Joint Legislative Budget Committee
Staff Memorandum

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DATE: December 2, 2014

TO: Members, Joint Legislative Income Tax Credit Review Committee

FROM: Hans Olofsson, Chief Economist

SUBJECT: 2014 INCOME TAX CREDIT REVIEW

This memo transmits background materials for the December 8**,** 2014 meeting of the Joint Legislative Income Tax Credit Review Committee.

Background

Laws 2002, Chapter 238 established the Joint Legislative Income Tax Credit Review Committee, and specified a schedule for review of corporate and individual income tax credits. The credits scheduled for review in 2014 include:

The Joint Legislative Income Tax Credit Review Committee is charged with determining the original purpose of each of the existing income tax credits and establishing a standard for evaluating the success or failure of the credit. Pursuant to statute (A.R.S. § 43-221), the standard for evaluation of the credits may include: (1) the history, rationale and revenue impact, (2) the benefit to the state in various economic terms, and (3) the complexity in the use and administration of the credit.

The Committee last reviewed the agricultural pollution control equipment tax credit, agricultural water conservation system tax credit, and healthy forest enterprise tax credits in 2009. The school tuition organization displaced/disabled student tax credit as well as the renewable energy investment tax credit will be reviewed for the first time in 2014.

Confidential Data

Pursuant to Laws 2010, Chapter 225, the Department of Revenue (DOR) is authorized to disclose confidential statistical information to this Committee and JLBC Staff. The non-disclosure of credit information prior to Chapter 225 was intended to protect taxpayer confidentiality. DOR considers tax credit information to be confidential if: (1) 3 or fewer taxpayers claimed the credit, or (2) 90% or more of the total credit used to offset tax liability was taken by 1 taxpayer.

(Continued)

All of the tax credits that are on the 2014 credit review list, except for the agricultural water conservation system credit, include confidential information for 1 tax year or more. After reviewing the data and consulting with DOR, JLBC Staff has concluded that the magnitude of the dollar value of the confidential information does not materially change the underlying evaluation of the credits. For this reason, the confidential credit data will not be included in general presentation to the Committee. As a result, the Committee will be able to remain in open session.

We have provided a separate memo to the Committee that contains the confidential credit data furnished by DOR. Any discussions regarding this memo must be held in Executive Session.

Limitations

There are several limitations that affect the evaluation of income tax credits. For example, the timeliness of data is one such limitation. The latest available tax credit data released by the Department of Revenue (DOR) is for tax year 2012. This information is preliminary, however, which suggests that it will likely be revised in future years.

A second limitation is the lack of performance measures for tax credits. While a few credits have stated performance measures or goals, all other credits have no such objectives included in statute. Laws 2002, Chapter 238, requires any new credit to include a clause that explains the rationale and objective of the credit (A.R.S. § 43-223).

Finally, the evaluation of tax credits is often hampered by the difficulty of measuring their costs and benefits. For example, the water conservation system 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 such incentive. However, due to the lack of data on water usage before and after credit enactment, it is difficult to measure such impact.

2014 Review

The following information is provided (where applicable) for each of the credit categories:

Description - The definition of the tax credit, and how the credit is calculated.

Refundable - Whether the credit is refundable or nonrefundable. A nonrefundable credit can never exceed the taxpayer's tax liability. Instead, any amounts not used to offset the taxpayer's liability in a taxable year can either be carried forward to future tax years or must be forfeited in the same tax year. By contrast, a refundable credit is allowed to exceed the taxpayer's tax liability and any excess amounts are refunded to the taxpayer.

Transferable - Whether or not any unused portion of the credit can be sold or otherwise transferred to other taxpayers. None of the credits included in the current review is transferable.

Carry Forward - Whether or not any unused nonrefundable credit may be carried forward into subsequent tax years, and if so, for how many years.

History and Rationale - The year the tax credit was implemented, revisions to the credit since its enactment, and relevant information regarding the intended purpose of the credit.

Revenue Impact - Based on data reported by DOR, information for each tax year on the number of claimants, the amount of total available credit, credit used, and credit carried forward to a subsequent tax year.

Economic Benefits - A summary of information available related to any economic benefits associated with each tax credit, including economic development, new investments, job creation or retention of existing jobs, and any other economic benefits that may be specific to each credit.

Complexity - Information related to the complexity of administration and application of each tax credit, including the perspective of the state agencies administering the credit, as well as the trade associations and representatives of the corporations and/or individuals claiming the credit.

Potential Performance Measures - A listing of potential measures that might be used to evaluate each of the income tax credits.

The reported information was obtained from a variety of sources. The JLBC Staff reviewed the statutes establishing each of the credits, as well as the tax forms and instructions used by businesses and individuals to claim the credits.

The JLBC Staff also reviewed summaries and minutes of committee and subcommittee hearings that were held prior to adoption of the credits. Various agencies were contacted, including DOR and the Arizona Commerce Authority.

HO:kp
Attachment
xc: Reed Spangler, Senior Policy Advisor, Senate
John Fetherston, Policy Advisor, Senate
Bill Ritz, Analyst, Senate Finance Committee
Lorenzo Romero, Director of Fiscal Policy, House
Eric Figueroa, Policy Advisor, House
Michael Madden, Assistant Analyst, House Ways and Means Committee

Agricultural Pollution Control Equipment Tax Credit

Agricultural Pollution Control Equipment Tax Credit

Summary

- The cost of the individual credit was $27,350 in tax year 2012, the last year for which data has been released. A total of 5 taxpayers claimed an average credit of $5,470 in tax year 2012.
- There were a total of 47 claims for the individual credit between 1999 and 2012.
- The corporate credit was not claimed between tax year 2007 and tax year 2012, the last year for which data has been released.
- There were a total of 7 claims for the corporate credit between 1999 and 2012.

Statute

A.R.S. § 43-1170.01 (Corporate)
A.R.S. § 43-1081.01 (Individual)

Description

The agricultural pollution control equipment credit is provided for the purchase of real or personal property that is used in the taxpayer's business to prevent or control pollution associated with the commercial production of livestock and agricultural crops, including the cultivation of flowers, ornamental plants, and grapes.

Only that portion of the property that is directly used to prevent or control pollution is eligible for the credit. The amount of the credit is 25% of the cost of the property, up to a maximum credit of $25,000. This credit can be claimed against both individual and corporate income taxes.

