More tax accountability leads to better decisions

Each Southern state should annually publish a comprehensive tax expenditure report to provide more accountability and information to lawmakers so they can make better decisions. The report should highlight missed revenue opportunities due to tax exemptions, breaks and deductions.

Background

Southern states annually lose a significant amount of possible revenue through tax credits, exemptions, deductions and other tax breaks that exempt some goods, services, income, people or property from taxation. Idea 1 discussed these revenue losses for the sales tax base, but there are considerable losses in the income tax, corporate income tax and property tax bases too.

States provide these special tax breaks for varied reasons. Corporate income tax credits, for example, often are enacted with the intention of stimulating job growth or...
investment. Sales tax breaks on food, on the other hand, carry the intention of helping low-income taxpayers with necessities. Although these tax breaks, which more formally are known as *tax expenditures*, cost states large amounts of foregone revenue, many states surprisingly do not keep track of the lost potential revenue.

While state budgets and appropriations are reviewed and voted on annually, these special tax breaks often remain in the tax code for years without debate or review. Like budget spending, this “tax spending” needs to be held accountable to the goals and values of the state and also needs to be used efficiently. Enacting measures such as annual *tax expenditure* reports and other accountability methods will improve tax systems of Southern states by ensuring legislators and voters know where the money goes—and where they’re not realizing potential revenue due to state policy decisions.

**While Southern states publish annual budgets, many don’t publish a comprehensive report that highlights how much in total revenue they’re not taking in due to special tax breaks.**

**Tax expenditure reports**

Most states publish a budget document annually that shows all appropriations, such as spending on education, healthcare and prisons. But many states do not do the same for *tax expenditures*, such as corporate tax credits and sales tax exemptions, even though these “cost” the state money because they’re missed opportunities.
The cost of any tax expenditure is the amount of tax the state would have collected if the credit or exemption did not exist. For example, if a state provides a $100 million corporate tax credit to an automobile company so it will locate in the state, from a tax perspective that means the incentive will “cost” the state $100 million because it could have collected that amount more in corporate income tax revenue if that credit did not exist.

To account for this loss in revenue, several Southern states offer annual tax expenditure reports, which list the credits and exemptions in the states and the cost of those expenditures (Figure 1). By providing this data, tax expenditure reports offer a tool for legislators and the public when discussing the needs of the state, the funds available, and the allocation of resources.

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Sources: Author’s research and information provided by Michael Mazerov, Center on Budget and Policy Priorities
(a) Limited to sales tax.
(b) Hard-copy only.
Across the U.S., 38 states had some form of *tax expenditure* report in 2004. In the South, six states have comprehensive *tax expenditure* reports and three have reports limited to sales *tax expenditures*. Georgia and South Carolina are the only two Southern states without a *tax expenditure* report.

Each state has a different method of reporting *tax expenditures*. The most basic examples include a list of credits and the cost of each credit. Other reports provide more detail, such as number of jobs created and number of businesses using the credit. Some even provide company-specific detail, known as disclosure reports, to show who receives the tax break and what that specific tax break is. North Carolina’s “William S. Lee” tax credits have such a disclosure report that annually lists the number and location of jobs created and provides the information online.¹

Louisiana offers an annual Tax Exemption Budget, which recognizes the concept that tax breaks should be considered a budget item by policymakers.

Louisiana’s Tax Exemption Budget offers an example for Southern states to follow.² Louisiana requires the annual report by state law and includes valuable data, such as purpose of each exemption and a five-year estimated revenue loss. Additional features of Louisiana’s report are an overview of report methodology, a summary of *tax expenditures* and a detailed description of each *tax expenditure*.³ It is worth noting that Louisiana uses the word “budget” in the title of its report as it brings to the forefront the concept of tax breaks as a budget item. These tax exemptions represent spending through the tax system on special
purposes, businesses or individuals. Without them, the state would have additional revenues to spend through the regular budgeting process.

