



## Five Steps Toward a Better Tax Expenditure Debate

Almost without exception, state lawmakers do not closely scrutinize special tax credits, exemptions, and other “tax expenditures” on a regular basis.<sup>1</sup> A recent report by the Pew Center on the States found, for example, that half the states have done nothing even remotely rigorous in the last five years to determine if even a single one of their economic development tax incentives is working.<sup>2</sup> Pew also found that “no state regularly and rigorously tests whether [tax incentives] are working and ensures lawmakers consider this information when deciding whether to use them, how much to spend, and who should get them.” While the Pew study didn’t look at tax breaks created for purposes other than economic development, there is little doubt that other tax breaks are flying just as far below the radar.

Fortunately, there are straightforward steps that states can take to remedy this problem, and a growing number of states have begun to take those steps in recent years. In particular, the five recommendations described below require evidence-based reviews of tax expenditures designed to gauge their success, and include reforms that encourage lawmakers to take those reviews seriously.<sup>3</sup> In brief, those recommendations include:

**Step #1:** Tax expenditure laws must include a specific explanation of what the expenditure is intended to achieve.

**Step #2:** Non-partisan analysts must regularly evaluate tax expenditures based on how successful they have been in achieving their objectives, and must offer lawmakers recommendations for reform.

**Step #3:** Tax expenditures must be scheduled to expire after a specific period of time, so that lawmakers can vote on the expenditure again in light of new evidence of its success, or lack thereof.

**Step #4:** The Governor’s budget must include specific recommendations related to any tax expenditure that has been recently evaluated under Step #2.

**Step #5:** The tax-writing committees of the legislature must hold hearings on any tax expenditure that has been recently evaluated under Step #2.

The success of these recommendations in improving a state’s tax policies depends on analysts having the resources needed to conduct rigorous reviews, and on lawmakers having a genuine interest in using those reviews to inform their deliberations. If those two conditions are met, these recommendations have the potential to greatly enhance the quality of information surrounding tax expenditures, and to pave the way for meaningful tax reform.

<sup>1</sup> An explanation of “tax expenditures” can be found in: Institute on Taxation and Economic Policy, “Tax Expenditures: Spending By Another Name,” (2011).

<sup>2</sup> Pew Center on the States, “Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth,” (2012).

<sup>3</sup> This recommendation builds on: Citizens for Tax Justice, “How to Enact (and Maintain) Tax Reform,” (2010).

Each of these five recommendations has been at least partially implemented in two or more states, and has been proposed by lawmakers in many more states. Six states have adopted one of the recommendations described below (Colorado, Connecticut, Iowa, Minnesota, New Mexico, and New York), while seven more states have implemented, or will soon implement, two or more of the recommendations (Arizona, Maryland, Nevada, Oregon, Vermont, Virginia, and Washington). No state has combined all five recommendations as of this writing, but each recommendation has the potential to be much more effective if enacted as a group rather than taken in isolation.

What follows is a listing of the five recommendations, along with citations of state laws and legislative proposals that have sought to implement each of those recommendations.

**STEP #1: Require that any bill creating, extending, or modifying a tax expenditure include a section stating the purpose and objectives of that tax expenditure, as well as measurable goals in cases where the objectives of the tax expenditure lend themselves to measurement.**

- Similar requirements have been **implemented** in five states:
  - (1) Arizona Revised Statutes 43-223. Applies only to new personal and corporate income tax credits.
  - (2) Colorado Revised Statutes 39-21-304. Applies to all new or renewed tax expenditures.
  - (3) Minnesota Statutes 3.192. Applies to all new or renewed tax expenditures.
  - (4) Nevada State Constitution: Article 10, Section 6. Applies only to new sales and property tax exemptions. *Approved by voters on November 4, 2008.*
  - (5) New Mexico Statutes 9-15-56. Applies only to new economic development tax incentives.
  