Refundable

The credit is not refundable.

Carry Forward

The tax credit may be carried forward for 5 taxable years.

History and Rationale

This credit was created by Laws 1998, Chapter 286 and became effective as of January 1, 1999. According to a fact sheet prepared by the Senate Staff on June 18, 1998, the agricultural industry was under increasing pressure by the government to reduce the amount of pollution it emitted as a result of traditional farming practices. The agricultural pollution control credit was created to mitigate the costs incurred by farmers and ranchers to comply with environmental regulations.

This credit is similar to the general pollution control equipment credit that was reviewed by the committee last year. To qualify for the credit, the general pollution control equipment must meet or exceed the rules or regulations regarding air, water, or land pollution of the U.S. Environmental Protection Agency, Arizona Department of Environmental Quality, or a political subdivision. Such requirements are not necessary in order to qualify for the agricultural pollution control credit.

According to the Arizona Farm Bureau Federation, dust pollution is the main source of agricultural pollution in Arizona. However, to a lesser extent, agricultural pollution can also be caused by streambank erosion. Dust pollution can be controlled by such means as installing dust filters in cattle feedyards, replacing dirt roads with gravel roads, and building wind breaks. Streambank erosion can be controlled by fencing areas near streams to keep cattle away.

Revenue Impact

The cost of the corporate credit was $0 in 2012, the last year for which data has been released. The cost of the individual credit was $27,350 in 2012, the last year for which data has been released. The table below, which was provided by DOR, summarizes the impact of the credits on corporate and individual income taxes.

Tax Year	# of Claimants	Total Credit Available	Credit Used	Carry Forward
Corporate				
1999	1	x	x	x
2000	1	x	x	x
2001	1	x	x	x
2002	1	x	x	x
2003	1	x	x	x
2004	1	x	x	x
2005	0	$0	$0	$0
2006	1	x	x	$0
2007	0	$0	$0	$0
2008	0	$0	$0	$0
2009	0	$0	$0	$0
2010	0	$0	$0	$0
2011	0	$0	$0	$0
2012	0	$0	$0	$0
Individual				
1999	1	x	x	x
2000	9	$77,096	$15,218	$61,878
2001	9	$54,870	$17,500	$37,370
2002	6	$47,706	$32,542	$15,164
2003	1	x	x	x
2004	1	x	x	x
2005	2	x	x	x
2006	1	x	x	x
2007	1	x	x	$0
2008	5	$14,331	$14,087	$244
2009	3	$16,569	$13,306	$3,263
2010	2	x	x	$0
2011	1	x	x	$0
2012	5	$27,350	$27,350	$0

# of Claimants- the number of taxpayers who claimed the credit in each year.
Total Credit Available– the total tax credits identified in each tax year, including any new credits and any credits carried over from a previous year and identified in that year.
Credit Used– the total value of credits claimed in each year.
Carry Forward – the total credit identified but not used in each year. The full carry forward may not be reflected in the following year's estimate. For example, a taxpayer could have $1 million in a particular credit identified in tax year 2007, use $400,000 of this amount in 2007 and leave $600,000 as a carry forward. If this taxpayer did not identify or claim the credit in 2008 the $600,000 carry forward would not be included in the credit carry forward total for 2008.
x - No data publicly released by the Department of Revenue.

Economic Benefits

New Investments
Creation of New Jobs or Retention of Existing Jobs
Commercial Infrastructure Development

This credit is not intended to promote economic development or spur new investments that would result in new jobs. Instead, according to DOR's August 2000 report "Income Tax Credits in Arizona," it is one of several tax credits in statutes intended to encourage environmentally responsible behavior.

In a theoretical sense, however, the credit may provide some economic benefits to Arizona. Environmental regulations impose costs on farmers and ranchers. To the extent that this credit mitigates such costs, it may enhance Arizona's competitiveness relative to other agricultural states. However, since so few taxpayers have claimed the credit, it is likely to have had a negligible impact on the state's economy.

Other

Generally, the credit may have a positive impact on the environment insofar as it induces taxpayers to reduce pollution that otherwise would not be reduced. However, since so few taxpayers have claimed the credit since it was created, it is unlikely that the credit has had any significant impact on agricultural pollution in Arizona.

According to a report by the Governor's Citizens Finance Review Commission issued August 22, 2003, none of the 10 states identified as Arizona's competitors offers a similar credit.

Complexity

The credit does not seem to be unnecessarily complex in the application, administration, and approval process.

Potential Performance Measures

Performance measures could include:

1. Type of equipment purchased and its related environmental impact.
2. Number of states where a farmer or rancher receives a comparable credit.

Prior Review

The agricultural pollution control equipment tax credit was last reviewed by the JLITCRC in 2009. The Committee recommended that the individual and corporate income tax credits for agricultural pollution control equipment should be eliminated.

Agricultural Water Conservation System Tax Credit

Agricultural Water Conservation System Tax Credit

Summary

- The cost of the individual income credit was $1.4 million in tax year 2012, the last year for which data is available.
- A total of 89 individuals claimed an average credit of $15,955 in tax year 2012.
- The corporate credit was repealed as of January 1, 2000.

Statute

A.R.S. § 43-1084 (Individual)

Description

The agricultural water conservation system credit is provided for the purchase and installation of systems primarily designed to substantially conserve water on land used to produce (1) crops, fruit or other agricultural products, (2) raise, harvest or grow trees, or (3) sustain livestock. The credit is available only as an individual income tax credit, and not as a corporate income tax credit. However, an S corporation may pass the credit through to its individual shareholders. A partnership may not claim this credit, but may pass the credit through to its individual partners.

The credit is equal to 75% of the qualifying expenses incurred during the taxable year for the purchase and installation of the system. There is no cap on the dollar value of the tax filer's credit. The expenses must be consistent with a conservation plan that the taxpayer has filed and is in effect with the U.S. Department of Agriculture (USDA).

According to USDA, the term "agricultural water conservation system" refers to a wide range of water management measures. For example, the term applies to irrigation equipment and machinery, including sprinklers, pipes, pumps, motors and engines, and computer systems for irrigation and water management.

Refundable

The credit is not refundable.

