

2018 Income Tax Credit Review

Joint Legislative Income Tax Credit Review Committee

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2018 Credit Reviews

- ☐ Annually reviews credits as determined in statute
- ☐ This year's review includes:
 - Research & Development Credit
 - Pollution Control Equipment Credit
 - Coal Consumed in Generating Electric Power Credit
- ☐ All 3 credits have been previously reviewed by the committee

Summary of Prior Credit Reviews

- ☐ Between 2002 and 2015, Committee reviewed 33 credits
- ☐ Committee did not convene in 2016 and 2017
- ☐ Between 2002 and 2015, Committee recommended 16 credits to be repealed
- ☐ 1 of the 16 credits was repealed by Legislature
- ☐ 8 of the 33 reviewed credits have since expired

Role of the Committee

- ☐ Determine original purpose of credit
- ☐ Establish standards for evaluating and measuring success or failure of credit
- ☐ After review process, recommend whether credit should be amended, repealed or retained

Standards for Evaluating Credit

- ☐ History, rationale and revenue impact of credit
- ☐ Benefits of credit in terms of measurable economic development, investments and jobs
- ☐ Complexity of credit in terms of application, administration and approval process

Confidential Taxpayer Information

- ☐ Statute authorizes DOR to disclose confidential “statistical information” to the Committee, JLBC Staff and Legislative 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
- ☐ All credits on the 2018 review schedule include confidential information

Issues Affecting Evaluation

- ☐ Lack of performance measures
- ☐ Certain costs and benefits can be difficult to quantify

Research and Development Tax Credit

Research and Development Tax Credit

– Summary

- ☐ Cost – \$78.9 million in *nonrefundable* credits and \$4.8 million in *refundable* credits used in FY 2018
- ☐ Purpose – attract high-tech industry and remain competitive with other states
- ☐ Complexity – unusually complex in calculation and administration; record-keeping requirement can be burdensome
- ☐ Performance Measures – none in statute

Research and Development Tax Credit

– Description of the Credit

- ☐ Credit is calculated based on same definitions as under federal R&D program
- ☐ Credit applies to R&D expenses above a certain base amount (“excess expenses”)
- ☐ If excess expenses \leq \$2.5m, credit is 24% of the amount; if excess expenses $>$ \$2.5m, credit is \$600,000 plus 15% of the amount above \$2.5m

Research and Development Tax Credit

– Nonrefundable R&D Credit Program

- ☐ Nonrefundable program consists of both the standard credit and an additional credit for university research
- ☐ University research credit is an additional 10% over and above amount allowed under standard credit
- ☐ Standard research credit has no cap and allows unused amounts to be carried forward up to 15 years
- ☐ University research credit is capped at \$10 million annually and provides a 5-year carry forward

Research and Development Tax Credit

– Refundable R&D Credit Program

- ☐ Credit is refundable for businesses with fewer than 150 full-time employees
- ☐ Refund is limited to 75% of the amount by which the credit exceeds the taxpayer's liability
- ☐ Remaining 25% of the excess credit must be forfeited
- ☐ Up to \$5 million in refundable credits can be authorized each year

