Joint Legislative Budget Committee
Staff Memorandum

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TO: Senator J.D. Mesnard, Chairman, Senate Finance and Commerce Committee
Representative Neal Carter, Chairman, House Ways and Means Committee

FROM: Hans Olofsson, Chief Economist

SUBJECT: 2024 INCOME TAX CREDIT REVIEW

Each year, the JLBC Staff prepares background materials for the Joint Legislative Income Tax Credit Review Committee as prescribed by A.R.S. § 43-221. At this time, a committee meeting has not been scheduled. Given that our background information may still be of interest, we are now transmitting our material (including a PowerPoint slideshow) for the credits on the 2024 review schedule.

A separate memo provides confidential data on these credits where applicable.

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. Pursuant to A.R.S. § 43-222, there are 6 credits scheduled for review in 2024, which are listed below.

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 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.

Pursuant to A.R.S. § 42-2003(H), the Department of Revenue (DOR) is authorized to disclose statistical information gathered from confidential tax credit information to this Committee, JLBC Staff and legislative staff. 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. All the tax credits on the 2024 review list, except for the Dependent Tax Credit and the Agricultural Water Conservation System Credit, include confidential statistical information.

We have provided a separate memo to the Committee that contains the confidential credit data furnished by DOR. According to DOR, each recipient of this confidential information pursuant to A.R.S. § 42-2003(H) is bound by confidentiality laws and therefore is not to release the information to others. Any discussions regarding this memo must be held in Executive Session.

<u>Limitations</u>

There are certain limitations affecting the evaluation of income tax credits. The lack of performance measures for tax credits is one such example. None of the credits reviewed this year has stated performance measures. 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).

The evaluation of tax credits in terms of their economic benefits to the state is often difficult to conduct since the data required to do so is rarely available.

<u>2024 Review</u>

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

Description - The definition of the tax credit, including 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 either can 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.

Carry Forward - Whether 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 by <u>fiscal year</u> on the number of claims and the amount of credit used. In addition, the review includes similar information by <u>tax year</u>.

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 the Department of Revenue and the Arizona Commerce Authority.

HO:kp
Attachment
xc: Duncan Spilsbury, Policy Advisor, Senate
Emma Blair, Policy Advisor, Senate
Sean Laux, Senior Policy Advisor, Senate
Molly Graver, Research Staff Deputy Director, Senate Finance and Commerce Committee
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Dependent Tax Credit

Dependent Tax Credit

Summary

- The purpose of the credit is to mitigate the costs incurred by taxpayers who care for dependents.
- The tax credit is $100 for each dependent under age 17 and $25 for each dependent age 17 and older.
- The credit is phased out for income above $200,000 for singles and above $400,000 for married couples.
- The cost of the credit was $144 million in FY 2024.
- The credit was claimed by slightly more than 1 million taxpayers at an average of $144 per claim.
- The credit is not refundable, and any unused amounts cannot be carried forward to future tax years.

Statute

A.R.S. § 43-1073.01 (Individual Income Tax)

Description

This credit, which has not been previously reviewed, is for taxpayers who claim certain qualifying dependents. The amount of the credit is equal to:

- $100 for each dependent who is under 17 years of age at the end of the taxable year.
- $25 for each dependent who is age 17 or older at the end of the taxable year.

The credit is gradually phased out for single, head of household, and married taxpayers filing separate returns whose federal adjusted gross income is above $200,000. The corresponding income threshold for married couples filing joint returns is $400,000.

For a taxpayer who is claiming a dependent as a qualifying parent or grandparent, they can claim either the dependent tax credit ($25 per qualifying parent or grandparent) or an exemption ($10,000 per qualifying parent or grandparent), but not both.

Refundable

The credit is not refundable.

Carry Forward

No carry-forward of unused credits is allowed.

History and Rationale

This credit was created by Laws 2019, Chapter 273 and became effective retroactively from January 1, 2019. According to a purpose statement included in the legislation, the credit was enacted "to mitigate the costs incurred by taxpayers who care for dependents."

Apart from the creation of the dependent tax credit, Chapter 273 made numerous other changes to the Arizona tax code. One of the provisions eliminated the dependent exemption for individual income taxpayers. The dependent tax credit established by Chapter 273 allows taxpayers who otherwise may have claimed the dependent exemption under prior law to claim this new credit instead.

Revenue Impact

The Department of Revenue (DOR) is required to report the use of individual income tax credits on a fiscal year basis. *Table 1* below shows the cost of the credit by fiscal year since the start of this program in FY 2020.

Table 1

Dependent Tax Credit by Fiscal Year

Fiscal Year	# of Claims	Credit Used
2020	867,704	$129,495,930
2021	1,069,546	$156,530,362
2022	988,167	$145,396,745
2023	989,954	$143,940,006
2024	1,000,117	$143,980,081

# of Claims - the number of taxpayers who claimed the credit each year
Credit Used - the total amount of credits used to reduce tax revenue each fiscal year

As shown in *Table 1*, after an initial increase in credit use from $129 million in FY 2020 to $156 million in FY 2021, the amount of credit use decreased to $145 million FY 2022 and $144 million in FY 2023. The level of credit use remained essentially unchanged in FY 2024.

DOR additionally reports credit use by tax year. As displayed in *Table 2*, such data is available from 2019, when the credit was first established. Credit use by tax year differs from credit use by fiscal year for several reasons, including the filing of extended and amended tax returns and time periods that do not fully overlap.

Table 2

Dependent Tax Credit – Credit Claims by Tax Year

Tax Year	# of Claims	Total Credit Available	Credit Used
2019	1,027,101	$150,259,177	$150,259,177
2020	994,901	$147,397,553	$147,397,553
2021	984,345	$144,591,809	$144,591,809
2022	986,503	$143,093,368	$143,093,368
2023 1/	976,618	$140,687,004	$140,687,004

1/ Tax Year 2023 data is preliminary.
# of Claims – the number of taxpayers who claimed the credit in each year.
Total Credit Available – the total tax credits identified in each tax year.

Economic Benefits

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

As noted earlier, the dependent tax credit was created to mitigate the costs incurred by taxpayers who care for dependents. Thus, unlike some other credits, it was not established to serve as an incentive for new investments or the creation of new jobs in the state. However, since the dependent tax credit has the effect of increasing the disposable income for about 1 million taxpayers at an average of $144 per household, all else equal, the credit may have an indirect impact on the Arizona economy insofar as it results in an increase in aggregate consumer spending.

Complexity

The dependent tax credit does not require a separate form to be appended to the individual income tax return filed by the taxpayer. Instead, there is a worksheet included in the instructions for the tax form that the taxpayer uses to calculate the amount of the credit. This worksheet appears to be relatively easy to use since all the information that is necessary for the credit calculation is included on the individual's income tax form. For this reason, the credit requires no separate administration or approval process by DOR.

Potential Performance Measures

There are no suggested performance measures.

Agricultural Pollution Control Equipment Tax Credit

Agricultural Pollution Control Equipment Tax Credit

Summary

- The cost of the individual tax credit was $0 in FY 2024 because no claims were filed.
- The corporate tax credit is no longer available, as it was repealed by Laws 2020, Chapter 43.
- The Agricultural Pollution Control Equipment credit was created to incentivize the purchase of pollution control and pollution prevention equipment associated with the commercial production of livestock and agricultural crops in Arizona.

Statute

A.R.S. § 43-1081.01 (Individual)

Description

The credit was last reviewed in 2019. The description of the credit as well as other sections of the credit review have been updated from our 2019 report when relevant.

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. The corporate credit was repealed in 2020, so this credit may only be claimed against individual income taxes.