Carry Forward

The tax credit may be carried forward for 5 taxable years.

History and Rationale

This credit was created by Laws 1994, Chapter 90 and became effective retroactively from January 1, 1994. According to legislative staff and the Arizona Farm Bureau Federation, the credit was created in response to the enactment of the 1980 Arizona Groundwater Management Code. One of the provisions in the Code directs the Arizona Department of Water Resources (ADWR) to develop and implement water conservation requirements for agricultural, municipal, and industrial water users in 5 consecutive periods. Each management period covers 10 years with the first period starting in 1980. Under the Code, the management plans will contain more rigorous water conservation and management requirements with each successive period.

According to the Arizona Farm Bureau Federation, this credit was established in an effort to mitigate the costs incurred by farmers and ranchers to comply with the increasingly rigorous water conservation requirements under the Code.

Laws 1999, Chapter 318 repealed the corporate credit for agricultural water conservation systems as of January 1, 2000. However, the law provided for corporate taxpayers to carry forward unused credits from prior tax years for up to 5 years. Besides this credit, the act also repealed 4 other corporate income tax credits. (Note that Laws 1999, Chapter 318 did not repeal any individual income tax credits.)

According to legislative documents, the intention of this legislation was to eliminate corporate income tax credits that were not widely used and then use the resulting General Fund savings to "buy down" the corporate income tax rate from 8.00% to 7.968%.

Revenue Impact

Individual: Pursuant to Laws 1999, Chapter 318, this credit is available to individuals only. The cost of the credit was $1.4 million in tax year 2012, the last year for which data is available. Data for tax year 2010-2012 is preliminary and may therefore understate the actual credit cost for those years. The table below, which was provided by the Department of Revenue, summarizes the individual income tax impact of the credit.

Tax Year	# of Claimants	Total Credit Available	Credit Used	Carry Forward
Individual				
1994	35	$1,800,000	$382,000	$1,400,000
1995	54	$2,600,000	$923,000	$1,700,000
1996	75	$4,247,392	$721,093	$3,524,790
1997	63	$3,752,833	$430,131	$3,323,906
1998	94	$4,567,632	$625,676	$3,941,314
1999	129	$8,484,744	$970,210	$7,213,521
2000	130	$8,157,000	$1,578,411	$6,527,281
2001	136	$8,444,943	$1,484,014	$6,160,791
2002	133	$7,984,544	$1,256,346	$6,157,459
2003	154	$9,170,688	$1,611,457	$7,273,813
2004	141	$10,366,257	$2,784,783	$6,855,589
2005	137	$8,868,257	$1,905,338	$6,409,360
2006	138	$8,880,517	$1,873,866	$6,202,735
2007	130	$8,912,273	$1,853,588	$6,333,995
2008	139	$8,607,672	$1,509,358	$6,333,955
2009	141	$6,377,016	$1,011,846	$4,542,186
2010	114	$5,842,594	$729,979	$4,670,024
2011	96	$6,281,311	$1,020,611	$4,967,965
2012	89	$5,039,014	$1,420,014	$4,111,979

# of Claimants- the number of taxpayers who claimed the credit in each year.
Total Credit Available– the total tax credits identified in each tax year, including any new credits and any credits carried over from a previous year and identified in that year.
Credit Used– the total value of credits claimed in each year.
Carry Forward – the total credit identified but not used in each year. The full carry forward may not be reflected in the following year's estimate. For example, a taxpayer could have $1 million in a particular credit identified in tax year 2007, use $400,000 of this amount in 2007 and leave $600,000 as a carry forward. If this taxpayer did not identify or claim the credit in 2008 the $600,000 carry forward would not be included in the credit carry forward total for 2008.

Economic Benefits

New Investments
Creation of New Jobs or Retention of Existing Jobs
Commercial Infrastructure Development

Since the inception of the program, the average annual credit cost per claimant has been between $6,400 and $19,800 with the average credit cost per claim being $11,300 for the entire period. This credit is not intended to promote economic development or spur new investments that would result in new jobs. Instead, according to DOR's August 2000 report "Income Tax Credits in Arizona," this credit is one of several tax credits in statutes primarily intended to encourage environmentally responsible behavior.

However, the credit may have a general economic benefit for Arizona. For example, lower water usage as a result of improved conservation measures (for which qualified taxpayers only bear 25% of the cost) is likely to reduce the cost of production, which in turn may enhance Arizona's competitiveness relative to other agricultural states. We are not able to measure such impact with available data.

Other

When last reviewed in 2009, USDA employees at the Yuma Service Center, who are familiar with this program, provided a favorable assessment of the agricultural water conservation system credit. While the USDA employees were unable to quantify the impact of the credit, they believed that the water savings resulting from this incentive have been substantial.

Complexity

The credit does not seem to be unnecessarily complex in the application, administration, and approval process.

Potential Performance Measures

Performance measures could include:
1. A requirement to report on the reduction in water usage as a result of the installation of a qualified water conservation system.
2. Number of states where taxpayers receive a comparable credit.

Prior Review

The agricultural water conservation system tax credit was last reviewed by the JLITCRC in 2009. The Committee recommended at that time that the credit should be eliminated.

School Tuition Organization
Displaced/Disabled Students Tax Credit

Corporate Contributions to School Tuition Organizations for Displaced or Disabled Pupils

Summary

- Current law allows corporations and insurers to receive tax credits for contributions to school tuition organizations (STOs) that award scholarships to "low income" and "displaced or disabled" pupils. This review does not address the much broader "low income" private school tuition tax credit.
- Actual tax credit data is available only through Tax Year 2012, when usage was only $272,600 under preliminary data. Tax credit data are reported on a tax year rather than fiscal year basis and typically lag contribution data by 2 or more years due to the timing of corporate income tax filings.
- Due to reporting requirements associated with the program's $5.0 million fiscal year cap, more "real time" contribution data is available. Based on those reports, contributions have increased significantly in the last several years.
- 28 corporations and insurers have contributed $5.0 million for "displaced or disabled" pupil scholarships in FY 2015 for an average contribution of $178,600. A contribution, however, does not necessarily result in an immediate tax credit.
- To the extent that scholarships result in students not attending public school, the credit results in foregone General Fund costs. To offset $5.0 million in tax credits, an estimated 270 students would have to be diverted from public schools due to the scholarships.