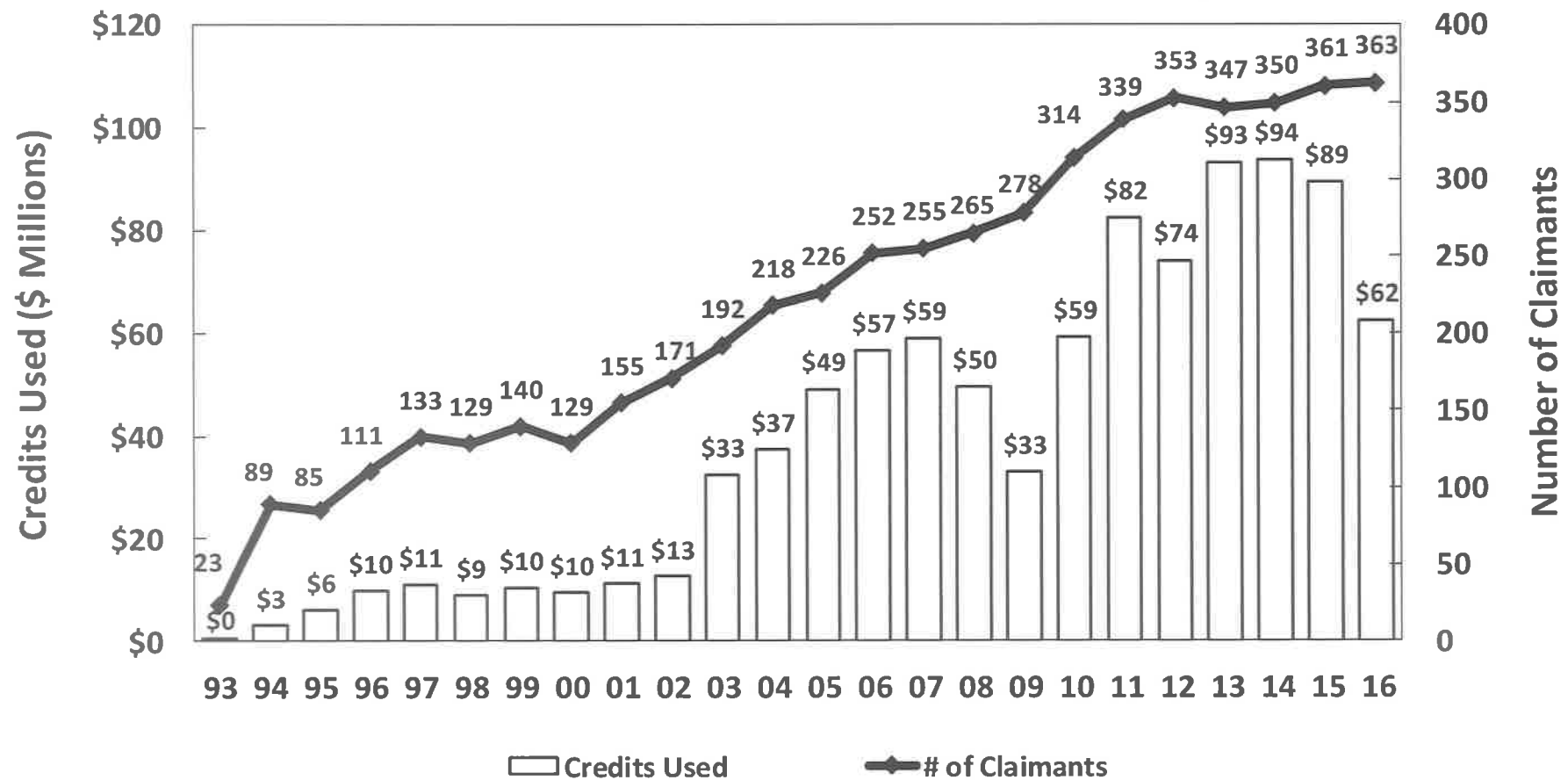
Research and Development Tax Credit

– Carry Forward of Unused Credits

- ☐ Credit carry forwards before 2003 are limited to \$500,000
- ☐ Limited carry forward amounts cannot be claimed after TY 2017
- ☐ Credit carry forwards from and after 2003 are not limited
- ☐ However, unlimited carry forwards cannot exceed taxpayer's liability

