

## Tax Expenditures

As discussed in greater detail in Note 19—Collections and Refunds of Federal Revenue, tax and other revenues reported reflect the effects of tax expenditures, which are special exclusions, exemptions, deductions, tax credits, preferential tax rates, and tax deferrals that allow individuals and businesses to reduce taxes they may otherwise owe.

Tax expenditures are estimated using data from previous years and the economic forecast from the FY 2023 Midsession Review. The largest tax expenditures in FY 2022 are the following (and see the table below):

- The exclusion from workers' taxable income of employers' contributions for health care, health insurance premiums, and premiums for long-term care insurance;
- The exclusion of contributions to and the earnings of employer defined benefit and defined contribution pension funds (minus pension benefits that are included in taxable income);
- Imputed rental income forms part of the total value of goods and services produced in a country. But unlike returns from other investments, the return on homeownership "imputed rent" is excluded from taxable income. In contrast, landlords must count as income the rent they receive, and renters may not deduct the rent they pay. A homeowner is effectively both landlord and renter, but the tax code treats homeowners the same as renters while ignoring their simultaneous role as their own landlords and exempting potential rent they would have paid themselves;
- Preferential tax rates on long-term capital gains; and
- Taxpayers who donate capital assets to charitable organizations can deduct the asset's current value without being taxed on any appreciation in value.

### Largest Income Tax Expenditures as of September 30, 2022

(In billions of dollars)

**2022**

|  |       |
|--|-------|
| Exclusion of employer contributions for medical insurance premiums & health care ..... | 224.5 |
| Defined benefit & defined contribution pension funds .....                             | 176.1 |
| Exclusion of net imputed rental income .....   | 129.0 |
| Preferential tax rates on long term capital gains .....                                | 112.1 |
| Deductibility of charitable contributions, other than education and health .....       | 55.5  |

Generally, identifying and measuring a tax expenditure requires defining a baseline tax system against which identified tax provisions are exceptions. The tax expenditures prepared for the Budget are estimated relative to a simplified comprehensive income tax, which defines income as the sum of consumption and the change in net wealth in a given period of time. Tax expenditure estimates do not necessarily equal the increase in federal revenues (or the change in the budget balance) that would result from repealing these special provisions, for the following reasons:

- Eliminating a tax expenditure may have incentive effects that alter economic behavior, which can affect the resulting magnitudes of the activity or of other tax provisions or government programs. For example, if capital gains were taxed at ordinary rates, capital gain realizations would be expected to decline, resulting in lower tax receipts. Such behavioral effects are not reflected in the estimates.
- Tax expenditures are interdependent even without incentive effects. Repeal of a tax expenditure provision can increase or decrease the tax revenue effect of other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase revenue costs from other deductions as some taxpayers move into higher tax brackets. Alternatively, an itemized deduction repeal could lower the revenue foregone from other deductions if taxpayers choose to claim the standard deduction over itemizing. Similarly, if two provisions were repealed simultaneously, the tax liability increase could be greater or less than the sum of the two separate tax expenditures, because each is estimated assuming that the other remains in force.
- Repeal effects may depend on concurrent tax rate changes. Lowering or raising tax rates can decrease or increase the estimated revenues from a particular provision. A \$10,000 charitable contributions deduction is worth \$3,500 in corporate tax revenues at a 35.0 percent tax rate, but only \$2,100 at a 21.0 percent tax rate.

A more comprehensive ranking, including rankings over a 10-year period, and descriptions of tax expenditures can be found at the following location from Treasury's Office of Tax Policy: <https://home.treasury.gov/policy-issues/tax-policy/tax-expenditures>.

## Unmatched Transactions and Balances

| <b>Unmatched Transactions and Balances as of September 30, 2022, and 2021</b> |                  |                  |
|---|------------------|------------------|
| (In millions of dollars)  | <b>2022</b>      | <b>2021</b>      |
| <b>Statement of Operations and Changes in Net Position:</b>                   |                  |                  |
| Custodial transfers non-exchange .....  | -                | (532.4)          |
| Benefit program revenue/cost.....   | 309.6            | 651.5            |
| Non-reciprocating .....   | (1,987.2)        | (3,761.3)        |
| Custodial and non-entity collections transferred out/in.....                  | 586.8            | 629.5            |
| Accrual amounts collected/transferred in.....                                 | (83.9)           | (209.4)          |
| Other .....   | 1,000.9          | 3,057.0          |
|   | <u>(173.8)</u>   | <u>(165.1)</u>   |
| <b>Balance Sheet:</b>   |                  |                  |
| Accounts payable/receivable .....   | 270.2            | 556.3            |
| Advances from/to others & deferred credits/prepayments.....                   | (778.8)          | (898.3)          |
| Non-reciprocating .....   | (205.6)          | (320.2)          |
| Fund balance with Treasury .....  | -                | (899.2)          |
| Other .....   | (576.4)          | (116.1)          |
|   | <u>(1,290.6)</u> | <u>(1,677.5)</u> |
| Unmatched transactions and balances, net.....                                 | <u>(1,464.4)</u> | <u>(1,842.6)</u> |
| ( ) Parentheses indicate a decrease to Net Position.                          |                  |                  |

The unmatched transactions and balances are needed to balance the accrual-based financial statements. Both the Statement of Operations and Changes in Net Position and the Balance Sheet include a line for the unmatched transactions and balances, while the unmatched transactions and balances are recorded in existing lines in the Statement of Net Cost, and thus, are not reported in the table above. Transactions and balances between federal entities must be eliminated in consolidation to calculate the financial position of the government. The amounts included in the table represent intra-governmental activity and balances that differed between federal entity trading partners and often totaled significantly more in the absolute than the net amounts shown. The table also reflects other consolidating adjustments and other adjustments that contributed to the unmatched transactions and balances amount. A number of lines in the "Unmatched Transactions and Balances" table were adjusted to zero after intra-governmental difference analysis determined they were immaterial at or below \$0.1 billion, and thus, are not reported in the table above. The adjustments were added to, or subtracted from, gross cost in the Statement of Net Cost in the year they were recorded. Unresolved intra-governmental differences (i.e., unmatched transactions and balances) result in errors in the consolidated financial statements.

Unmatched transactions and balances between federal entities impact not only in the period in which differences originate but also in the periods where differences are resolved. As a result, it would not be proper to conclude that increases or decreases in the unmatched amounts shown in the "Unmatched Transactions and Balances" table reflect improvements or deteriorations in the government's ability to resolve intra-governmental transactions. The federal community considers the identification and accurate reporting of intra-governmental activity a priority.

The unmatched transactions and balances, net reflects the combined impact that each statement line has on the overall net position of the *Financial Report*.