Using Tax Data to Measure the Effectiveness of Income Tax Credits

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The Comptroller's Office has provided tax credit data from tax returns to the General Assembly and others for years and will continue to do so. Generally, the only tax credit information that can be gleaned from income tax returns with any certainty is the aggregate cost to the State of nonrefundable and refundable credits with no detail, and this information changes over time for any particular tax year. For reasons discussed below, the cost to the State of any particular credit, the timing of activity underlying the credits, and any other detail of activity underlying the credits cannot be known for certain from tax return data. For those credits for which a taxpayer must be certified by another State agency, it is likely that those agencies are in a better position to assess the effectiveness of the credits.

- Collection of data

  Business tax credits are claimed on Form 500CR, which also shows some ancillary data regarding the tax credits. These forms are scanned into the tax processing system, but the data is not captured in an automated fashion. Through a manual process (roughly six weeks of work), all data from the 500 CR is entered into spreadsheets.

  If a taxpayer has earned credits during a tax year but has no taxable income, the taxpayer may not enter anything for nonrefundable business tax credits (line 10c of Form 500 or line 28 of Form 502). If there is no entry for that line, we cannot identify that return as having a Form 500CR attached. And since the credit has no impact on tax liability, it is conceivable that taxpayers may not attach the 500 CR. Detail for those credits will likely never be collected (see "Carryforwards," below).

  Additionally, to the extent that taxpayers undertake activity making them eligible for a credit but, for whatever reason, do not claim the credit on a tax return, that activity may well be a result of the credit, but the effects will remain unknown to the Comptroller's Office.

- Timing of filing of returns

  Until a tax return is filed, the Comptroller's office has no information whatsoever about credits earned or claimed for a tax year. Generally, for taxpayers whose tax year is a calendar year, returns are due on March 15 for corporations and April 15 for individuals. All returns are not processed until mid-June, so July is the earliest any analysis could be available.

  Corporate taxpayers often make use of filing extensions, as do many high-income individuals who often report income from pass-through entities (PTEs) on their individual income tax returns. The extension for both corporate and individual returns is October 15, so November is the earliest any analysis of calendar year tax data could be available.

The tax year for almost 30% of corporations, however, does not begin on January 1. About 6% of corporations have tax years that end in June, and 5% have tax years that end in September. All tax returns for a tax year are not due, including extensions, until September of the second year following the end of a calendar year. For example, data from all tax year 2008 returns are not collected until September of 2010. Thus, analysis of tax credits from a complete tax year's tax return data will always be about two years after the fact.

Another implication of this is that tax return data from one tax year covers activity over a period of almost 24 months, which at times can encompass very different economic conditions. Tax return data cannot be used to show activity occurring during any consistent 12 month calendar period; the only consistent period for which tax return data can be used is a tax year.

- Amended returns

  Corporate returns and individual returns showing income from PTEs are frequently amended, often due to net operating loss (NOL) carrybacks or audits. Amendments of any type could affect tax credits earned and claimed in a particular year. If, for example, a credit was earned and claimed, reducing tax, but NOLs from a future year are carried back eliminating taxable income, the credit would become "unclaimed," and available for use in a future tax year (if it can be carried forward). Additionally, some credits can only be claimed on amended returns.

  Thus, the cost to the State for tax credits can increase, decrease, or shift over time as amended returns are filed. Detail regarding the activity underlying the credit may or may not be known, and may or may not be associated with the proper tax year if it is known.

- Lack of prioritization of credits

  Because credits are not prioritized–there is no statutory order in which credits must be claimed–if two or more credits are claimed by a taxpayer for a tax year, and the credits exceed tax liability, there is no certainty as to how much of which credits are used (which also affects the following tax year, although see "Carryforwards" below).

- Carryforwards

  Generally, credits are entered on the Form 500CR in the year in which they are earned. Most nonrefundable credits can be carried forward if they exceed tax liability. The following year, however, they are entered on the Form 500CR as a credit carryover. Any credit claimed as a carryforward (or carryback) therefore loses its identity as a specific credit.

In addition, to the extent that carryforward credits cannot be claimed in a future tax year, they may be double-counted without research into every return claiming a carryforward credit.

- Pass-Through Entities

  Data associated with tax credits (such as the number of qualified employees, first year wages paid, etc.) is reported on the Form 500CR. That data, along with the credits earned, is manually captured and reported but, to the extent these credits are earned by PTEs, may be overstated or understated. A Form 500CR is supposed to be submitted by the PTE with the Form 510, along with Schedule K-1s that show each member's share of the credits earned by the PTE. There is no indication within the system that a Form 500CR has been submitted with a Form 510, and any data on that form is therefore not captured.

  The PTE's credits are then reported on the individual members' 500CRs. Members are instructed to attach the K-1 and statements from the PTE showing their share of any credits earned, and to only fill out the summary section of the 500CR. In that case, any detail regarding the credits other than the dollar amount is lost.

  If members do fill out the detailed data, such as the number of qualified individuals hired, that data will be double-counted since the tax processing system cannot tie together returns or data of PTE members, or tie them back to the PTE return.

  In any case, the number of credits actually earned and claimed are overstated to the extent PTEs have more than one member–the number we actually report is the number of tax returns with each type of credit claimed.

  It is important to note that the dollar amount of credits earned and claimed is not double-counted due to this problem.