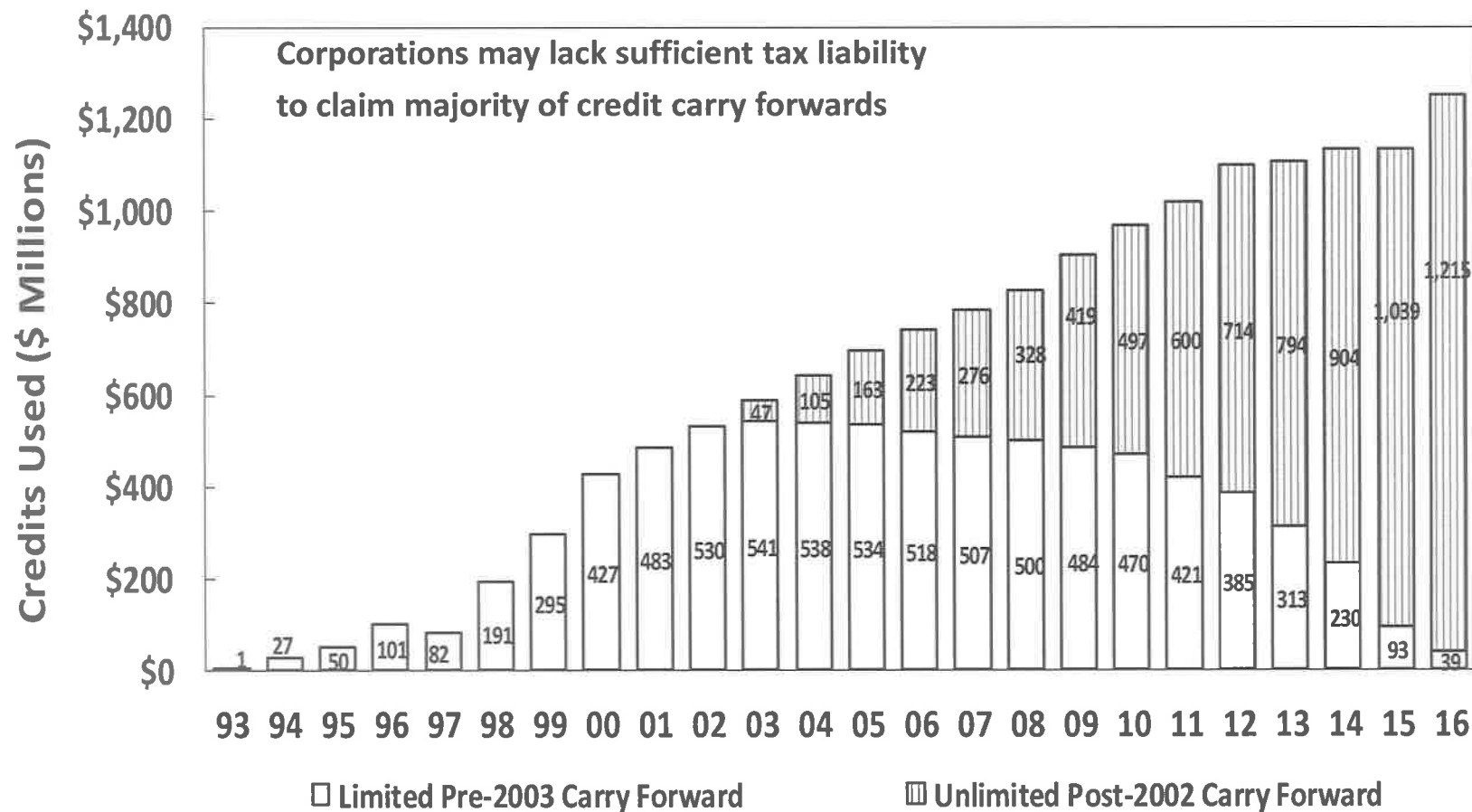
Research and Development Credit (Corporate)

