# Joint Legislative Budget Committee
# Staff Memorandum

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DATE: December 7, 2015

TO: Members, Joint Legislative Income Tax Credit Review Committee

FROM: Hans Olofsson, Chief Economist

SUBJECT: 2015 INCOME TAX CREDIT REVIEW

This memo transmits background materials for the December 14, 2015 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 2015 include:

Credit | Page #



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 has reviewed the credit for Employment of Temporary Assistance for Needy Families (TANF) Recipients and the credit for Contributions to Qualifying Charitable Organizations twice before – in 2005 and 2010. The credit for the Employment of National Guard Members was previously reviewed by the Committee in 2010.

Confidential Data
Pursuant to Laws 2010, Chapter 225, the Department of Revenue (DOR) is authorized to disclose confidential statistical information to this Committee and the 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 2015 credit review list, except for the Contributions to Qualifying Charitable Organizations credit, include confidential information for 1 tax year or more. After reviewing the data and consulting with DOR, the 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 certain limitations affecting the evaluation of income tax credits. The lack of performance measures for tax credits is one such example. 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).

Another limitation is that the evaluation of tax credits is often hampered by the difficulty of measuring their associated costs and benefits. For example, the TANF employment tax credit may produce cost savings to the state insofar as it reduces TANF caseload expenditures that would not occur otherwise. However, it cannot be determined from available data how many former TANF recipients would have found employment without the existence of the state tax credit.

2015 Review

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.

*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.

(Continued)

*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 Department of Economic Security.

HO:kp
Attachment
xc: Reed Spangler, Senior Policy Advisor, Senate
John Fetherston, Policy Advisor, Senate
Bill Ritz, Analyst, Senate Finance Committee
Travis Swallow, Policy Advisor, House
Eric Figueroa, Policy Advisor, House
Michael Madden, Analyst, House Ways and Means Committee

# Employment of National Guard Members Tax Credit

## Employment of National Guard Members Credit

**Summary**

- The credit has been available since January 1, 2006.
- The credit is equal to $1,000 per tax year for each employee who is placed on active duty by the Arizona National Guard.
- The cost of the corporate credit was $7,000 in 2011, $6,000 in 2012, and $9,050 in 2013.
- The cost of the individual credit was $0 in tax years 2013 and 2014, the last years for which data has been released.
- Very few corporate and individual taxpayers have used the credit. The corporate credit was claimed by 4 entities in 2013, 5 in 2012, and 5 in 2011. The individual credit was last claimed by 3 taxpayers in 2012, but has not been claimed in 2013 or 2014.

**Statutes**

A.R.S. § 43-1167.01 (Corporate) and A.R.S. § 43-1079.01 (Individual)

**Description**

The statutes provide an income tax credit for corporations and individuals that employ Arizona National Guard members who are placed on active duty. The credit is equal to $1,000 per taxable year, per applicable employee. To qualify for the credit, several more conditions must be met:

- The employees claimed under the credit must be full-time.
- The employee must have served during the taxable year on active duty for training that exceeds the required annual training period, including any activation for federal or state emergencies.

**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**

This credit was created by Laws 2005, Chapter 264 and became effective January 1, 2006. According to a purpose statement included in the legislation, the credit was enacted in order to provide employers with some financial incentive to employ members of the National Guard. Arizona does not offer any other tax incentives for employers of National Guard members.

In the 2005 Legislative Session, Laws 2005, Chapter 115 created the National Guard Relief Fund consisting of donations from private citizens through their state individual income tax return. The monies are used to provide financial assistance to families of National Guard members when they are placed on active duty and are serving in a combat zone. Laws 2015, Chapter 208, however, repealed the National Guard Relief Fund and transferred the remaining balance to the Arizona Department of Veterans' Services for grants to nonprofit organizations that provide financial assistance to Arizona National Guard members and their families. Through FY 2015, the National Guard Relief Fund collected $1.3 million in revenues and had no expenditures.

