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Other States Take Action on Tax Breaks

Opportunities for Sunsets, Caps, and Evaluation of Georgia's Tax Code Spending

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Summary

Tax exemptions and credits are enacted each year and, once in the tax code, remain there without evaluation or scrutiny. These tax preferences shrink the tax base and many reduce fairness by shifting the tax obligation onto other businesses and individuals who do not receive the exemption or cause lawmakers to reduce state services.

Georgia can follow models other states have used to scrutinize these tax breaks by:

- Putting sunsets on both existing and new tax preferences, with some exceptions.
- Staggering sunset dates to allow for more in-depth reviews.
- Enacting caps on the total size of certain tax credits.
- Creating a commission or working group to regularly review "sunsetting" tax breaks in order to inform legislative debates over their extension.

Georgia Needs to Take a Hard Look at Tax Breaks

The Georgia Budget and Policy Institute (GBPI) provided the following recommendations to the legislative-created Special Council on Tax Reform and Fairness for Georgians in August 2010 in its report, *Advancing Georgia's 1930s Tax System to the Modern Day*.

Lawmakers have been enacting new corporate exemptions and credits each year, however, once in the tax code, they remain there without evaluation or scrutiny. These tax preferences shrink the tax base and reduce fairness by shifting the tax obligation onto other businesses and individuals who do not receive the exemption or, alternatively, cause lawmakers to reduce state services. Although some of these tax preferences serve valid policy purposes, others likely are not producing the intended results.

The Special Council on Tax Reform and Fairness for Georgians' recommendations would increase fairness and protect adequacy by specifying that the state evaluate which exemptions and credits serve or do not serve the agreed upon public purposes before adding more tax breaks on top of the many existing tax breaks.

In addition, the Council could improve tax breaks management by recommending that lawmakers explicitly agree on how much Georgia is willing to spend on economic development through tax exemptions and credits. Currently, most exemptions and credits are allowed to grow without any limit on their size. By contrast, the size of programs such as QuickStart, technical colleges and universities, K-12 education, and the Department of Economic Development all are limited to the amount agreed upon through the appropriations process.

Also, the state's revenue stream could be made more adequate and efficient – key principles of effective tax reform – if the merits of new exemptions and credits are weighed against existing tax breaks, with discussion of whether less worthwhile tax preferences should be eliminated or replaced as a new exemption is added.

For example, one proposed exemption that has been a particular focus of the corporate community is the sales tax exemption on energy used in manufacturing, estimated to cost the state $80 million if enacted.[1] This is likely a worthwhile exemption due to the fact that raw materials are typically exempt from sales tax. However, because it is prudent to refrain from adding a new tax break in a vacuum and causing a loss in revenue without a corresponding gain, this new exemption could be offset by eliminating potentially outdated and inefficient tax breaks elsewhere in Georgia's tax code.

Other States Take Action

Sunsets

Oregon enacted legislation in 2009 to sunset most of its tax credits. The sunsets will affect different categories of credits in the coming years:

- Environment, business, and agriculture tax credits will sunset at the end of 2011.
- Education, housing, and community service tax credits sunset in 2013.
- Medical care, child care, and family tax credits sunset in 2015.

Some of these credits will likely be renewed because they serve valid policy purposes; however, the legislation will push lawmakers to evaluate credits and debate their effectiveness. It is unclear what review process will guide legislators since the legislation did not provide guidelines for evaluation. (Note: Oregon does not have a sales tax, thus the sunsets only apply to income tax credits.)

Other recent examples of states using or considering tax break sunsets are Nevada and Missouri. **Nevada** voters passed a constitutional amendment in 2008 requiring new sales and property tax exemptions to include a sunset date. Similarly, in November 2010, **Missouri**'s Tax Credit Review Commission recommended the elimination of 28 tax credits and sunsets for remaining credits according to a schedule:

- Two year sunset for banking and insurance tax credits.

- Four year sunset for economic development, agriculture, environment, and distressed communities tax credits.
- Six year sunset for historic preservation, low-income housing, and social/contribution tax credits.

Caps

Missouri's Tax Credit Review Commission proposed caps for tax credits, recommending:

> "where appropriate and feasible the General Assembly impose an annual cap on any tax credit program that currently lacks a statutory cap. Such an annual cap will limit the total amount of tax credits that may be authorized annually in order to achieve additional budget certainty for the State."

Prior to the Commission's recommendations Missouri lawmakers proposed two bills that would have subjected tax credits to the budget appropriations process. The bills failed to make it through the 2010 legislative session. The Commission considered those proposals but settled on caps and sunsets as an alternative to inserting tax credits into the appropriations process.

Iowa places caps on certain tax credits, and recently decided to lower many existing caps on credits after the state's Tax Credit Review Panel found that many credits were not living up to their intended purposes.

