Periodic "tax expenditure" reviews by other states

(Excerpts from multiple emails from Richard Cram, Kansas Department of Revenue)

Email/Listserv request sent to other states:

We have been asked by our legislature to identify any state legislatures that conduct (or require some other entity/agency to conduct) regular periodic reviews of current sales tax exemptions and income tax credits, including studies of whether the exemptions/credits are justified and accomplish their intended purposes (as opposed to conducting such reviews on an ad hoc basis). If your state legislature has such a regular periodic review procedure in place, I would appreciate a description of, or any other information you may have on that review process.

Arizona

In Arizona, on or before November 15 of each year issue a written report to the governor and legislature detailing the approximate costs in lost revenue for all state tax expenditures in effect at the time of the report.

For the purpose of this paragraph, "tax expenditure" means any tax provision in state law which exempts, in whole or in part, any persons, income, goods, services or property from the impact of established taxes including deductions, subtractions, exclusions, exemptions, allowances and credits.

Also in Arizona, there is a Legislative income tax credit review committee:

The committee shall determine the original purpose of existing tax credits and establish a standard for evaluating and measuring the success or failure of the tax credits. The standard for evaluating tax credits may include:

1. The history, rationale and estimated revenue impact of the credit.

2. Whether the credit has provided a benefit to this state including, for corporate tax credits, measurable economic development, new investments, creation of new jobs or retention of existing jobs in this state.

3. Whether the credit is unnecessarily complex in the application, administration and approval process.

C. The committee shall review the individual and corporate income tax credits pursuant to the schedule prescribed in section 43-222. The committee shall use the joint legislative budget committee staff and may use the staff of the department of revenue and legislative council for assistance.

Special Committee on Taxation
Date: 12-9-15
Attachment: 1

D. After completing the review process, the committee shall determine whether the credit should be amended, repealed or retained. If the credit is recommended to be retained or amended, the committee shall recommend that the credit be returned to the income tax credit review schedule prescribed in section 43-222. The next review year shall be the fifth full calendar year following the date the credit was reviewed. The committee shall report its findings and recommendations to the president of the senate, the speaker of the house of representatives and the governor by December 15 of the year that the committee reviews the credit. The committee shall provide a copy of the report to the director of the Arizona state library, archives and public records.

Washington

Washington State law currently requires the Department of Revenue to produce a Tax Exemption Study every four years (during some periods of time we were required to produce the study more frequently). The first study was due in January 1984 and we are in the process of completing our thirteenth study that will be due to our Legislature in January 2016. This study is statutorily required (RCW 43.06.400).

These studies are posted on our website at: Tax Exemption Studies.

We do not include analysis of whether the exemptions are justified or meet their intended purpose. However, legislation was passed in 2006 to create a Citizen Commission for Performance Measurement of Tax Preferences (RCW 43.136). This statute calls for review of tax preferences by staff of the Joint Legislative Audit and Review Committee. Their reviews can be found on the Citizen Commission website at: Reports.

Indiana

The Indiana General Assembly website publishes the annual tax incentive review that Indiana conducts by statute.

It provides a detailed description of their statutes and tax incentive evaluation process (which runs on a five-year cycle). (See attached excerpt from Indiana 2015 report)

California

The California Department of Finance is required by statute (California Government Code Section 13305) to produce a tax expenditure report providing information on every tax expenditure expected to cost over $5 million annually. This requirement has been in statute since 1971. The report covers tax expenditures in personal income tax, corporation tax, sales and use tax, fuel taxes, and property taxes. Additionally, as with New Mexico, most California tax breaks that have been adopted in the last 10 years or so have included sunset provisions. Thus, there is some level of review if the tax expenditure is to be extended. California's two major tax agencies, the Franchise Tax

Board and the Board of Equalization, also produce tax expenditure estimates and the Legislative Analyst's Office does occasional review of specified tax expenditures.

Illinois

Illinois has no requirements to periodically review income tax credits.

Iowa

In Iowa, a legislative committee was created in 2010 with the charge of reviewing all tax expenditures to assess its equity, public purpose and conformance with enacting legislation, with a minimum requirement to review all tax credits over a five year cycle.

