500) for more than one. Individuals must also be self-employed or covered through plans offered by small employers. Eligibility to establish accounts will be restricted to 750,000 taxpayers nationally. Once restricted, participation will be generally limited to those individuals who previously had contributions to their accounts or who work for participating employers. Unqualified distributions are included in taxable income and a 15% penalty is added except in cases of disability, death or attaining age 65.

PURPOSE: To slow the growth of health care costs by requiring high deductible insurance. Presumably this encourages consumers to make more cost-conscious choices. Medical savings accounts were also advanced as a way to preserve a role in the system for health care indemnity insurance, that is, insurers who reimburse providers on a fee-for-service basis.

WHO BENEFITS: The self-employed and employees receiving employer-sponsored health benefits (and their respective spouses and dependents, as applicable) who desire this form of health benefit coverage. Employers may benefit by offering additional choice of health benefit plans in the recruitment and retention of employees.

EVALUATION: It is premature to evaluate the impact of medical savings accounts (MSA's) as either a medical cost containment strategy or an alternative to managed care strategies in the private sector. MSA's appear to be attractive to higher income individuals with favorable health status profiles since time is necessary to accumulate enough to cover non-catastrophic expenses associated with preventive and chronic health care services. This tax policy treats MSA's, a recent innovation in health care benefits, on an equitable basis with other models of health benefits available to employers and the self-employed. *[Evaluated by Oregon Health Plan Policy & Research.]*

1.060 IRA CONTRIBUTIONS AND EARNINGS

Internal Revenue Code Sections: 219 and 408
Oregon Statute: 316.048 (Connection to federal personal taxable income)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1974

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Applicable	$72,100,000	$72,100,000
1999–01 Revenue Impact:	Not Applicable	$88,100,000	$88,100,000

DESCRIPTION: Taxpayers who make contributions to an Individual Retirement Account (IRA) may subtract amounts up to $2,000 from personal taxable income. For individuals participating in an employer-provided retirement plan, the amount of the subtraction is phased out at certain income ranges. In 1998, some deductibility is allowed as long as income is under $60,000 on a joint return or under $40,000 on a single return. These income limits increase over the next several years until they reach $100,000 for joint returns (in 2007) and $60,000 for single returns (in 2005). Taxes on IRA earnings are deferred until distribution. Withdrawals from IRAs are included in taxable income.

Deductible contributions of up to $2,000 per year are also allowed for spouses of individuals who participate in an employer-sponsored retirement plan. This deduction is phased out for taxpayers with income between $150,000 and $160,000.

Federal legislation in 1997 created a new nondeductible IRA called the Roth IRA. Contributions are not tax deductible. The contribution amount is limited to $2,000 per year for an individual, and is phased out for incomes between $150,000 and $160,000 for joint returns ($95,000 and $110,000 for single returns). Qualified distributions from a Roth IRA are not taxed. Accounts must be held at least five years in order for distributions to qualify for the tax exemption. Individuals with income of $100,000 or less may convert an IRA into a Roth IRA.

The new legislation also allows penalty-free withdrawals from all IRAs for qualified higher education expenses and up to $10,000 of first-time homebuyer expenses.

PURPOSE: To provide an incentive for taxpayers to save for retirement, education and homeownership, and to provide a savings incentive for workers who do not have employer-provided pension plans.

WHO BENEFITS: The number of full-year residents claiming an adjustment for contributions has steadily fallen from 97,700 in 1990 to 79,200 in 1996. During this same time period, the average adjustment rose from $1,400 to $1,490.

EVALUATION: This tax expenditure has partially achieved its purpose. Whether it has substantially increased savings for retirement is a still a matter of debate. Proponents have argued that the tax benefits of IRAs induce savings while opponents maintain that they simply result in a transfer of savings. Those with higher incomes (below the cap) benefit more from this deduction because participation rates steadily decline as income declines. While this tax deduction does provide an incentive to save for retirement, current forecasts indicate that retirement savings for people aged 30–48 needs to increase three-fold from present standards in order for these individuals to maintain their living standards. Without sufficient savings for retirement, there is an increased likelihood of reliance on government service programs. One possible improvement to this tax expenditure would be to increase the income thresholds to claim this deduction. [*Evaluated by the Senior and Disabled Services Division.*]

1.061 KEOGH PLAN CONTRIBUTIONS AND EARNINGS

Internal Revenue Code Sections: 401–407, 410–418E, and 457
Oregon Statute: 316.048 (Connection to federal personal taxable income)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1962

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Applicable	$28,200,000	$28,200,000
1999–01 Revenue Impact:	Not Applicable	$31,900,000	$31,900,000

DESCRIPTION: Self-employed taxpayers who make contributions to their own retirement (Keogh) accounts may subtract those contributions from personal taxable income. The maximum adjustment allowed is the lesser of 25 percent of income or $30,000. Taxes on Keogh earnings are deferred until distribution during retirement. Withdrawals from Keoghs are included in personal taxable income.

PURPOSE: To encourage the self-employed to save for retirement and to eliminate discrimination against the self-employed who do not have access to other tax-deferred pension plans.

WHO BENEFITS: The number of full-year residents making contributions to Keogh plans has increased from about 12,400 in 1990 to 17,800 in 1996. The average adjustment has ranged from approximately $7,500 to $7,700. In 1996, it was $7,560.

EVALUATION: This tax expenditure achieves its purpose and is an important option in accumulating retirement savings. As our national economy changes and self-employment becomes an option for many people, this savings option becomes more vital. Keogh accounts provide a valuable tax-deferred savings device to that segment of the population without comparable alternatives. Current forecasts indicate that current retirement savings of those aged 30–48 are not nearly sufficient to maintain their current lifestyles. While by itself this tax expenditure will not solve the problem, it does address certain aspects of it. One potential improvement would be to raise the thresholds and allow greater participation. [*Evaluated by the Senior and Disabled Services Division.*]

1.062 REMOVAL OF ARCHITECTURAL BARRIERS

Internal Revenue Code Section: 190
Oregon Statute: 316.695 and 317.013 (Connections to federal personal and corporation taxable deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1976

	Corporation	Personal	Total
1997–99 Revenue Impact:	$100,000	Less than $50,000	$100,000
1999–01 Revenue Impact:	$100,000	Less than $50,000	$100,000

DESCRIPTION: A deduction from corporation or personal taxable income of up to $15,000 is allowed for the removal of architectural and transportation barriers. Eligible expenses include those necessary to make facilities or transportation vehicles for use in the trade or business more accessible to the handicapped and those 65 and over.