Statute

A.R.S. § 43-1184

Description

Current law authorizes tax credits for 4 different types of corporate or insurer contributions to school tuition organizations (STOs):

1. Corporate contributions to STOs awarding "low-income scholarships" (A.R.S § 43-1183),
2. Insurer contributions to STOs awarding "low-income scholarships" (A.R.S. § 20-224.06),
3. Corporate contributions to STOs awarding scholarships to "displaced or disabled" pupils (A.R.S § 43-1184), and
4. Insurer contributions to STOs awarding scholarships to "displaced or disabled" pupils (A.R.S § 20-224.07).

This review pertains to corporate income tax credits for "displaced or disabled" contributions pursuant to A.R.S § 43-1184. It also addresses insurance premium tax credits for "displaced or disabled" contributions pursuant to A.R.S § 20-224.07 because data for both programs typically are reported together. The tax credit review statute (A.R.S. § 43-222), however, does not literally require review of insurance premium tax credits for "displaced or disabled" STO contributions.

Tax Credits

There is no separate cap on the amount of tax credits that an individual corporation or insurer can claim under the program. In the aggregate, however, total combined corporate and insurer tax credits for contributions for "displaced or disabled" pupil scholarships are permanently capped at $5.0 million per year pursuant to A.R.S. § 43-1184C1. Because of this cap, STO contributions from corporations and insurers must be pre-approved by DOR in order to be eligible for a tax credit. DOR reported in November 2014 that STOs had received $5.0 million in corporate and insurer contributions for FY 2015, which was the first time that contributions for this program had reached the capped level (*see Table 1 below*).

Contributions do not necessarily result in the taxpayer using the credit immediately. A corporation may lack sufficient liability to take the credit in the year in which the donation is made. To address that issue, A.R.S. § 43-1184E allows corporations to carry forward any claimed but unused credit for up to 5 years. *Table 2* shows, however, that corporations that claimed credits for tax years 2011 and 2012 (the only years with currently reported data for credits) used the total amount of credits available.

STOs and Scholarships

This credit is provided to corporations and insurers for voluntary contributions to STOs. A STO is a charitable organization that is exempt from federal taxation and that allocates at least 90% of its revenue for educational scholarships or tuition grants to children to attend non-governmental elementary or secondary schools. A STO may use up to 10% of corporate contributions for administration expenses.

STO scholarships from this program may be awarded only to students who lived in foster care at any time prior to graduating from high school or obtaining a GED, or who have been identified at any time as having a disability under federal or state law. Prior to FY 2015, recipients typically also had to be prior public school pupils, but that restriction and other related qualifiers (such as being a military dependent) were eliminated by Laws 2014, Chapter 278.

A student's scholarship or grant under the program is capped at the actual cost of their tuition or at 90% of the amount of state aid that the student would receive if in public school, whichever is less (A.R.S. § 43-1505B).

A corporation or insurer may not use a tax credit for any "displaced or disabled" contribution if it designates the scholarship for a particular student.

Refundable

The credit is not refundable.

Carry Forward

The unused portion of the credit may be carried forward for a maximum of 5 consecutive years.

Transferable

The credit is not transferable.

History and Rationale

The corporate and insurer "displaced or disabled" tax credits were both created by Laws 2009, 2nd Special Session, Chapter 1 and became effective starting in FY 2010. They were established after the Arizona Supreme Court ruled in March 2009 that scholarship programs established for displaced or disabled pupils by Laws 2006, Chapters 340 and 358 violated a prohibition in the state Constitution on appropriating public monies to private schools. The "displaced or disabled" tax credit program addressed the ruling by funding scholarships for displaced or disabled pupils indirectly through tax credit-eligible STO contributions from corporations and insurers, rather than directly from the state General Fund.

In September 2006 (3 years before the "displaced/disabled" tax credits took effect), the Arizona School Boards Association and the Arizona Chapter of the American Civil Liberties Union filed suit against the state regarding the related corporate "low income student" STO tax credit (A.R.S § 43-1183). In *Green v. Garriott*, plaintiffs alleged that corporate contribution "set asides" in the associated laws violated the "general and uniform" provision of the state's public education system. The Maricopa County Superior Court ruled in favor of the state in a ruling that was later upheld by the Arizona Court of Appeals. The plaintiffs appealed to the Arizona Supreme Court, but in 2009 it declined to review the case, making the Maricopa County Superior Court ruling stand.

Revenue Impact

Table 1 summarizes corporate and insurer contributions to STOs for "displaced or disabled" pupil scholarships since the beginning of the program in FY 2010. In FY 2015, 19 insurance companies and 9 non-insurance corporations donated a total of $5.0 million to STOs under these programs.

Table 1

Corporate Contributions to School Tuition Organizations for Displaced or Disabled Pupil Scholarships by Fiscal Year

Fiscal Year	Statutory Limitation	# of Corporations [1/]	$ Approved by DOR	$ Received by STOs
2010	$5,000,000	6	$1,478,880	$1,478,880
2011	$5,000,000	8	$1,079,000	$1,029,000
2012	$5,000,000	6	$283,000	$283,000
2013	$5,000,000	14	$3,580,350	$3,505,350
2014	$5,000,000	28	$2,962,700	$2,962,700
2015	$5,000,000	28	$5,000,000	$5,000,000

1/ The number contributing, including insurers.

The average contribution made by corporations and insurers in the first year of the program (FY 2010) was $246,500 ($1,478,880 ÷ 6 corporations). The average contribution in the most recent data year (FY 2015) was $178,600 ($5,000,000 ÷ 28 corporations).

DOR also reports tax credits claimed for STO contributions, although on a tax year basis (January 1 - December 31 for most taxpayers) rather than a fiscal year basis (July 1 - June 30). A tax year may start in any month of the calendar year. Given the overlap of tax years and fiscal years, the liability for any one tax year could affect one of 4 fiscal years. *Table 2* summarizes tax credit data for the program since its inception (2012 data are preliminary and are the latest available due to lags in corporate income tax filings). Given the lags, the Table 1 data is probably more reflective of the credit's current use.