The Iowa Department of Revenue, in a supporting role, produces evaluation studies on those tax credits on the same cycle and presents that information to the committee each fall (we just completed seven presentations today).

The Iowa Department of Revenue also completes a tax expenditure study every five years. This is not mandated, but is of high interest. I believe legislators would prefer we complete it more often than every five years, with particular interest in the sales tax expenditures.

Massachusetts

A few years ago Massachusetts legislature set up a commission to study our tax expenditures and make recommendation to Governor and legislature. The final report recommended such periodic reviews; there have been proposals to do just that but they did not go anywhere.

Michigan

No review in Michigan. We have long published an annual review of tax expenditures that describes the credits, deductions and exemptions against the various state and local taxes and attempts to estimate the budgetary impact. No attempt is made to gauge the effectiveness of any of the provisions.

Minnesota

In Minnesota we are required to produce a tax expenditure report every two years that contains estimates for each of the provisions. We do not do an evaluation of whether the provisions are justified and accomplish their purpose.

Nebraska

Each even year, we are required to produce a tax expenditure report that estimates the values of all tax expenditures in force for all tax programs.

In the reports, we do not comment on whether the tax expenditures fulfill the Legislature's intent or whether they are justified.

We have been publishing tax expenditure reports since 1979. Starting this year and following odd years, we are required to review a portion of the sales tax expenditures, compile them in an interim report, and present them to a joint hearing of the Revenue and Appropriations Committees. The Legislature itself only conducts ad hoc reviews of the tax code.

New Mexico

In 2011 Governor Martinez required TRD to annually compile a tax expenditure report that sets forth the fiscal impact and evaluation of exemptions, deductions, credits, and rate differentials across multiple tax programs. While not legislatively mandated, the report serves the function you addressed.

Ohio

We do a tax expenditure report as part of our biennial budget. This attempts to estimate the direct impact on the tax expenditure (for those taxes that are deposited into our general revenue fund). This is statutory.
What we have attempted is to require a review by a joint legislative/administration committee to recommend to keep/repeal/modify by a schedule. That is what was stripped out in our last budget.

Oklahoma

2 new laws in Oklahoma.

1. The Incentive Evaluation Act (62 O.S. §§ 7001 – 7005) created the Incentive Evaluation Commission charged with ensuring that state incentives are evaluated at least once during every four-year period, establish evaluation criteria and provide a timeline for implementation. Went into effect November 1, 2015.

2. Under 46A O.S. § 62, any economic incentive provision enacted after January 1, 2016 is required to include a measurable goal or goals. In this measure "incentive" is defined as any provision available to a business entity in the form of a credit, exemption, deduction or rebate pertaining to a state tax liability of any kind; any grant, loan or financing program offered by the state or a state-beneficiary public trust; or any program for incentive payments from the state. This goes into effect January 1, 2016.

Oregon

For Oregon, the 1995 Budget Accountability Act requires the governor, with the assistance of the Department of Revenue and the Department of Administrative Services, to produce a tax expenditure report every biennium, along with the Governor's

Recommended Budget. The report was first prepared in 1996 for the 1997-99 biennium and the most recent report for the 2015-17 biennium, describing 372 tax expenditures (e.g. deductions, credits, exemptions, etc.) in 15 tax programs.

Additionally, the 2013 Oregon Legislature passed HB 2002 which organized only the tax credits into three groups based on policy goals and put sunsets on all but three of the credits. The three groups were given sunsets dates of January 1 in 2012, 2014, and 2016, so that a comprehensive review of the tax credits could occur during the legislative session before the scheduled sunset dates. The first group of tax credits were reviewed during the 2011 legislative session. Subsequently, the 2013 Oregon Legislature passed HB 2002, requiring a detailed report on sunsetting tax credits.

West Virginia

Per WV Code 11-10-5s - c) - Beginning on January 15, 1992, and every January 15 thereafter, the Governor shall submit to the President of the Senate and the Speaker of the House of Delegates a tax expenditure report. This report shall expressly identify all tax expenditures. Within three-year cycles, the reports shall be considered together to analyze all tax expenditures by describing the annual revenue loss and benefits of the tax expenditure based upon information available to the Tax Commissioner. For purposes of this section, the term "tax expenditure" means a provision in the tax laws administered under this article including, but not limited to, exclusions, deductions, tax preferences, credits and deferrals designed to encourage certain kinds of activities or to aid taxpayers in special circumstances.

