

2014 Income Tax Credit Review

Joint Legislative Income Tax

Credit Review Committee

December 8, 2014

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JLBC

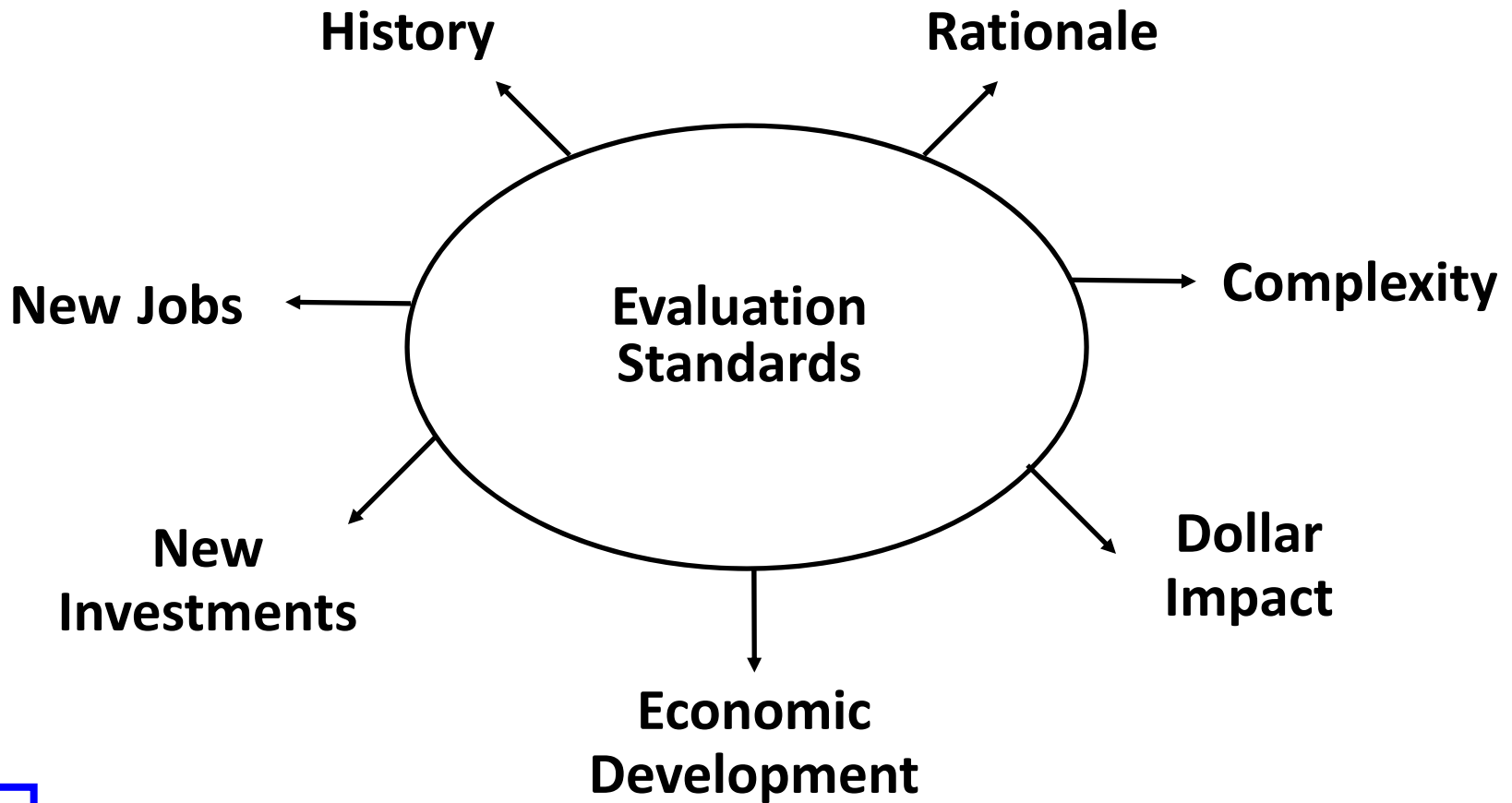
2014 Credit Reviews

- ❑ Annually reviews credits as determined in statute.
- ❑ This year's review includes:
 - Agricultural Pollution Control Equipment Credit
 - Agricultural Water Conservation System Credit
 - Corporate School Tuition Credit for Displaced/Disabled Students
 - Healthy Forest Enterprise Credits
 - Renewable Energy Investment Credit
- ❑ Healthy forest enterprise credits as well as the agricultural pollution and water conservation credits were last reviewed in 2009.