PURPOSE: To encourage the modification of business facilities to a more barrier-free environment for both employees and customers.

WHO BENEFITS: The taxpayers incurring the costs of making the structural changes and the elderly and handicapped who have access to areas they may not have had without the deduction.

EVALUATION: This tax expenditure has not really achieved its purpose. The program incentives have been adjusted downward over time rather than upward to correspond with increasing costs due to inflation and tighter regulations. While the Americans with Disabilities Act did not require retrofitting, it does mandate that if modifications are made, they must comply with all of the Act’s requirements. The current ceiling of $15,000 allowable for deduction most often is not representative of the real cost of the rehabilitation necessary to bring about access accommodation. [*Evaluated by the Senior and Disabled Services Division.*]

1.063 RESEARCH AND DEVELOPMENT COSTS

Internal Revenue Code Section: 174
Oregon Statutes: 316.695 and 317.013 (Connections to federal personal and corporation deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1954

	Corporation	Personal	Total
1997–99 Revenue Impact:	$12,200,000	Less than $50,000	$12,200,000
1999–01 Revenue Impact:	$14,200,000	Less than $50,000	$14,200,000

DESCRIPTION: Research and development (R&D) expenditures can be fully expensed in the year made for purposes of computing corporation and personal taxable income. This is considered a tax expenditure because these expenditures presumably provide a business with benefits over a period of time. To be consistent with the treatment of other investments with multi-year benefits, R&D expenditures would need to be depreciated over their useful life.

PURPOSE: To encourage investment in research and development. Additionally, to avoid the difficulty of determining whether the expenditures are "successful" and the length of useful life.

WHO BENEFITS: Firms with certain research and experimental expenditures.

EVALUATION: This expenditure appears to achieve its purpose. In conjunction with the Oregon tax credit (1.120 Qualified Research Activities), it benefits research intensive companies such as the recently expanding high-tech industry. The following benefits can be identified:

- Encourages existing companies to put more efforts into research and development. Product introduction cycles for products such as personal computers and high definition television and telecommunication products are getting shorter and shorter. They demand R&D commitments.
- Encourages small companies to explore new niche technology opportunities, and enhances their ability to attract joint R&D capital.
- Encourages companies to utilize existing state research institutes to assist with R&D activities.

This last point is an issue in Oregon. Recent data indicate that corporate R&D dollars to state research institutes are very small compared to other states. This could be an indication that state research facilities are not well equipped to assist or are not responsive to industry needs, or that corporations fail to engage Oregon's research facilities for some other reason. [*Evaluated by the Economic Development Department.*]

1.064 SECTION 179 EXPENSING ALLOWANCES

Internal Revenue Code Section: 179
Oregon Statutes: 316.695 and 317.013 (Connections to federal personal and corporation deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1959

	Corporation	Personal	Total
1997–99 Revenue Impact:	$2,900,000	$2,400,000	$5,300,000
1999–01 Revenue Impact:	$3,200,000	$2,500,000	$5,700,000

DESCRIPTION: In general, the cost of business property must be deducted from personal and corporation income as it depreciates over its useful life. This expenditure allows a taxpayer to deduct as an expense up to $17,500 of the cost of qualifying property in the year it is purchased. The amount that can be expensed is phased out if the taxpayer purchases more than $200,000 of property during the year. This phase out directs much of the benefit to smaller businesses.

PURPOSE: To promote investment in equipment, specifically by smaller businesses.

WHO BENEFITS: Firms with tangible personal property purchases below $217,500 are the direct beneficiaries. A portion of the benefits to the businesses are likely passed along to the businesses' employees, customers, and suppliers.

EVALUATION: This expenditure appears to achieve its purpose. Expensing the cost of an investment allows the business to reduce its tax in the year of purchase rather than over a longer period of depreciation. An investment tax credit tailored to smaller businesses could serve as an alternative to this provision, although it is unlikely to be any more efficient at stimulating small business investment. [*Evaluated by the Economic Development Department.*]

1.065 AMORTIZATION OF BUSINESS START-UP COSTS

Internal Revenue Code Section: 195
Oregon Statutes: 316.695 and 317.013 (Connections to federal personal and corporation deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1980

	Corporation	Personal	Total
1997–99 Revenue Impact:	$100,000	$2,100,000	$2,200,000
1999–01 Revenue Impact:	$100,000	$2,100,000	$2,200,000

DESCRIPTION: Generally, costs incurred before the beginning of a business are not deductible. However, under this tax provision a taxpayer may elect to deduct from personal or corporation taxable income eligible start-up expenditures over a period of at least five years. An expenditure must satisfy two requirements to qualify for this treatment. First, it must be paid in connection with creating or investigating a trade or business before the taxpayer begins an active business. Second, it must be an expenditure that would have been deductible for an active business.

PURPOSE: To encourage the formation of new businesses, and to reduce the controversy over how these start-up costs were supposed to be treated for tax purposes.

WHO BENEFITS: New businesses that incur start-up costs. As new businesses are formed, these businesses may create employment opportunities for Oregon residents who become indirect beneficiaries of the tax expenditure.

EVALUATION: This expenditure appears to achieve its purpose by putting new businesses on a more even playing field with existing businesses. Many new businesses have insufficient income from which to benefit by a deduction of all their startup costs in the first year or two. Established businesses that are expanding, on the other hand, are more likely to have sufficient income to benefit by deducting their expansion expenses in one year. An indirect benefit is increased free market competition. Finally, the “cost” of this provision is quite likely more than recovered by the increased economic activity and improved distribution of income encouraged by this provision. [*Evaluated by the Economic Development Department.*]

1.066 CONSTRUCTION FUNDS OF SHIPPING COMPANIES

Internal Revenue Code Section: 7518
Oregon Statute: 317.013 (Connection to federal corporation deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1936

	Corporation	Personal	Total
1997–99 Revenue Impact:	$500,000	Not Applicable	$500,000
1999–01 Revenue Impact:	$500,000	Not Applicable	$500,000

DESCRIPTION: U.S. operators of vessels in foreign, Great Lakes, or noncontiguous domestic trade, or in U.S. fisheries, may each establish a capital construction fund into which they may make certain deposits. Such deposits are deductible from corporate taxable income, and income tax on the earnings of the deposits in the fund is deferred. When tax-deferred deposits and their earnings are withdrawn from a fund, no tax is due if the money is used to construct, acquire, lease, or pay off the debt on a qualifying vessel.