Table 2

Corporate Contribution Credit Claims by Tax Year

Tax Year	# of Claimants	Total Credit Available	Credits Used	Carry-Forward
2009	x	x	x	$0
2010	x	x	x	$0
2011	3	$170,000	$170,000	$0
2012 (preliminary)	4	$272,600	$272,600	$0

# of Claimants- the number of taxpayers who claimed the credit in each year.
Total Credit Available– the total tax credits identified in each tax year, including any new credits and any credits carried over from a previous year and identified in that year.
Credit Used– the total value of credits claimed in each year. Since the credit is refundable, the amount of used credits equals the amount of available credits.
x – No data publicly released by the Department of Revenue.

The tax credit may impact state K-12 education costs, since some students receiving "displaced or disabled" scholarships under the program otherwise might have attended public schools. Currently each pupil added to the statewide K-12 Average Daily Membership (ADM) count costs the state General Fund on average about $5,500, or roughly $21,000 if they are disabled (depending on their disability). Data on the mix of "displaced" versus "disabled" pupils receiving STO scholarships under this program are not available. For the Empowerment Scholarship Account (ESA) program authorized by A.R.S. § 15-2402, however, (which also primarily serves displaced or disabled pupils) ADE currently reports that there are approximately 6 "disabled" students for every 1 "displaced" student in the program. Assuming this same ratio for the corporate and insurer "displaced or disabled" STO tax credit program would result in an assumed average savings for that program of roughly $18,700 per student for students who otherwise would attend public schools ($21,000 X 6 students + $5,100 X 1 student / 7 = $18,700 average savings per student).

This implies that roughly 270 students would have to no longer attend Arizona public schools because of the program in order for it to have no net state cost ($5.0 million in FY 2015 credits ÷ $18,700 average assumed state savings per student ≈ 270 students). The number of students receiving a STO "displaced or disabled" scholarships who otherwise would be attending state-funded public schools is unknown. In addition, the "break even" number of public school "leavers" under the program would vary from year to year depending on the total value of tax credits used and the mix of "displaced" versus "disabled" pupils in the program.

Beyond its impact on K-12 operating costs, the credit theoretically could result in lower School Facilities Board (SFB) costs for new school construction. New school construction costs would be reduced if the SFB approved fewer new schools because of lower public school enrollment growth from the credit. Currently, however, very little state-funded school construction is occurring due to low population growth and the overbuilding of schools that occurred during the Great Recession.

Economic Benefits

This credit is not directly designed to promote economic development or spur new investments that would result in new jobs. It instead makes private schools more affordable for students who wish to attend them.

In FY 2013, STOs distributed $732,500 in scholarships (218 scholarships to 86 schools) from corporate and insurer contributions (*see Table 3*). The $732,500 scholarship total for FY 2013 is substantially less than the $3,505,400 contribution total shown for the year in Table 1 because scholarships typically lag contributions by 1 year for timing reasons. In addition, STOs sometimes dedicate a portion of current year donations for multi-year scholarships for specific students, rather than earmarking all prior year contributions for current year scholarships. The data cited in *Table 3* are from STO annual reports, rather than corporate or insurer income tax filings, so are not confidential.

Table 3

Scholarships for Fiscal Year 2013 by School Tuition Organization

School Tuition Organization	# of Scholarships	# of Schools	Scholarship Amount	Average
Arizona Leadership Foundation	7	6	$35,695	$5,099
Arizona School Choice Trust	27	14	120,036	4,446
Financial Assistance for Independent Schools	48	3	158,666	3,306
Institute for Better Education	84	39	73,260	872
School Choice Arizona	10	4	62,310	6,231
Tuition Organization for Private Schools	42	20	282,500	6,726
TOTAL	**218**	**61** 1/	**$732,468**	**$3,360**

1/ Unduplicated total, as some schools received scholarships from more than one STO.

Historically, the average scholarship has remained relatively constant, as shown in *Table 4*. Between FY 2010 and FY 2013, there was an increase of 52 scholarships distributed, or 31%. At the same time, the total amount of dollars distributed increased by $17,100, or 2%. DOR notes in its report for STO-related individual income tax credits that individual students may receive scholarships from more than one STO.

Table 4

School Tuition Organization Scholarships

Fiscal Year	# Scholarships	# Schools 1/	$ Distributed	Avg. Scholarship
2010 2/	166	68	$715,400	$4,310
2011	115	44	$561,000	$4,878
2012	119	38	$585,600	$4,921
2013	218	61	$732,500	$3,360

1/ Unduplicated total, as some schools received scholarships from more than one STO.
2/ Reported data are for calendar year rather than fiscal year (reporting period changed after FY 2010).

Complexity

DOR indicates that it is administratively simple for corporations to donate to STOs and claim the credit, and for STOs to receive pre-approval from DOR to receive corporate donations. DOR notes, however, that the annual reporting process for donations is time-consuming for both STOs and DOR because of the sheer number of STOs and the fact that many STOs utilize volunteer staff, which leads to reporting inconsistencies and makes it difficult for DOR to educate STO staff on reporting requirements. Finally, DOR describes its oversight responsibilities over STOs as a “daunting task” that has not yet been fully accomplished and which has been affected by changing statutory requirements.

Potential Performance Measures

Performance measures could include:

1. Percentage of STO revenues retained for administrative costs.

   The STOs would have this information readily available.

2. Percentage of private school tuition paid for with award funding.

   This information appears to be collected by STOs, but would require additional reporting.

Prior Review

None

Healthy Forest Enterprise Tax Credits

Employment and Workforce Training Credits for Healthy Forest Enterprises

Summary

- There have been no claims of corporate credit since tax year 2009. While there was some use in 2007-2009, it was minimal.
- There have been no claims of the individual credit since its inception in tax year 2005.

Statute

Employment Credit:	Workforce Training Credit:
A.R.S. § 43-1162 (Corporate)	A.R.S. § 43-1162.01 (Corporate)
A.R.S. § 43-1076 (Individual)	A.R.S. § 43-1076.01 (Individual)

Description

The healthy forest enterprise credits are offered to companies that are primarily engaged in the business of harvesting, processing, or transporting qualifying forest products for commercial use. Qualifying forest products include dead standing or fallen timber, and forest thinnings resulting from the harvest of small diameter timber, wood chips, peelings, brush and other woody vegetation removed from federal, state, and private forest land. Possible commercial use associated with the credit would be the burning of biomass in order to generate electricity. Additionally, the business operation is required to enhance or sustain forest health, sustain or recover watershed, or improve public safety.