Role of the Committee

- Determine original purpose of tax credit
- Establish standards for evaluating and measuring success or failure
- Recommend changes

Statute Provides Possible Standards



Confidential Taxpayer Information

- Statute authorizes DOR to disclose confidential “statistical information” to the Committee and JLBC Staff
- DOR considers credit information confidential if:
 - credits were claimed by 3 or fewer taxpayers, or
 - a single taxpayer used more than 90% of total credits
- 4 of 5 credits have confidential information
- Since no material impact on evaluation, data is excluded from JLBC presentations

Issues Affecting Evaluation

- ❑ Timeliness of data
 - Most credit data from Tax Year 2012
 - Tax Year can start in any month, which delays finalizing data
 - DOR has been asked to start reporting Fiscal Year data annually by September
- ❑ Lack of performance measures
- ❑ Certain costs and benefits can be difficult to quantify

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Agricultural Pollution Control Tax Credit

Agricultural Pollution Control Credit

- Summary

- ❑ Cost – \$0 in tax year 2012 for the corporate credit and \$27,350 in tax year 2012 for the individual credit.
 - 47 claims filed by individuals between 1999 and 2012.
 - 7 claims filed by corporations between 1999 and 2012.
- ❑ Purpose – mitigate costs incurred by farmers and ranchers to comply with environmental regulations.
- ❑ Complexity – simple to use and administer.
- ❑ Performance Measures – none in statute.