Refundable

The credit is not refundable.

Carry Forward

The unused portion of the credit may be carried forward for a maximum of 5 consecutive 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 in 2023. 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

Beginning in FY 2015, the Department of Revenue (DOR) is required to report the use of individual income tax credits on a fiscal year basis. *Table 1* below shows the cost of the credit by fiscal year going back to FY 2015.

Table 1
Individual Income Tax Credit Use by Fiscal Year

Fiscal Year	# of Claims	Credit Used
2015	0	$0
2016	4	$21,311
2017	4	$18,342
2018	0	$0
2019	4	$16,225
2020	4	$19,751
2021	4	$16,905
2022	4	$25,000
2023	NR	NR
2024	0	$0

# of Claimants - the number of taxpayers who claimed the credit each year.
Credit Used - the total amount of credits used to reduce tax revenue each fiscal year.
NR - data is not releasable due to Arizona confidentiality laws.

DOR also reports credit use on tax year basis. This data is available from 1999, when the credit was first established. This data differs from credit use by state fiscal year for several reasons, including filing extensions and varied tax years depending on when a business' fiscal year begins. *Table 2* below shows the impact of the credit on individual income taxes by tax year since the credit's inception in 1999. The tax year 2022 credit data is preliminary.

Table 2

Individual Income Tax Credit Use by Tax Year

Tax Year	# of Claimants	Total Credit Available	Credit Used	Carry Forward
1999	1	NR	NR	NR
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	NR	NR	NR
2004	1	NR	NR	NR
2005	2	NR	NR	NR
2006	1	NR	NR	NR
2007	1	NR	NR	NR
2008	5	$14,331	$14,087	$244
2009	3	$16,569	$13,306	$3,263
2010	2	NR	NR	NR
2011	1	NR	NR	NR
2012	5	$27,350	$27,350	$0
2013	3	NR	NR	NR
2014	5	$22,916	$22,916	$0
2015	4	$18,342	$18,342	$0
2016	0	$0	$0	$0
2017	4	$16,225	$16,225	$0
2018	4	$19,752	$19,752	$0
2019	4	$16,905	$16,905	$0
2020	4	$25,000	$25,000	$0
2021	0	$0	$0	$0
2022	NR	NR	NR	NR
2023	NR	NR	NR	NR

# 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.
NR – data is not releasable due to Arizona confidentiality laws.

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, DOR states that it is one of several tax credits in statute 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.

Complexity

Tax credit forms and instructions reviewed by JLBC Staff suggest that the credit is not unnecessarily complex in terms of 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 2019. The Committee recommended that the individual and corporate income tax credits for agricultural pollution control equipment should be repealed.

Agricultural Water Conservation System
Tax Credit

Agricultural Water Conservation System Tax Credit

Summary

- The cost of the individual income credit was $1.1 million in FY 2024. The credit was claimed by 101 taxpayers at an average of $10,622 per claim.
- The corporate tax credit is no longer available, as it was repealed by Laws 1999, Chapter 318.
- The credit is equal to 75% of the qualifying expenses incurred for the purchase and installation of a water conservation system used for agricultural purposes.

Statute

A.R.S. § 43-1084 (Individual)

Description

The credit was last reviewed in 2019. The description of the credit as well as other sections of the credit review have been updated from our 2019 report when relevant.

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

Beginning in FY 2015, the Department of Revenue (DOR) is required to report the use of individual income tax credits on a fiscal year basis. *Table 1* below shows the cost of the credit by fiscal year going back to FY 2015.

Table 1
Individual Income Tax Credit Use by Fiscal Year

Fiscal Year	# of Claims	Credit Used
2015	104	$1,103,860
2016	126	$1,308,663
2017	117	$1,913,058
2018	109	$3,040,183
2019	108	$2,687,622
2020	104	$1,527,982
2021	113	$1,962,422
2022	123	$1,442,422
2023	135	$1,625,059
2024	101	$1,072,853

# of Claimants - the number of taxpayers who claimed the credit each year.
Credit Used - the total amount of credits used to reduce tax revenue each fiscal year.

DOR also reports credit use on a tax year basis. This data is available from 1994, when the credit was first established. This data differs from credit use by state fiscal year for several reasons, including filing extensions and varied tax years depending on when a business' fiscal year begins. *Table 2* below shows the impact of the credit on individual income taxes by tax year since the credit's inception in 1994. The tax year 2023 credit data is preliminary.

Table 2

Individual Income Tax Credit Use by Tax Year

Tax Year	# of Claimants	Total Credit Available	Credit Used	Carry Forward
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	137	$8,910,104	$1,853,588	$6,331,826
2008	139	$8,607,460	$1,509,358	$6,319,174
2009	141	$6,805,785	$1,046,140	$4,962,270
2010	114	$5,881,565	$731,746	$4,727,748
2011	97	$5,687,843	$1,015,966	$4,609,905
2012	93	$7,179,476	$1,454,021	$4,875,372
2013	100	$8,891,857	$1,303,244	$6,869,616
2014	125	$10,306,941	$1,163,539	$8,927,831
2015	126	$13,199,232	$2,150,572	$10,784,162
2016	119	$19,158,761	$2,892,280	$15,738,303
2017	105	$16,970,577	$2,614,803	$14,355,744
2018	99	$16,467,911	$1,568,908	$14,899,003
2019	112	$15,371,478	$1,744,994	$13,626,484
2020	123	$15,730,402	$2,125,600	$13,604,802
2021 1/	116	$14,258,361	$1,483,235	$12,577,471
2022	132	$9,314,055	$1,221,179	$7,511,953
2023 2/	97	$5,681,099	$738,799	NIA

# 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.
NIA – No information available at the time of publication.
1/ Tax Year 2021 data includes credits claimed under the Small Business Income Tax.
2/ Tax Year 2023 data is preliminary.

Economic Impact

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, DOR states that it is one of several tax credits in statute intended to lower water usage. 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.

Complexity

Tax credit forms and instructions reviewed by JLBC Staff suggest that the credit is not unnecessarily complex in terms of 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 2019. The Committee recommended that the credit should be amended to include the performance measures listed above.

Tax Credit for Qualified Facilities

Qualified Facility Tax Credit

Summary

- According to the enacting legislation, the credit was created to encourage business investment that will produce high quality jobs in the state.
- A "qualified facility" dedicates at least 80% of its property and payroll to manufacturing, headquarters, or research that meets the credit's employment and revenue requirements.
- This credit is refundable, which means that the credit can exceed the taxpayer's liability.
- The Arizona Commerce Authority is authorized to pre-approve up to $125 million in credits per calendar year. However, no single taxpayer can be pre-approved for more than $30 million per calendar year.
- In FY 2024, there were 48 <u>corporate</u> income tax credit claims for a total of $51.5 million.
- The cost and number of <u>individual</u> credit claims in FY 2024 have not been released by the Department of Revenue (DOR) due to confidentiality laws.

Statute

A.R.S. § 41-1512
A.R.S. § 43-1083.03 (Individual)
A.R.S. § 43-1164.04 (Corporate)

Description

A *refundable* credit is allowed for expanding or locating a qualified facility in Arizona. The capital investment of at least $250,000 must be made within 12 months following pre-approval by the Arizona Commerce Authority (ACA).

A "qualified facility" is a facility that devotes at least 80% of the property and payroll at the facility to qualified manufacturing, qualified headquarters, or qualified research. It must also create full-time employment positions where a majority must be paid at least 125% of the state median wage if located in an urban area. Rural locations must pay at least 100% of the state median wage. According to ACA, from the second half of 2024 to the first half of 2025, the median wage is $44,595, and 125% of that median wage is $55,744. Companies must offer health insurance and cover 65% of each new employee's premium. To qualify for the credit, at least 65% of the project's revenues must come from outside of Arizona.

