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RENAME ANNUAL "TAX EXPENDITURE" REPORT

House Bill 4524 as enrolled
Public Act 68 of 2003
Sponsor: Rep. Chris Ward

House Committee: Tax Policy
Senate Committee: Finance

Senate Bill 362 as enrolled
Public Act 38 of 2003
Sponsor: Sen. Nancy Cassis

Senate Committee: Finance
House Committee: Tax Policy

Second Analysis (8-7-03)

THE APPARENT PROBLEM:

Public Act 72 of 1979 requires the governor to report, with the annual budget message to the legislature, various "tax expenditure" items listed in the act. Public Act 72 says, "The message shall include tax expenditures by budget and also shall contain a separate report on tax expenditures in total which may be printed as an appendix to the budget. The Department of Treasury shall furnish these items to the governor for inclusion in the report." This year's report runs to nearly 100 pages and is available on the Department of Treasury web site. Generally speaking, it catalogues the various exclusions, deductions, exemptions, credits, deferrals, or lower tax rates throughout state tax law and attaches a price tag to each.

The regular use of the term "tax expenditures" is said to date back about 30 years, and the term is found now in budget and tax reports at the federal level and in many states. In Michigan, the first such report predates by one year the 1979 act making it mandatory. This year's state report says that, "*Tax expenditures can be defined broadly as the tax revenue foregone as a result of preferential provisions such as exclusions, deductions, exemptions, credits, deferrals, or lower tax rates. These provisions are tax expenditures because, like appropriations, they allocate resources for specific public purposes, but do so through the tax system rather than the expenditure system.*"

It adds later that, "*Tax expenditures are so named because they can be viewed as alternatives to direct government appropriation or regulation. In fact, tax expenditures are very similar to direct appropriations in many respects. The main difference is that while appropriations achieve policy goals directly, tax expenditures achieve policy goals indirectly by changing relative prices or reducing costs.*"

The concept of tax expenditures is, however, not without controversy. Critics say that the concept is biased toward government spending rather than toward taxpayers because it appears to assume that money belongs to the government unless the tax laws specifically permit taxpayers to keep it! Critics also question what items should fall under the category in any report or listing, noting that even the state's annual report itself concedes that "classifying items as tax expenditures is a subjective process." Legislation has been introduced that would change the current description of the annual report to eliminate the term "tax expenditure" and instead describe it simply and straightforwardly as a report of credits, deductions, and expenditures.

THE CONTENT OF THE BILL:

Public Act 72 of 1979 requires the governor to report certain tax expenditure items with the annual budget message. Senate Bill 362 would amend the act

(MCL 21.271 et al.) to replace the reference to "tax expenditure items" with "tax credits, deductions, and exemptions".

The Management and Budget Act, similarly, requires that an annual "tax expenditure" report be submitted with the governor's annual budget message to the legislature. House Bill 4524 would amend the Management and Budget Act (MCL 18.1361) to rename the report as "the tax credit, deduction, and exemption report".

FISCAL IMPLICATIONS:

The Senate Fiscal Agency reports that the bills would have no fiscal impact on state or local government. (Floor analysis of House Bill 4524 dated 6-20-03 and analysis of Senate Bill 362 dated 6-10-03.)

ARGUMENTS:

For:

The advocates for this change in nomenclature say, in brief, that the use of the term "tax expenditures" is both confusing and wrongheaded. It is confusing because it may lead people to believe that the various credits, deductions, and exemptions listed in the annual report from the Department of Treasury are really equivalent to "spending" by state government. That could lead to the conclusion that in times of budget difficulties, the state should "reduce" this "spending", when in fact eliminating credits, deductions, and exemptions is really about raising taxes. The use of the term is wrongheaded because it appears to assume that all money belongs to the government except that which it allows citizens to keep. Under this theory, if the taxpayer keeps his or her own money, it is somehow an "expenditure" by the government!

The Michigan Chamber of Commerce has said, among other things, that this bill is not just a technical change but an important change, adding, "This report is simply a catalog of tax credits, deductions and exemptions. In fact, most years, this document goes largely unnoticed by the general public. Recently, however, this report has been misrepresented and misused as a "cookbook" of potential tax increases. Some proponents of raising taxes hide behind this report. Instead of just saying they want to raise taxes, they question whether the legislature 'meant' to exempt items from taxation or claim that some things have been 'inadvertently' not taxed, when in reality they are explicitly exempted in statute."

Response:

This report has been in existence for many years under its current name. The term "tax expenditure" may not be widely understood by the public and may be offensive in principle or on ideological grounds to some people. The concept of a tax expenditure may be somewhat elusive and imprecise and its application open to honest debate. Nevertheless, it is a relatively well known term of art in public finance. The federal government publishes a tax expenditure report. So do many states. The term has its own entry in the Encyclopedia of Taxation and Tax Policy. The name has been around for a quarter of a century at least. It should be noted that this report has retained its current name through several administrations with varying attitudes towards tax policy.

Against:

Some people, including representatives of the Michigan Chamber of Commerce, would prefer the report be eliminated, saying that "it uses unreliable data, it overestimates the data, and it is based on a flawed premise that everything should be taxed unless someone can fight tooth and nail to demonstrate why it shouldn't. For example, throughout this act is a requirement that the estimates shall include revenue foregone by nontaxation of items not specifically exempted." Chamber representatives also have cited a number of phrases from the report that they characterize as an acknowledgement of its own shortcomings. They cite such phrases as "classifying items as tax expenditures is a subjective process"; "the tax expenditure estimates do not necessarily reflect the amount of actual revenue that would be gained through the repeal of specific provisions"; and "tax expenditure estimates that appear in this report have different levels of reliability depending on the accuracy of the data and the estimation procedure employed". If the report is to be maintained, the Chamber wants the estimates of "revenue foregone from nontaxation of items not specifically exempted" eliminated from the report.

Response:

The annual report contains a great deal of valuable information about the cost of the many credits, deductions, and exemptions that exist throughout tax statutes. It is a useful guide in understanding the state's tax system. The phrases from the report that are criticized by the Chamber can be understood as honest expressions of the methodological difficulties in carrying out the necessary data gathering, calculations, estimates, and interpretations. Even if the information contained in the report starts as many arguments as it settles, it is useful to policy makers interested in evaluating the state's tax system. Tax specialists say that tax expenditures traditionally have served two purposes, to redistribute the tax burden and to create incentives for individuals or businesses to change behavior. It is possible for credits, deductions, and exemptions to outlive their usefulness in achieving these purposes. Also, consider that in many cases, tax expenditure items represent preferential treatment for a specific class of taxpayers and that a reduction in credits, deductions, and expenditures could lead to lower tax rates for all taxpayers.

Analyst: C. Couch

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.