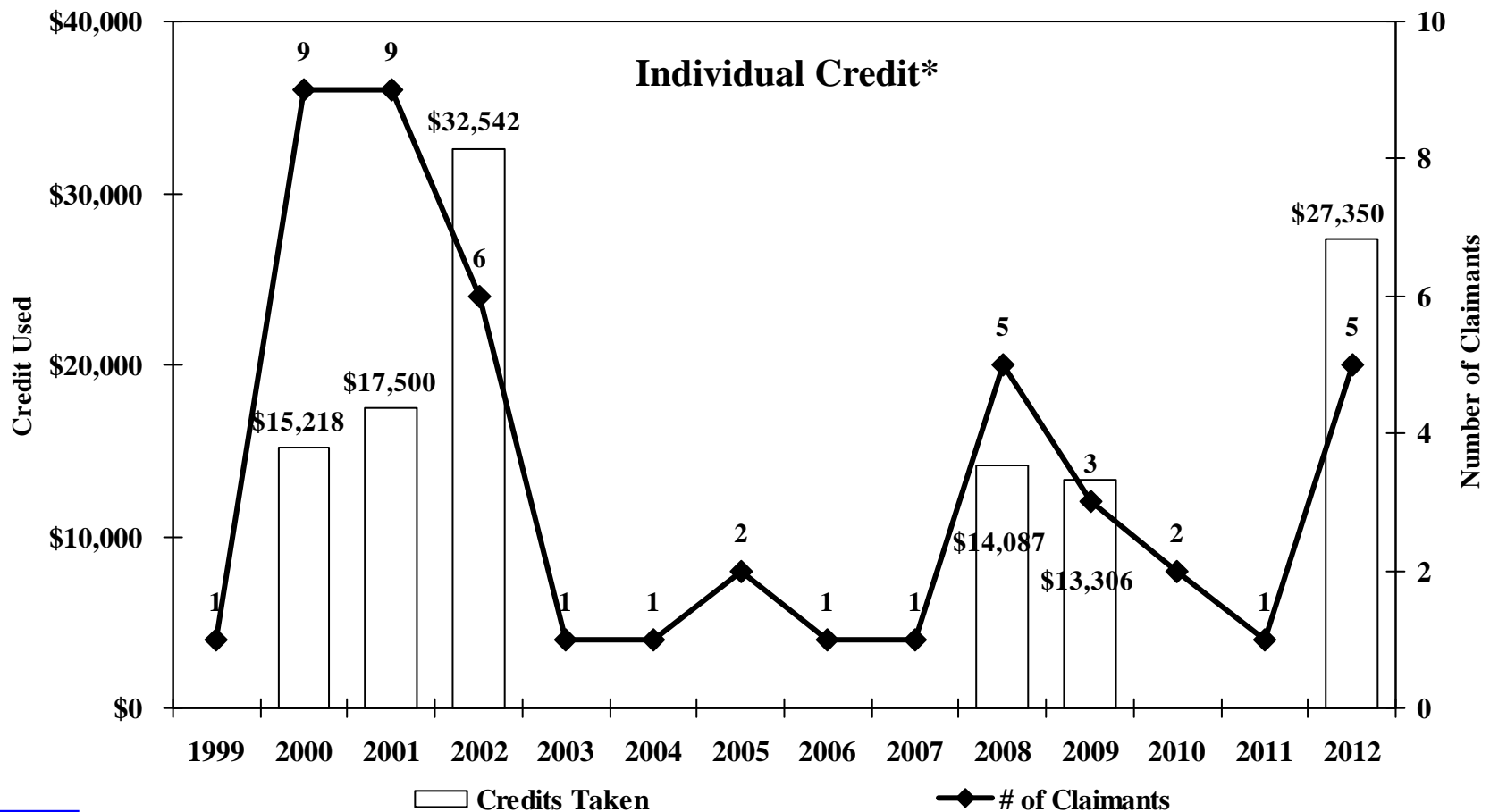
Agricultural Pollution Control Credit

- Description of Credit

- The credit is for expenses incurred to acquire agricultural pollution control equipment.
- Example of equipment that may qualify for the credit is dust filters in cattle feed yards.
- The credit is equal to 25% of the cost of equipment up to a maximum of \$25,000.
- Credit is nonrefundable.
- Carry forward is 5 years.

Agricultural Pollution Control Credit

- Amount of Credits Taken & Number of Claimants



*No data publicly released by DOR with respect to credit use for tax years 1999, 2003-2007, and 2010-2011



Agricultural Pollution Control Credit

- Benefits to the Arizona Economy

- Impact on the state's economy is likely negligible due to the limited use of the credit.
- Credit may have a small positive impact on the environment insofar as it induces taxpayers to reduce pollution that would not occur in the absence of the credit.

Agricultural Pollution Control Credit

- Potential Performance Measures

- Type of equipment purchased and its related environmental impact.
- Number of other states where a taxpayer receives a comparable credit.
- Last reviewed in 2009.
- Committee recommended that the tax credits be eliminated.

Agricultural Water Conservation Tax Credit

Agricultural Water Conservation Tax Credit

– Summary

- ❑ Cost – \$1.4 million in tax year 2012.
 - 89 claims filed by individual taxpayers in 2012.
 - Corporate credit was repealed in 2000.

- ❑ Purpose – mitigate cost incurred by farmers and ranchers to comply with water conservation requirements under the 1980 Groundwater Management Code.

- ❑ Complexity – simple to use and administer.

- ❑ Performance Measures – none in statute.