PURPOSE: To encourage domestic ship-building and registry under the U.S. flag, and to ensure an adequate supply of shipping capability for national security.

WHO BENEFITS: U.S. ship-building firms.

EVALUATION: The estimated revenue impacts above imply that about $7 million of deposits and their earnings were withdrawn for qualifying capital expenditures. While we cannot easily determine the additional amount of money that has been spent for these purposes as a result of the existence of this tax expenditure, it is likely that this provision has some stimulative impact. [*Evaluated by the Economic Development Department.*]

1.067 MOVING EXPENSES

Internal Revenue Code Sections: 1073–1078
Oregon Statute: 316.048 (Connection to federal personal taxable income)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1964

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Applicable	$1,100,000	$1,100,000
1999–01 Revenue Impact:	Not Applicable	$1,200,000	$1,200,000

DESCRIPTION: Taxpayers may take qualified moving expenses as an adjustment to personal taxable income. The expenses include costs of moving household goods and traveling expenses while moving. The move must be in conjunction with a new job or business at least 50 miles farther away than one's current job. Congress limited the deductible amount in 1993 but made the deduction available to taxpayers who take the standard deduction.

PURPOSE: To provide tax relief for people where moving expenses are an employee business expense necessary to earn income.

WHO BENEFITS: Employees incurring moving expenses related to a new job or business. The number of taxpayers claiming this adjustment in 1996 was slightly down from 1995, falling from approximately 14,600 to 14,500. The average moving expense adjustment in 1996 was roughly $1,850.

EVALUATION: This tax expenditure achieves its purpose. It provides an incentive for taxpayers to accept new jobs or opportunities that they may not otherwise find acceptable. For example, it facilitates the mobility of the person who has a job offer of equal pay but more growth potential. It lessens the financial risk and contributes to economic growth by encouraging workers to take advantage of better jobs in different locations. It may also lessen the need for public assistance for those who face the choice of relocation or unemployment. [*Evaluated by the Employment Department.*]

1.068 HOMEOWNER PROPERTY TAXES

Internal Revenue Code Section: 164
Oregon Statute: 316.695 (Connection to federal personal deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1913

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Applicable	$164,500,000	$164,500,000
1999–01 Revenue Impact:	Not Applicable	$183,400,000	$183,400,000

DESCRIPTION: Property taxes paid by owner-occupants on their primary and secondary residences are deductible from personal taxable income for taxpayers that itemize deductions. Starting in 1991 the deduction is subject to phase-out for high-income taxpayers. The phase-out is indexed to inflation, and in 1995 started at an income of $121,200 ($60,600 for married filing separately).

PURPOSE: To promote home ownership by reducing the after-tax cost. According to Congressional Research Service, under the original 1913 Federal income tax law nearly all State and local taxes were deductible. The rationale was that such payments reduced disposable income "in a mandatory way," and thus affected the taxpayer's ability to pay federal income tax. Congress has since eliminated the deductibility of many taxes, such as local excise taxes and sales taxes.

WHO BENEFITS: In 1996, about 460,000 Oregon taxpayers claimed $952 million in itemized deductions for the property taxes paid on their residences (average deduction was $2,073), for an average Oregon tax benefit of about $180 per return. Taxpayers with incomes greater than $40,000 accounted for 60 percent of the itemized property tax returns, while about 72 percent of tax benefits went to those higher income taxpayers.

EVALUATION: This expenditure appears to achieve its purpose. According to Congressional Research Service, proponents of the continuing deductibility of property taxes argue that it promotes fiscal federalism by helping state and local governments raise revenue from their own taxpayers. Itemizers receive an offset for their deductible state and local taxes in the form of lower federal income taxes. Deductibility thus helps to equalize total federal-state-local tax burdens across the country: Itemizers in high tax states pay somewhat lower federal taxes as a result of their deduction, and vice versa.

The Congressional Research Service notes that property tax is one of several deductions subject to the phaseout on itemized deductions for taxpayers whose AGI exceeds the applicable threshold amount. To some extent, this addresses criticisms that the deduction primarily benefits higher income taxpayers. Higher income taxpayers are more likely to itemize deductions, have higher marginal tax rates, and have higher assessed values on their homes. Because of the relatively greater benefits afforded higher income taxpayers, questions as to the fiscal effectiveness of this tax expenditure were raised. However, the phaseout of the benefit reduces that concern. [*Evaluated by the Housing and Community Services Department.*]

1.069 HOME MORTGAGE INTEREST

Internal Revenue Code Section: 163(h)
Oregon Statute: 316.695 (Connection to federal personal deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1913

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Applicable	$525,100,000	$525,100,000
1999–01 Revenue Impact:	Not Applicable	$567,900,000	$567,900,000

DESCRIPTION: Mortgage interest paid by owner-occupants on their primary and secondary residences is deductible from personal taxable income for taxpayers who itemize deductions. Interest may be deducted on loans up to $1,000,000 for the purchase of the residence ($500,000 in the case of a married individual filing a separate return), and on loans up to $100,000 ($50,000 for married individuals filing separately) for home equity loans. These dollar limitations do not apply, however, to qualified indebtedness acquired on or before October 13, 1987. Starting in 1991 the deduction is subject to phase-out for high-income taxpayers. The phase-out is indexed to inflation, and in 1995 started at an income of $121,200 ($60,600 for married filing separately).

This deduction qualifies as a tax expenditure because other interest that can be deducted, such as interest paid to acquire investments or interest allocable to a trade or business, is limited to circumstances where income generated by the investments is taxable. In this case, the interest payments are not used to finance any taxable activity.