The credit must be approved by the ACA, and they are allowed to pre-approve up to $125 million in credits per calendar year, which are authorized on a first-come, first-served basis. Following a project's completion, ACA performs a review with the company to verify that its facility meets the requirements of the credit. If the project is deemed eligible, the company receives post-approved status. The credit program is available through December 31, 2030.

The tax credit is equal to the lesser of:

(1) 10% of the total qualified investment made at the facility
(2) $20,000 per qualified job created at the facility if the total qualified investment is less than $2 billion
(3) $30,000 per qualified job created if the total qualified investment is equal to or greater than $2 billion

(4) $30 million per taxpayer per year.

The credit must be taken in 5 equal annual installments.

Refundable

The credit is refundable.

Carry Forward

Since the credit is refundable, there are no unused amounts to be carried forward to future tax years.

History and Rationale

This credit was created by Laws 2012, Chapter 343 and became effective January 1, 2013. According to the purpose statement included in legislation, the credit was created to encourage business investment that will produce high quality employment opportunities and enhance the position of the state as a center for corporate headquarters, commercial research, and manufacturing.

Laws 2016, Chapter 372 reduced the employer's required share of health insurance premium coverage from 80% to 65%. In addition, Chapter 372 lowered the wage requirement for employees in rural locations from 125% to 100% of the state median wage.

Laws 2020, Chapter 7 extended the repeal date for the credit from December 31, 2022, to December 31, 2030.

Laws 2021, Chapter 80 made several changes to the Qualified Facility credit. These were:

- Increased the credit from $20,000 to $30,000 per net new job if the total qualifying investment is $2 billion or more.
- Increased the aggregate cap of the credit that can be pre-approved by ACA from $70 million to $125 million per calendar year.
- Expanded the statutory definition of "qualified manufacturing" to include products sold to other qualifying facilities regardless of whether such facilities have been pre-approved by ACA.

Revenue Impact

The Department of Revenue (DOR) is required to report on credit use by fiscal year, beginning in FY 2015 for the individual income tax, and beginning in FY 2016 for the corporate income tax. *Table 1* below shows the cost of the individual credit by fiscal year going back to FY 2015.

As shown in *Table 1*, due to taxpayer confidentiality, DOR did not report the cost of the individual credit in FY 2020, FY 2021, and FY 2024. No claims were made for the individual Qualified Facility credit in FY 2015 to FY 2017, and in FY 2022 and FY 2023.

Table 1
Individual Income Tax Credit Use by Fiscal Year

Fiscal Year	# of Claims	Credit Used
2015	0	$0
2016	0	$0
2017	0	$0
2018	3	$26,000
2019	3	$26,000
2020	NR	NR
2021	NR	NR
2022	0	$0
2023	0	$0
2024	NR	NR

# of Claims - the number of taxpayers who claimed the credit each year
Credit Used - the total amount of credits used to reduce tax revenue each fiscal year.
NR - data is not releasable due to Arizona confidentiality laws.

Table 2 below shows the cost of the corporate credit by fiscal year going back to FY 2016. As displayed in *Table 2*, the cost of the corporate Qualified Facility credit increased from $3.4 million in FY 2020 to $51.5 million in FY 2024, a 15-fold increase over this 5-year timespan. The average credit use per claim increased from $286,058 to $1.1 million during the same 5-year period.

Table 2
Corporate Income Tax Credit Use by Fiscal Year

Fiscal Year	# of Claims	Credit Used
2016	0	$0
2017	NR	NR
2018	NR	NR
2019	NR	NR
2020	12	$3,432,690
2021	12	$4,663,310
2022	25	$24,641,213
2023	47	$37,338,516
2024	48	$51,468,499

# of Claims - the number of taxpayers who claimed the credit each year
Credit Used - the total amount of credits used to reduce tax revenue each fiscal year.
NR - data is not releasable due to Arizona confidentiality laws.

DOR also reports credit use on a tax year basis. This data is available from 2013, when the credit was first established. It should be noted that this data differs from credit use by fiscal year for several reasons, including filing extensions and varied corporate tax years. *Table 3* shows the cost of the individual tax credit by tax year since the credit's inception in 2013. The tax year 2022 individual credit data is preliminary.

Table 3

Individual Income Tax Credit Claims by Tax Year

Tax Year	# of Claimants	Total Credit Used
2013	0	$0
2014	0	$0
2015	0	$0
2016	3	$26,000
2017	3	$26,000
2018	NR	NR
2019	NR	NR
2020	0	$0
2021	NR	NR
2022	0	$0
2023 1/	0	$0

1/ Tax Year 2023 data is preliminary.
NR - data is not releasable due to Arizona confidentiality laws.
Source: Department of Revenue

Table 4 displays the same information for the corporate tax credit. The tax year 2021 corporate credit data is preliminary. Businesses follow a pre-approval, post-approval, and claims process. Pre-approval does not guarantee receipt of tax credits; it is simply the application process where the eligibility requirements must be met (as outlined in the description section above). Post-approval indicates that the facility is operational and allows the taxpayer to claim a tax credit. Companies must then make claims against the granted tax credits to receive the benefit. They must take the credit in 5 equal annual installments.

Tables 1-4 show actual tax credit use following post-approval.

Table 4

Corporate Income Tax Credit Claims by Tax Year

Tax Year	# of Claimants	Total Credit Used
2013	0	$0
2014	0	$0
2015	NR	NR
2016	NR	NR
2017	6	$2,812,000
2018	13	$3,432,000
2019	16	$5,118,786
2020	34	$27,725,956
2021	39	$33,718,623
2022 1/	48	$52,227,656

1/ Tax Year 2022 data is preliminary.
NR - data is not releasable due to Arizona confidentiality laws.
Source: Department of Revenue

In comparison to claimed tax credits, *Table 5* displays the ACA estimate of the post-approval liability from 2013 through 2023, which totaled $325.3 million with 73 unique claimants, as shown in the table below. We do not have data on whether these were from individual or corporate tax credits, or whether the approvals were the result of qualified investments, employment, or both.

Table 5

Calendar Year	# of Claimants	Post-Approved Tax Credit [1/]
2013	0	$0
2014	0	$0
2015	1	$17,540,000
2016	3	$1,860,000
2017	2	$740,000
2018	5	$5,220,000
2019	5	$2,549,337
2020	8	$47,920,485
2021	19	$85,833,059
2022	15	$39,812,543
2023	15	$123,803,428

1/ Figures do not necessarily reflect actual tax credits used by claimants.
Source: Arizona Commerce Authority

Economic Impact

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

Table 6

Calendar Year 2023 Post Approved Projects

Business Name	Post-Approved Credit
Ball Metal Beverage Container Corp.	$4,720,000
Covetrus, Inc. and Subsidiaries	$1,076,905
FM Industries, Inc.	$2,000,000
Healthcare Arizona, LLC	$3,437,369
Intel Corporation	$16,880,000
Intel Corporation	$7,710,000
Lawrence Semiconductor Research Laboratory, Inc.	$311,590
Lucid Motors	$29,840,000
Mitsubishi Chemical Advanced Materials, Inc.	$600,000
Nextiva, Inc.	$1,960,000
Nikola Motor Company	$3,740,000
NXP (FKA Freescale Semiconductor, Inc.)	$660,000
Precision Aero, Inc.	$377,564
TSMC North America	$20,490,000
TSMC North America	$30,000,000
Total	**$123,803,428**

Source: Arizona Commerce Authority

Table 6 displays the credit amount associated with post-approved projects by business in calendar year 2023.

