

**INDIANA TAX EXPENDITURE STUDY
INDIVIDUAL INCOME TAX DEDUCTIONS AND
EXEMPTIONS
TAX YEARS 2005, 2006, AND 2007**

**INDIANA STATE BUDGET AGENCY
TAX AND REVENUE DIVISION
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Income tax deductions and exemptions exclude specified amounts of income from taxation. Exemptions are generally broad-based such as an exemption from taxation of the first \$1,000 of every taxpayer's income while deductions are more narrowly applied such as a deduction of a specified amount available to taxpayers undertaking a particular economic activity. Deductions and exemptions reduce tax receipts from what they otherwise would be thereby reducing funding available for other government programs and services or foregoing an opportunity for a more broad-based tax decrease. Within that context, providing a deduction or exemption is analogous to direct spending by a governmental entity and for that reason is often described as a tax expenditure. Unlike direct expenditures, however, tax expenditures are generally not subject to budgeting and appropriation processes. Nor, are tax expenditures generally subject to regular reviews for efficiency and efficacy.

Working under a confidentiality agreement with the Indiana Department of Revenue, the Indiana State Budget Agency has access for research purposes to tax return data that have been cleaned of information that could be used to identify a particular taxpayer. Using this data, the Budget Agency quantified the reductions in state income tax liabilities resulting from the deductions and exemptions available in tax years 2005, 2006 and 2007 by simulating their elimination. The dynamic interactions between a particular deduction or exemption and all of the other deductions and exemptions were captured by recalculating each tax return as though that deduction or exemption did not exist.

For tax year 2007, twenty-five deductions and exemptions were available to individuals with income subject to taxation by the State of Indiana. These deductions and exemptions reduced tax liabilities by a total of \$589.1M, or 12.6% of total individual income tax collections, for that year. This report provides detailed information on those reductions along with comparable information for tax years 2005 and 2006. A future report will quantify the tax reductions resulting from income tax credits available to Indiana income taxpayers in tax years 2005, 2006 and 2007.