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# Tax Expenditure Evaluation

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PRESENTED TO:

Assembly Committee on Revenue and Taxation  
Hon. Jacqui Irwin, Chair



LEGISLATIVE ANALYST'S OFFICE

## Tax Expenditure Data Sources

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***Department of Finance (DOF) Annual Tax Expenditure Report.*** A detailed listing of tax expenditures exceeding \$5 million.

***Tax Agency Reports and Open Data Portals.*** The Franchise Tax Board, California Department of Tax and Fee Administration, and Board of Equalization publish recurring reports on state tax expenditures. These agencies also maintain open data portals.

***Reports Provide Basics Statistics, Not Evaluation.*** Reports from DOF and tax agencies generally provide basic statistics but do not evaluate whether tax expenditures are achieving intended goals.



## Data Quality Depends on Type of Tax Expenditure

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***Competitive Tax Expenditures Generally Have Better Oversight.*** Tax expenditures like California Competes and the Film Tax Credit collect and report detailed information about recipients.

***Basic Information Generally Available About Tax Credits, Deductions, and Partial Exemptions.*** The state typically has at least basic information about tax expenditures that require taxpayers to claim them on a tax return, complete a form, or otherwise report to the state. This generally is true of tax credits, deductions, and partial exemptions from the sales tax.

***Often Little or No Information Collected About Full Exemptions and Exclusions.*** Some tax expenditures entirely exclude or exempt certain activities from the state's tax base. In these cases, the state often has little or no information about the beneficiaries of the tax expenditure.



## Tax Expenditure Evaluation Is Rare

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***Good Evaluation Is Difficult and Time Intensive.*** Even when quality data is available, conducting a thorough evaluation requires significant time and expertise.

***Most Tax Expenditures Rarely or Never Evaluated.*** With limited exceptions, tax expenditures are evaluated rarely, if ever. Film tax credits and research and development credits are examples of tax expenditures that have been subject to considerable academic research, although little of this research is specific to California.



## Considerations for Tax Expenditure Evaluation

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***Data on Outcomes Among Recipients Very Helpful but Not Enough for Evaluation.*** Having good information on outcomes of interest among tax expenditure recipients is a good starting point for evaluation, but it is not enough.

***Also Have to Consider the Other Important Factors.*** Evaluations also must consider:

- ***“But for” Question.*** To what extent would the desired outcomes have occurred without the tax expenditure? Taxpayers often receive tax benefits for actions they would’ve taken anyway.
- ***Indirect Effects.*** Did the tax recipients’ response result in indirect effects on nonrecipients?
- ***Opportunity Costs.*** Forgone revenue due to tax expenditures could have been spent on alternative programs. Those alternatives would have had positive benefits that should be weighed against the benefits of the tax expenditure.



## The “but for” Question

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**Answering the “but for” Question Is Difficult.** There is no straightforward way to determine what would have happened in the absence of the tax expenditure.

**Focus of Evaluation Should Depend on Context.** In some cases, the focus of an evaluation should be recipient outcomes. In other cases, the focus should be on target demographic groups, industries, or geographical areas.

**Best Methods Use Control Group.** The best way to estimate how a tax expenditure affects a target population is to compare their outcomes to a control group—similar individuals or business that did not benefit from the tax expenditure. Some ways of defining control groups include:

- Random assignment or lotteries.
- Natural experiments.
- Other statistical methods.

**Even the Best Methods Have Limitations.** One high-quality study is better than no study at all, but a collection of high-quality studies is even better. Regardless, many important questions about tax expenditures cannot be answered with a high degree of certainty.

