Tax Expenditure Review Commission:

Tax expenditure background and governing statute

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Presented by: House Research & Senate Counsel, Research, and Fiscal Analysis

Overview

Presentation overview

1. What is a tax expenditure?
2. Context for review commission: recent legislative activity around tax expenditures.
3. Overview of key components of MS 3.8855
    1. Commission membership
    2. Components of review
    3. Public hearings & report submission

What is a tax expenditure?

- Broadly, a tax expenditure is “spending” through the tax code.

- Many ways tax expenditures can be provided:
  - Exclusions, deductions, exemptions
  - Preferential rates
  - Credits
  - Timing: acceleration of deductions or deferral of liability

Statutory Definition

Minnesota Statutes, section 270C.11, subdivision 6:

“Tax expenditure" means a tax provision which provides a gross income definition, deduction, exemption, credit, or rate for certain persons, types of income, transactions, or property that results in reduced tax revenue, but excludes provisions used to mitigate tax pyramiding.

- Components:
  - Gross income definition, deduction, exemption, credit, or rate
  - Certain persons, types of income, transactions, or property
  - Must “result in reduced tax revenue”
  - Excludes provisions used to mitigate pyramiding (taxes on intermediate business-to-business transactions)

Policy Considerations

- **Durability**: tax expenditures not subject to the annual appropriations process, may continue in perpetuity.
- **Visibility:** tax expenditures not included in the state budget, not included in national rankings of spending and taxation.
- **Complexity:** tax expenditures add to the complexity of the state tax system, which makes tax filing more difficult for taxpayers and DOR.
- **Tax base erosion:** tax expenditures shrink the tax base, requiring higher tax rates to raise the same amount of revenue.
- **Ease of administration:** would a direct expenditure be more or less difficult to administer?
- **Effectiveness**: Does the expenditure provide a benefit at the margin or reward taxpayers for something they already do? Could a direct expenditure accomplish the same goal more efficiently.

Legislative Activity Around Tax Expenditures

- **2005**: Legislature requires Department of Revenue to publish tax expenditure budget.

- **2010-2011:** Tax Expenditure Review Report: Bringing Tax Expenditures into the Budget Process
  - Department of Revenue report, published under contract with academic economists
  - Recommended that all tax expenditures be formally evaluated on an eight-year cycle

- **2010:** Legislature requires bills that "create, renew, or continue" a tax expenditure to include "a statement of intent that clearly provides the purpose of the tax expenditure and a standard or goal against which the effectiveness may be measured."

Legislative Activity Around Tax Expenditures

- **2013:** House Research publishes "A Review of Selected Tax Expenditures."
  - Description, cost, rationale/objective, related direct spending programs, incidence, (academic) evidence on effectiveness.
- **2021**: Omnibus tax bill contained significant changes to tax expenditure laws:
  - Established the Tax Expenditure Review Commission.
  - Required bills creating or renewing a new tax expenditure to expire within eight years of the provision taking effect.
  - DOR's tax expenditure budget required to include purpose statements, tax incidence of "significant" expenditures, and revenue-neutral amount by which rates could be reduced if expenditure was repealed.

Membership of Commission

SENATE MAJORITY LEADER 2 Members	SENATE MINORITY LEADER 2 Members	HOUSE SPEAKER 2 Members	HOUSE MINORITY LEADER 2 Members	COMMISSIONER OF REVENUE 1 Member	EX OFFICIO (NONVOTING MEMBERS)
SEN. WEBER	SEN. REST	REP. SCHULTZ	REP. HERTAUS	COMMISSIONER ROBERT DOTY	SEN. NELSON
SEN. BAKK	SEN. DZIEDZIC	REP. GOMEZ	REP. DAVIDS		REP. MARQUART

Duties of the Commission

1. **Initial Review (within three years of establishment)**
   - Commission *must* identify the purpose of the state's tax expenditures
   - Commission *may also* identify metrics for evaluating the effectiveness of a tax expenditure.

2. **Ongoing Review (every year following initial review)**
   - Commission *must* review and evaluate Minnesota's tax expenditures on a regular, rotating basis.
   - Commission *must* establish a review schedule that ensures each tax expenditure will be reviewed by the commission at least once every ten years.
   - Commission *may* review expenditures affecting similar constituencies or policy areas in the same year, but the commission must review a subset of the tax expenditures within each tax type each year.
   - Commission *may* decide not to review a tax expenditure that is adopted by reference to federal law.

Components of Review

1. **REVENUE LOSS** as a result of the tax expenditure
2. **PURPOSE** of the tax expenditure
3. **MEASURABLE IMPACTS & EFFICIENCY** in accomplishing its purpose
4. **COMPARE TO APPROPRIATION** of a tax expenditure and a direct expenditure with the same purpose
5. **POTENTIAL IMPROVEMENTS** to the tax expenditure to increase efficiency or effectiveness

Components of Review

6. **TAX RATE REDUCTION** if the revenue lost due to the tax expenditure were applied to a rate reduction
7. **INCIDENCE** of the tax expenditure and the effect of the expenditure on the incidence of the state's tax system (if tax expenditure is significant)
8. **CUMULATIVE FISCAL IMPACTS** of other state and federal taxes providing benefits to taxpayer for similar activities
9. **RECOMMEND** whether the tax expenditure be continued, repealed, or modified

Public Hearings & Report to Legislature

- By December 1, each year
  - Public hearing(s) on reviewed tax expenditures, including a presentation of review components
- By December 15, each year
  - Submit a written report to the legislative committees with jurisdiction over tax policy
  - The report must detail the results of the commission's review of tax expenditures in the previous calendar year, including the review components outlined in statute.
  - The report may include any additional information the commission deems relevant to the review of an expenditure.

Thank You

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