Evaluation

Coupling sunsets and caps with official, rigorous analyses of tax breaks has the potential to result in much more productive debates over these provisions. **Washington State** has perhaps the most robust tax break review system in the country. The legislature created the Citizen Commission for Performance Measurement of Tax Preferences in 2006, comprised of seven-members: the State Auditor, Chair of the Joint Legislative Audit and Review Committee, two members appointed by the House, two appointed by the Senate, and one appointed by the Governor.

The Commission creates a schedule to review tax breaks with the intent of reviewing the vast majority of tax breaks at least once every 10 years. Exceptions include smaller tax breaks, $10 million or less, and ones deemed to be a "critical part of the [tax] structure."[2] Examples of tax breaks that are *not* subject to review include:

- "tax preferences required by constitutional law;
- sales and use tax exemptions for machinery and equipment for manufacturing, research and development, or testing;
- the small business credit for the business and occupation tax;
- sales and use tax exemptions for food and prescription drugs;
- property tax relief for retired persons;
- and property tax valuations based on current use."[3]

The staff of the Joint Legislative Audit and Review Committee provides analysis of tax breaks for the Commission, and recommends to the Commission whether they should modify, continue, or eliminate certain tax preferences.

Maine's legislature asked several state agencies to study possible evaluation methods for tax breaks. The working group recommended that Maine adopt an evaluation and review process similar to Washington's commission. (The group's report includes discussion of evaluation practices by several states, and can be downloaded in the box below.)

Other states created permanent review committees, such as **Iowa**'s Legislative Tax Expenditure Committee, or have undertaken one-time studies of tax incentives, such as the **North Carolina** Joint Select Committee on Economic Development Incentives' evaluation of the effectiveness of corporate tax credits.

RESOURCES: Legislation and Reports

Sunsets

Oregon House Bill 2067, http://www.leg.state.or.us/09reg/measures/hb2000.dir/hb2067.en.html

Nevada Constitution, Article 10, Section 6, http://www.leg.state.nv.us/const/nvconst.html#Art10Sec6

Missouri Tax Credit Review Commission, http://tcrc.mo.gov/

Caps

Missouri Tax Credit Review Commission, http://tcrc.mo.gov/

Missouri Senate Bill 954, http://www.senate.mo.gov/10info/BTS_Web/Bill.aspx?SessionType=r&BillID=3324357

Iowa Senate File 2380, http://coolice.legis.state.ia.us/linc/SF2380_Enrolled.pdf

Evaluation

Washington State Commission for Performance Review of Tax Preferences, http://www.citizentaxpref.wa.gov/

Maine Working Group Report on Evaluation Practices, www.maine.gov/legis/ofpr/taxation_committee/materials/impact_tax_expenditure_programs.pdf

Iowa Senate File 2380, http://coolice.legis.state.ia.us/linc/SF2380_Enrolled.pdf

North Carolina's Joint Select Committee on Economic Development Incentives, http://www.ncleg.net/documentsites/committees/JSCEDI/Final%20Report.pdf

Additional Resources

GBPI, Advancing Georgia's 1930s Tax System to the Modern Day, http://www.gbpi.org/documents/20100825.pdf

Citizen's For Tax Justice, "How to Enact (and Maintain) Tax Reform" (includes procedural changes such as sunsets and caps), http://www.ctj.org/pdf/maintainingtaxreform.pdf

Conclusion

Sunsetting, capping, and evaluating tax breaks has the potential to make Georgia's tax system more adequate, fair, simple, economically neutral and transparent. As discussed in GBPI's *Advancing Georgia's 1930s Tax System to the Modern Day*, additional tax reform opportunities include:

- Lowering the state sales tax rate and simultaneously broadening the tax base to mirror 21st century spending habits.
- Modernizing income tax brackets, rates, and standard deductions to better reflect current income levels.
- Creating an earned income tax credit (EITC) to offset highly regressive sales taxes for the state's lowest earners.
- Closing corporate loopholes and updating the corporate net worth tax to prevent profitable corporations from avoiding paying their fair share.
- Updating cigarette and motor fuel excise tax rates.

These tax reform options stress a practical *combination* of raising enough money to meet Georgia's growing needs, updating the tax system to reflect today's economy, keeping rates as low as possible, and tying the system more closely to ability to pay than it is now. Georgia can make a number of changes that, when taken together, ensure the state can fairly raise adequate funds to pay for crucial public investments that expand opportunity for families and businesses.

Endnotes

[1] Georgia Department of Audits and Accounts, "Fiscal Note: House Bill 271," February 5, 2009.
[2] Washington State Citizen Commission for Performance Review of Tax Preferences. http://www.citizentaxpref.wa.gov/.
[3] Ibid.

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