PURPOSE: To promote home ownership. According to the Congressional Research Service, initial enactment of the mortgage interest deduction in 1913 was part of the deduction for all types of interest, which in those days were almost exclusively business related. The original purpose was not, therefore, to encourage home ownership. In recent years the deduction has, however, been defended on those grounds.

WHO BENEFITS: In 1996, about 430,000 taxpayers claimed a total of $2.8 billion of itemized deductions for home mortgage interest (average deduction was $6,400), for an average Oregon tax benefit of about $400 per return. Taxpayers with incomes greater than $40,000 accounted for 62 percent of the itemized home mortgage returns, while about 73 percent of tax benefits went to those higher income taxpayers.

EVALUATION: Generally, this expenditure appears to achieve its purpose. It is likely that for some individuals, the deductibility of mortgage interest is the determining factor in an economic decision to purchase a home. The Congressional Research Service points out that the rate of home ownership in the United States is not significantly higher than in countries such as Canada that do not provide a mortgage interest deduction under their income tax. However, other factors may impact the housing market differently in the United States.

The Congressional Research Service notes that mortgage interest is one of several deductions subject to the phaseout on itemized deductions for taxpayers whose AGI exceeds the applicable threshold amount. To some extent, this addresses criticisms that the deduction primarily benefits higher income taxpayers. Higher income taxpayers are more likely to itemize deductions, have higher marginal tax rates, qualify for larger loans and tend to spend more on housing. In addition, no equivalent benefit exists for renters, who tend to be lower income than homeowners. Because of the relatively greater benefits afforded higher income taxpayers, questions as to the fiscal effectiveness of this tax expenditure are raised. However, the phaseout of the benefit at higher incomes reduces that concern.

Down payment assistance programs, or other programs targeting low to median income populations represent alternatives to increase home ownership. [*Evaluated by the Housing and Community Services Department.*]

1.070 CASH ACCOUNTING FOR AGRICULTURE

Internal Revenue Code Sections: 162, 175, 180, 447, 461, 464, and 465
Oregon Statute: 316.695 and 317.013 (Connections to federal personal and corporation taxable deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1916

	Corporation	Personal	Total
1997–99 Revenue Impact:	$300,000	$1,500,000	$1,800,000
1999–01 Revenue Impact:	$500,000	$2,000,000	$2,500,000

DESCRIPTION: For income tax purposes, cash accounting typically results in a deferral of taxes relative to the accrual method, which is considered the standard, so cash accounting represents a tax expenditure. Most farm operations, with the exception of some farm corporations, may use the cash method of accounting to deduct costs attributable to goods held for sale and in inventory at the end of the year. These farms also can expense some costs of developing assets that will produce income in future years. Both of these rules allow deductions to be claimed in the calendar year the expense occurred, while income associated with the deductions may be realized in later years.

PURPOSE: The cash method of accounting serves two purposes for the agriculture industry: 1) simplification of record-keeping for family farms; and 2) a way to deal with the cyclical nature of income that is part of the industry, with some years bringing large revenues and others large losses.

WHO BENEFITS: Small farmers.

EVALUATION: This expenditure achieves its purpose. Because of the variation in farm commodities (some are perishable and sold soon after harvest, while others can be stored for years), this provision enables producers to recognize expenses in the year they occur, while assisting producers to meet marketing objectives by selling crops when they feel the market conditions are best. Income averaging was reinstated in 1997 to assist producers by enabling averaging of income over three years. Requiring all producers to use an accrual accounting system would place a large burden on small operators. [*Evaluated by the Department of Agriculture.*]

1.071 SOIL AND WATER CONSERVATION EXPENDITURES

Internal Revenue Code Section: 175
Oregon Statute: 316.695 and 317.013 (Connections to federal personal and corporation taxable deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1954

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Available	Not Available	$300,000
1999–01 Revenue Impact:	Not Available	Not Available	$300,000

DESCRIPTION: For corporation and personal income tax purposes, certain investments in soil and water conservation projects that produce benefits over a number of years can be expensed rather than depreciated. The expensing of these costs represents a departure from typical practice and represents a tax expenditure because deductions can be claimed before the income associated with the deductions is realized.

PURPOSE: To encourage expenditures that promote soil and water conservation and to reduce the tax burden on farmers.

WHO BENEFITS: Farmers who engage in projects that conserve soil and water.

EVALUATION: This expenditure appears to be achieving its purposes. Most soil and water conservation cost-sharing and payment programs were incorporated into the 1996 Farm Bill, and oversight is primarily by the Natural Resources Conservation Service. The Conservation Reserve Program and Wetland Reserve Program allow farmers to set aside land that is either highly erodible or which should be protected as wetland, without the farmers having to suffer a significant loss of income.

The 1996 Farm Bill also created a new program, the Environmental Quality Incentives Program (EQIP), which combines the functions of the previous Agricultural Conservation Program and the Water Quality Incentives Program. EQIP changes somewhat who is eligible for cost-sharing funds, the limits on the amount of incentive payments available, and who makes the decision on how the funds are distributed. Numerous public meetings have been held around the United States to obtain input on these programs. [*Evaluated by the Department of Agriculture.*]

1.072 FERTILIZER AND SOIL CONDITIONER COSTS

Reg. S1.180-1 and S1.180-2
Oregon Statute: 316.695 and 317.013 (Connections to federal personal and corporation taxable deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1960

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Available	Not Available	$300,000
1999–01 Revenue Impact:	Not Available	Not Available	$300,000

DESCRIPTION: For corporation and personal income tax purposes, certain investments in soil fertilization and conditioning projects that produce benefits over a number of years can be expensed rather than depreciated. The expensing of these costs represents a departure from typical practice and represents a tax expenditure because deductions can be claimed before the income associated with the deductions is realized.

PURPOSE: To promote activities that maintain and improve the fertility of the soil, and to reduce the tax burden on farmers.

WHO BENEFITS: Generally, farmers who invest in projects to fertilize and condition their soil.