– Amount of Credits Used & Number of Claimants



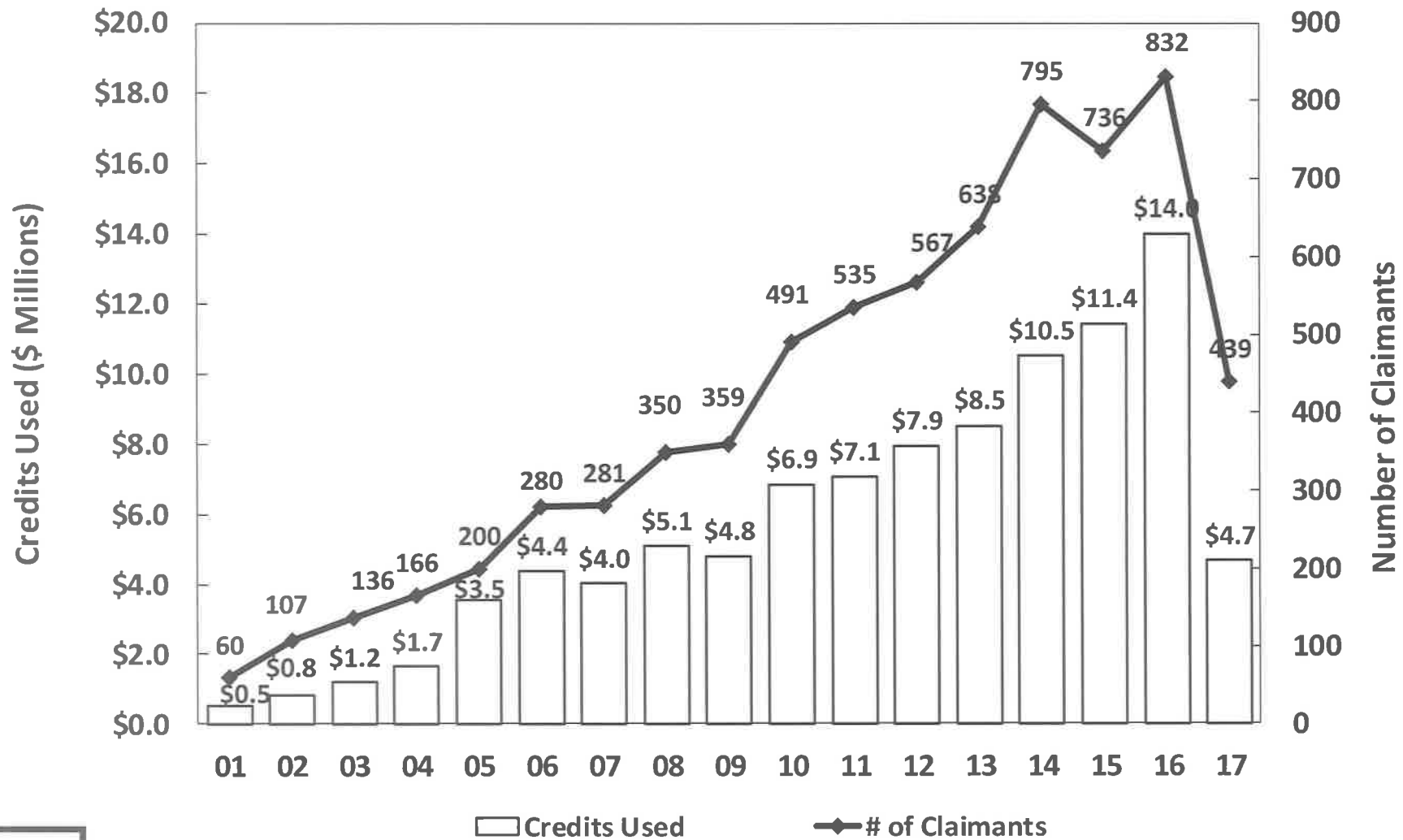
Research and Development Credit (Corporate)

– Amount of Limited and Unlimited Credit Carry Forward



Research and Development Credit (Individual)

– Amount of Credits Used & Number of Claimants



Research and Development Tax Credit

– Benefits to the Arizona Economy

- ☐ Qualified R&D spending since inception of program is about \$18.6 billion
- ☐ It is not known, however, how much of the R&D spending was directly attributable to the credit program
- ☐ Arizona's share of national R&D spending is 1.5%, the 18th highest among states.
- ☐ Academic studies show varied results regarding the effectiveness of state R&D credits
- ☐ Impact of R&D program on Arizona jobs and investments is uncertain