The Tax Commissioner shall promulgate rules setting forth the procedure by which he or she will compile the reports and setting forth a priority for the order in which the reports will be compiled according to type of tax expenditure.

South Dakota

South Dakota does not do periodic reviews of this nature.

Wisconsin

The Wisconsin Department of Revenue is required to publish a report on all 'tax-exemption devices" every other year. It is presented to the state legislature and gives the cost and a summary of all tax credits and exemptions. This has been in place since 1975; the 21st edition was released this year in February.

Richard observes:

You will see several states require a "tax expenditure report" to be done annually, and the Kansas Department of Revenue does this currently (although I don't believe it is statutorily required), publishing annually on our website our Tax Expenditure Report.

Introduction

A tax incentive is a provision of the tax code aimed at encouraging a taxpayer to conduct specified activities or undertake certain behavior by reducing the taxpayer's tax liability in relation to the targeted activity or behavior. Over the course of the last 30 to 40 years tax incentives have become a significant and growing part of local tax laws, state tax codes, and the federal Internal Revenue Code. At the forefront of this expansion in tax incentive use has been the growth in the number and scale of economic development tax incentives tied to business employment, wages, and investment. In contrast to direct spending programs, tax incentive programs direct public funding to certain purposes by foregoing tax revenue. Moreover, tax incentive programs are different than direct spending programs because tax incentives typically are not subject to the periodic scrutiny that direct spending programs are subject to through the normal budgetary process. During this 30-to-40 year period a robust literature has also developed examining these tax policies (Abravanel, Pindus, & Theodos, 2010). This literature comprises the following:

- Surveys of business leaders relating to the impact of state and local taxes on business location decisions.
- Econometric research examining the link between state and local tax levels and business locations, business investment, gross state product, and the like.
- Econometric research examining the effectiveness of specific tax incentives (such as investment tax credits) on capital investment, employment, and wages.
- Econometric and other research examining the effectiveness of incentive programs like enterprise zones, tax increment financing, and the like.

The 2012 report *Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth* by the PEW Center for the States suggested that at the time only about one fourth of the states did intensive tax incentive analysis, while another one fourth of the states examined incentives to a lesser extent with mixed results. The report suggested that half the states essentially take little or no action to examine tax incentives. PEW (2015) suggests that "[s]tate leaders need better information to avoid unexpected budget challenges, identify effective incentives, and reform or end programs that are not meeting expectations."

Responding to these circumstances, a number of states have recently initiated tax incentive review processes to examine the usage, effectiveness, and economic impacts of tax incentives. PEW (2015) has been instrumental in helping to initiate and support these state efforts as a part of its Business Incentives Initiative. The purposes of this initiative include the identification of effective ways to assess tax incentive policies, the improvement of state data collection and reporting on tax incentives, and the development of best practices for states relating to data collection and reporting on tax incentives. PEW (2015) reports that 17 states and the District of Columbia have enacted laws since 2012 either establishing regular evaluation of tax incentives or making improvements to existing tax incentive evaluation processes. Indiana is one of these states.

Tax incentives have been examined in Indiana prior to the current program. Indiana initiated a review of state tax credits, including many incentives, under HEA 1072-2012. This act required the Commission on State Tax and Financing Policy to conduct a study of all income tax credits during the 2012 and 2013 legislative interims.

The Commission held two hearings during the 2012 interim and one hearing during the 2013 interim to receive tax credit reviews prepared by the Office of Fiscal and Management Analysis, Legislative Services Agency.

HEA 1020-2014 established the current tax incentive review process, which was modified by HEA 1142-2015. The first tax incentive review under the current program was published in 2014. The tax incentives reviewed in 2014 were: (1) the home insulation deduction, (2) the solar-powered roof vent/fan installation deduction, and (3) the Indiana Partnership long-term care insurance premiums deduction.

