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TO: Senator Nathan Libby, Senate Chair
Representative Maureen Terry, House Chair
Members, Tax Expenditure Review Working Group

FROM: Lucia Nixon, Director

DATE: October 8, 2021

RE: OPEGA Experience with Tax Expenditure Review Process

Thank you for the invitation and opportunity to provide information to the Tax Expenditure Review Working Group. The memo has two parts. First, it provides background and context on the development and implementation of OPEGA's role in the tax expenditure review process. Second, it provides OPEGA's perspective on the four items identified by the Working Group:

1. What is working well?
2. What are challenges?
3. Ideas for change and improvement
4. Information requested – OPEGA resources

I. OPEGA & Tax Expenditure Reviews - Background and Context

In 2013, during the First Regular Session of the 126th Legislature, OPEGA became involved with the Legislature's consideration of tax expenditure reviews from two angles:

- The Legislature established the *Tax Expenditure Review Tax Force* as part of the budget bill (PL 2013, chapter 368, Part S), and OPEGA, along with the Office of Fiscal and Program Review (OFPR), provided nonpartisan staffing support to the Task Force. The Task Force was charged with identifying the repeal or reduction of tax expenditures to achieve savings of at least \$40 million in FY14-15 and with developing a process for ongoing evaluation of state tax expenditures.
- Concurrently, the Government Oversight Committee (GOC) assigned OPEGA a special project to begin developing a proposal for ongoing review of tax expenditures.

In its December 2013 report, the Task Force recommended that the Joint Standing Committee on Appropriations and Financial Affairs (AFA) Committee: (1) consider certain modifications to tax expenditures to achieve savings in FY14-15, and (2) continue work with OPEGA, the GOC and Joint Standing Committee on Taxation (TAX) to develop an ongoing process for evaluation of tax expenditures and report out legislation to the 2nd Regular Session of the 126th Legislature to implement this process. Rather than go straight to implementation, the Legislature passed a resolve (Resolve 2013, c.115, LD 1463) in the 2nd Regular Session directing OPEGA to prepare and submit a proposal to the GOC and TAX by March 2015, for a process for ongoing review and evaluations of tax expenditures. The Resolve required OPEGA’s proposal to include classification of all tax expenditures into the three familiar categories we have today:

- A. **Full evaluation review** for tax expenditures that are intended to provide an incentive for specific behaviors, that provide a benefit to a specific group of beneficiaries or for which measurable goals can be established;
- B. **Expedited review** for tax expenditures that are intended to implement broad tax policy goals that cannot be reasonably measured; and
- C. **No review** for tax expenditures with an impact on state revenue of less than \$50,000 or that otherwise do not warrant either a full evaluation or expedited review.

In March 2015, OPEGA submitted the required proposal as a report to the GOC and TAX. Around the same time, a bill was introduced (LD 941, Sen. Davis) in concept draft form to improve the evaluation process for tax expenditures based on the OPEGA report. The bill was heard, worked and amended in TAX and enacted as PL 2015, c.344, establishing the tax expenditure review framework under discussion today. The law assigned specific responsibilities to two legislative committees—the GOC and TAX—and one nonpartisan legislative office—OPEGA—to implement the review process. It established a 6-year cycle to complete the reviews of tax expenditures classified for “full evaluation review” (category A) and for “expedited review” (category B). The law directed OPEGA to conduct the full evaluation reviews and directed TAX to conduct the expedited reviews with OPEGA providing information to TAX to support the reviews. The bill included appropriations for 2 FTE positions in OPEGA to support the expansion of its overall work.

Early Experience and Amendment to Full Evaluations

As OPEGA embarked on full evaluations of tax expenditures in 2016 and 2017, it became clear that the 6-year timeline to complete the “full evaluation reviews” for the approximately 30 tax expenditures in that category was not realistic. To keep that schedule, without impacting quality, would require an increase in resources or decrease in scope of the work on these evaluations. After consideration by the GOC, legislation was proposed and enacted to remove the 6-year timeline for completing the full evaluation reviews and to remove related deadlines in the law (PL 2017, c. 266). This change allowed OPEGA to continue its current approach and scope for the evaluations (in-depth, comprehensive evaluations) within existing resources. Instead of a set schedule, the new law provided that GOC and TAX set priorities for the order in which the full evaluations would be completed.

Where We Are Now

OPEGA has been carrying out the requirements of the tax expenditure review statutes enacted in 2015 (PL 2015, c.344) for approximately 6 years. The status of OPEGA's progress on full evaluation reviews and support for expedited reviews is as follows:

- **Full Evaluations:** OPEGA has completed full evaluations of 7 tax expenditures and has 2 full evaluations in progress with one scheduled to be reported out next month. There are currently 23 tax expenditures in the full evaluation category that have yet to be evaluated. During this time, OPEGA has also completed special projects and reports related to 2 tax expenditures in the full evaluation category. (See page 6 for a complete list of tax expenditures categorized for full evaluation review, organized by evaluation status.)
- **Support for Expedited Reviews:** OPEGA has compiled and reported the required information for expedited reviews to TAX each year. This year, 2021, is final year in the 6-year cycle. OPEGA is on track to submit the required materials to TAX by December 15 in accordance with statute, so that TAX can conduct the review.