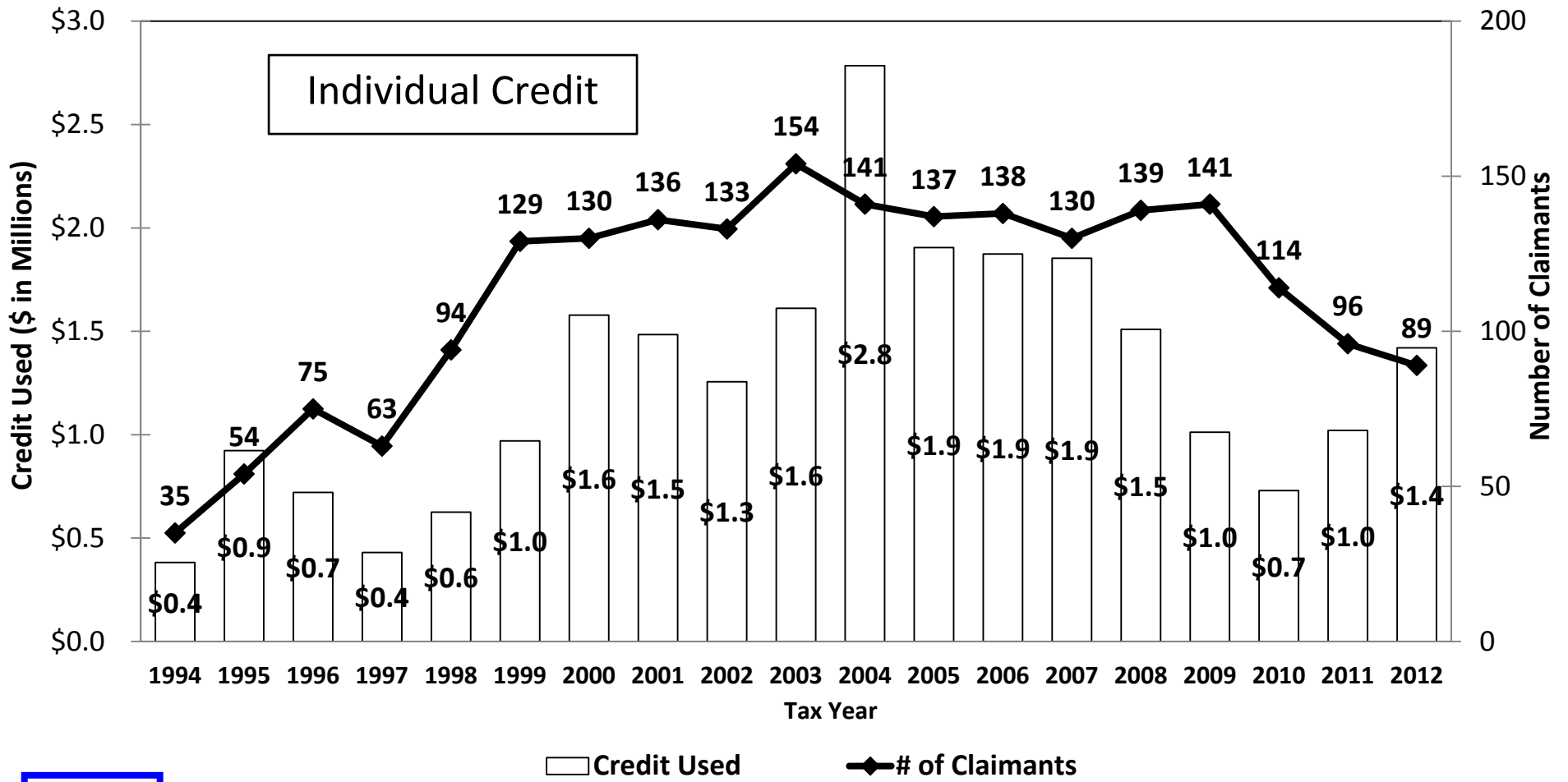
Agricultural Water Conservation Tax Credit

– Description of the Credit

- The credit is equal to 75% of expenses for the purchase and installation of an agricultural water conservation system during the taxable year. The credit has no cap.
- Examples of a water conservation systems that may qualify for the credit include irrigation equipment and machinery, such as sprinklers, engines, water pumps, and computer systems designed to aid irrigation and water management.
- Taxpayer must have a conservation plan on file with the USDA to qualify for credit.
- Credit is nonrefundable.
- Carry forward is 5 years.

Agricultural Water Conservation Tax Credit

- Amount of Credits Taken and Number of Claimants



Agricultural Water Conservation Tax Credit

– Benefits to the Arizona Economy

- ❑ Credit may have a positive impact on the environment insofar as it induces taxpayers to reduce water usage that would not occur in the absence of the credit.
- ❑ Credit may enhance Arizona's competitiveness relative to other states by reducing cost of production.
- ❑ No data is available to quantify potential impact on the state's economy.