EVALUATION: The effectiveness of the federal fertilizer and soil conditioners cost-sharing program is difficult to determine, and the program has an uncertain future. Historically the Agricultural Stabilization and Conservation Service (ASCS), under the United States Department of Agriculture, has managed this program for farmers as part of its Agricultural Conservation Practices program. Farmers participating in the program were able to grow clover and plow it under as “green manure” in addition to other types of soil amendments, and get cost-sharing payments from ASCS. [*Evaluated by the Department of Agriculture.*]

1.073 COSTS OF RAISING DAIRY AND BREEDING CATTLE

Internal Revenue Code Section: 263A(d)(1)(A)(i)
Oregon Statute: 316.695 and 317.013 (Connections to federal personal and corporation taxable deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1916

	Corporation	Personal	Total
1997–99 Revenue Impact:	Less than $50,000	$800,000	$800,000
1999–01 Revenue Impact:	Less than $50,000	$1,000,000	$1,000,000

DESCRIPTION: Costs incurred in the raising of dairy and breeding cattle can be expensed rather than depreciated in calculating taxable income. In most industries, expenses that provide benefits over a number of years must be depreciated. This approach includes dairy and breeding cattle because they generate income over an extended period of time. The expensing of these costs represents a departure from typical practice and represents a tax expenditure because deductions can be claimed before the income associated with the deductions is realized. Producers generally borrow funds to purchase these animals and expenses accrue from the date of purchase for feed, care, etc. Breeding stock and dairy cattle are generally kept for five to eight years or longer. Income is generated from the sale of byproduct (milk) or offspring rather than from the original stock. The “expenditure” in this case enables producers to expense the purchase along with the costs associated with the animal rather than waiting until the animal is sold years later.

PURPOSE: To reduce the tax burden on farmers.

WHO BENEFITS: Farmers who raise dairy and breeding cattle.

EVALUATION: This expenditure achieves its purpose. The ability to expense the purchase reduces the complication of accounting and expenses associated with record keeping. The cash method of accounting fits the treatment of animals better than the accrual method because the value of the animals can vary significantly from year to year, first increasing, then falling. Under the accrual method, producers would have to depreciate the purchase amount of the animals over some set amount of time. The impact would be increased record keeping requirements and a mismatch between the actual value of the animals and the value used for tax purposes. [*Evaluated by the Department of Agriculture.*]

1.074 REDEVELOPMENT COSTS IN CONTAMINATED AREAS

Internal Revenue Code Section: 198
Oregon Statute: 316.048 and 317.013 (Connection to federal personal and corporation taxable incomes)
Federal Law Sunset Date: 12-31-00
Year Enacted in Federal Law: 1997

	Corporation	Personal	Total
1997–99 Revenue Impact:	$0	$0	$0
1999–01 Revenue Impact:	$500,000	$100,000	$600,000

DESCRIPTION: Certain environmental remediation expenditures that would otherwise be deducted over a number of years can be fully deducted from taxable personal or corporate income in the year the expenditures were made. The expenditures must be incurred in connection with the abatement or control of hazardous substances at qualified contaminated sites ("brownfields") that are located within targeted areas.

PURPOSE: To encourage the cleanup of environmentally contaminated areas, by reducing the cost.

WHO BENEFITS: The brownfields tax incentive primarily benefits taxpayers that purchase property that has already been contaminated. Taxpayers who cause contamination can already, under a 1994 IRS ruling, deduct certain environmental cleanup expenditures. The tax incentive permits taxpayers not causing the contamination to deduct remediation expenditures on property located in the target areas. It may also allow taxpayers responsible for the contamination to deduct remediation-related expenditures that would otherwise be chargeable to a capital account. Because the tax incentive promotes environmental cleanup efforts that might otherwise not be undertaken, it also benefits the general public, especially the communities in the targeted areas. These include Enterprise Communities, Empowerment Zones and certain other areas with high poverty rates.

EVALUATION: DEQ has received several requests for information on this tax incentive in its initial year, but has not yet received a request for certification. The Department believes that this may be due to the lead time required for investment in applicable properties, investigation and cleanup. Activity will likely increase in subsequent years. The revenue impacts assume no project are undertaken in the 1997–99 biennium. *[Evaluated by the Department of Environmental Quality.]*

1.075 MULTI-PERIOD TIMBER GROWING COSTS

Internal Revenue Code Sections: 162, 263(d)(1)
Oregon Statute: 316.695 and 317.013 (Connections to federal personal and corporation taxable deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1986

	Corporation	Personal	Total
1997–99 Revenue Impact:	$ 7,200,000	$1,100,000	$8,300,000
1999–01 Revenue Impact:	$7,300,000	$1,100,000	$8,400,000

DESCRIPTION: Indirect expenses incurred in the growing of timber can be expensed rather than capitalized when computing corporation and personal taxable income. Expensing allows full deduction in the year the expenses are incurred, while capitalization requires the deduction to be taken over a number of years. In most other industries, these expenses must be capitalized.

PURPOSE: Probably to provide tax relief to the timber-growing sector. The Tax Reform Act of 1986 reduced the overall capital gains tax rate, removed a number of exemptions from capital gains taxation (including a portion of timber value), and maintained the practice that nearly all young-growth timber growing costs are to be capitalized rather than expensed. The law continued Congress' recognition of the long growing periods for timber during which no revenue is produced by continuing a favorable tax treatment of timber. It did so by permitting indirect costs of growing timber (expenses not associated with re-establishment of a timber stand and not producing revenue) to be expensed during the year they occurred.

WHO BENEFITS: Taxpayers who have timber growing expenses that are not connected with a timber harvest or reforestation activity. According to the Congressional Research Service, nationally about 80 percent of the benefits accrue to corporations, and 20 percent to non-corporate timber growers. In Oregon the percentage benefiting corporations may be even greater because the proportion of Oregon private timberlands that is owned by corporations is larger than the national average.

EVALUATION: It is not clear if this expenditure is achieving its purpose. If the purpose is to extend tax benefits to all who grow timber for sale, the purpose has not been fully achieved because the expensing is unavailable to those who are not "materially participating" in the management of the timber stand involved. If the taxpayer is an "investor" these expenses must be capitalized, thus effectively adding to the current tax burden. If the purpose extends only to those investing "sweat equity" in the land, and to those entities for which the timber-growing is their sole business, then there is evidence that the purpose is being achieved.