In addition to the above work, each year OPEGA has compiled information on the newly enacted, amended and repealed tax expenditures for presentation to the GOC and TAX for consideration of adjustments to the categorization of expenditures (full evaluation review by OPEGA, expedited review by TAX, no review) and scheduling priority for reviews.

II. Information Requested by the Working Group

1. What is Working Well?

First, OPEGA is providing independent, nonpartisan, objective research and analysis that can be used by the Legislature to inform policy and budgetary decisions. This is a valuable resource and service to support the Legislature's work. The full evaluations delivered by OPEGA are of high quality, evidence-based, thorough and independent. OPEGA provides support to the GOC, and TAX as needed, as the committees work through the evaluation reports and make decisions regarding any follow-up action or further research.

Second, now that OPEGA has gotten through the start-up phase and climbed the learning curve for tax expenditure evaluation, the pace and efficiency of full evaluations has been increasing. OPEGA has built a strong foundation in conducting tax expenditure evaluations and seeks opportunities to implement its learning from each evaluation to improve and benefit future projects. This year, OPEGA—at the request of the GOC—has been experimenting with options for completing full evaluations more quickly than has been typical. In the current evaluation of the Historic Rehabilitation Tax Credit (HRTC), this has worked well. The GOC communicated its priorities for timing and OPEGA presented options to the GOC for what would be completed within a certain timeline, and the HRTC evaluation has proceeded accordingly.

One element of OPEGA's increased pace to completion has been finding ways to conduct the full evaluations without accessing confidential taxpayer data held by MRS, as accessing and using such data has proven to require significant time and resources and extended the length of

prior evaluations. Adapting the evaluations in this way has increased OPEGA's ability to complete and deliver evaluation reports to meet the needs of the Legislature, but does have trade-offs in terms of what is analyzed as part of the evaluation.

Third, we note that 6-year timeline for completion of expedited reviews by TAX, with support from OPEGA, has worked well. OPEGA is poised to complete its background research on the 6th and final set of these tax expenditures and submit that to TAX in December 2021.

2. What are Challenges?

One of the key challenges faced by OPEGA is that aside from a few recently enacted tax expenditures, the expenditures classified for full evaluation have been on the books for some time and are often not well set up to be evaluated. There are a number of important ingredients needed for effective evaluation of a policy or program. At the most basic level, evaluation requires: clarity of the purpose and goals of the policy or program under evaluation, clarity of the desired outcomes—particularly measurable outcomes; and availability of relevant data on program activity and outcomes--meaning that relevant data is collected and is accessible to evaluators. OPEGA has found that many existing tax expenditures are missing one or more of these basic ingredients.

Data has been a particular challenge on several fronts, including lack of data being collected, issues with quality of data that is collected, and issues relating to accessing confidential taxpayer information maintained by MRS. A significant portion of OPEGA resources were required during the initial evaluations to iron out processes and agreements with MRS with respect to confidential taxpayer data. Once those agreements were worked out, obtaining requested data and working through the processes required by the agreements continued to be time intensive. As noted above, OPEGA has adapted to this by reducing reliance on these data when possible.

The interest of policy committees in having evaluation results for work sessions on tax expenditure legislation they are deliberating can present challenges. Unless the tax expenditure is in the full evaluation category and has a completed evaluation, OPEGA does not have results at the ready. To date, it is often the case that proposed legislation comes before the Legislature to amend a tax expenditure that has not yet had an evaluation. By definition, evaluation takes time. It is purposefully systematic and methodical and often involves a series of sequential steps. As OPEGA continues to complete tax expenditure evaluations, this challenge will be moderated.

OPEGA has observed that it can be challenging for each of the three key entities (GOC, TAX and OPEGA) to have the resources needed to fulfill their respective roles at certain times. For example, during session, TAX has a very high workload with bills to hear, work, vote and report out. At times, it can be very challenging for TAX to carry out its responsibilities to review and report to the Legislature on the full evaluations that are completed and to conduct the expedited reviews. The GOC generally has more bandwidth to take up tax expenditure matters during session; however, it can also be challenging for the GOC to jump in and out of thinking about tax expenditures, particularly when there are other urgent and pressing concerns about other matters of government oversight. Similarly, when the GOC has urgent time sensitive priorities for OPEGA's limited staff, this can delay work on tax expenditures.

We note that even with good data on a tax expenditure, identifying the impacts of that tax expenditure can be challenging when there are multiple tax and non-tax incentive programs play in a comprehensive benefit “package” as is typical with economic development incentives in particular.

3. Ideas for Change and Improvement

As the Tax Expenditure Review Working Group continues its work and explores options for change and improvement, OPEGA offers the following ideas for consideration.