Agricultural Water Conservation Tax Credit

– Potential Performance Measures

- A requirement to report on the reduction in water usage as a result of the installation of a qualified water conservation system.
- Number of other states where a taxpayer receives a comparable credit.
- Last reviewed in 2009.
 - Committee recommended at the time that the credit should be eliminated.

Private School Tuition Organization Credit

Private School Tuition Organization Credit

– Summary

- ❑ Cost – \$5.0 M in donations in FY 2015
 - actual credit usage may vary
- ❑ Purpose – assist parents with the cost of private school tuition for displaced or disabled pupils
- ❑ Complexity – simple to use for donors.
Administration, reporting and oversight are time-consuming for STOs and DOR because of the number of students and STOs and data quality issues
- ❑ Performance Measures – none in statute

Private School Tuition Organization Credit

– Description of Credit

- ❑ Corporate and insurance premium income tax credit for contributions to a school tuition organization (STO):
 - charitable organization exempt from federal taxes
 - awards 90% of tax credit revenue for scholarships & grants
- ❑ Maximum credit allowed is \$5 million statewide:
 - no separate maximum for individual corporations or insurers
 - DOR must preapprove credits, which provides “real time” data
 - cap reached for 1st time in FY 2015
- ❑ 8 STOs received contributions in FY 2013