Tax Incentive Review Process

IC 2-5-3.2-1 establishes an annual review, analysis, and evaluation process for state and local tax incentives. Appendix 1 contains the text of IC 2-5-3.2-1. The tax incentive review is conducted by the Office of Fiscal and Management Analysis, Legislative Services Agency. The annual tax incentive review is to be conducted over a five-year cycle with each tax incentive being reviewed at least one time during that review cycle. The statute requires the Legislative Services Agency to develop and publish a multi-year review schedule specifying the year in which each tax incentive will be reviewed.

The five-year review cycle must be conducted twice. The first five-year review cycle began during the 2014 legislative interim and will be completed with the tax incentive review conducted during the 2018 interim.

The statute requires the Legislative Services Agency to submit a report containing the results of the annual tax incentive review to the Legislative Council and the Interim Study Committee on Fiscal Policy. The report must be submitted before October 1 each year. The statute requires the Committee to hold at least one public hearing between September 30 and November 1 at which the Legislative Services Agency presents its report and the Committee receives information concerning tax incentives. In addition, the Committee is required to submit to the Legislative Council its recommendations relating to the tax incentive review. The statute requires the General Assembly to use the Legislative Services Agency's report and the Committee's recommendations to determine whether a tax incentive (1) is successful; (2) is provided at a cost that can be accommodated by the state's biennial budget; and (3) should be continued, amended, or repealed.

Tax Provisions to be Included in the Tax Incentive Review

IC 2-5-3.2-1 defines a tax incentive as a benefit provided through a state or local tax that is intended to alter, reward, or subsidize a particular action or behavior by the tax incentive recipient, including a tax incentive providing a benefit intended to encourage economic development.

A tax incentive includes an exemption, deduction, credit, preferential rate, or other tax benefit that reduces a taxpayer's state or local tax liability or results in a tax refund. A tax incentive also includes a program where revenue is dedicated by a political subdivision to pay for improvements in an economic or sports development area, a community revitalization area, an enterprise zone, a tax increment financing district, or a similar area or district.

Tax Incentive Review Purposes and Approaches

IC 2-5-3.2-1 essentially specifies that the purpose of the annual tax incentive review is to (1) ensure tax incentives accomplish the purposes for which they were enacted; (2) include the cost of tax incentives in the biennial budgeting process; and (3) provide information needed by the General Assembly to make policy choices about the efficacy of tax incentives. IC 2-5-3.2-1 lists a variety of descriptive and analytical information that could accomplish these tax incentive review goals. This information is as follows:

- The attributes and policy goals of the tax incentive.
- The tax incentive's equity, simplicity, competitiveness, public purpose, adequacy, and conformance with the purposes of the legislation enacting the incentive.
- The activities the tax incentive is intended to promote and the effectiveness of the tax incentive in promoting those activities.
- The number of taxpayers applying for, qualifying for, or claiming the tax incentive, and the tax incentive amounts (in dollars) claimed by taxpayers.
- The tax incentive amounts (in dollars) claimed over time.
- The tax incentive amounts (in dollars) claimed by industry sector.
- The amount of income tax credits that could be carried forward for the ensuing five-year period.
- An estimate of the economic impact of the tax incentive, including a return on investment calculation, cost-benefit analysis, and direct employment impact estimate.
- The estimated state cost of administering the tax incentive.
- The methodology and assumptions of the tax incentive review, analysis, and evaluation.
- The estimated leakage of tax incentive benefits out of Indiana.
- Whether the tax incentive could be made more effective through legislative changes.
- Whether measuring the economic impact of the tax incentive is limited due to data constraints and whether legislative changes could facilitate data collection and improve the review, analysis, or evaluation.
- An estimate of the indirect economic activity stimulated by the tax incentive.

Tax Incentive Review Report

IC 2-5-3.2-1 requires the Legislative Services Agency to submit a report containing the results of the annual tax incentive review to the Legislative Council and the Interim Study Committee on Fiscal Policy. The report must be submitted before October 1 each year.
The report must include at least the following:

- A detailed description of the review, analysis, and evaluation for each tax incentive reviewed.
- Information to be used by the General Assembly to determine whether a reviewed tax incentive should be continued, modified, or terminated, the basis for the recommendation, and the expected impact of the recommendation on the state's economy.
- Information to be used by the General Assembly to better align a reviewed tax incentive with the original intent of the legislation that enacted the tax incentive