Employment Credit:
The credit, which is available from tax year 2005 through tax year 2024, is based on the net increase in the number of qualified employment positions that are created and filled by a qualified healthy forest enterprise. The amount of the credit per employee is based on the employee's wage and year of employment. For a qualified employment position, the credit is equal to:

- 1/4 of wages paid to the employee in the 1st year of employment up to a maximum of $500 per employee
- 1/3 of wages paid to the employee in the 2nd year of continuous employment up to a maximum of $1,000 per employee
- 1/2 of wages paid to the employee in the 3rd year of continuous employment up to a maximum of $1,500 per employee

This means that over a period of 3 years the total amount of credits claimed per qualified employment position cannot exceed $3,000. Additionally, a taxpayer cannot claim more than 200 qualified employment positions in any given tax year.

Workforce Training Credit:
The credit, which is available from tax year 2012 through tax year 2024, is based on the expenses incurred by a healthy forest enterprise in training a new employee in a qualified employment position. The amount of the 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. Additionally, a taxpayer cannot claim more than 200 employees in any given tax year.

To be eligible for the employment and workforce training tax credits, a business must employ at least 1 full-time employee in a qualified employment position in the first year the credit is claimed. To be a "qualified employment position," statute requires that the position:

- is filled by an individual who resides in Arizona on the date of hire and was not employed by the business in the prior 12 months
- is for an employee who was employed for at least 90 days during the first taxable year
- is a full-time permanent job (at least 1,550 hours per year)
- primarily involves or directly supports the harvesting, initial processing, or transporting of qualifying forest products

- pays an hourly wage above the "Wage Offer by County" (currently between $9.19 and $18.48 depending on the county in which the business is located)
- provides health insurance to the employee and for which the employer pays at least 25% to 50% of the cost depending on the year in which the credit is claimed

The Healthy Forest Enterprise Incentives Program was originally enacted in 2004. Besides the income tax credits, the program also offers the following tax incentives:

- use fuel tax reduction
- sales tax exemption on purchased, leased, or rented equipment, equipment repair parts, construction contracts, motor vehicle fuel and use fuel
- use tax exemption on equipment, equipment repair parts, vehicle fuel and use fuel purchased out of state
- property tax reduction

The table below, which is based on information furnished by the Arizona Commerce Authority (ACA), shows the number of businesses applying for a particular type of incentive in each year between 2006 and 2014.

Number of Businesses Applying for Incentives under the Healthy Forest Enterprise Program

Year	Certified Businesses	Tax Credit	Use Fuel Tax Reduction	Sales Tax Exemption on Purchased Equipment	Sales Tax Exemption on Leased/Rented Equipment	Sales Tax Exemption on Contracts	Use Tax Exemption	Property Tax Reduction
2006	6	6	5	6	6	4	6	4
2007	6	3	2	2	0	1	1	1
2008	7	0	0	5	0	1	2	1
2014 1/	7	0	4	0	0	0	3	0

1/ ACA did not provide data on years 2009 through 2013.

The sales tax exemption on purchased equipment has been the most frequently used incentive by certified businesses. While a company may have applied for a particular incentives program, it may not necessarily use that incentive.

A business that wants to use the tax credits or any of the other tax incentives under the program must obtain certification as a qualified healthy forest enterprise by the Arizona Commerce Authority (ACA). According to ACA, each certificate is valid for 5 years as long as the business maintains eligibility. A total of 7 businesses were certified for the incentives program in FY 2014. A business is also required to enter into a *memorandum of understanding* with ACA. The business must submit a copy of the certification to the Department of Revenue (DOR) for final approval before any tax incentives under the program can be used. The certified business is required to submit an annual report to ACA and apply for recertification every 5 years. If the certification is terminated or revoked, the incentives under the program are subject to recapture.

A business that claims any of the credits under the Healthy Forest program can neither claim the New Job nor the Military Reuse Zone credit with respect to the same employee.

Refundable

The credit is not refundable.

Carry Forward

The tax credit may be carried forward for 5 taxable years.

History and Rationale

The federal Healthy Forests Initiative was launched in 2002 with the stated purpose of protecting United States' forests from wildfire by increasing hazardous fuel reduction efforts. In response to federal efforts, the Arizona

Legislature appointed the Joint Legislative Healthy Forest Task Force and the Governor established the Forest Health Oversight Council. Both of these groups were responsible for making recommendations promoting forest health in Arizona.

Based on the recommendations provided by the Task Force and Council, the Legislature enacted Laws 2004, Chapter 326, which included sales, use and income tax incentives for businesses that promote forest health in the state. Laws 2005, Chapter 278 added 2 additional tax incentives: use fuel tax reduction and property tax reduction. Additionally, Chapter 278 modified some of the requirements to qualify for the income tax credit. For example, the act reduced the minimum number of full-time employees from 10 to 3, decreased the number of hours an employee must work to be considered full-time from 1,750 to 1,550 hours per year, and modified the health insurance requirements for employees.

Laws 2005, Chapter 278 expanded the potential use of the credit by including the burning of forest products to produce electricity under the definition of "processing" of qualifying forest products.

Laws 2010, Chapter 225 added the requirement that ACA submits an annual report to JLBC that includes information regarding the quantity of qualifying forest products harvested, processed, and transported each year. Additionally, ACA must also report on the number of employees that qualify for the credits.

Laws 2012, Chapter 331 added the workforce training income tax credit, increased the certification period from 1 year to 5 years, and continued the use fuel tax and property tax reduction incentives. Chapter 331 further reduced the minimum number of full-time employees from 3 to 1. Additionally, Chapter 331 extended the tax credit through December 31, 2024.

Revenue Impact

Corporate: The tax credit has not been used since 2009, when its usage was minimal.

Individual: The credit has never been used.