Private School Tuition Organization Credit

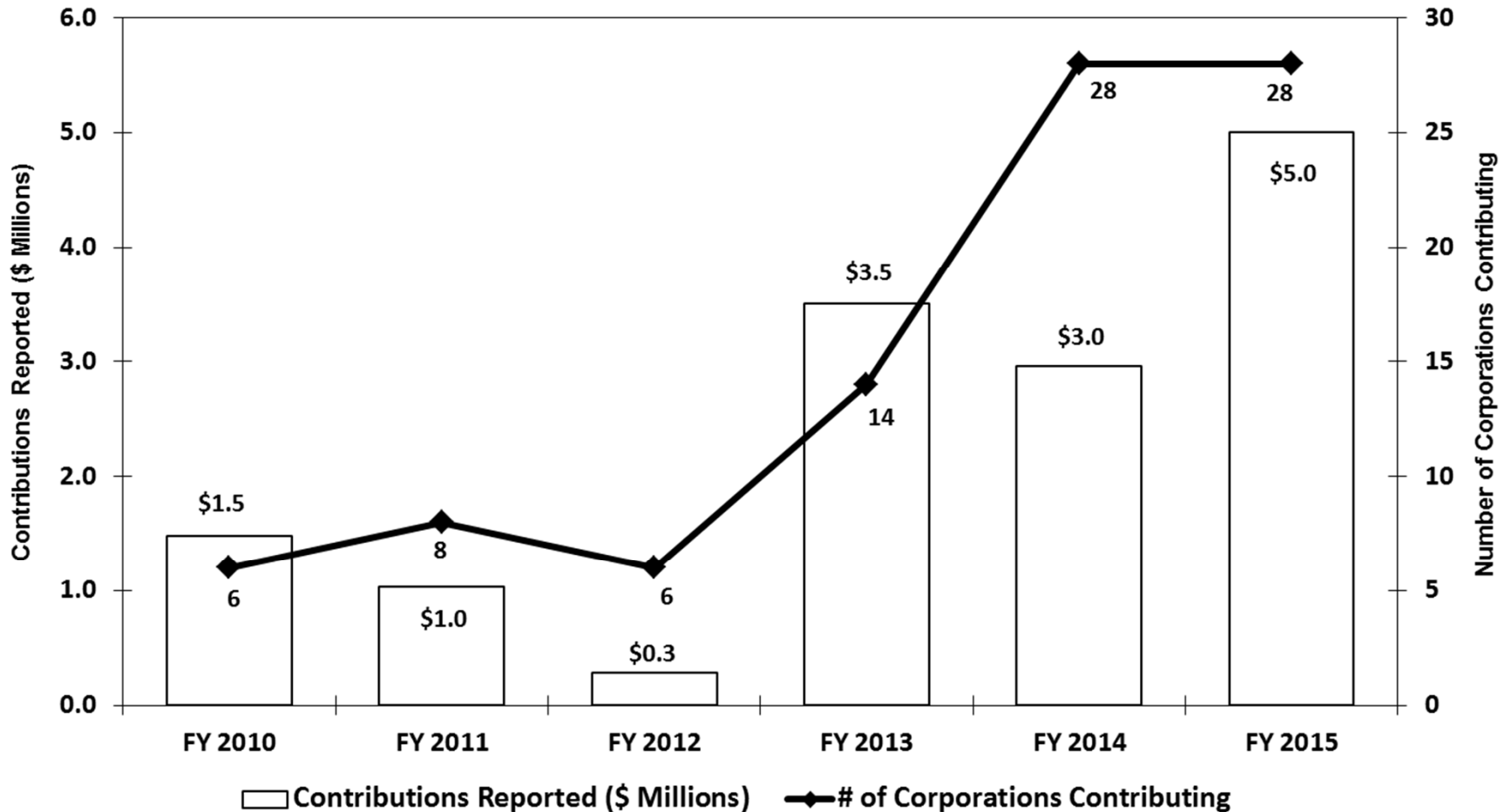
– Related STO Credits

Three other STO tax credits exist (none under review this year):

- Corporate & insurer “low income” STO credit
 - scholarships for “low income” students
- Individual “original” STO credit
 - scholarships for private school students (not restricted to low income or displaced/disabled)
- Individual “switcher” STO credit
 - scholarships mainly for students who switch to private schools
 - donor must first take maximum “original” STO credit

Private School Tuition Organization Credit

– In FY 2015, Average Contribution Was \$178,600



Private School Tuition Organization Credit

– Impact on State Revenues

- \$5.0 M in donations would result in \$(5.0) M state revenue loss if all donations resulted in credits
- Amount and timing of credits is uncertain because one tax year can cover 4 fiscal years
- Plus credits may be carried forward 5 years
- Only data on credits are for TY 11 & TY 12
- For TY 12 corporations used \$272,600 in credits, which was the total amount available for that year (no carry forward)

Private School Tuition Organization Credit

– Impact on State K-12 Costs

- ❑ Revenue loss is offset to the extent that credit allows students to attend private school who otherwise would have attended public school
- ❑ State K-12 Costs:
 - Operating – \$18,700 per ADM (assumed blended average for disabled & displaced pupils)
 - Capital – New construction and building renewal savings