- Similar requirements have been formally **proposed** in at least six more states:
  - (1) Alaska: SB 29 (27th Legislature, Second Session, 2012).
  - (2) California:
    1. SB 508 (2011 legislative session). *Passed both legislative chambers, but vetoed by Governor.*
    2. SB 1272 (2010 legislative session). *Passed both legislative chambers, but vetoed by Governor.*
  - (3) Hawaii: SB 1197 (25th Legislature, 2009).
  - (4) Ohio:
    1. HB 590 (129th General Assembly, Regular Session, 2011-2012).
    2. HB 61 (126th General Assembly, Regular Session, 2005-2006).
  - (5) Rhode Island:
    1. H7724 (January Session, 2012).
    2. H5737 (January Session, 2011).
  - (6) Washington:
    1. HB 2762-S (62nd Legislature, 2012 Regular Session).
    2. SB 6088-S (62nd Legislature, 2012 Regular Session). *Passed Senate 45-3.*

**STEP #2: Require that all (or most) tax expenditures above a certain fiscal cost be evaluated by trained, non-partisan analysts at least every 5-10 years, and that the evaluations include specific recommendations regarding whether to continue, modify, or terminate each evaluated tax expenditure.<sup>4</sup> In the case of tax expenditures that are scheduled to expire, evaluations must be released in advance of the expenditure's scheduled expiration date in order to inform lawmakers' consideration of the expiring provision.**

- Requirements for *ongoing* expert evaluations have been **implemented** in two states:
  - (1) Connecticut General Statute 578-32-1r. Report only includes tax credits and abatements “enacted for the purpose of recruitment or retention of businesses.”
  - (2) Washington: RCW 43.136. Nearly all tax expenditures are evaluated in some way through a process involving both the Joint Legislative Audit and Review Committee (JLARC) and the Citizen Commission for Performance Measurement of Tax Preferences.
  
- Requirements for *ongoing* expert evaluations **exist, but have not been adequately implemented** in ten states:<sup>5</sup>
  - (1) Delaware Code, Title 29, §8305(6). Tax expenditure report is required to include evaluations of tax expenditures' effectiveness. But while the report includes some discussion of various tax expenditures' effects, it does not contain true evaluations.
  - (2) Louisiana Revised Statutes 47:1517. Tax expenditure report is required to include evaluations of tax expenditures' effectiveness, but this requirement has not been met.
  - (3) Maryland: SB 739 (2012 legislative session). First batch of professional evaluations must be released by October 31, 2013.
  - (4) Missouri Revised Statutes 620.1300. The state auditor has produced some high-quality evaluations of tax credits as required by law, but has been unable to meet the required schedule due to resource constraints.
  - (5) Nebraska Revised Statute 77-382. Tax expenditure report is required to include recommendations regarding the reform or repeal of tax expenditures, but this requirement has not been met.
  - (6) New Jersey Permanent Statute 52:27B-20a. Tax expenditure report is required to include evaluations of tax expenditures' effectiveness. But while the report includes some discussion of various tax expenditures' effects, it does not contain true evaluations.
  - (7) New Mexico:
    1. Executive Order 2011-071. Tax expenditure report is required to include evaluations of whether the intended purposes of tax expenditures are being achieved, but the 2012 report states that “the ability to analyze the specific benefits of the tax expenditures is largely beyond the scope of the analyses summarized in this Report, and will require a concerted, multi-agency effort.”<sup>6</sup>
    2. New Mexico Statutes 9-15-56. New economic development tax incentives must be evaluated every seven years based on measurable goals, but the Legislative Finance Committee reports that “there is no comprehensive and regular analysis by executive agencies charged with administering economic development incentive programs.”<sup>7</sup>

<sup>4</sup> The likelihood that high-quality evaluations will result from this requirement can be improved if lawmakers provide evaluators with specific criteria to consider in conducting those evaluations. Examples of such criteria can be found in Washington State (RCW 43.136), and in federal legislation proposed in 2009 (HR 4213, Sec. 622, 111th Congress, as passed by the House). Guidance regarding issues to be considered in evaluating economic development tax expenditures is also provided in Pew's *Evidence Counts* report.

<sup>5</sup> A Minnesota statute encourages, but does not require evaluations. Minnesota Statute Sec. 270C.11 says that the Commissioner of Revenue “may” analyze whether a tax expenditure is achieving its intended purpose.

<sup>6</sup> New Mexico Taxation and Revenue Department, “2012 New Mexico Tax Expenditure Report,” (2012).