First, OPEGA encourages the Working Group to take time to review and get clear on the Legislature’s purpose, intent and priorities for tax expenditure reviews. Is it to inform and support the budget process? Is it to inform tax policy decisions? Is the goal to have something to pull off the shelf when questions arise? What are the priorities in the balancing act between output, resources and scope of work, while ensuring quality is maintained? Answers to these questions will provide valuation help inform whether and what changes could be made.

OPEGA suggests the following areas for consideration by the Working Group:

- Consider options for proceeding with the remaining expenditures classified for full evaluation. Would it be helpful to take stock of what is not yet evaluated as a group? Would it be helpful to have the information typically compiled for expedited reviews and/or some very targeted background, preliminary research to help assess degree to which these are “ready” for evaluation (specified purpose/goals, outcomes, data availability) and what would be needed to address gaps?

Now that the full evaluation process has been in place for some time and matured, it may be a good time to review the statutory language set up to guide the process before we had experience with the reviews. With what has been learned, are there ways the statutory language could be improved? Areas to consider might include the degree of specificity and the process requirements around approval of goals, beneficiaries and evaluations objectives.

- Consider options for the future of expedited reviews conducted by TAX now that the first 6-year cycle is nearly complete. It may be worthwhile to seek input from TAX members and staff about the experience and value of these reviews. OPEGA provides the information required as input to these reviews, but has less information beyond that point.
- Consider options to address the needs of TAX and other policy committees during session when committees are hearing and working bills that relate to tax expenditures. What is realistic when an expenditure has not yet been evaluated? Who is best suited to provide the information? Consider the role and purpose and expertise of OPEGA and the other nonpartisan offices in supporting the policy committees.

- Consider options to help ensure the statutes governing tax expenditures are set up for future evaluation. One option could be to create a checklist or other tool that lists key items to consider when drafting, or amending, tax expenditure laws to bring attention to what is needed to provide the key ingredients for future evaluation, with particular attention to data necessary for evaluation. If desired, a process could be set up ensure proposals to create or amend tax expenditures gets reviewed by TAX before reported out of other policy committees.

4. Information requested – OPEGA Resources

The Working Group asked for some information on OPEGA staffing for tax expenditure review and evaluation. When the tax expenditure work was added to OPEGA’s plate, the Legislature created 2 additional FTE positions in OPEGA. Initially the new hires were primarily focused on the new tax work. Over time, this has shifted such that OPEGA analysts are deployed for maximum efficiency and productivity across the overall OPEGA work portfolio, guided by priorities and deadlines established by GOC. At this time 4 of the 7 analysts have experience working on tax expenditure evaluation work. The number of staff and percentage of individuals’ time that is allocated to tax expenditure work will vary over the course of a year, depending on the full slate of OPEGA work and the workflow of projects. Given the small size of the OPEGA office, there are times when “all hands on deck” priority is established by the GOC on an urgent area of concern and other projects, including tax expenditure evaluation, may need to be delayed for a period.

List of Tax Expenditures in the Full Evaluation Category – By Evaluation Status

Completed (7)

1. New Markets Capital Investment Credit
2. Pine Tree Development Zones (*Note: in addition to the full evaluation report, OPEGA completed a follow-up report on this expenditure*)
3. Employment Tax Increment Financing
4. Reimbursement for Business Equipment Tax Exemption (BETE)
5. Reimbursement for Taxes Paid on Certain Business Property (BETR)
6. Maine Capital Investment Credit
7. Maine Seed Capital Investment Credit

In Progress (2)

1. Historical Rehabilitation Tax Credit (November 2021)
2. Research Expense Tax Credit (2022)

Future (23)

1. Shipbuilding Facility Credit
2. Tax Benefits for Media Production Companies
3. Major Food Processing & Manufacturing Facilities Expansion Credit
4. Deduction for Contributions to Capital Construction Funds for maintenance or replacement of fishing vessels
5. Major Business Headquarters Expansion (*Note: OPEGA reviewed the provisions of credit relating to tax expenditure review and reported to GOC/TAX February 2018*)
6. Credit for Educational Opportunity
7. Employer credit for family and medical leave
8. Deduction for Interest and Dividends on Maine State and Local Securities - Individual Income Tax
9. Deduction for Interest and Dividends on U.S., Maine State and Local Securities
10. Earned Income Credit
11. Additional Standard Deduction for the Blind and Elderly
12. Income Tax Credit for Child & Dependent Care Expense
13. Deduction for Pension Income & IRA Distributions
14. Deduction for Social Security Benefits Taxable at Federal Level
15. Property Tax Fairness Credit
16. Sales Tax Fairness Credit
17. Railroad Track Materials
18. Refund of Sales Tax on Purchases of Parts and Supplies for Windjammers
19. Certain Telecommunications Services
20. Credit for Affordable Housing
21. Partial Cigarette Stamp Tax Exemption for Licensed Distributors
22. Air & Water Pollution Control Facilities
23. Sales Through Coin Operated Vending Machines