Research and Development Tax Credit

– Potential Performance Measures

- ☐ Total research dollars spent in Arizona each year
- ☐ Numbers of persons employed in research activities
- ☐ Total research payrolls
- ☐ Introduction of new products as a result of R&D activities
- ☐ Last reviewed in 2013
 - Committee recommended to amend credit with enhanced performance measures

Pollution Control Equipment Tax Credit

Pollution Control Equipment Tax Credit

– Summary

- ☐ Cost – \$2.5 million for the corporate credit in FY 2018 and \$100,000 for the individual credit in FY 2017 (FY 2018 not reported due to confidentiality)
- ☐ Purpose – to encourage investment in pollution control and pollution prevention equipment
- ☐ Complexity – verification sometimes difficult for DOR, as it can require some scientific knowledge
- ☐ Performance Measures – none in statute

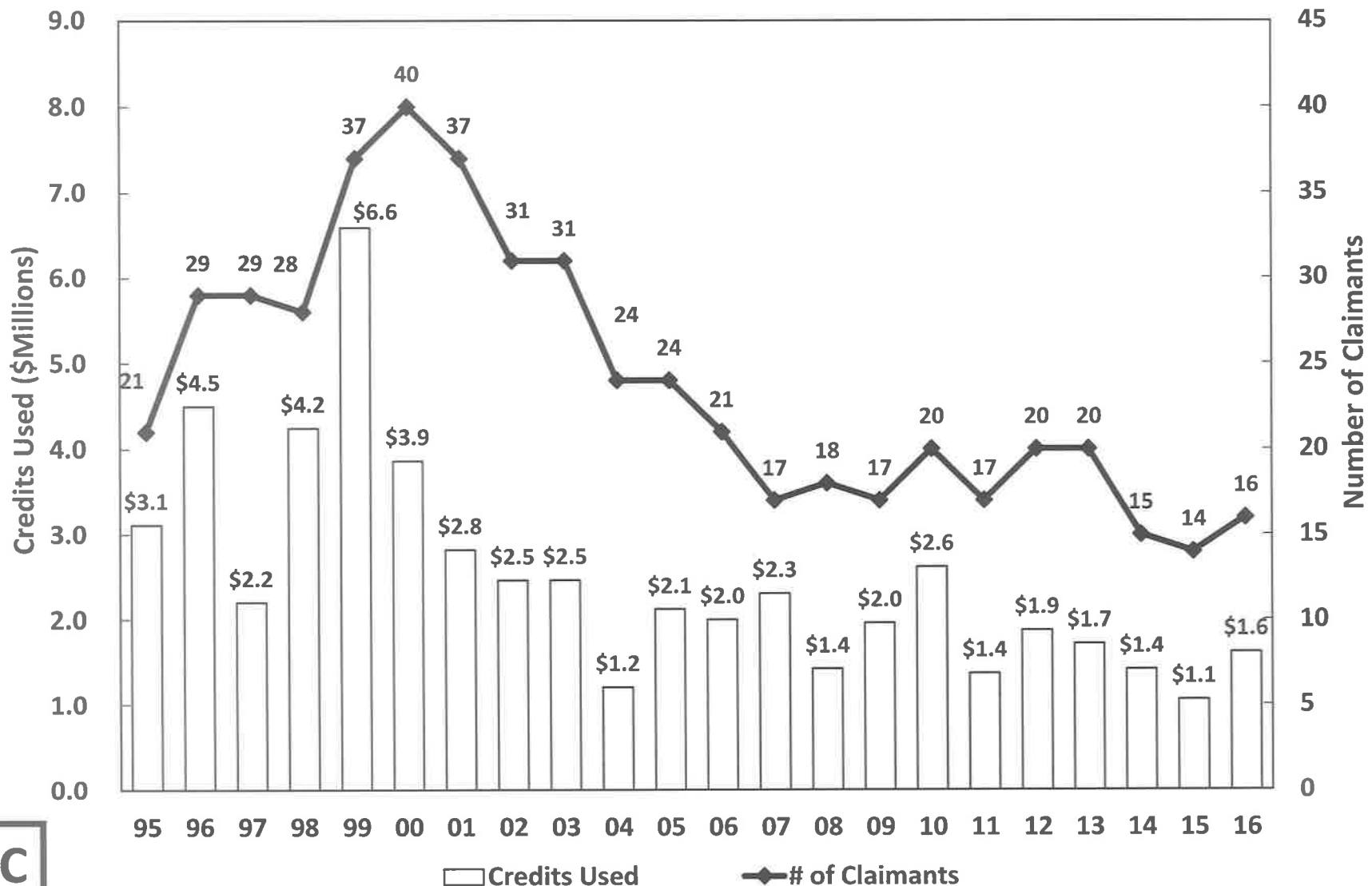
Pollution Control Equipment Tax Credit

– Description of the Credit

- ☐ Individual and corporate credits are applicable to pollution control equipment required by the EPA, DEQ, or other political subdivision
- ☐ The credit is equal to the lesser of 10% of the purchase price of pollution control equipment or \$500,000
- ☐ Credit is non-refundable
- ☐ Carry forward is 5 years