There is controversy surrounding this tax provision. The position of IRS and Congress' tax-writing committees is that equity has been achieved through the 1986 Tax Reform Act so far as timber growing is concerned. Many landowners and small woodlands groups maintain, however, that their tax burdens were increased as a result of the passive loss rules and loss of the 60 percent capital gains exclusion provisions of the Act. They feel strongly that their ability to produce timber in a cost-effective manner has been diminished. [*Evaluated by the Forestry Department.*]

1.076 DEVELOPMENT COSTS: NONFUEL MINERALS

Internal Revenue Code Sections: 263(1)A, 291, 616–617, 56, and 1254
Oregon Statute: 316.695 and 317.013 (Connections to federal personal and corporation taxable deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1951

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Available	Not Available	$100,000
1999–01 Revenue Impact:	Not Available	Not Available	$100,000

DESCRIPTION: Firms engaged in mining are allowed to expense, rather than capitalize, certain exploration and development costs when computing corporation and personal taxable income. Expensing allows full deduction in the year the expenses are incurred, while capitalization requires the deduction to be taken over a number of years.

PURPOSE: To encourage mining and to reduce the ambiguity in the way mining operations were taxed.

WHO BENEFITS: Mining companies.

EVALUATION: This provision effectively allows mining companies to get a quicker return on their investment through tax deductions, hence it encourages more mining explorations and operations. For a state like Oregon, which has relatively little mineral mining, this provision costs very little, but may lead to long-term increases in economic activity and tax revenue by encouraging explorations.

According to the Congressional Research Service, however, the expensing of capital costs for tax purposes can lead to investment decisions that are based solely on tax considerations rather than on the inherent economic worth of the activity. The result in this case may be more resources devoted to mining than is economically justified. [*Evaluated by the Department of Geology and Mineral Industries*.]

1.077 DEPLETION COSTS FOR NONFUEL MINERALS

Internal Revenue Code Sections: 611, 612, 613, and 291
Oregon Statute: 316.695 and 317.013 (Connection to federal personal and corporation taxable deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1913

	Corporation	Personal	Total
1997–99 Revenue Impact:	$900,000	$700,000	$1,600,000
1999–01 Revenue Impact:	$900,000	$700,000	$1,600,000

DESCRIPTION: Firms that extract minerals, ores, and metals from mines are permitted a deduction from corporation or personal taxable income to recover their capital investment. There are two methods of calculating this deduction: cost depletion and percentage depletion. Cost depletion is considered the standard method for tax purposes. Because percentage depletion is based on the market value of the minerals recovered, it generally exceeds cost depletion, which is limited to the total capital investment. To the extent that percentage depletion exceeds cost depletion, this provision is a tax expenditure.

PURPOSE: To encourage discovery and development of mineral deposits by reducing the taxes on mining operations.

WHO BENEFITS: Mining companies using the percentage depletion method.

EVALUATION: This provision appears to be effective in encouraging exploration and development of mineral deposits by reducing tax liabilities of mining companies. It is difficult to measure how effective it has been, but it should have a positive effect stimulating mining activity in Oregon. [*Evaluated by the Department of Geology and Mineral Industries.*]

1.078 MINING RECLAMATION RESERVES

Internal Revenue Code Section: 468
Oregon Statute: 316.695 and 317.013 (Connection to federal personal and corporation taxable income)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1984

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Available	Not Available	$200,000
1999–01 Revenue Impact:	Not Available	Not Available	$200,000

DESCRIPTION: Mine reclamation costs, which typically occur at the end of a mining project, are deductible from corporation and personal taxable income at the beginning of the project, thus allowing deduction of the expenses before they occur.

PURPOSE: To encourage mine reclamation activities and to compensate mining companies for the cost of reclamation.

WHO BENEFITS: Mining companies with reclamation costs. Oregonians also benefit greatly from the reclamation encouraged through this expenditure. The environmental and habitat benefits can be very large, although difficult to place exact values on.

EVALUATION: This provision has been effective at assisting mining operations because tax deductions can be taken for the life of the mining operation instead of at the tail end of the project. It encourages reclamation throughout the length of the mining operation, which probably has the long-term value of benefiting mine site and surrounding land values during and after mining. It appears to be an effective way to encourage reclamation and help the environment. [*Evaluated by the Department of Geology and Mineral Industries.*]

1.079 BAD DEBT RESERVES OF FINANCIAL INSTITUTIONS

Internal Revenue Code Sections: 585, 593, and 596
Oregon Statute: 317.013 (Connection to federal corporation taxable income)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1947

	Corporation	Personal	Total
1997–99 Revenue Impact:	$100,000	Not Applicable	$100,000
1999–01 Revenue Impact:	$100,000	Not Applicable	$100,000

DESCRIPTION: Small banks and savings and loans can use a reserve method of accounting in calculating write-offs for bad debts. Under a reserve method, payments are made into a reserve account to cover bad debts in the future. These payments can be deducted from corporate taxable income. This differs from large commercial banks, which can only write off bad debts at the time they become worthless. The effect of the reserve method is to allow future bad debts to be written off against current income. In effect, this defers taxes, lowering the effective tax rate on the financial institution.

PURPOSE: To provide tax relief to small banks and savings and loans.

WHO BENEFITS: Small banks and savings and loans.

EVALUATION: This expenditure appears to achieve its purpose. Bad debt reserves create a cushion for loans that may go bad. It is probably the simplest and easiest way to mediate the vagaries of the business cycle. If the benefit were removed, banks would be more inclined to curtail risks and tighten underwriting standards. The economy could be affected if this resulted in reduced availability of loans. [*Evaluated by the Department of Consumer and Business Services.*]

1.080 SMALL LIFE INSURANCE COMPANIES

Internal Revenue Code Section: 806
Oregon Statute: 317.013 (Connection to federal corporation taxable income)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1984

	Corporation	Personal	Total
1997–99 Revenue Impact:	$500,000	Not Applicable	$500,000
1999–01 Revenue Impact:	$500,000	Not Applicable	$500,000

DESCRIPTION: Life insurance companies with less than $500 million in assets and taxable income of less than $15 million are allowed a special deduction on their corporate income taxes. For taxable income less than $3 million, companies can deduct 60 percent of their corporate taxable income. The deduction is reduced by 15 percent of the amount of taxable income that exceeds $3 million, so the deduction falls to zero when taxable income reaches $15 million.