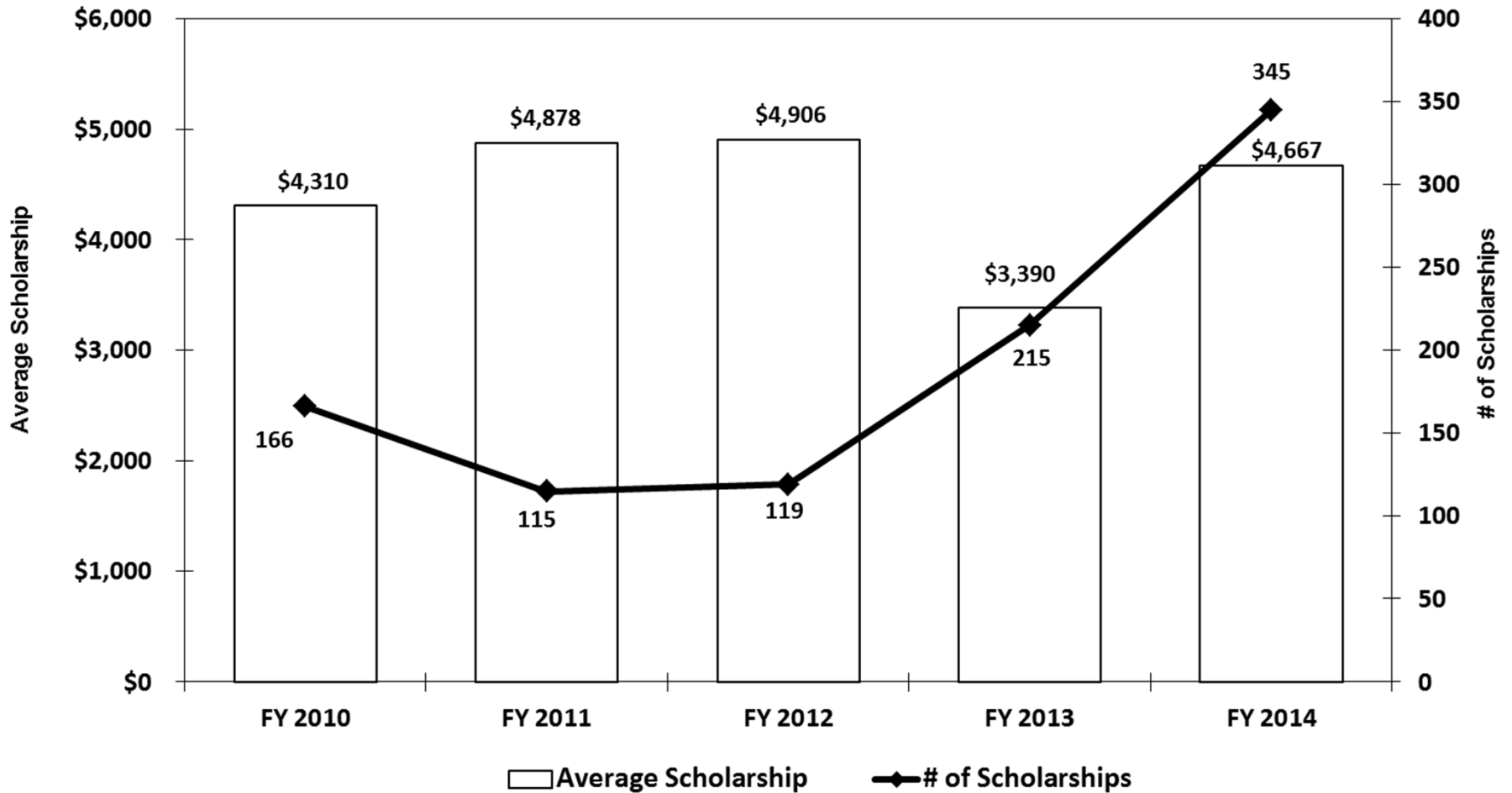
Private School Tuition Organization Credit

– Impact on State K-12 Costs

- ❑ No net long-term GF cost if FY 2015 donations of \$5.0 M (for example) reduced public school attendance by at least 270 pupils ($\$5.0 \text{ M} \div \$18,700$ presumed average savings per pupil = 270 students)
- ❑ 345 scholarships were awarded in FY 2014
- ❑ No data on the proportion of scholarship recipients who otherwise would attend public schools

Private School Tuition Organization Credit

– 345 scholarships awarded in FY 14 (average = \$4,667)



Data for FY 13 & FY 14 are preliminary



Private School Tuition Organization Credit

– Average Scholarship Funding and Tuition

- ❑ 345 scholarships in FY 2014 versus 130,000+ displaced or disabled pupils in Arizona
- ❑ Scholarships probably cover less than 25% of private school tuition costs for disabled pupils (\$4,667 average versus \$18,000 assumed tuition based roughly on special education voucher costs)

Private School Tuition Organization Credit

– Potential Performance Measures

- Percent of STO revenues retained for administrative costs
- Percent of private school tuition paid for with award funding

Healthy Forest Tax Credits

Healthy Forest Credits

– Summary

- ❑ Cost – \$0 in tax year 2012 for both the corporate and individual income tax credit.
 - No corporate credit claimed since tax year 2009, when its use was minimal.
 - No individual income credit claimed since inception.
- ❑ Purpose – Provide incentive to help establish businesses that promote forest health.
- ❑ Complexity – Not difficult to use but requires significant paperwork for application and reporting purposes.
- ❑ Performance Measures – Exist in statute as a result of 2009 Committee review.

Healthy Forest Credits

– Description of Employment Credit

- ❑ Employment credit is based on the net increase in the number of qualified employment positions created and filled.
- ❑ Amount of credit per employee depends on employee's wage and year of employment:
 - 1/4 of employee's wage in the 1st year of employment up to \$500
 - 1/3 of wage in the 2nd year of continuous employment up to \$1,000
 - 1/2 of wage in the 3rd year of continuous employment up to \$1,500
- ❑ Taxpayer cannot claim more than 200 qualified employment positions in any given tax year.