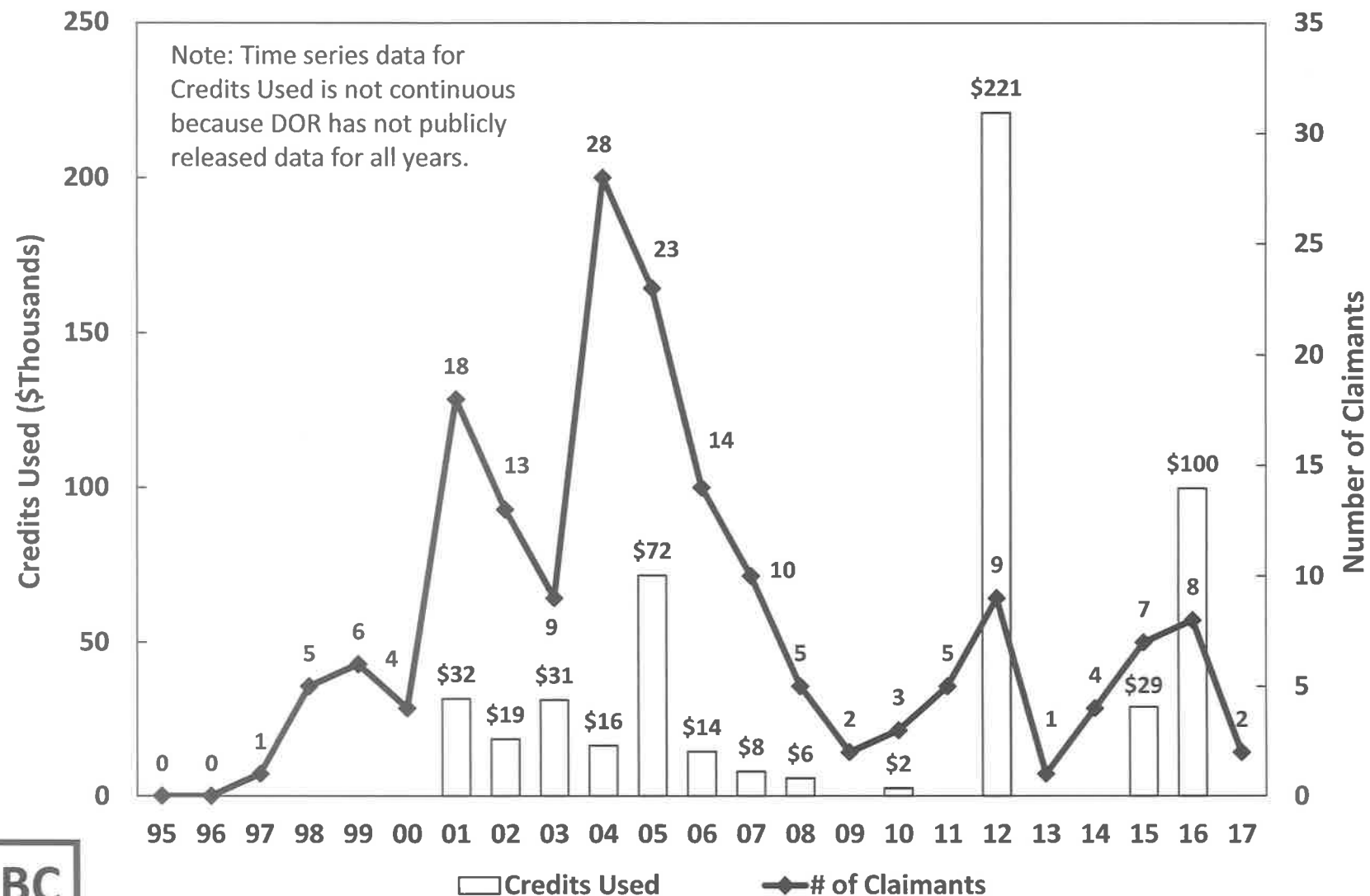
Pollution Control Equipment Tax Credit

– Amount of Corporate Credits Used & Number of Claimants



Pollution Control Equipment Tax Credit

– Amount of Individual Credits Used & Number of Claimants



Pollution Control Equipment Tax Credit

– Benefits to the Arizona Economy

- ☐ Since 1995, DOR reports the credit has been used for \$1.3 billion of anti-pollution investments
- ☐ May have benefited the Arizona economy insofar as it has resulted in capital investments, job creation, and mitigation of pollution that would not have occurred in the absence of the credit
- ☐ No empirical evaluation of the credit has been conducted to date

Pollution Control Equipment Tax Credit

– Potential Performance Measures

- ☐ Type of equipment purchased and its related environmental impact
- ☐ Increase in pollution control equipment purchases relative to states who do not offer similar credits.
- ☐ Last reviewed in 2013
 - Committee recommended amendment to enhance performance measures
 - No such legislation was proposed

Coal Consumption Tax Credit

Coal Consumption Tax Credit

– Summary

- ☐ Cost – \$1.4 million in FY 2018
- ☐ Purpose – to encourage purchase and delivery of coal in Arizona, and maintain tax base in rural counties
- ☐ Complexity – simple to use and administer
- ☐ Performance Measures – none in statute

Coal Consumption Tax Credit

– Description of the Credit

- ☐ Corporate income tax credit allowed for taxpayer purchases of coal consumed in generating electricity in Arizona
- ☐ The credit is equal to 30% of the amount paid as transaction privilege or use tax with respect to the coal sold to the taxpayer
- ☐ The credit is non-refundable
- ☐ The tax credit may be carried forward for up to 5 years