PURPOSE: To provide a benefit to small insurance companies in an industry dominated by very large companies.

WHO BENEFITS: Small life insurance companies with assets less than $500 million and taxable income of less than $15 million. Competitive pressures in the life insurance industry may cause the benefits to be passed on to policyholders in the form of lower premiums.

EVALUATION: This expenditure is generally effective in achieving its purpose. It may serve to help newer companies to become established and build up the reserves state law requires of insurance companies. Many of these newer companies are located in smaller communities where they become an integral part of the economic fiber. Without this tax law incentive to strengthen smaller life companies, they could be swallowed up by the larger national companies.

However, there is a concern that inequities are created by this expenditure, since taxes on business income are based on the size of the business rather than profitability. It distorts the efficient allocation of resources, since it offers a cost advantage based on size and not economic performance. Nor does this tax reduction serve any simplification purpose, since it requires an additional set of computations and some complex rules to keep it from being abused. [*Evaluated by the Department of Consumer and Business Services.*]

1.081 UNPAID LOSS RESERVES

Internal Revenue Code Sections: 832(b)(5) and 846
Oregon Statute: 317.013 (Connection to federal corporation taxable income)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1986

	Corporation	Personal	Total
1997–99 Revenue Impact:	$13,100,000	Not Applicable	$13,100,000
1999–01 Revenue Impact:	$14,700,000	Not Applicable	$14,700,000

DESCRIPTION: In calculating corporate taxable income, most businesses cannot deduct expenses until the company becomes liable for paying them. Property and casualty insurance companies, however, are allowed to deduct the estimated losses they expect to pay in the future, including claims in dispute. This allows them to deduct future expenses from current income and thereby defer tax liability.

PURPOSE: To make tax rules consistent with standard industry accounting practices. For most regulated industries, the tax code was written to be consistent with the accounting rules already used in those industries (in most cases dictated by state regulation). In the insurance industry it is common practice to use some form of reserve accounting in estimating net income, and those methods were adopted for tax purposes when property and casualty insurance companies first became taxable in 1909.

WHO BENEFITS: Competitive pressures in the insurance industry probably result in the benefits being passed on to policyholders in the form of lower premiums.

EVALUATION: This expenditure achieves its purpose. The nature and purpose of insurance is to reduce financial uncertainty. Insurers must estimate the amounts of unpaid losses because of the same uncertainty. Were this not so, insurance would be unnecessary. Historically, the liability estimates have been accurate or understated. Excessive estimates result in tax penalties and competitively ineffective pricing.

Insurance pricing already anticipates investment income or the time value of maintaining assets for unpaid liabilities. The insurance-buying public benefits from this tax expenditure because any increase in the taxes insurance companies must pay or any acceleration in the taxes requires the companies to increase the cost of insurance protection. The tax expenditure may encourage insurance companies to maintain liabilities at adequately stated values. Historically, companies have tended to understate unpaid liabilities. Eliminating or reducing this expenditure could increase the risks of company insolvencies to the detriment of those who purchase insurance and to the state General Fund that offsets premium taxes for guaranty fund assessments on surviving companies. [*Evaluated by the Department of Consumer and Business Services.*]

1.082 BLUE CROSS/BLUE SHIELD AND OTHER NONPROFITS

Internal Revenue Code Section: 883
Oregon Statute: 317.013 (Connection to federal corporation taxable income)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1986

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Available*	Not Applicable	Not Available*
1999–01 Revenue Impact:	Not Available*	Not Applicable	Not Available*

* In certain cases, revenue numbers are not provided for tax expenditures that may affect at most a few taxpayers. This includes tax expenditures that do not currently affect any Oregon taxpayer, but could at a later date.

DESCRIPTION: Blue Cross and Blue Shield health insurance companies in existence on August 16, 1986, and other nonprofit health insurers that meet strict community service standards, are allowed a special deduction from corporate taxable income of up to 25 percent of the excess of the year's health-related claims over their accumulated surplus at the beginning of the year. These organizations are also allowed a full deduction for unearned premiums, unlike other property and casualty insurance companies.

PURPOSE: To encourage the provision of health insurance by companies that provide community-service and "community-rated" insurance coverage (coverage at rates that take into account the customer's ability to pay) .

WHO BENEFITS: Because of competitive pressures in the health insurance industry, the benefits of this provision probably accrue to policyholders.

EVALUATION: This expenditure appears to achieve its purpose. These companies contain in their charters a commitment to offer individual policies not available elsewhere. Some continue to offer policies with premiums based on community payout experience ("community rated"). Their former tax exemption and their current reduced tax rates presumably serve to subsidize these community activities. The question to ask is whether for-profit health insurers would make available health care to the less fortunate of society if there were no nonprofit insurers. Without this exemption, the state might spend more in social services than is lost in revenue. [*Evaluated by the Department of Consumer and Business Services.*]

1.083 MAGAZINE CIRCULATION EXPENDITURES

Internal Revenue Code Section: 173
Oregon Statute: 316.695 and 317.013 (Connections to federal personal and corporation taxable deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1950

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Available	Not Available	$200,000
1999–01 Revenue Impact:	Not Available	Not Available	$200,000

DESCRIPTION: Publishers of periodicals are permitted to deduct from corporation and personal taxable income expenditures to establish, maintain, or to increase circulation in the year that the expenditures are made. Normally, those expenses pertaining to establishing and developing circulation would have to be capitalized. The tax expenditure is the difference between the current deduction of costs and the recovery that would have been allowed if these expenses were capitalized and deducted over time.

PURPOSE: To reduce the cost of tax compliance by eliminating the problem of distinguishing between expenditures to maintain circulation and those to establish or develop circulation.