<sup>7</sup> Legislative Finance Committee, “Economic Development Department and Taxation and Revenue Department Job Creation Incentives: The Job Training

- (8) Oklahoma §68-205.4. The Incentive Review Committee is a nine member panel appointed by the Governor and legislative leaders. The Committee's 2011 report says: "Additional resources are needed for the proper evaluation of tax incentives. Any agency charged with evaluating tax incentives will need resources for staff and research."
  - (9) Oregon Revised Statutes 291.203. Tax expenditure report is required to include evaluations of tax expenditures' effectiveness, but many discussions of effectiveness fall short of true evaluation, while other tax expenditures are not examined for effectiveness at all.
  - (10) Wisconsin Statute Sec. 16.425. Tax expenditure report is required to include evaluations of tax expenditures' effectiveness, but this requirement has not been met.
- Requirements for *ongoing* expert evaluations have been formally **proposed** in at least four more states:
    - (1) California:
      - 1. AB 1933 (2006 legislative session). *Passed Assembly 47-33.*
      - 2. AB 735 (2005 legislative session).
    - (2) Hawaii: SB 1197 (25th Legislature, 2009).
    - (3) Kentucky: HB 116 (2011 Regular Session).
    - (4) New York: SB 7347 (2010 legislative session).
  - Requirements for *one-time* expert evaluations of certain tax expenditures are fairly common, and are not included in the lists above.

**STEP #3: Require that all (or most) tax expenditures sunset every 5-10 years. Extensions of expiring tax expenditures can be for a period of no longer than 5-10 years.<sup>8</sup>**

- Systematic (though not comprehensive) sunset requirements have been **implemented** in three states:
  - (1) Nevada State Constitution: Article 10, Section 6. *Approved by voters on November 4, 2008.*
  - (2) Oregon: HB 2067 (75th Oregon Legislative Assembly, 2009 Regular Session)
  - (3) Virginia: § 30-19.1:11 (Chapter 265, 2012 session)
- Systematic (though not necessarily comprehensive) sunset requirements have been formally **proposed** in at least fourteen more states:
  - (1) Arizona:
    - 1. HB 2645 (2012, Second Regular Session).
    - 2. HB 2685 (2012, Second Regular Session).
  - (2) California:
    - 1. SB 508 (2011 legislative session). *Passed both legislative chambers, but vetoed by Governor.*
    - 2. SB 1272 (2010 legislative session). *Passed both legislative chambers, but vetoed by Governor.*
  - (3) Hawaii: SB 1197 (25th Legislature, 2009).
  - (4) Idaho: SB 1381 (60th Legislature, Second Regular Session, 2010). *Passed Senate 27-7-1.*
  - (5) Indiana: SB 344 (2012 Second Regular Session). *Bill was eventually amended to remove sunsets. See original bill as introduced.*

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Incentive Program, the Local Economic Development Act, and Select Economic Development Tax Expenditures," Report #12-08, (2012).

<sup>8</sup> This requirement can be crafted to sunset only those tax expenditures created, renewed, or modified after a certain date (as in Nevada and Virginia), or to also sunset some or all existing tax expenditures (as in Oregon). Tax expenditures required by the federal government (such as the income tax exemption for federal bond interest) should not be subject to sunset.

- (6) Kentucky: HB 116 (2011 Regular Session).
- (7) Maryland: SB 739 (2012 legislative session). *Bill was eventually amended to remove sunsets. See original bill as introduced.*
- (8) Missouri: SB 548 (2012 Regular Session).
- (9) Nebraska:
  1. LB 385 (101st Legislature, First Session, 2009).
  2. LB 386 (101st Legislature, First Session, 2009).
- (10) New Jersey: A 2007 (215th Legislature, 2012). *Passed Assembly 47-31.*
- (11) Ohio: HB 61 (126th General Assembly, Regular Session, 2005-2006).
- (12) Oklahoma: HB 2978 (2012 Regular Session).
- (13) Rhode Island:
  1. H7724 (January Session, 2012).
  2. H5737 (January Session, 2011).
- (14) Washington:
  1. HB 2762-S (62nd Legislature, 2012 Regular Session).
  2. SB 6088-S (62nd Legislature, 2012 Regular Session). *Passed Senate 45-3.*

**STEP #4: Require that the Governor’s budget submission include a section addressing the most recent set of evaluations completed under Step #2, and providing specific recommendations regarding whether to continue, modify, or terminate each evaluated tax expenditure. Where the Governor’s recommendation differs from that made under Step #2, the budget submission must provide the reasoning behind the Governor’s recommendation.**