Each row in *Table 6* represents a distinct project, so a corporation is listed in the table for each of its post-approved projects in 2023. As shown in the table, ACA post-approved a total of $123.8 million in credits in CY 2023. The companies that received the most credits were the Taiwan Semiconductor Manufacturing Company (TSMC), Intel Corporation, and Lucid Motors. Projects from these 3 corporations made up 84.7% of the total amount of post-approved credit in CY 2023.

Complexity

The credit may result in some administrative complexity in order to prove that the company meets the stated eligibility requirements. This is handled by an accountant approved by ACA. This tax credit also involves a lengthy, multi-step procedure to receive the benefit.

Potential Performance Measures

Performance measures could include:

1. Number of new employees hired.

2. Total capital expenditures invested as a result of this tax credit.

Prior Review

The Qualified Facility tax credit was last reviewed by the Joint Legislative Income Tax Credit Review Committee (JLITCRC) in 2019. In the December 2019 meeting, the JLITCRC recommended its continuation.

Tax Credit for Renewable Energy Investment and Production for Self-Consumption by International Operations Centers

Credit for Renewable Energy Investment and Production for Self-Consumption by International Operations Centers

Summary

- According to the enacting legislation, the credit was created "to provide incentives to manufacturers that are committed to reducing their carbon footprint by investing in and producing renewable energy for self-consumption."
- To qualify for the credit, a taxpayer is required to make significant investments in both renewable energy facilities and an "International Operations Center."
- The credit amount is $5 million per year over 5 years, for a cumulative total of $25 million.
- Only one company was approved to use the credit before the due date to qualify expired on December 31, 2018.
- No credits, other than unused carryforwards, can be claimed after December 31, 2025.
- The cost of the corporate credit was $0 in FY 2024. Costs from FY 2019 to FY 2023 are not releasable due to confidentiality laws.
- The individual tax credit is no longer available, as it was repealed by Laws 2019, Chapter 203.

Statute

A.R.S. § 41-1520
A.R.S. § 43-1164.05 (Corporate)

Description

This is a corporate income tax credit for investment in new renewable energy facilities that produce energy for self-consumption using renewable energy sources if the power is primarily used by an International Operations Center.

The taxpayer must qualify for this credit as an International Operations Center (IOC), which requires the taxpayer to:

- Invest at least $100 million in one or more renewable energy facilities in Arizona by December 31, 2018.
- Invest least $1.25 billion in new capital assets, including land, buildings, and IOC equipment, within 10 years after being certified as an IOC by the Arizona Commerce Authority (ACA).
- Use at least 51% of the energy produced for self-consumption by the 5th year the IOC is in operation.

Note that a taxpayer that is initially authorized as an IOC after December 31, 2018 is not eligible for this credit.

Approval by the Department of Revenue (DOR) is required to take the credit. The amount of the credit is $5 million per year for 5 years for each renewable facility. The credit per taxpayer cannot exceed $5 million per year, and $25 million in total over 5 years. The total amount of credits that DOR can approve for all taxpayers in a calendar year is $10 million. No new credits can be claimed for any taxable year beginning after December 31, 2025.

To meet the definition of a "renewable energy facility" for purposes of claiming the credit, the taxpayer must have invested at least $30 million in each facility. Furthermore, the facility must have a minimum generating capacity of 20 megawatts, or a minimum annual generation of 40,000 megawatt hours, be located in Arizona, and produce electricity using a renewable energy resource.

According to DOR's most recent "Arizona's Individual and Corporate Income Tax Report," one renewable energy facility has been approved for this credit. Since no other taxpayer met the minimum investment requirement by the statutory due date of December 31, 2018, no additional credits will be authorized under this program.

According to ACA's Annual Reports, to date, two companies have been certified as an IOC: (1) Apple Inc., which was pre-approved in FY 2017 and post-approved in FY 2018, and (2) the Microsoft Corporation, which was pre-approved in FY 2022 and post-approved in FY 2023. Under current statute, ACA is authorized to certify IOCs through December 31, 2030.

Since Apple Inc. was the only IOC that met the required minimum investment of $100 million by the statutory due date of December 31, 2018, it is also the only company that qualified for the income tax credit under A.R.S. § 43-1164.05.

Besides the tax credit for investments in new renewable energy facilities, there is also a transaction privilege tax (TPT) and use tax exemption on the sale of electricity and natural gas to a business that operates as an IOC. This sales tax exemption, referred to as "utility relief" under A.R.S. § 41-1520, is currently available to both Apple Inc. and the Microsoft Corporation. Any business certified by ACA as an IOC on or before December 31, 2030 would be eligible for the "utility relief" but not the income tax credit.

Refundable

The tax credit is not refundable.

Carry Forward

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

History and Rationale

History

Laws 2014, Chapter 8 created an individual and corporate income tax credit for investments in new renewable energy facilities that produce energy for self-consumption if the power is primarily used in manufacturing. Laws 2015, Chapter 6 expanded this credit program to include certified IOCs. In addition, Laws 2015, Chapter 6 provides a sales tax exemption on electricity and natural gas purchased by an IOC.

Laws 2017, Chapter 299 repealed the tax credit for manufacturers originally enacted under Laws 2014, Chapter 8. The credit for IOCs, however, was retained. The requirements to qualify for the credit as a manufacturer under Laws 2014, Chapter 8 were more stringent than as an IOC under Laws 2015, Chapter 6. Instead of a minimum investment requirement of $100 million in new renewable energy facilities, a manufacturer was required to invest at least $300 million to qualify for the credit. Moreover, a manufacturer was required to use at least 90% of the electricity produced by the renewable energy facilities for self-consumption compared to 51% for an IOC.

Laws 2019, Chapter 203 repealed the individual income tax credit for IOCs but retained the corporate income tax credit. Laws 2020, Chapter 7 changed the due date to fulfill the $100 million minimum investment requirement to qualify for the credit from December 31, 2018 to December 31, 2030. However, Chapter 7 also added a provision that stipulates that any IOC certified by ACA after December

31, 2018 cannot claim the credit. Laws 2021, Chapter 266, added provisions allowing third-party investments on behalf of taxpayers to count towards the credit's investment requirements.

Rationale

According to the intent clause of the enacting legislation (Laws 2014, Chapter 8), the purpose of the credit is to "provide incentives to manufacturers that are committed to reducing their carbon footprint by investing in and producing renewable energy for self-consumption."

Credit data reported by DOR suggests that no company qualified for the credit under the original program created by Laws 2014, Chapter 8, which specifically targeted manufacturers. As noted earlier, ACA's Annual Reports indicate that Apple Inc. was the only company that qualified for the income tax credit under Laws 2015, Chapter 6.

Revenue Impact

Beginning in FY 2016, the Department of Revenue (DOR) is required to report the use of corporate income tax credits on a fiscal year basis. *Table 1* below shows the cost of the credit by fiscal year going back to FY 2019 when it was first claimed.

Table 1

Corporate Income Tax Credit Use by Fiscal Year

Fiscal Year	# of Claims	Credit Used
2019	NR	NR
2020	NR	NR
2021	NR	NR
2022	NR	NR
2023	NR	NR
2024	0	$0

# of Claimants - the number of taxpayers who claimed the credit each year.
Credit Used - the total amount of credits used to reduce tax revenue each fiscal year.
NR - data is not releasable due to Arizona confidentiality laws.

