# Tax Expenditures and Tax Expenditure Evaluation

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# WHAT ARE TAX EXPENDITURES?

**Tax Expenditure**: "A tax provision that provides a gross or taxable income definition, deduction, exemption, credit, or rate for certain persons, types of income, transactions, or property that results in reduced tax revenue."

- *2018 Tax Profile & Expenditure Report*; 39-21-302, C.R.S.

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# TYPES OF TAX EXPENDITURES

- **Credit**: Reduces tax liability dollar-for-dollar
- **Deduction**: Reduces tax liability by reducing taxable income when certain conditions are met.
  - Usually related to expenses incurred by the taxpayer.
- **Exemption**: Reduces tax liability based on category, class, or status.
  - Exemptions are, by definition, not subject to taxation in the first place.

# STRUCTURAL EXPENDITURES

- Establish the basic elements of a tax provision
- Avoid duplication of a tax
- Promote administrative efficiency
- Clarify the definition of the types of transactions or individuals who are subject to a tax
- Ensure that taxes are evenly applied

Examples: exemptions for business inputs, net operating loss deduction, credit for taxes paid to another state, etc.

# PREFERENTIAL EXPENDITURES

- Incentivize certain behaviors/ activities
- Assist certain industries
- Stimulate certain types of economic activity

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## INCENTIVIZE CERTAIN BEHAVIORS/ ACTIVITIES

- Child care contribution credit
- Colorado works program credit
- Food contributed to hunger relief charitable organizations credit
- Innovative truck credit
- Innovative motor vehicle credit
- Plastic recycling investment credit
- Historic property preservation credit
- Preservation of historic structures credit

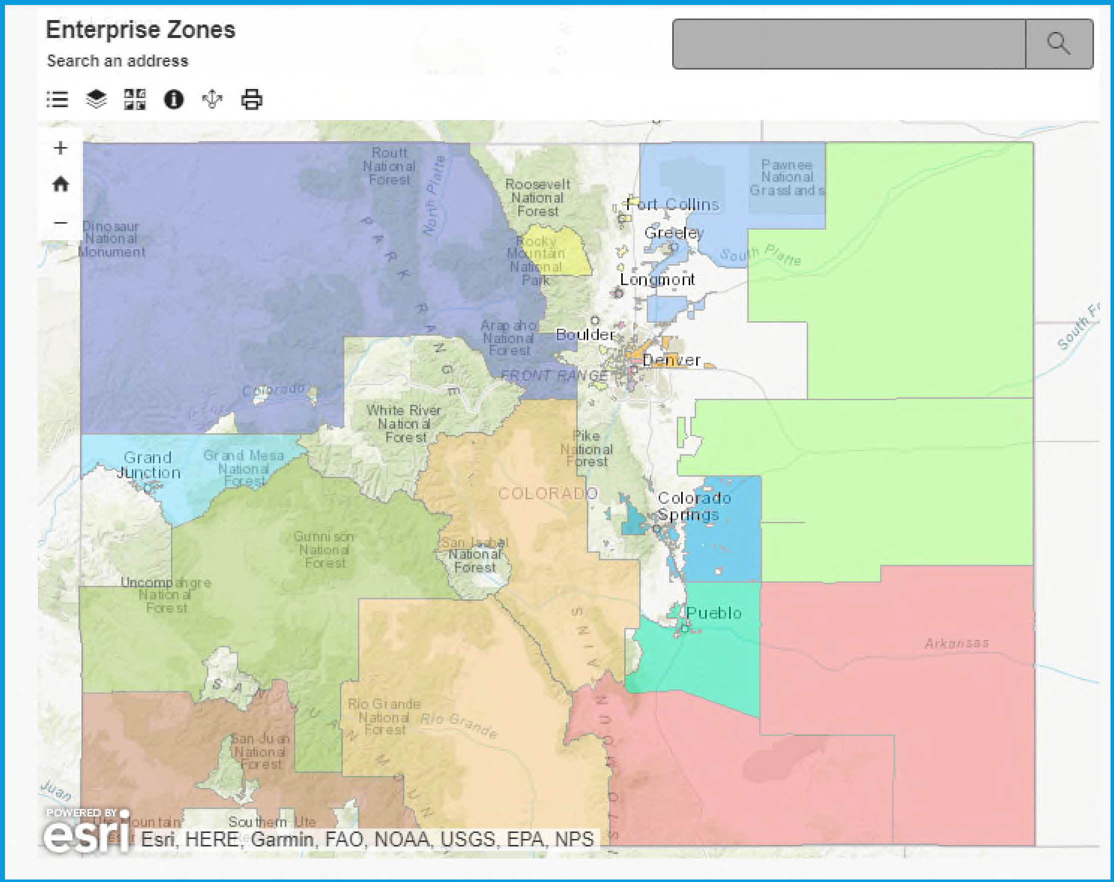
## TO ASSIST CERTAIN INDUSTRIES

- Aircraft manufacturer new employee credit
- Certified auction group license fee credit
- Alternative fuel refueling facility credit
- Child care center investment credit

## TO STIMULATE ECONOMIC ACTIVITY

- Colorado job growth incentive credit
- New investment tax credit
- Old investment tax credit
- Rural jump start zone credits
- Enterprise zone credits

# ENTERPRISE ZONES




Source: Colorado Office of Economic Development and International Trade

# HOW EFFECTIVE ARE STATE CORPORATE TAX INCENTIVES?

*"R&D tax credits are indeed effective at increasing R&D within the state… However… nearly all of the resulting increase comes at the expense of reduced R&D spending in other states."*

– Daniel J. Wilson, "Beggar Thy Neighbor? The In-State, Out-of-State, and Aggregate Effects of R&D Tax Credits" (2009)

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# HOW EFFECTIVE ARE STATE CORPORATE TAX INCENTIVES?

*"Firms taking the credit created 23.5 to 27.6 percent more jobs… than eligible firms not taking the credit…The flip side of the issue is that 72.4 to 76.5 percent of the employment change in participating firms would have been created in the absence of the credit."*

– Dagney Faulk, "Do State Economic Development Incentives Create Jobs? An Analysis of State Employment Tax Credits" (2002)

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# HOW EFFECTIVE ARE STATE CORPORATE TAX INCENTIVES?

*"Tax credit programs are more properly viewed as tax subsidies than as 'incentives' to induce investment behavior. If the purpose of tax incentive programs is to influence investment behavior, state policymakers should consider abandoning these programs in favor of more equitable approaches such as across-the-board reductions in corporate income tax rates, which benefit all corporations equally."*

– David S.T. Matkin, "Designing Accountable and Effective Economic Development Tax Incentives" (2010)

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## EVALUATING PREFERENTIAL TAX EXPENDITURES

- What is the purpose of this incentive?
- Is there a way to measure results?
- Does this expenditure incentivize long-term investments or short-term gaming of the tax code?
- Could the tax code be more competitive through rate or structural reform instead of this expenditure?

# Questions?

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