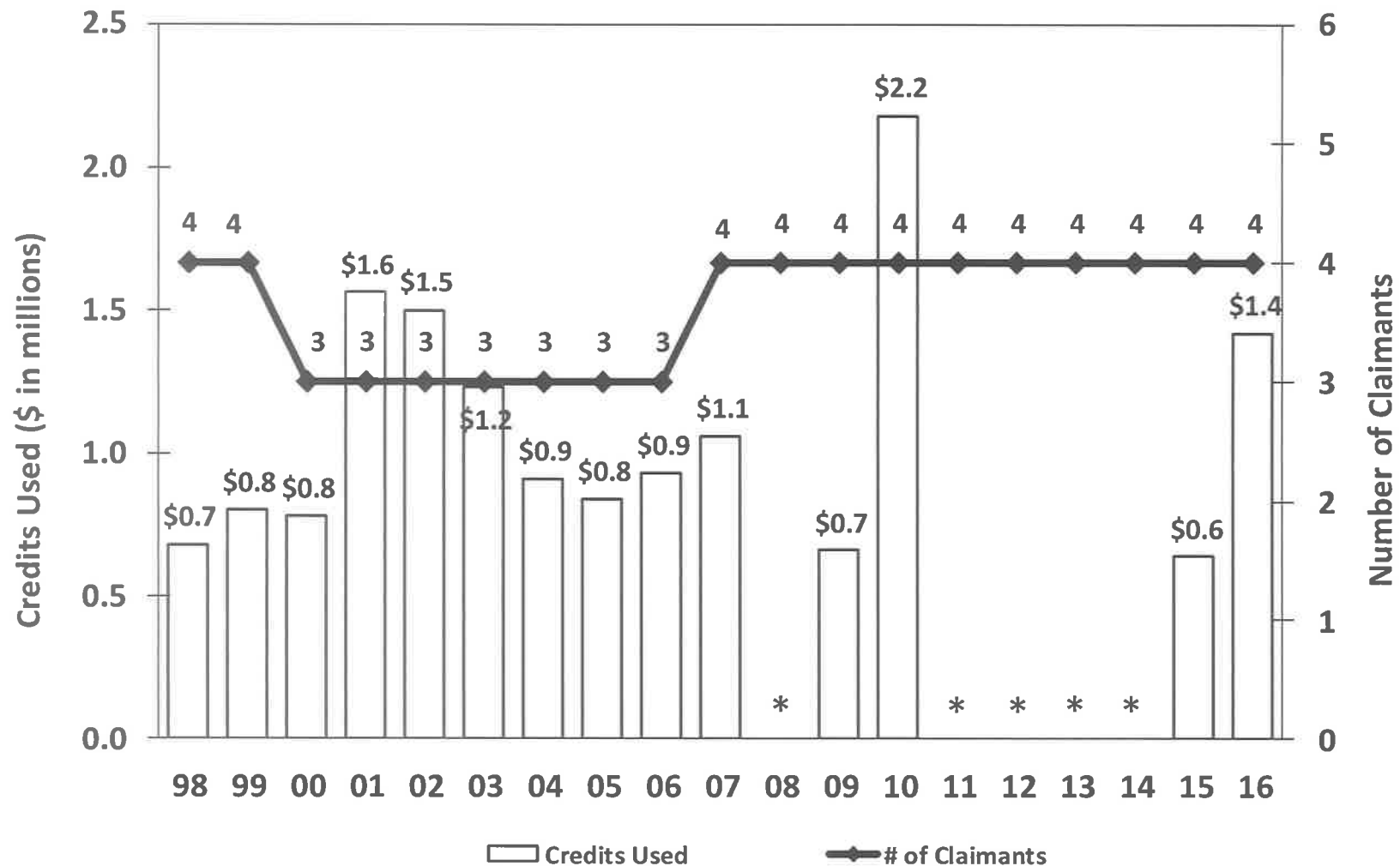
Coal Consumption Tax Credit

– Recent Legislation

- ☐ Laws 2018, Ch. 263 conditionally exempts purchased coal from state and municipal TPT.
- ☐ Only effective if Navajo Generating Station transferred to new ownership by December 31, 2022.
- ☐ If law becomes effective, the dollar value of corporate income tax credit would be reduced.

Coal Consumption Tax Credit

– Amount of Credits Used & Number of Claimants by Tax Year



*Years without data due to confidential credit information

Coal Consumption Tax Credit

– Benefits to the Arizona Economy

- ❑ If coal purchases have shifted from other states to Arizona, some of the lost corporate income tax revenue from the credit would be offset by increased sales and use tax revenue
- ❑ The benefits directly resulting from this tax credit are unknown. However, by enhancing revenue in counties where coal purchases are made, the counties are able to maintain or improve their tax base

Coal Consumption Tax Credit

– Potential Performance Measures

- ☐ Estimates by the affected counties of the credit's net fiscal impact on their budgets
- ☐ Annual estimates and the dollar value of coal purchased for electrical generation in Arizona
- ☐ Last reviewed in 2013
 - Committee recommended credit be amended to enhance performance measures - no legislation introduced