- Budget document instructions related to tax expenditures have been implemented in at least four states:<sup>9</sup>
  - (1) New York: Executive Law Article 8, Section 181. The governor “shall” submit to the legislature a tax expenditure report containing “any recommendations of the governor regarding continuing, modifying, or repealing such tax expenditures ... [and] comment, if any, on the effectiveness and efficiency of other tax expenditures.”
  - (2) Oregon: ORS 291.214. The governor “shall ... identify each tax expenditure that has a full or partial sunset ... and shall prepare a recommendation ... that indicates the Governor’s opinion on whether the full or partial sunset of the tax expenditure should be allowed to take effect as scheduled or should be revised to a different date.”
  - (3) Vermont: 32 V.S.A. § 306. The governor “shall” submit a “tax expenditure budget which shall embody his or her estimates, requests, and recommendations” on tax expenditures falling into specific categories outlined in the law.
  - (4) Washington: RCW 43.06.400. The governor is “requested” to review the most recent tax expenditure report and “may” submit recommendations on the repeal or modification of any tax expenditure.
- Budget document instructions have been formally **proposed** in at least two more states:
  - (1) Alaska: SB 29 (27th Legislature, Second Session, 2012). The Governor is required to “consider” tax expenditures in preparing the budget.
  - (2) Washington: HB 1827 (60th Legislature, 2007 Regular Session). The Governor “shall” make recommendations on expiring tax expenditures.

<sup>9</sup> Some states require the Governor to include a tax expenditure report in his or her budget, but do not specifically urge the inclusion of policy recommendations or analysis related to tax expenditures. Included among those states are Michigan, Nebraska, New Jersey, Ohio, Pennsylvania, Tennessee, and Wisconsin.

**STEP #5: Require that the tax-writing committees in each legislative chamber hold public hearings following the release of the evaluations described under Step #2 in order to receive testimony regarding the evaluated tax expenditures.**

- Legislative process requirements have been **enacted or implemented** in seven states:
  - (1) Arizona Revised Statutes, Title 43, Chapter 2, Article 2.
  - (2) Iowa SF 2380 (83rd General Assembly, 2010).
  - (3) Maryland SB 739 (2012 legislative session). First legislative tax credit “Evaluation Committee” will be appointed by May 31, 2013.
  - (4) Oregon: There is no legal requirement for legislative review, but the “Joint Committee on Tax Credits” was formed to review the tax expenditures scheduled for sunset as a result of HB 2067 (75th Oregon Legislative Assembly, 2009 Regular Session).
  - (5) Vermont: 32 V.S.A. § 306. House and Senate tax committees must review the Governor’s tax expenditure recommendations and report their own recommendations in bill form.
  - (6) Virginia: § 30-51, sections 330 through 332 (Chapter 777, 2012 session).
  - (7) Washington: RCW 43.136.065
  
- Legislative process requirements have been formally **proposed** in at least four more states:
  - (1) California: AB 735 (2005 legislative session).
  - (2) Idaho: SB 1381 (60th Legislature, Second Regular Session, 2010). *Passed Senate 27-7-1.*
  - (3) Ohio:
    1. HB 590 (129th General Assembly, Regular Session, 2011-2012).
    2. HB 61 (126th General Assembly, Regular Session, 2005-2006).
  - (4) Rhode Island:
    1. H7723 (January Session, 2012).
    2. H7724 (January Session, 2012).
    3. H5737 (January Session, 2011).

**Conclusion**

The dozens of laws and bills cited above encompass a broad range of approaches to reform, both in terms of how many tax expenditures they would apply to, and how fundamentally they would change the process for reviewing and debating those tax expenditures. Interested readers have plenty of sources here at their disposal for investigating that range of options. But even a casual reading of the above list should be enough to show that there is widespread support for giving tax expenditures greater scrutiny on an ongoing basis, and that specific reforms exist for making this goal a reality. 🎯

## More Resources

For more information on tax expenditures, see the following reports and testimony from ITEP and its sister-organization, Citizens for Tax Justice (CTJ):

- **CTJ: How to Enact (and Maintain) Tax Reform:**  
<http://www.ctj.org/pdf/maintainingtaxreform.pdf>
- **ITEP: Tax Expenditures: Spending By Another Name:**  
<http://www.itep.org/pdf/pb4exp.pdf>
- **ITEP Testimony on HB 5737 before the Rhode Island House Finance Committee:**  
[http://www.itep.org/pdf/ri\\_te\\_testimony\\_0511.pdf](http://www.itep.org/pdf/ri_te_testimony_0511.pdf)
- **ITEP Testimony on SB 29 before the Alaska Senate State Affairs Committee:**  
[http://www.itep.org/pdf/AK%20Expenditure%20Testimony\\_3612.pdf](http://www.itep.org/pdf/AK%20Expenditure%20Testimony_3612.pdf)
- **CTJ: Judging Tax Expenditures:**  
<http://www.ctj.org/pdf/judgingtep1109.pdf>