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SPECIAL POINTS OF INTEREST

- Tax expenditures are the exemptions, deductions, incentives, credits and the like that allow taxes not to be paid when they otherwise would.
- There are over 450 separate tax expenditures in Oklahoma law; together, their total estimated fiscal impact is at least \$5.6 billion.
- The state has made important progress in recent years in increasing disclosure and scrutiny of tax expenditures.
- Further progress could be made by increasing disclosure, evaluating existing incentive programs, creating front-end evaluation of new incentives, and limiting fiscal exposure through financial caps and triggers.

MAKING OKLAHOMA'S TAX EXPENDITURES MORE TRANSPARENT AND ACCOUNTABLE

The state's deep and prolonged budget crisis is creating an urgent need to review how the state raises revenues and delivers public services. One subject that is already beginning to attract greater scrutiny is the state's extensive set of tax exemptions, deductions, incentives, credits, and the like, known collectively as tax expenditures.

The Oklahoma Tax Commission (OTC) identifies over 450 separate provisions of state law that provide for some reduction in the amount of state taxes that would have been collected but for preferential tax treatment. The total cost of tax expenditures - at least \$5.6 billion in FY '08 - equals more than 75 percent of total state appropriations and grew by over \$1 billion, or 23 percent, in just two years.

Tax preferences are usually justified as instruments for accomplishing worthwhile public purposes and as needed for encouraging economic development. However, as policy instruments, tax expenditures also raise serious problems and concerns, including:

- Tax expenditures are largely invisible, as they are not subject to annual appropriations and legislative oversight;
- Tax expenditures have a substantial fiscal impact and their cost tends to be unlimited, even in times of revenue downturns and budget cuts.

- Many tax preferences may be inefficient in achieving their purposes;
- There are frequently weak accountability provisions to ensure that goals associated with tax preferences are met;
- Offering preferential tax treatment to certain entities and not others substitutes political choices for market decisions in the allocation of resources;
- Tax breaks granted by the state can have a significant impact on state and local revenues.

While the merits of granting tax preferences can be debated as a matter of principle, the reality is that they are unlikely to be abandoned as an instrument of policy. Instead, we should identify what distinguishes good policy from bad in the area of tax expenditures. Our issue brief sets out a dozen specific policy recommendations that are guided by these four principles:

1. There should be maximum public transparency into tax expenditures;
2. Existing tax expenditures should be formally reviewed and evaluated as to their effectiveness in achieving their goals;
3. Tax incentive programs should include front-end eligibility evaluations;
4. The state's fiscal exposure to at least some tax expenditures should be limited by spending caps and triggers. ...cont

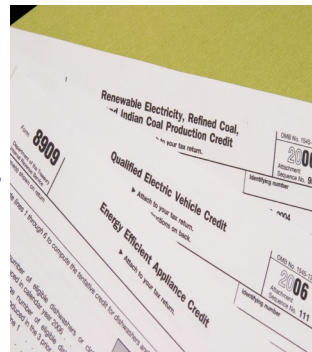


Table 1: Tax Expenditures with an FY '08 Estimated Cost Impact >\$25 million
 Source: Oklahoma Tax Commission, Tax Expenditure Report 2007-08 (Online Version) and 2005-06