Tax Incentive Review Schedule

Table 1 specifies the tax incentives and incentive programs reviewed during the 2015 interim. The remaining schedule for 2016 to 2018 is specified in Table 2 at the end of this section. A total of 55 tax incentives and 6 incentive programs were scheduled for review from 2015 to 2018, and 3 incentives were evaluated in 2014. The tax incentives included on the review schedule are associated with the corporate income tax and individual income tax (27 tax incentives), the property tax (21 tax incentives), the sales tax (6 tax incentives), and other taxes (1 tax incentive). The 6 incentive programs are tax increment financing (TIF), enterprise zones (EZs), community revitalization enhancement districts (CREDs), professional sports development areas (PSDAs), certified technology parks (CTPs), and the motor sports development district. Appendix 2 contains a list of tax incentives and incentive programs on the review schedule, including descriptions.

Table 1: Tax Incentives and Incentive Programs Scheduled for Review in 2015

Tax	Tax Provision
Corporate Income Tax (C) / Individual Income Tax (I)	• Earned Income Tax Credit (I) • Historic Rehabilitation Credit (C)(I) • Indiana Colleges and Universities Contribution Credit (C)(I) • Indiana 529 College Savings Account Contribution Credit (I) • Individual Development Account Credit (C)(I) • Neighborhood Assistance Credit (C)(I) • Residential Historic Rehabilitation Credit (I) • School Scholarship Contribution Credit (C)(I) • 21st Century Scholars Program Credit (C)(I)
Property Tax	• Low-Income Housing Exemption • Low-Income Residence Exemption • Rehabilitated Property Deduction • Rehabilitated Residential Property Deduction
Other	• Tax Increment Financing

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Table 2: Tax Incentives and Incentive Programs Scheduled for Review from 2016 through 2018

Tax	Tax Provision
2016	
Corporate Income Tax (C)/ Individual Income Tax (I)	• Community Revitalization Enhancement District Credit (C)(I) • Community Revitalization Enhancement District Local Credit (I) • Enterprise Zone Employment Expense Credit (C)(I) • Enterprise Zone Investment Cost Credit (C)(I) • Enterprise Zone Loan Interest Credit (C)(I) • Industrial Recovery Credit (C)(I)
Property Tax	• Enterprise Zone Investment Deduction • Enterprise Zone Obsolescence Deduction (Marion County)
Other	• Community Revitalization Enhancement Districts • Enterprise Zones
2017	
Corporate Income Tax (C)/ Individual Income Tax (I)	• Economic Development for a Growing Economy (EDGE) Credit (C)(I) • Headquarters Relocation Credit (C)(I) • Hoosier Business Investment Credit (C)(I) • Patent-Derived Income Deduction (C)(I) • Research Expense Credit (C)(I) • Special Rate for Income Derived Inside a Military Base (C) • Venture Capital Investment Credit (C)(I)
Property Tax	• Certified Technology Park Deduction • Economic Revitalization Area Personal Property Tax Abatement • Economic Revitalization Area Real Property Tax Abatement • Infrastructure Development Zone Deduction • Marine Opportunity District Deduction
Sales Tax	• Research and Development Property
Other	• Certified Technology Park • Professional Sports Development Areas

Tax	Tax Provision
2018	
Corporate Income Tax (C)/ Individual Income Tax (I)	• Adoption Tax Credit (Effective 2015) (I) • Alternative Fuel Vehicle Manufacturing Investment Credit (C)(I) • Coal Gasification Technology Investment Credit (C)(I) • Natural Gas-Powered Vehicles (C)(I)
Property Tax	• Aircraft Deduction • Brownfields Revitalization Zone Deduction • Coal Combustion Product Deduction • Deduction for Purchases of Investment Property by Manufacturers of Recycled Components • Geothermal Energy Heating or Cooling Device Deduction • Hydroelectric Power Device Deduction • Intrastate Aircraft Deduction • Resource Recovery/Coal or Oil Shale System Deduction • Solar-Energy Systems Deduction • Wind-Powered Devices Deduction
Sales Tax	• Aircraft Parts • Aviation Fuel • Cargo Trailers/RVs Sold to Certain Nonresidents • Certain Aircraft • Certain Racing Equipment
Other	• Motorsports Investment District • Promotional Free-Play Deduction