Although DOR does not report the amount of the credit used due to taxpayer confidentiality laws, since only one renewable energy facility was approved before the December 31, 2018 deadline, we assume that absent a credit recapture, the cost of the credit will total $25 million over 5 years (= $5 million per year x 5 years), as this is the amount provided by statute.

Economic Benefits

While the IOC certification requires significant investments (a minimum of $100 million for renewable energy facilities and $1.25 billion in capital assets, including buildings, land and equipment, over a 10-year period), the JLBC Staff is not able to quantify the economic impact from available data. Such an analysis would require detailed spending and employment data, along with a detailed timeline of construction costs, equipment spending, and hiring of new personnel.

While the JLBC staff does not have access to the data required to prepare an impact analysis, various reports in local media indicate that the original credit program was primarily created to incentivize a manufacturing company that supplied glass for a large high-tech company (which later qualified as the sole IOC company) to locate in Arizona. This manufacturing company, however, reportedly filed for bankruptcy in 2014. Following the bankruptcy of the glass-manufacturer in 2014, the credit was amended in 2015 to include IOCs.

As noted earlier, ACA's Annual Reports indicate that only one company, Apple Inc., was approved as an IOC under this tax credit program pursuant to A.R.S. § 43-1164.05. According to an article published by the Arizona Republic on February 5, 2015, "Apple will establish a command center for its global data networks in Mesa, Arizona, promising to invest $2 billion over 10 years." According to the same article, this data center is "expected to create 150 full-time jobs and could generate up to 500 construction and trade jobs." In addition, the article also noted that "Apple is expected to build and finance solar projects that provide enough energy to power more than 14,000 homes in Arizona." Apple claims that the Mesa data center is currently operating on 100% renewable energy.

While the Arizona Republic reported on August 15, 2018, that Apple operates a "1.3 million-square-foot data center" in Mesa, Arizona, the article also noted that the company "would not share many specifics" about its operations at the data center. Without more specific information, we are not able to determine to what extent the company's stated investment, employment and construction objectives have been met.

Complexity

Tax credit forms and instructions reviewed by JLBC Staff suggest that the credit is not unnecessarily complex in terms of the application, administration, and approval process.

Potential Performance Measures

Performance measures could include:

1. Number of net new jobs created by the International Operations Center (IOC).

2. Percentage of electricity generated by renewable energy facilities used for self-consumption by the IOC.

Prior Review

The renewable energy investment and production for self-consumption by international operations centers tax credit was last reviewed the by JLITCRC in 2019. The Committee recommended that the tax credit be retained.

Tax Credit for Contributions to School Tuition Organizations for Displaced or Disabled Students

Corporate Contributions to School Tuition Organizations for Displaced or Disabled Pupils

Summary

- The credit is capped at $6.0 million annually.
- The cost of the credit was $7.9 million in FY 2024 ($2.2 million for corporations, $5.4 million for insurers, and $0.3 million for individuals (S-corporations)). Depending on the tax year in which the taxpayer claims the credit, the amount on a fiscal year basis can exceed the $6 million cap.
- In FY 2024, the credit was claimed by 22 individuals (S-corporations) at an average of $13,593 per claim, and by 9 corporations at an average of $238,870 per claim.
- In total, there are 4 private school tax credits with a combined cost of $234.7 million for FY 2024.

Statute

A.R.S. § 43-1184, A.R.S. § 43-1089.04, and § 20-224.07

Description

The credit was last reviewed in 2019. The description of the credit as well as other sections of the credit review have been updated from our 2019 report when relevant.

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

1. Corporate, individual (S-corporation), and insurer contributions to STOs awarding "low-income scholarships" (A.R.S § 43-1183, § 43-1089.04 and § 20-224.06),
2. Corporate, individual (S-corporation), and insurer contributions to STOs awarding "displaced or disabled pupil scholarships" (A.R.S § 43-1184, § 43-1089.04 and § 20-224.07),
3. Private contributions by individuals to STOs awarding scholarships to private school students. (This credit is commonly referred to as the "Original STO Credit" A.R.S § 43-1089, A.R.S § 43-1601 through § 43-1605), and
4. Private contributions by individuals to STOs awarding "switcher scholarships" to students switching from one mode of school to private school if the amount of the taxpayer's donation exceeds the "Original STO Credit" limit under A.R.S § 43-1089. (This credit is commonly referred to as the "Switcher STO Credit" A.R.S § 43-1089.03, A.R.S § 43-1601 through § 43-1605).

This review pertains to corporate income tax credits for displaced or disabled pupil scholarship contributions pursuant to A.R.S § 43-1184. It also addresses individual (S-corporation) income tax credits and insurance premium tax credits for displaced or disabled pupil scholarship contributions pursuant to A.R.S § 43-1089.04 and A.R.S § 20-224.07, respectively. Individuals (as shareholders of an S corporation) and insurers share the program's $6 million annual tax credit cap. The tax credit review statute (A.R.S. § 43-222), however, does not literally require review of individual (S-corporation) income tax credits and insurance premium tax credits for "displaced or disabled" STO contributions.

This credit is provided to corporations, individuals (as shareholders of an S-corporation), 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, S-corporation, or insurer may not use a tax credit for any contribution for displaced or disabled pupil scholarships if it designates the contribution for a particular student.

The Arizona Department of Revenue (ADOR) typically reports tax credit data for this program separately from related data on STO contributions and scholarships, and typically reports more current data for the former. In addition, some of ADOR's tax credit data excludes insurers, and the Arizona Department of Insurance and Financial Institutions (DIFI) reports less detailed data on insurer tax credits for the program than ADOR reports for corporations and S-corporations. This analysis uses whatever available data are most recent and complete for each metric. This analysis is therefore not always able to compare data for different program metrics, such as STO contributions and tax credits claimed, for the same fiscal year.

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.

History and Rationale

The corporate and insurer displaced or disabled pupil scholarship 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 prior 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 pupil scholarship tax credit program addressed that 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 or disabled pupil scholarship 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 scholarship" 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 Superior Court ruling stand.

Laws 2015, Chapter 301 expanded the credit for displaced or disabled pupil scholarship contributions to include businesses classified as Subchapter S corporations. (Chapter 301 allows an individual shareholder to claim the credit for their pro rata share of the contributions by an S Corporation to a STO.)

Corporations, individuals (S-corporations), and insurers also may receive tax credits for contributions to STOs under a separately authorized program for "low-income" students. The "low-income pupil scholarship" STO tax credit is not subject to Committee review this year. *Attachment 1* provides an overview of all current STO tax credit programs.

The statute creating the displaced or disabled pupil scholarship income tax credit program does not include a specific statement of purpose or a rationale. As noted above, however, the program was created after a related state-funded program for providing scholarships to displaced or disabled students was ruled unconstitutional.

Revenue Impact

There is no separate cap on the amount of tax credits that an individual corporation, individual (S-corporation), or insurer can claim under the program. However, from FY 2010 (the inception of the credit) to FY 2021, the aggregate corporate, individual (S-corporation), and insurer tax credits for contributions for displaced or disabled pupil scholarships were capped at $5.0 million per year. Laws 2021, Chapter 412 increased the cap to $6.0 million per year, beginning in FY 2022. Because of this cap, STO contributions from corporations, individuals (S-corporations), and insurers must be pre-approved by the ADOR to be eligible for a tax credit. Since FY 2015, contributions from corporations, individuals (S-corporations) and insurers combined have met the annual cap (*see Table 1 below*).