Tax Type	Description	Amount FY '08	***	Amount FY '06
Sales & Use Tax Exemptions	Sales to manufacturers	\$ 1,623,110,000		\$ 1,532,912,000
Sales & Use Tax Exemptions	Sales for resale	\$ 1,493,000,000		\$ 773,781,000
Income Tax Deduction	Itemized & standard deductions	\$ 685,506,000		\$ 562,862,000
Income Tax Exemption	Personal exemption	\$ 137,911,000		\$ 150,273,000
Corporate Tax Credits	Income tax credit for investment or increased employment	\$ 118,738,138	***	\$ 40,244,733
Sales & Use Tax Exemptions	Subdivisions or agencies of state government	\$ 104,750,000		\$ 98,929,000
Sales & Use Tax Exemptions	Utilities for residential use	\$ 99,592,000		\$ 94,058,000
Cigarette Tax Stamp	Indian tribal compact sales	\$ 96,648,000		\$ 119,261,050
Sales & Use Tax Exemptions	State of Oklahoma	\$ 85,105,000		\$ 80,376,000
Income Tax Exemption	Social security benefits	\$ 77,496,000		\$ 71,904,000
Motor Vehicle Excise Tax	Used motor vehicle dealers	\$ 70,725,758		\$ 56,522,440
Property Tax Exemptions	Homestead exemption (1)	not provided		\$ 65,997,987
Sales & Use Tax Exemptions	Agricultural sales	\$ 63,905,000		\$ 33,264,000
Motor Vehicle Excise Tax	Prorate vehicle excise tax - trucks and truck-tractors	\$ 63,516,288		\$ 55,497,150
Sales & Use Tax Exemptions	Drugs and medical devices	\$ 60,967,000		\$ 14,021,000
Gross Production and Petroleum Excise Taxes	Incentive rebates	\$ 57,000,000		\$ 106,000,000
Income Tax Exemption	Government retirement benefits	\$ 50,215,000		\$ 43,592,000
Sales & Use Tax Exemptions	Livestock purchased outside of state	\$ 48,049,000		\$ 45,379,000
Sales & Use Tax Exemptions	Advertising sales	\$ 46,794,000		\$ 44,194,000
Sales & Use Tax Exemptions	Commercial airlines or railroads	\$ 45,706,000		\$ 43,166,000
Corporate Tax Credit	Investment in rural venture capital companies and rural small business ventures	\$ 45,068,020	***	\$ 2,794,369
Property Tax Exemptions	Manufacturing facilities (2)	\$ 44,825,246		\$ 46,930,867
Estate Tax	Parents', children's or descendants' bequests	\$ 38,381,000		\$ 35,441,785
Income Tax Credit	Low-income sales tax relief	\$ 37,813,000		\$ 37,813,000
Income Tax Credit	Nonrefundable tax credit for taxes paid to another state by resident individuals upon personal services compensation	\$ 33,321,000		\$ 28,225,000
Personal Income Tax	Oklahoma Earned Income Tax Credit	\$ 30,243,000		\$ 26,661,000
Corporate Tax Credits	Venture capital	\$ 26,615,717	***	\$ 1,664,000
	ALL OTHER EXPENDITURES (<\$10M FY '08)	\$ 321,860,223		\$ 350,237,170
	TOTAL OF ALL ESTIMATED EXPENDITURES	\$ 5,606,861,385		\$ 4,562,001,551

NOTES

***Items marked with asterisk represent significant discrepancies between online report and print report

(1) OTC did not provide estimates on ad valorem exemptions in 2008 as these affect local tax revenues

(2) 2007-08 data from OTC Ad Valorem Division on Exempt Manufacturing Reimbursements

Our twelve recommendations from the four guiding principles are:

Recommendation 1A: Expand Oklahoma's Tax Expenditure Report to provide more detailed and comprehensive information.

Recommendation 1B: Expand the Openbooks.ok.gov website to cover a fuller range of tax expenditures and provide more aggregated information.

Recommendation 1C: Consider exempting certain tax credits and/or information on individual taxpayers claiming credits below threshold amounts from the Openbook.gov website.

Recommendation 1D: Integrate the information currently provided separately in the Tax Expenditure Report and Openbook.gov

Recommendation 2A: Add sunset provisions to all tax incentives that are not currently sunsetted.

Recommendation 2B: Enact a statutory requirement that before any sunsetted incentive can be reauthorized, it must undergo a formal "performance review" and legislative recommendation by the Incentive Review Committee or similar entity.

Recommendation 2C: Strengthen ongoing monitoring and evaluation of existing tax credits.

Recommendation 2D: Develop a unified economic development budget that compiles information on all forms of development spending, including direct expenditures and tax incentives.

Recommendation 3A: Establish formal eligibility processes for new and existing incentive programs.

Recommendation 3B: Promote accountability by creating and enforcing standards for companies receiving incentives.

Recommendation 4A: Limit the cost impact of existing and future tax incentives through caps on overall amounts.

Recommendation 4B: Limit the cost impact of existing and future tax expenditures through triggers that would suspend or reduce selected preferences in times of budget shortfalls.

The full issue brief is available at: <http://okpolicy.org/shining-light-tax-breaks>

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