By requiring annual *tax expenditure* reports, Southern states would bring tax spending into the budget process. Those states that already mandate such reports can make improvements, such as including all credits and expenditures, not just sales. They also can analyze the effectiveness of such exemptions and study who the expenditures benefit as done in Texas. Equally important, *tax expenditure* reports should be made accessible to legislators and the public, as North Carolina does online.

**Other accountability measures**

In addition to annual *tax expenditure* reports, states can improve their tax exemption process by including provisions in tax credit and exemption legislation.

- **Sunset dates.** States can include sunset dates in legislation to provide a specific time period for a tax credit to be available. When the sunset date arrives, legislators then will be required to revisit the credit or exemption and pass new legislation to continue it. Having this provision will ensure credits and exemptions are not left on the books forever and that each exemption is continually debated and studied, just as all appropriations in a state’s budget are reviewed annually.

- **Expenditure caps.** A second measure to limit the use of *tax expenditures* and control the cost is an expenditure cap. Legislation proposing a new tax credit can include an expenditure cap that limits the amount of revenue that can be lost to a certain credit.
• **Evaluation.** Finally, *tax expenditures* should include evaluation measures, which will provide data on the effectiveness of the program when the credit is reevaluated at the sunset date. Evaluation is a key component of good accountability in *tax expenditure* legislation since it provides evidence of what is working and what is not.

An example of recent legislation containing all three provisions is Georgia’s telework tax credit from the 2006 legislative session. This program offers businesses an income tax credit for certain expenses relating to teleworking employees. The legislation included a two-year sunset date, a $2 million expenditure cap and an incentive for evaluation and assessment of telework programs. Through these measures, the state ensured it would not lose more than $2 million in revenues and the credit will be reevaluated in two years. If the credit proves to be worth the cost, policymakers in Georgia may propose legislation to continue the program for another specified amount of time and cost.

**Other tools: Job-quality standards and clawback provisions**

Other reform measures to increase accountability are more deal- or company-specific. Legislation on *tax expenditures* for companies can include measures to encourage the creation of good jobs and to protect government subsidies. Job-quality standards are a requirement for corporate tax credits in many states. They require that jobs have a specific level of income or wages for employers to qualify for the tax credit. Health care standards can also be a job-quality standard required for such credits.
To protect government subsidies, deals can include so-called “clawback provisions,” which are money-back guarantees that assure government will receive its expenditures back if a deal falls through or a company leaves. Examples of clawback provisions are those in Georgia’s Business Expansion Tax Credit program, North Carolina’s Job Development Investment Grant, South Carolina’s Economic Impact Zone Investment Tax Credit and Virginia’s Major Business Facility Job Tax Credit.5 Clawback provisions and job-quality standards promote accountability within each deal and further protect taxpayers’ money.

Making government more accountable

States spend hundreds of millions of dollars every year through the tax system. Tax credits, deductions and exemptions are all considered tax expenditures because they cause a decrease in revenues. These large expenses can go undocumented if states do not implement annual tax expenditure reports to track the cost of each of program.

Like budget items, tax spending should be accounted for and should be debated as to the effectiveness and need for the myriad of credits and exemptions. Other accountability measures, such as job-quality standards and clawback provisions, should also be implemented to ensure all credit and exemption programs fulfill the goals of the state and are limited to a desired time and cost.

Talking points

• While Southern states offer annual budgets for spending, they generally don’t provide as good of informa-
tion on the revenues they’re missing because of public policy decisions that created corporate, sales and other tax credits, breaks and exemptions.

- To be more responsive to lawmakers and the public, states should annually publish a report that highlights all tax expenditures—the revenues they’re missing from tax incentives, tax credits, tax breaks, exemptions and other measures.

- By providing tax expenditure information, a state’s tax system will become more transparent. And if lawmakers better understand the effects of providing tax expenditures, they likely will discover opportunities and better be able to rethink their state’s public policy on taxes to be fairer to all.

- Just as lawmakers discuss the state budget annually, they should review state tax breaks annually to provide better value and management for taxpayers.

**Endnotes**

3 Richie (2004)