Table 1 summarizes contributions to STOs for displaced or disabled pupil scholarships since the beginning of the program in FY 2010 through FY 2023 (data for FY 2024 will not be released until the spring of 2025). In FY 2023 (latest published data on donations received), 18 individuals (S-corporations) and 3 insurers (21 donors total) donated a total of $6.0 million to STOs under the program. The average contribution made by donors in the first year of the program (FY 2010) was $246,500 ($1,478,880 ÷ 6 corporations). The average contribution in the most recent year for which data is available (FY 2023) was $285,700 ($6,000,000 ÷ 21 donors).

ADOR also reports tax credits claimed for STO contributions on a tax year basis. Every taxpayer is required to calculate their taxable income based on an annual accounting period called a tax year. For most individual income taxpayers, the calendar year is also their tax year. Other taxpayers, such as regular corporations and S corporations may use a fiscal year as their tax year. A corporation's fiscal year is 12 consecutive months ending on the last day of any month except December 31. Depending on a corporation's elected tax year (calendar year or fiscal year) and whether the corporation files for a 6-month extension, the corporation's liability for any one tax year could affect collections in 1 of 4 state fiscal years.

Table 1

Contributions to School Tuition Organizations for Displaced or Disabled Pupil Scholarships by Fiscal Year [1/]

Fiscal Year	Statutory Limitation	# of Donors	$ Approved by DOR [2/]	$ 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	27	$3,112,745	$2,957,765
2015	$5,000,000	28	$5,000,000	$5,000,000
2016	$5,000,000	38	$5,325,000	$5,000,000
2017	$5,000,000	34	$5,147,000	$5,000,000
2018	$5,000,000	14	$5,000,000	$5,000,000
2019	$5,000,000	50	$5,000,000	$5,000,000
2020	$5,000,000	42	$5,973,400	$5,000,000
2021	$5,000,000	29	$7,700,500	$5,000,000
2022	$6,000,000	20	$6,050,000	$6,000,000
2023	$6,000,000	21	$6,321,000	$6,000,000
2024	$6,000,000	NA	NA	NA

1/ Data are for corporations, individuals (S-corporations) and insurers combined.
2/ After approval by DOR, a taxpayer must make its donation to the STO within 20 days (A.R.S § 43-1184D). If a taxpayer fails to meet the required 20-day donation window, the taxpayer's approved credit amount is forfeited. The column "Approved by DOR" reflects the amount of credits that DOR approved within a fiscal year regardless of whether the taxpayer made the donation within the required 20-day window.

Source: "School Tuition Organization Income Tax Credits in Arizona: Fiscal Year 2023" (page 39) from the Arizona Department of Revenue (March 2024)

Table 2 summarizes tax credit claims for corporations and individuals (S-corporations) for the program by tax year since its inception, as reported by ADOR. TY 2022 data for individuals (S-corporations) are preliminary due to extension returns pending at the time of the report. Note that this information does not include credit claims by insurers.

Contributions do not necessarily result in the taxpayer using the credit immediately. A corporation, individual (S-corporation), or insurer may lack enough liability to take the full credit in the year in which the donation is made. To address that issue, A.R.S. § 43-1184E, A.R.S. § 43-1098.04C, and A.R.S. § 20-224.07D allow them to carry forward any claimed but unused credit for up to 5 years. *Table 2* shows the amount of credits claimed and carried forward by corporations and individuals (S-corporations) by tax year since the program's inception. Similar but less detailed data for insurers are summarized in *Table 3*.

Table 2

Tax Credit Claims by Tax Year (Corporations and S-corporations only) 1/ 2/

Tax Year	# of Claimants 3/	Total Credit Available 4/	Credits Used 5/	Carry-Forward
2009	1	NR	NR	NR
2010	1	NR	NR	NR
2011	3	$170,000	$170,000	$0
2012	4	NR	NR	NR
2013	14	$506,600	$368,600	$138,000
2014	17	$2,624,300	$2,334,000	$290,300
2015	29	$2,684,200	$2,388,400	$601,600
2016	21	$1,190,400	$769,100	$421,200
2017 6/	35	$380,700	$318,500	$62,200
2018	47	$2,215,500	$2,007,200	$208,300
2019	40	$1,532,000	$1,245,000	$287,000
2020 6/	33	$646,300	$422,900	$223,400
2021 7/	33	$1,667,200	$1,151,700	$441,600
2022 8/	28	$1,243,800	$970,600	$29,700

1/ As reported by the Arizona Department of Revenue (ADOR). Excludes credits claimed by insurers, which are not reported by ADOR. The Arizona Department of Insurance and Financial Institutions (DIFI) reports tax credit usage data for insurers for this program, but in a less detailed manner and on a fiscal year rather than tax year basis *(see Table 3).*
2/ The table combines data reported for corporations and individuals (S-corporations).
3/ The number of taxpayers who claimed the credit in each year.
4/ 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.
5/ The total value of credits claimed in each tax year.
6/ No data publicly released by ADOR for Corporate Credits in TY 2017 and TY 2020. Amounts of credit available, credits used, and credit carry-forward in TY 2017 and TY 2020 are solely for individual income taxpayers (S-corporations).
7/ The amount of credit carry-forward for TY 2021 is solely for individual income taxpayers (S-corporations).
8/ The amount of credit carry-forward for TY 2022 is solely for individual income taxpayers (S-corporations). Corporate credit use is preliminary for TY 2022.
NR – Data is not releasable due to Arizona confidentiality laws.

Source: Arizona Department of Revenue "Arizona's Individual and Corporate Income Tax Credit Report (November 2023)."

Table 3 below summarizes tax credit data for insurance companies by fiscal year, as reported by DIFI. This data is available from FY 2015 through FY 2024. *Table 3* does not include any information on the number of claims, as such data is not reported by DIFI.

Given the multi-year period over which corporations and insurers can claim credits under this program, the *Table 1* data on contributions are probably more reflective of the credit's current use than the *Table 2* & *3* data on credit usage.

The credit may result in foregone General Fund spending to the extent that STO-funded scholarships result in reduced public school enrollment. We are unable, however, to determine whether or how many additional students would have attended public schools instead of private schools without a STO scholarship.

Table 3
Tax Credit Claims by Fiscal Year (Insurers only) 1/

Fiscal Year	Credit Used
2015	$2,988,400
2016	$2,950,900
2017	$3,477,300
2018	$2,762,900
2019	$3,448,100
2020	$2,949,100
2021	$4,325,700
2022	$5,589,500
2023	$5,602,200
2024	$5,443,400

1/ As reported by the Arizona Department of Insurance and Financial Institutions (DIFI). DIFI was not required to report this information prior to FY 2015.

Economic Benefits

This credit is not directly designed to promote economic development or spur investments that would result in new jobs. Instead, this credit is one of several tax credits in statute that appears to be primarily intended to encourage cash contributions to certain target groups in society, such as the working poor or students in private or public schools.

More Background

In FY 2023 (latest published data), STOs distributed $4,490,197 in displaced or disabled pupil scholarships (1,168 scholarships to 137 schools) from individual (S-corporation) and insurer contributions (*see Table 4*). 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 4* are from STO annual reports, rather than corporate or insurer income tax filings, so are not confidential.

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Historically, the average displaced or disabled pupil scholarship has varied from a low of $3,360 in FY 2013 to a high of $5,485 in CY 2009 (the program's first year) *(see Table 5).* The number of scholarships distributed under the program has remained relatively stable since FY 2017.

ADOR's March 2024 STO report notes that the number of scholarships paid does not equate to the number of students receiving scholarships because families often apply for scholarships from more than one STO. Thus, the number of scholarships reported in *Tables 4* and *5* do not equal the number of students receiving STO scholarships from this program. Schools do not report the number of individual students receiving STO scholarships.