Healthy Forest Credits

– Description of Workforce Training Credit

- Workforce Training credit is based on the expenses incurred by a healthy forest enterprise in training a new employee in a qualified employment position.
- Amount of credit is the net cost to the taxpayer of training and certifying a new employee but not more than \$3,000 for each full-time employee in each of the first 3 years of employment.
- Taxpayer cannot claim more than 200 qualified employment positions in any given tax year.

Healthy Forest Credits

– Description of Credits (continued)

- ❑ Prior to using any tax incentive under the program, a business must first be approved (“certified”) by ACA. (A total of 7 businesses certified in 2014.)
- ❑ Certified business must submit an annual report to ACA and reapply for certification every 5 years.
- ❑ Besides the tax credit, the program also offers other incentives related to use fuel, sales and property taxes.
- ❑ Credit is nonrefundable with a 5-year carry-forward.

Healthy Forest Credits

– Amount of Credits Taken & Number of Claimants

- No corporate tax credit claimed since 2009.
- No taxpayers claimed the individual income tax credits from 2005 to 2013.

Healthy Forest Credits

– Benefits to the Arizona Economy

- ❑ Impact on the state's economy is likely negligible due to the limited use of the credit.
- ❑ Certified businesses have indicated that the incentives program was an important factor in the decision to locate, expand, or remain in the state.
- ❑ Beginning in 2011, ACA has reported to JLBC on the total weight of harvested, processed and/or transported forest materials.

Healthy Forest Credits

– Performance Measures

- ❑ The following performance measures were adopted as a result of Committee review in 2009:
 - Requirement to report quantity of qualifying forest products harvested, processed, or transported for commercial use.
 - Total statewide number of new jobs created as a result of the program.
- ❑ The Committee also recommended that the credit be continued and receive enhanced performance measures.

Renewable Energy Investment and Employment Tax Credit

Renewable Energy Investment Tax Credit

– Summary

- Cost – Prior to '13, no usage of credit. In '13, one business did receive final approval.
- Purpose – to encourage renewable energy investment that results in high-income employment
- Complexity – simple to administer due to third party verification. Credit recapture could add complexity
- Performance Measures – amount of investment qualifying for pre-approval and post-approval

Renewable Energy Investment Tax Credit

– Description of the Credit

- ❑ Individual and corporate credits for renewable energy investments in manufacturing or company headquarters
- ❑ Eligibility for full 10% credit, requires 1 of 2 conditions to be met:
 - up to \$500,000 of manufacturing investment per 1.5 new jobs
 - up to \$200,000 of headquarters investment per 1 new job
- ❑ New jobs must meet wage and health insurance requirements
- ❑ Available through 2019 and has an annual cap of \$70 million statewide and \$30 million per company
 - Cap is shared with the Qualified Facility Credit

Renewable Energy Investment Tax Credit

– Description of the Credit

- ❑ Credit is refundable, which means the state will pay the credit even if the company has insufficient tax liability
 - Refundable credits create more financial risk for the state
- ❑ Commerce Authority approves credit amounts
 - Pre-approval establishes the company's priority in receiving credits
 - Post-approval includes third party verification of the company's investment and job creation

Renewable Energy Investment Tax Credit

– Benefits to the Arizona Economy

- ❑ Since 2010, \$101.6 million of investment has been pre-approved, but only \$21.4 million has been post-approved
- ❑ ACA has post-approved \$1.6 million in credits for 1 business – must be spread over 5 years
- ❑ Difficult to determine if investments and job creation would have occurred in the absence of the credit

Renewable Energy Investment Tax Credit

– Potential Performance Measures

- ❑ Statute requires the Commerce Authority to report annually on the amount of investment and credits receiving pre-approval and post-approval
- ❑ Additional measures could include:
 - number of qualifying jobs
 - number of other states where a business receives a comparable credit
- ❑ This is the credit's first review since its 2010 creation