Tax Year	# of Claimants	Total Credit Available	Credit Used	Carry Forward
Corporate				
2005	0	$0	$0	$0
2006	0	$0	$0	$0
2007	x	x	x	x
2008	x	x	x	x
2009	x	x	x	x
2010	0	$0	$0	$0
2011	0	$0	$0	$0
2012	0	$0	$0	$0
Individual				
2005	0	$0	$0	$0
2006	0	$0	$0	$0
2007	0	$0	$0	$0
2008	0	$0	$0	$0
2009	0	$0	$0	$0
2010	0	$0	$0	$0
2011	0	$0	$0	$0
2012	0	$0	$0	$0

# of Claimants- the number of taxpayers who claimed the credit in each year.
Total Credit Available– the total tax credits identified in each tax year, including any new credits and any credits carried over from a previous year and identified in that year.
Credit Used– the total value of credits claimed in each year.
Carry Forward – the total credit identified but not used in each year. The full carry forward may not be reflected in the following year's estimate. For example, a taxpayer could have $1 million in a particular credit identified in tax year 2007, use $400,000 of this amount in 2007 and leave $600,000 as a carry forward. If this taxpayer did not identify or claim the credit in 2008 the $600,000 carry forward would not be included in the credit carry forward total for 2008.
x - No data publicly released by the Department of Revenue.

DOR's 2014 Income Tax Credit Report shows that no individual or corporate claims have been filed to date for the workforce training income tax credit.

Economic Benefits

New Investments
Creation of New Jobs or Retention of Existing Jobs
Commercial Infrastructure Development

Pursuant to Laws 2004, Chapter 326, Section 19, the employment credit was enacted to help to establish "commercial enterprises that promote forest health and reduce the risk of catastrophic wildfire and destructive insect infestation in the forested areas in this state." Additionally, pursuant to Laws 2012, Chapter 331, Section 14, the workforce training credit was enacted "to encourage the employment and training of entry level workers for ecological restoration efforts in the state." However, due to the limited use of the credit, as reported by DOR, it is not clear to what extent the incentives program has achieved these objectives. For the same reason, it seems unlikely that the tax credit has had more than a negligible impact on new investments, job creation and retention, and the development of commercial infrastructure.

When the credit was last reviewed in 2009, ACA reported that most companies that answered the program evaluation section of the annual report indicated that the incentives program had been an important factor in the decision to locate, expand, or remain in the state.

The table below, which is based on the annual reports to JLBC pursuant to Laws 2010, Chapter 225, shows the quantity of qualifying forest products harvested, processed, and transported by certified businesses each year between 2011 and 2014. None of the certified businesses participated in the tax credit program during this timeframe. For this reason, no full-time employees were hired or employed in qualified employment positions during this period.

Total Weight of Harvested, Processed and/or Transported Forest Products

Year	Certified Businesses	Total weight of forest products (in tons)
2011	4	144,977
2012	5	355,818
2013	4	1,011,986
2014	7	800,901

The reasons that so few businesses have used the credit to date are not fully understood. Based on feedback received by ACA when advertising the program in certain areas of the state, one explanation is that the 3 full-time employee requirement under the program until 2012 may have been too restrictive. However, none of the one-person operated forestry businesses in the state have taken advantage of the program since the full-time employee requirement was reduced.

Complexity

According to ACA, none of the comments contained in the annual reports filed in prior years by certified healthy forest enterprises directly addressed the issue of complexity in terms of the application, administration, and approval process of the program.

Based on feedback from ACA when the credit was last reviewed in 2009, the program requires a significant amount of paperwork for the agency to review and process. However, it does not consider the administration of the program to be "unnecessarily complex." Additionally, the 3 agencies involved in the processing of paperwork (ACA, Revenue, and Transportation) have all been able to successfully streamline this process.

Performance Measures

The following performance measures were adopted as a result of the recommendation made to the committee in 2009 and exist in statute pursuant to Laws 2010, Chapter 225:

1. A requirement to report on the quantity of qualifying forest products harvested, processed, or transported for commercial use.
2. The total statewide number of new jobs created as a result of the tax incentives offered under the program.

Prior Review

The healthy forest enterprise tax credit was last reviewed by JLITCRC in 2009. The Committee recommended that the credit be continued, should receive enhanced performance measures, and should require taxpayers to waive their confidentiality rights to the related credits to allow DOR to release more complete information on their use. In 2010, the Legislature required that ACA submit an annual report to the Joint Legislative Budget Committee.

Renewable Energy Investment and Employment Tax Credit

Renewable Energy Investment and Employment Credit

Summary

- Prior to 2013, the corporate credit was not claimed. In 2013, the credit was claimed for a minimal amount.
- The individual credit was not claimed in 2013 or prior years.

Statute

A.R.S. § 43-1083.01 (Individual)
A.R.S. § 43-1164.01 (Corporate)

Description

Statute permits individual and corporate credits on new renewable energy capital investments in manufacturing or company headquarters, for up to 10% of the taxpayer's total capital investment. The credit is subject to an annual aggregate cap of $70 million and an annual per company cap of $30 million, which it shares with the qualified facility credit program (A.R.S. § 43-1083.03 and A.R.S. § 43-1164.04).

Recipients must receive their credit in 5 equal portions over 5 consecutive tax years. The taxpayer must also operate within the state for 5 years after receiving final approval for the credit or face recapture of any credits received. The tax credit is available for tax years 2010 to 2019.

To be eligible to receive the full 10% credit, a company must meet at least 1 of the following investment requirements:

- Renewable energy manufacturing operations must create at least 1.5 full-time employment positions for each $500,000 increment of capital investment.
- Renewable energy headquarter operations must create at least 1 full-time employment position for each $200,000 increment of capital investment.

To qualify for the credit, the company must also meet each of the following requirements for the full-time employment positions they create:

- Pay at least 51% of new full-time employees' wages that exceed 125% of the median annual wage in the state.
- Pay 80% or more of the premium for all full-time employees' health insurance.

The Arizona Commerce Authority (ACA) is responsible for pre-approving credit amounts, based on the taxpayer's estimated future qualifying investments and additional positions. The pre-approval application process establishes the tax filer's priority in receiving the credit, in the event that the credit's $70 million annual cap is met. A company must make at least $250,000 in qualifying investments within 12 months of receiving pre-approval of credits. Upon completion of the project, the company's investment and job creation must be verified by a certified public accountant chosen by ACA and paid for by the applicant. Following this third party verification, the ACA makes a final approval of credits available to the taxpayer.