Table 4

Displaced or Disabled Pupil Scholarships for Fiscal Year 2023 by School Tuition Organization

School Tuition Organization	# of Scholarships	# of Schools	Scholarship Amount	Average
Academic Opportunity of Arizona	46	15	$453,297	$9,854
America's Scholarship Konnection Inc.	5	1	$24,000	$4,800
Arizona Leadership Foundation	432	82	$2,774,121	$6,422
Arizona Private Education Scholarship Fund, Inc.	75	15	$296,755	$3,957
Arizona School Choice Trust	1	1	$2,503	$2,503
Arizona Tuition Connection	3	2	$6,500	$2,167
Arizona's Catholic Tuition Support Organization (CTSO)	21	8	$38,415	$1,829
Catholic Education Arizona	151	32	444,793	$2,946
Financial Assistance for Independent Schools	18	1	$120,391	$6,688
Institute for Better Education	380	103	$229,971	$605
School Choice Arizona, Inc.	36	12	$99,451	$2,763
TOTAL	**1,168**	**137** 1/	**$4,490,197**	**$3,844**

1/ Unduplicated total, as some schools received scholarships from more than one STO.
Source: "School Tuition Organization Income Tax Credits in Arizona: Fiscal Year 2023" (page 44) from the Arizona Department of Revenue (March 2024)

Table 5

Displaced or Disabled Scholarships by Fiscal Year

Fiscal Year	# STOs	# Scholarships	$ Distributed	Avg. Scholarship
2009 1/	5	114	$625,335	$5,485
2010 1/	6	166	$715,424	$4,310
2011	5	114	$559,333	$4,906
2012	5	119	$583,865	$4,906
2013	6	217	$731,231	$3,360
2014	8	346	$1,611,469	$4,657
2015	12	806	$3,581,873	$4,444
2016	14	934	$4,370,439	$4,679
2017	18	1,103	$5,750,839	$5,214
2018	14	1,162	$5,205,607	$4,480
2019	14	1,105	$5,860,589	$5,304
2020	11	961	$4,885,395	$5,084
2021	15	928	$4,518,492	$4,869
2022	13	1,345	$5,061,161	$3,763
2023	11	1,168	$4,490,197	$3,844

1/ Reported data are for calendar year rather than fiscal year (reporting period changed after FY 2010).

Source: "School Tuition Organization Income Tax Credits in Arizona: Fiscal Year 2023" (page 41) from the Arizona Department of Revenue (March 2024)

There are 4 different private school STO tax credit programs *(see Attachment 1)*. Students received 75,817 scholarships from the 4 STO scholarship programs combined in FY 2023 *(see Table 6)*. Some pupils, such as public school switchers and military dependents, can receive scholarships from more than one STO program (such as Switcher and Corporate Low Income) in addition to receiving scholarships from more than one STO within the same STO program (such as Switcher).

Table 6

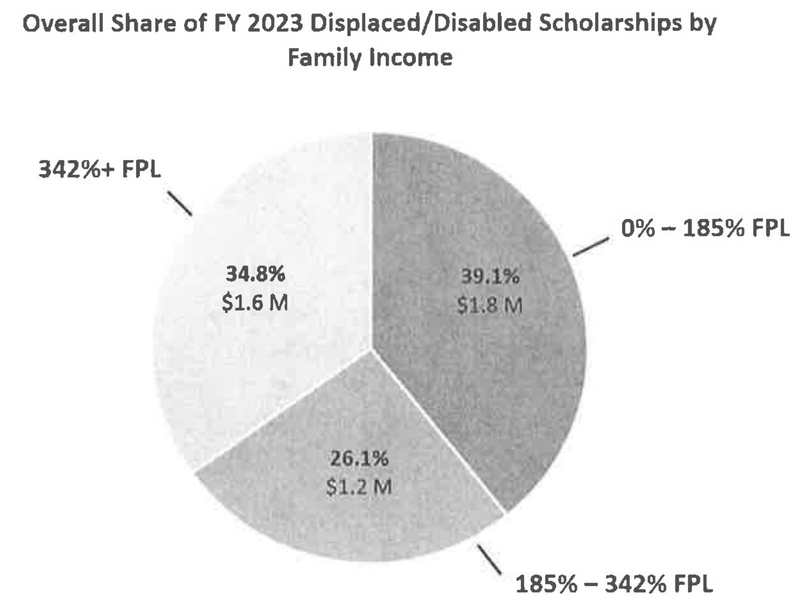
Scholarship Summary for All STO Program Combined for FY 2023

STO Program	Number of Scholarships	Scholarships ($)	Tax Donations ($)
Original Individual	23,826	$49,878,260	$69,544,712
Switcher Individual	21,241	$36,322,839	$46,695,361
Low-Income Corporate	29,582	$113,411,370	$142,111,227
Displaced/Disabled Corporate	1,168	$4,490,197	$6,000,000
Total	**75,817**	**$204,102,666**	**$264,351,300**

Source: " School Tuition Organization Income Tax Credits in Arizona: Fiscal Year 2023" (pages 11, 21, 30, and 39) from the Arizona Department of Revenue (March 2024)

A.R.S. § 43-1603B5 requires STOs to report the percentage and total dollar amount of scholarships awarded during the previous year to the following: 1) students whose family income qualifies them for free or reduced price lunches (FRPL) under the federal school lunch program (up to 185% of the poverty level, or $51,337 for a family of four for FY 2023), and 2) students whose family income exceeds the FRPL eligibility threshold by less than 185% (up to 342.25% of the poverty level, or $94,974 for a family of 4 for FY 2023). ADOR reports that for FY 2023, students with family income of up to 185% of the federal poverty level (FPL) received 39.1% ($1.8 million) of program scholarships that year and that students with family income of 185% to 342% of the FPL received 26.1% ($1.2 million) of scholarships. The remaining 34.8% of scholarships ($1.6 million) went to students whose family income was greater than 342% of the FPL ($94,974 for a family of 4 for FY 2023) (see *Chart 1*).

Chart 1



Complexity

ADOR indicates that it is administratively simple for corporations, insurers, and individuals (S-corporations) to donate to STOs and claim the credit. However, the large volume of corporate donation pre-approval requests and the statutory requirement to process them on a first-come/first-served basis requires a process that is complex for both the STOs and ADOR. According to ADOR, recent process improvements have increased the efficiency of credit pre-approval for both STOs and ADOR.

ADOR continues to use a streamlined annual reporting process for the STOs. ADOR reports, however, that many STOs still utilize volunteer staff, which leads to reporting inconsistencies and makes it difficult to educate STO staff on reporting requirements. ADOR indicates that its oversight responsibilities of STOs currently rely on the review of annual reports and audits/reviews submitted by the STOs. It notes that oversight by ADOR could be enhanced with additional staffing capacity.

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

The Credit for Contributions to School Tuition Organizations for Displaced or Disabled Students was previously reviewed during the 2019 review cycle. The Committee recommended that the credit be retained and placed on the income tax credit review schedule for 2024.