WHO BENEFITS: Publishers of periodicals

EVALUATION: According to the Congressional Research Service, this expenditure greatly simplifies tax compliance for magazine publishers and is unlikely to adversely affect economic behavior. [*Evaluated by the Department of Revenue.*]

1.084 NET OPERATING LOSS LIMITATION

Internal Revenue Code Section: 381(l)(5)
Oregon Statute: 317.013 (Connection to federal corporation taxable income)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1954

	Corporation	Personal	Total
1997–99 Revenue Impact:	$2,300,000	Not Applicable	$2,300,000
1999–01 Revenue Impact:	$2,300,000	Not Applicable	$2,300,000

DESCRIPTION: Under federal tax law, when one corporation acquires another, the acquiring corporation inherits the tax situation of the acquired corporation, including net operating loss carryovers. Limitations are imposed, however, so that the acquiring corporation cannot write off losses faster than the acquired corporation would have. The limitations were imposed to avoid abuses. When the acquired corporation is in bankruptcy, however, the limitations do not apply. The favorable tax treatment in this departure from the limitations is a tax expenditure.

PURPOSE: To allow creditors of a bankrupt corporation that is acquired by another corporation to recover some of their losses through faster write-off of the bankrupt corporation's losses against the acquiring corporation's income.

WHO BENEFITS: Creditors of bankrupt corporations that are acquired by other corporations.

EVALUATION: According to the Congressional Research Service, the rationale for the provision is reasonable, but the exception is not structured to be fully consistent with the rationale. There is no test to determine what portion, if any, of the preacquisition net operating loss carryforwards was borne by creditors who became shareholders. [*Evaluated by the Department of Revenue.*]

1.085 COMPLETED CONTRACT RULES

Internal Revenue Code Section: 460
Oregon Statute: 316.695 and 317.013 (Connections to federal personal and corporation taxable deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1986

	Corporation	Personal	Total
1997–99 Revenue Impact:	$900,000	$100,000	$1,000,000
1999–01 Revenue Impact:	$900,000	$100,000	$1,000,000

DESCRIPTION: Some taxpayers with construction or manufacturing contracts extending for more than one tax year are allowed to use the "completed contract" method of accounting rather than normal accounting rules. Under this method, income and costs pertaining to the contract are reported when the contract is completed; however, several indirect costs may be deducted from corporation and personal taxable income in the year paid or incurred. This mismatching of income and expenses results in a deferral of tax payments.

PURPOSE: The original purpose was that long-term contracts involved so many uncertainties that profit or loss could not be determined until the contract was complete.

WHO BENEFITS: Construction and manufacturing companies.

EVALUATION: According to the Congressional Research Service, the principal justification for the completed contract method of accounting has always been the uncertainty of the outcome of long-term contracts, an argument that lost a lot of its force when applied to contracts in which the Government bore most of the risk. It was also noted that even large construction companies, who used the method for tax reporting, were seldom so uncertain of the outcome of their contracts that they used it for their own books; their financial statements were almost always presented on a strict accrual accounting basis comparable to other businesses.

Since the use of completed contract rules is now restricted to a very small segment of the construction industry, it produces only small revenue losses for the government and probably has little economic impact in most areas. One area where it is still permitted, however, is in the construction of single-family homes, where it adds some tax advantage to an already heavily tax-favored sector. [*Evaluated by the Department of Revenue.*]

1.086 CASUALTY AND THEFT LOSSES

Internal Revenue Code Section: 165(c)(3)
Oregon Statute: 316.695 (Connection to federal deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1913

	Corporation	Personal	Total
1997–99 Revenue Impact:	Not Applicable	$1,300,000	$1,300,000
1999–01 Revenue Impact:	Not Applicable	$1,300,000	$1,300,000

DESCRIPTION: Taxpayers who itemize deductions may deduct from personal taxable income nonbusiness casualty and theft losses that are not reimbursed through insurance. Taxpayers may deduct only losses of more than $100 each, but only to the extent that the total of such losses exceed 10 percent of adjusted gross income (AGI).

PURPOSE: To reduce the tax burden for taxpayers who experience large casualty and theft losses.

WHO BENEFITS: Approximately 3,000 taxpayers claimed $36 million in casualty and theft losses that were not covered by insurance in 1996. The average deduction was $12,100. Usage of this deduction in 1995 and 1996 was significantly higher than in 1994 due to the floods.

EVALUATION: Critics have pointed out that when uninsured losses are deductible but insurance premiums are not, the income tax discriminates against those who carry insurance and favors those who do not. It similarly discriminates against people who take preventive measures to protect their property but cannot deduct their expenses. No distinction is made between loss items considered basic to maintaining the taxpayer's household and livelihood versus highly discretionary personal consumption. The taxpayer need not replace or repair the item in order to claim a deduction for an unreimbursed loss.

Up through the early 1980s, when tax rates were as high as 70 percent and the floor on the deduction was only $100, high income taxpayers could have a large fraction of their uninsured losses offset by lower income taxes, providing them reason not to purchase insurance. The imposition of the 10-percent-of-AGI floor effective in 1983, together with other changes in the tax code during the 1980s, substantially reduced the number of taxpayers claiming the deduction. (Congressional Research Service, p. 513) [*Evaluated by the Department of Revenue.*]

1.087 CHARITABLE CONTRIBUTIONS: OTHER

Internal Revenue Code Sections: 170 and 642(c)
Oregon Statutes: 316.695 and 317.013 (Connections to federal personal and corporation deductions)
Federal Law Sunset Date: None
Year Enacted in Federal Law: 1917 (personal) and 1935 (corporation)

	Corporation	Personal	Total
1997–99 Revenue Impact:	$5,100,000	$138,700,000	$143,800,000
1999–01 Revenue Impact:	$5,600,000	$150,100,000	$155,700,000

DESCRIPTION: Contributions to charitable, religious, and certain other nonprofit organizations are allowed as itemized deductions from personal taxable income of amounts up to 50 percent of adjusted gross income. Corporations can deduct from corporate taxable income contributions up to 10 percent of pre-tax income. Taxpayers who donate property may deduct the current market value of the property and do not need to pay tax on any capital gains realized on the property.

PURPOSE: To encourage donations to designated charitable organizations.

WHO BENEFITS: In 1996, nearly 425,000 Oregonians took a deduction for charitable contributions worth a total of nearly $944 million, of which $741 million went to charitable organizations not classified as education or health. The average total contribution was $2,200.

EVALUATION: Not Evaluated