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Testimony before the NYS Senate Joint Committee Hearing on Economic Development Incentives

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Overview

Since the late 1930s, tax incentives have been used in the US as part of a bidding war among the states that feel compelled to match what other states are offering or risk being left out of the fight to grow their economies. The value of tax incentives has tripled since the 1990s[1] making them the nation's most extensive place-based economic development policy.

Proponents of business tax incentives argue that they are necessary and that the revenue foregone from the incentives is partially, or totally, offset by the additional revenues derived from the increased economic activity generated by the businesses receiving them. They generally posit a counterfactual about the effect of incentives on business behavior positing that but-for the incentives businesses would not make the same investments in the state. Although the counterfactual has informed both legislative decision-making and academic research, there is little evidence to support or refute it. Opponents of the incentives argue that they represent an inefficient spending of scarce government resources on business expansion and location decisions that often would have occurred absent the incentives. If the two sides of the tax incentive debate could be reconciled by a review of empirical facts about their effects, they would be. The truth is, we don't know the truth.

Another dimension to the debate is the conflict between tax principles and tax incentives. Six widely accepted principles against which to judge tax policies are economic neutrality, adequacy, simplicity, transparency, competitiveness and equity. An economically neutral tax does not influence economic behavior – individuals and businesses make decisions based on economic merit rather than tax implications. An adequate tax system raises enough revenue to support desired government services and investments. A simple and transparent system is easy to understand, relatively inexpensive for taxpayers to comply with, and relatively inexpensive for the government to administer. A competitive tax system does not impede the ability of companies to compete with those located outside the area and does not limit the ability to attract new business. An equitable system does not favor one group of taxpayers over another.

Almost by definition, business tax incentives violate these principles. Their explicit goal is to alter business decisions, encouraging more of a particular activity in a given area than private markets would undertake absent the incentives. Depending on the activity, this may be appropriate, but it places great responsibility on public officials to understand how the market is "wrong" and how the tax system can fix it. By lowering taxes for some taxpayers while keeping them higher for others, incentives may treat similarly situated taxpayers differently and can make it harder to raise adequate revenue with minimum public resistance. Myriad eligibility rules and credit calculations violate the simplicity principle for taxpayers and tax collectors. By lowering taxes for some taxpayers while keeping them higher for others, incentives treat similarly situated taxpayers differently and are thus not equitable. In industries producing similar products, they favor one set of companies over another. For example, an incentive for solar energy panels would be perceived as inequitable by producers of wind turbines.

[1] Timothy Bartik. 2019 . *Making Sense of Incentives: Taming Business Incentives to Promote Prosperity*. Kalamazoo: W.E. Upjohn Institute for Employment Research.

Transparency

One of the hallmarks of business tax incentive programs is their almost total lack of transparency. In 2015, in an effort to get states to provide information to the public on tax incentives, the Governmental Accounting Standards Board (GASB)[2] issued GASB Statement No. 77 requiring state (and local) governments to disclose key information about their tax abatement agreements that has not been consistently or comprehensively available before.

Details about tax incentives are generally available only in Tax Expenditure Reports (TER) issued by the states (generally on an annual basis) that are, with few exceptions, chronically incomplete. In a 2017 report, the National Conference of State Legislators (NCSL) outlined the elements of a TER that should be codified in state statutes. According to NCSL the TER should:

1. Be easily accessible and available on-line;
2. Be completed in time for budget and policy decisions;
3. Define or describe the normal tax structure for each tax included in the report and identify deviations, both those that benefit and those that penalize a class of taxpayers;
4. Include, for each tax expenditure
    a. the date the tax expenditure was enacted,
    b. the statutory citation,
    c. the tax policy rationale and desired outcome, including, where specified in law and as appropriate for each tax expenditure, clearly identified metrics for assessing the effectiveness of the expenditure (e.g. number of jobs created, low-income citizens served, conflicts with federal tax policy avoided, etc.),
    d. information regarding the categories of taxpayers that benefit,
    e. an updated estimate of the revenue impact (positive or negative) of the tax expenditure,
    f. categorization of tax expenditures both by tax type and, as appropriate, budget category, and
    g. a review schedule and/or, as desired or specified in law, an expiration or sunset date;
5. Make clear the methodology and limits of estimates provided in the report.

NYS Tax Expenditure Report

How does New York State incorporate the elements suggested by the NCSL in its TER?

- It is accessible and available on line
- It is completed on time
- It intentionally does not describe "normal tax structure"
- for each tax expenditure, the NYS report
    - provides date is was enacted
    - provides the statutory citation

[2] Established in 1984, the Governmental Accounting Standards Board (GASB) is the independent, private- sector organization based in Norwalk, Connecticut, that establishes accounting and financial reporting standards for U.S. state and local governments that follow Generally Accepted Accounting Principles (GAAP).

does not provide tax policy rationale
does not provide information regarding categories of taxpayers that benefit
provides an updated estimate of revenue impact

The failure of New York's TER to clearly provide the rationale for tax incentives, to identify metrics for assessing their effectiveness (e.g. number of jobs actually created) and to evaluate whether incentives are achieving their stated objectives suggest a system of taxpayer expenditures, albeit indirect, without compliance safeguards.

Refundable Tax Credits

A tax credit can be either refundable or non-refundable. Refundable tax credits mean that if the dollar value of the credit is greater than what a business owes in corporate business taxes in the year in which the credit is received, the State will refund the remaining balance to the business. Refundable tax credits thus constitute state spending that requires direct monetary outlays but is not subject to budget scrutiny as is direct spending, making the credits totally nontransparent.

Refundability can be quite costly. While draining state revenues upfront (by allowing companies to claim credits now that they otherwise would carry forward), refundability also gives cash payments to corporations now for credits that could eventually expire without the corporations ever using them. In addition, upfront tax benefits could provide opportunities for taxpayers to create fraudulent companies, file falsified tax returns claiming refundable tax credits, and then liquidate the companies.

Equity

State (and local) governments have the potential to make substantial and lasting impact on equity for all residents; one of the most change-making tools is their budget. Budgeting for equity requires governments to rebuild their budget from the ground up, including redefining “fair” to focus on outcomes and then aligning budgets with equity goals. Tax incentives that "spend" through the tax code should be part of government's effort to use budgets to promote equity. In a recent study of NJ tax incentives, it was found that equity is generally not one of the objectives of the incentives.[3]

Evaluation

Once granted tax incentives usually remain unless revoked or introduced with a ‘sunset clause’. There is thus a need to assess performance on a regular basis. Performance reviews may be conducted once every few years and would include the costs as well as the benefits of the tax incentive and assess whether it has met its intended objective. The results of such periodic reviews would inform decision-making around the continuation of individual tax incentives. The review criteria and results should be reported publicly. To the extent possible, behavioral responses, both good (e.g., additional incremental investment) and bad (e.g., aggressive tax planning) should be tracked and communicated.

[3] Unpublished study by author.