Attachment 1

COMPARISON OF PUBLIC AND PRIVATE SCHOOL TAX CREDITS

Table A: Statutes, Caps & Data

<table>
<tr><th rowspan="2">Type</th><th rowspan="2">Category</th><th colspan="2">Statute</th><th rowspan="2" colspan="2">Cap</th><th rowspan="2"># of STOs 1/ (that received donations)</th><th colspan="3">Donations 1/</th><th colspan="2">Scholarships 1/</th><th rowspan="2">Credits Claimed 1/</th></tr>
<tr><th>STO</th><th>Tax Credit</th><th>$ 2/</th><th>#</th><th>Average</th><th>#</th><th>Average</th></tr>
<tr><td rowspan="3">Individual</td><td>Public School Extracurricular</td><td>NA</td><td>A.R.S. § 43-1089.01</td><td colspan="2">$200 single/ $400 married filing jointly</td><td>--</td><td>$42.5M</td><td>194,414</td><td>$219</td><td>--</td><td>--</td><td>$35.3M</td></tr>
<tr><td>Private School Original</td><td colspan="2">A.R.S. § 43-1601 through 43-1605</td><td>A.R.S. § 43-1089</td><td>$769 single/ $1,535 married filing jointly 3/</td><td>51</td><td>$69.5M</td><td>80,057</td><td>$869</td><td>23,826</td><td>$2,093</td><td>$67.9M</td></tr>
<tr><td>Private School "Switcher" 4/</td><td colspan="2">A.R.S. § 43-1601 through 43-1605</td><td>A.R.S. § 43-1089.03</td><td>$766 single/ $1,527 married filing jointly 3/</td><td>49</td><td>$46.7M</td><td>49,323</td><td>$947</td><td>21,421</td><td>$1,710</td><td>$42.7M</td></tr>
<tr><td rowspan="2">Corporate, IIT S-Corporations & Insurance Premium</td><td>Private School Low-Income Student</td><td colspan="2">A.R.S. § 43-1501 through 1507 (except 1505)</td><td>A.R.S. § 43-1183, 43-1089.04 & 20-224.06</td><td>$135,000,000 5/</td><td>45</td><td>$142.1M</td><td>1,151</td><td>$123,468</td><td>29,582</td><td>$3,834</td><td>$116.2M</td></tr>
<tr><td>Private School Displaced/ Disabled Student</td><td colspan="2">A.R.S. § 43-1501 through 1507 (except 1504)</td><td>A.R.S. § 43-1184, 43-1089.04 & 20-224.07</td><td>$6.0 M</td><td>6</td><td>$6.0 M</td><td>21</td><td>$285,714</td><td>1,168</td><td>$3,844</td><td>$7.9M</td></tr>
</table>

1/ Public school tax credit donations and scholarship data are for *calendar* year 2023 (latest reported data); private school donations and scholarship data are for *fiscal* year 2023 (individual income tax and corporate income tax; latest reported data). Data on credits claimed for both the public school credit and STOs are for *fiscal year* ~~2023~~ 2024.

2/ In addition to the $42.5 million of public school donations in calendar year 2023, FY 2023 private school donations in the table total $264.3 million. Donations for a given year may not equal tax credits for that year depending on donors' tax liabilities and because corporations and insurers may carry forward tax credits for up to 5 years before using them. Similarly, donations for a given year may not equal total scholarship disbursements for that year because STOs may reserve a portion of current year donations for future year scholarships and may use up to 10% of donations for administration.

3/ Adjusted annually for inflation. Figures shown are for Tax Year 2025.

4/ Referred to as the "Switcher" credit in Department of Revenue publications, since it is limited mostly to students switching from public to private schools (A.R.S. § 43-1603E)

5/ Cap is for FY 2025. As amended by Laws 2024, Chapter 221, A.R.S. § 43-1183.C1 sets the cap at $135M in FY 2025 and for each year thereafter.

Note: "Empowerment Scholarship Accounts" (ESA's) authorized by A.R.S. § 15-2402 are not included in this analysis, as they are funded with appropriated state monies rather than contributions that qualify an individual or corporation for a state tax credit. Student must meet criteria specified in A.R.S. §15-2401 (original) or A.R.S. §15-2401 (universal) to qualify for an ESA. ESAs are funded under formulas prescribed in A.R.S. §15-2402C&D.

Table B: Program Restrictions

Type	Category	Donors	Recipients	Use of Funds 1/	Earmarking	Other
Individual	Public School Extracurricular	Individual income tax filers	Public schools	Extracurricular activities, character education, and college or industry testing fees	Can designate a specific student, school club, or use	Funds can only be used for activities or programs of public schools specified in statute, such as standardized testing for college credit, standardized testing preparation, industry certification exams, CPR training, character education programs and extracurricular activities. Extracurricular activities include band uniforms, equipment or uniforms for varsity athletics, scientific laboratory equipment or materials, or in-state or out-of-state trips that are solely for competitive events. Extracurricular activities do not include any senior trips or events that are recreational, amusement or tourist activities.
	Original	Individual income tax filers	Private school students	Private school scholarships	Taxpayer may recommend recipient; may not recommend funds for own dependent or another's dependent in a donation swap	The tax credit is not allowed if the taxpayer designates the taxpayer's contribution to the school tuition organization for the direct benefit of any dependent of the taxpayer or if the taxpayer designates a student beneficiary as a condition of the taxpayer's contribution to the school tuition organization. A taxpayer may not claim a tax credit if the taxpayer agrees to swap donations with another taxpayer to benefit either taxpayer's own dependent. A STO cannot award, restrict or reserve scholarships solely based on a donor's recommendation. If a STO scholarship exceeds a school's total cost of educating the recipient, the school must return the excess portion to the STO.
	"Switcher"	Individual income tax filers	Private school students	Private school scholarships	Taxpayer may recommend recipient; may not recommend funds for own dependent or another's dependent in a donation swap	The tax credit is allowed only after the taxpayer has used the maximum tax credit available under the "Original" program. All restrictions for "Original" also apply to "Switcher." In addition, "Switcher" scholarships may only be awarded to public school transfers, kindergartners, preschool disabled students, military dependents, pupils who received a corporate STO or "Switcher" scholarship in the prior year, are homeschooled before enrolling in a private school, moved from out of state before enrolling in a private school, or previously participated in the ESA program. A STO shall give priority to students and siblings of students on a waiting list for scholarships if the STO maintains a waiting list. If a STO scholarship exceeds a school's total cost of educating the recipient, the school must return the excess to the STO.
Corporate and Insurance Premium	Low-Income Student	Corporations, Insurers & S Corporations	Private school students from "low income" households	Private school scholarships	Not allowed	1. Family income cannot exceed 185% of the income limit required to qualify a child for reduced price lunches under the national school lunch and child nutrition acts (maximum annual income of $106,782 for a family of four for FY 2025). 2. The student receiving the scholarship must meet one of the following: a. Attended a public primary or secondary school as a full-time student or attended a public program for preschool disabled pupils for at least ninety days or one full semester of the prior fiscal year. b. Enroll in a private school kindergarten or preschool disabled program. c. Be a military dependent. d. Be homeschooled before enrolling in a private school. e. Moved from out of state before enrolling in a private school. f. Previously Participated in the ESA program g. Received an individual or corporate STO scholarship in the prior year and continues to attend a qualified private school. 3. The total scholarship amount per pupil from each STO increases each year by $200. In FY 2025, a STO cannot issue a scholarship in an amount that exceeds: a. $6,200 for students in kindergarten through grade 8 b. $8,100 for students in grades 9 through 12.
	Displaced/ Disabled Student	Corporations, Insurers & S Corporations	Private school students with disabilities or foster care history	Private school scholarships	Not allowed	1. The student must have been either placed in foster care at any time before graduating from high school or obtaining GED or have been identified at any time as having a disability under federal or state law. 2. The amount of the scholarship shall not exceed the lesser of the cost of tuition or 90% of the amount of state aid that would have been computed for the student to attend public school.

1/ All STOs must allocate at least 90% of their tax credit-related revenues for scholarships or grants, so STOs can spend a maximum of 10% of those revenues on program administration.