



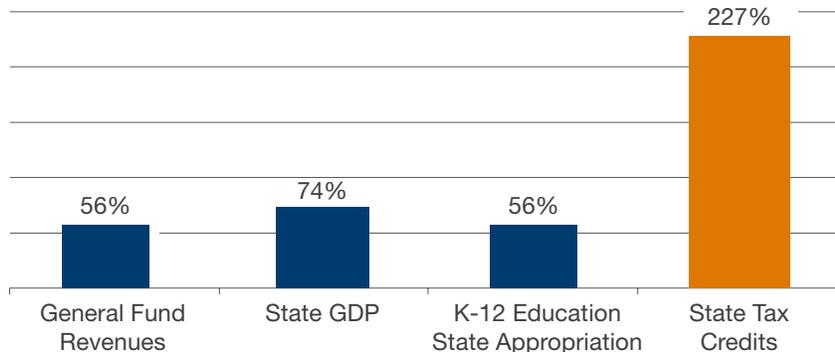
# TAX CUTS AND TAX CREDITS

## What are tax credits doing to the state budget?

Tax credits cost the state budget \$311 million in 2012 and have been growing fast. They compete with state agency budgets for the same pot of funding, but state lawmakers have virtually no accountability or control over tax credits once they are in state law.

A tax credit reduces the amount of taxes owed on a dollar-for-dollar basis—a \$400 tax credit can wipe out a \$400 tax bill. The dollar value of tax credits claimed is growing at a much faster rate than state revenues, the state's economy, or state spending on K-12 education. Each legislative session since 2005, at least one new tax credit has been added or expanded. Between 2010 and 2013, even as state revenues were plummeting due to the recession, eight new credits were created. Today there are 27 credits available to individuals and 22 available to corporations.

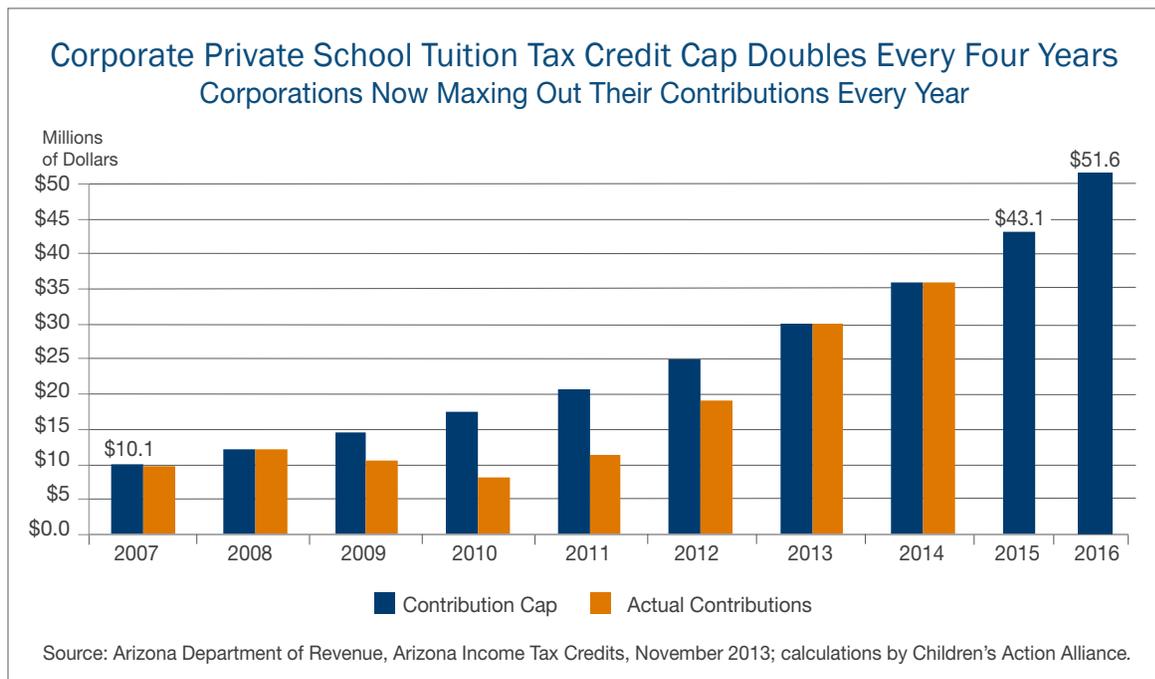
Tax Credits Are Growing Fast - Percent of Growth 1999 to 2012



Source: Joint Legislative Budget Committee Staff, *Appropriations Reports for FY 1999, FY 2000, FY 2012 and FY 2013*; Arizona Department of Revenue, *Arizona Income Tax Credits*, November 2014; U.S. Bureau of Economic Analysis, *Gross Domestic Product by State*.

Tax credits lack the basic accountability and control that state spending has. Unlike agency budgets that must be approved by the state legislature every year, tax credits are reviewed only once every five years. Even after a review that shows questionable results, tax credits continue forever unless a bill to repeal them passes with a two-thirds vote in both the house and the senate. While state agency spending is capped at the appropriated amount, only 10 out of the 49 credits have an aggregate cap. State legislators don't know what the fiscal impact of any tax credit will be in any particular year until after the credit has already been taken.

The expansion of the private school tuition tax credits in particular is having a significant impact on state revenues. Arizona now has two individual and two corporate tax credits for contributions to “student tuition organizations” that use the funding to grant scholarships for private school tuition. Combined, the amount claimed for these four credits rose from under \$14 million in 1999 to \$108 million in 2013. The largest of the corporate tax credits (shown below) has an aggregate cap that grows by 20 percent each year and has been maxed out the last several years.



Another feature that puts tax credits outside legislative budget control is the carry forward balance that taxpayers are allowed to accumulate and use in future years. For most tax credits, if taxpayers don’t owe enough income taxes to use the whole credit, they are allowed to save the unused portion of the credit and apply it against future tax liability. For instance, if a taxpayer owes \$300 in taxes and has contributed \$400 to the qualifying charitable organizations tax credit, the \$100 unused portion of the credit can be carried forward and used on the next year’s tax return. The number of years a credit can be carried forward ranges from 5 to 15 years.

Today, individuals and corporations are carrying forward a combined \$1 billion balance in tax credits that can hit the state budget at any time. This carry-forward amount is three times greater than the credits claimed in any single year. The carry forward balance for corporations is expected to grow because the amount of corporate taxes due will decrease with the phasing down of the corporate tax rate.