Investments of at least $25 million that qualify for the credit also qualify the taxpayer for a property tax reduction, whereby the company's property receives a class 6 designation (5% assessment ratio) instead of a class 1 designation (19% assessment ratio in TY 2014, decreasing to 18% in TY 2016). The class 6 property designation remains in effect for 10 or 15 years, depending on the level of wages paid to employees of the facility in relation to the state's median wage (A.R.S. § 41-1511). A taxpayer that claims the renewable energy investment and employment credit may not also claim a credit under the military reuse zone (A.R.S. § 43-1167), qualified facility, or healthy forest credits (A.R.S. § 43-1076 and A.R.S. § 43-1162) with respect to the same employee. [A.R.S. § 43-1083.01; A.R.S. § 43-1164.01; A.R.S. § 41-1511].

Refundable

The credit is refundable.

Carry Forward

Refundable credits may be used in full to offset tax liability for the tax year they are earned, even if the value of a taxpayer's credits exceeds their tax liability. As a result, no credits are carried forward.

History and Rationale

The renewable energy investment and employment credit was first passed and signed into law in July 2009 (Laws 2009, Chapter 96) and became effective in TY 2010. The credit has been amended several times. Laws 2010, Chapter 303 caps the amount of the credit a company can use at the final amount approved by the ACA. The act additionally allows recapture of credits if it is determined that the taxpayer has committed fraud or relocated outside the state within 5 years of first receiving the credit. Laws 2012, Chapter 343 extended the final date the credit can be authorized from December 31, 2014 to December 31, 2019. The act additionally established the qualified facility credit, which shares an aggregate and per company annual cap with the renewable energy investment and employment credit.

The renewable energy investment and employment credit's purpose, as stated in statute, is to encourage business investment that produces high-income employment and to promote the state as a location for producing and using renewable energy products.

Revenue Impact

Based on data provided by the Department of Revenue (DOR), the credit was first used in 2013. Prior to 2013, neither the corporate nor individual credit had been claimed since the incentive became available. *Table 1* summarizes the tax impact of this credit by year, as reported by DOR.

Table 1

Renewable Energy Investment and Employment Credit
Corporate and Individual Claims by Tax Year

Tax Year	# of Claimants	Total Credit Available	Credit Refunded
Corporate			
2010	0	$0	$0
2011	0	$0	$0
2012	0	$0	$0
2013	x	x	x
Individual			
2010	0	$0	$0
2011	0	$0	$0
2012	0	$0	$0
2013	0	$0	$0

# of Claimants – the number of taxpayers who claimed the credit in each year.
Total Credit Available – the total tax credits identified in each tax year, including any new credits and any credits carried over from a previous year and identified in that year.
Credit Used – the total value of credits claimed in each year.
Credits Refunded – the total value of credits refunded in each year. Since the credit is refundable, the amount of available credits equals the amount of refunded credits.
x – According to ACA, 1 company has been post-approved for a credit amount of $1.6 million, which will be spread in equal amounts over 5 years.

Economic Benefits

Measurable Economic Development
New Investments
Creation of New Jobs or Retention of Existing Jobs

From 2010 to 2013, ACA pre-approved a total of $122,969,549 in qualifying investments and $9,101,000 in credits. Of those amounts, $21,354,439 of investment made by 1 corporation (publically available on ACA website) has received post-approval for $1,633,333 in earned credits (*see Table 2*). Once post-approved, the credit must be taken over 5 years.

During 2011, First Solar applied for pre-approval of corporate credits for an anticipated capital investment of $2.1 billion and creation of 5,100 qualified new jobs. This amount of investment and job creation would have qualified the company for the maximum $30 million in credits available to a company in a year. First Solar's application was withdrawn and is not included in the information in *Table 2*.

Table 2

Pre-Approval and Post-Approval of Renewable Energy Investment and Employment Credits

Tax Year	# of Companies	Amount of Investment	Estimated New Jobs	Credits Approved
Pre-Approval				
2010	1	$9,659,549	15	$950,000
2011	1	$25,000,000	341	$2,500,000
2012	3	$84,800,000	102	$5,300,000
2013	1	$3,510,000	x	$351,000
Total	**6**	**$122,969,549**	**x**	**$9,101,000**
Post-Approval				
2010	0	$0	0	$0
2011	0	$0	0	$0
2012	0	$0	0	$0
2013	1	$21,354,439	x	$1,633,333 1/
Total	**1**	**$21,354,439**	**x**	**$1,633,333**

x – Amount not reported by ACA.
1/ Once a credit is post-approved, it is taken over 5 years.

Source: ACA's annual *Renewable Energy Tax Incentives Program Reports*.

The economic benefits resulting from the credit depend on the extent to which investment and job creation would have occurred in its absence. It is difficult to determine if the economic activity related to the credit's use would have otherwise been realized. To some extent, the credit enhances Arizona's competitiveness relative to other states by lowering the cost of doing business.

According to the U.S. Department of Energy, at least 3 other states provide an income tax credit (Montana, New Mexico and South Carolina) targeted to investments in renewable energy company manufacturing facilities or company headquarters and at least 5 states provide an exemption (Arkansas, Mississippi, Texas, Utah and Washington). Unlike the credit provided in Arizona, incentives in 4 of these states do not include minimum requirements for job creation (Montana, Texas, Utah and Washington). Some other states also allow taxpayers to claim investment or headquarter relocation tax credits for this type and other types of investment.

Complexity

According to ACA and DOR, the credit is not unusually complex in terms of its application, administration, and approval process. A statutory requirement for third party verification of a company's qualifying investment and employment removes some of ACA's burden in approving the credit. A requirement that DOR recapture credits used by a company that later commits fraud or relocates to another state within 5 years of first receiving the credit could potentially add complexity. The $70 million cap that is shared with the qualified facility credit could also add complexity, but credit use is not close to that level yet.

Potential Performance Measures

A.R.S. § 41-1511 requires that ACA publish a report by April 30 of each year that includes information collected from renewable energy investment and employment credit applications. The statute specifically requires that the report includes amounts of approved credits and qualifying investments.

Additional performance measures to specify in statute could include:

1. Number of qualifying full-time jobs determined by ACA during final approval of credits.

2. Number of states where a comparable credit is offered.

Prior Review

The credit has not been reviewed by the committee before.