

TAX EXPENDITURE REPORTING TO IMPROVE ACCOUNTABILITY

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Presented to the Legislative Finance Committee

August 19, 2011

Executive Order 2011-071

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Whereas:

- Tax benefits are sometimes a form of state spending
- New Mexico needs a systematic way of evaluating tax expenditures
- Many provisions that prevent taxation are not tax expenditures, they are needed to properly define the tax base, e.g. avoid double taxation

Therefore:

- Annual tax expenditure budget will be prepared by executive agencies
- Distinguish tax expenditures from other tax provisions
- Identify fiscal impacts, purpose of provisions
- Evaluate whether purpose is being achieved and estimate cost-effectiveness
- Recommend improvements

Defining “Tax Expenditures”

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- The name refers to the use of the tax code in lieu of direct spending to achieve a public policy purpose.
- Tax expenditures must be distinguished from tax exemptions and deductions that are needed to properly define the tax base.
- This is usually done by comparing a provision with a “normal” or “benchmark” tax base.

Defining a “Benchmark” Tax Structure

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- Defining the benchmark base sometimes involves many decisions and judgments about what should and should not be considered a tax expenditure
- Income Taxes:
 - ▣ Should the tax base be income or consumption?
 - ▣ How progressive should the tax rate structure be?
 - ▣ Should corporations be taxed as well as individuals?
- Sales Taxes:
 - ▣ Should the base be retail sales, all consumption or value added?
 - ▣ Should business purchases be included in the tax base?

Challenges in Measuring Tax Expenditures

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- Tax return data are unavailable for many tax provisions
 - Most GRT deductions and exemptions are not separately stated on the return.
 - Data are available only for credits affecting small numbers of taxpayers.
- Requiring detailed reporting would significantly increase administrative and compliance costs.

Challenges in Evaluating Tax Expenditures

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- The purpose of a tax expenditure is often not made explicit
- Tax policy criteria may not be relevant if a provision is really a substitute for expenditure policy
- Information is often lacking to evaluate positive or negative “externalities”
 - i.e. effects of behavior on others
 - ▣ Positive examples: education, health care, culture
 - ▣ Negative examples: pollution, congestion, negative health impacts

Balancing Accountability With Efficiency

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- In an ideal world, taxpayers benefitting from tax incentives would report to the state every year on the uses to which they have put the money
- In reality, these reports could be burdensome, they could compromise proprietary information and the results might still not be reliable.
- Information requests must strike a balance between the need for information and the administrative and compliance costs of collecting and processing information

Tax Expenditures vs Direct Spending

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- Tax expenditures enable targeting, and allow taxpayers to make independent decisions about how to respond to an incentive
- Value of tax benefits may not be known until long after a taxpayer spends/invests creating a lack of predictability
- Benefits of deductions and exemptions depend on the taxpayer's pre-incentive liability which is often difficult to predict

Contents of Tax Expenditure Report

Evaluations should include direct expenditure accountability criteria:

- ▣ The purpose should be clearly defined
- ▣ Eligibility and certification requirements should be clarified
- ▣ Quantifiable program evaluation criteria should be established
- ▣ Information/reporting burdens should be balanced with the use of the information
- ▣ Shortcomings should be identified
- ▣ Alternative policies should be evaluated

Criteria for Evaluating Tax Expenditures

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- Efficiency:
 - ▣ Does the tax expenditure improve the growth of the state's economy?

- Equity:
 - ▣ Who is most likely to benefit from the provision? Are the benefits distributed fairly?

- Simplicity:
 - ▣ Can the tax expenditure be administered at low cost?
 - ▣ Is it difficult or expensive for taxpayers to utilize the incentive?