**Revenue Impact**

The most recent data reported by DOR shows an aggregate cost to the state of $9,050 in 2013. As of August 31, 2015, 7,850 individuals were enlisted in the Arizona National Guard, of which, 2,018 are employed on a full-time basis with the National Guard. If the credit were to be claimed for National Guard members that are not full-time employees of the National Guard, the impact to the state would equal $5.8 million annually.

| Tax Year | # of Claimants | # of Employees Claimed | Total Credit Available | Credit Used | Carry Forward |
|---|---|---|---|---|---|
| **Corporate** | | | | | |
| 2006 | 3 | 5 | $5,000 | $5,000 | $0 |
| 2007 | 2 | x | x | x | x |
| 2008 | 5 | 9 | $9,000 | $3,100 | $5,900 |
| 2009 | 6 | 9 | $14,900 | $7,000 | $7,900 |
| 2010 | 8 | 10 | $17,900 | $17,900 | $0 |
| 2011 | 5 | 7 | $7,000 | $7,000 | $0 |
| 2012 | 5 | 6 | $6,000 | $6,000 | $0 |
| 2013 | 4 | 10 | $10,000 | $9,050 | $950 |
| **Individual** | | | | | |
| 2006 | 1 | x | x | x | x |
| 2007 | 1 | x | x | x | x |
| 2008 | 1 | x | x | x | x |
| 2009 | 2 | x | x | x | x |
| 2010 | 2 | x | x | x | x |
| 2011 | 2 | x | x | x | x |
| 2012 | 3 | x | x | x | x |
| 2013 | 0 | x | $0 | $0 | $0 |
| 2014 | 0 | x | $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 $400 in a particular credit identified in tax year 2010, use $300 of this amount in 2010 and leave $100 as a carry forward. If this taxpayer did not identify or claim the credit in 2011 the $100 carry forward would not be included in the credit carry forward total for 2011.
x – No data publicly released by the Department of Revenue.

**Economic Benefits**

*Creation of New Jobs or Retention of Existing Jobs*

While this credit may encourage employers to retain existing employees or to take on more employees than they otherwise would have due to the lowered cost of labor, it is unlikely that this credit will have any measurable economic impact on the state as a whole.

**Complexity**

The credit does not appear to be unusually complex in its description, calculation or application.

**Potential Performance Measures**

The number of employers claiming the credit and the number of National Guardsmen claimed under this credit can both be determined from available data. As a result, no additional performance measures are suggested.

**Prior Review**

At its December 2010 meeting, the Joint Legislative Income Tax Credit Review Committee reviewed the credit and recommended its continuation.

# Employment of Temporary Assistance for Needy Families (TANF) Recipients Credit

## Employment of Temporary Assistance for Needy Families (TANF) Recipients Credit

**Summary**

- The individual credit was claimed by a total of 27 taxpayers and the corporate credit was claimed by a total of 42 taxpayers through 2013, the last year for which data is available.
- 2,045 positions have been claimed under this credit for an average benefit of $1,008 per job.
- The net cost of the corporate credit was $111,500 in 2013, the latest tax year for which information is available.
- The number of former TANF recipients claimed as new hires decreased significantly – from 408 in 2003 to 72 in 2013. During the same time, the number of TANF recipients has declined significantly.
- The credit supplements similar federal income tax credits. While the state provides up to $500, $1,000 and $1,500 in credits for the first 3 years after hiring a TANF recipient, an employer may also qualify for federal tax credits of up to $4,000 in the first year and $5,000 in the second year.
- It is difficult to determine whether the credit directly results in savings from lower TANF participation. Former TANF recipients may find employment regardless of the income tax credits especially as the economy begins to improve.

**Statutes**

A.R.S. § 43-1175 (Corporate) and A.R.S. § 43-1087 (Individual)

**Description**

The statutes provide corporations and individuals an income tax credit for employing Arizona residents who are recipients of the low-income TANF assistance program. To qualify for the credit, several more conditions must be met:

- The employees claimed under the credit must be full-time.
- The employer must provide health insurance if coverage is provided to other employees not on TANF.
- The wages must meet or exceed the legal minimum wage and be comparable to wages received by non-TANF employees.
- The TANF employees must be employed for at least 90 days during the first year the credit is claimed.
- Periods for which the employee’s wages were subsidized through the Jobs Program as provided by A.R.S. § 46-299 are not allowed to be included as periods of employment. (The Jobs Program is Arizona’s mandatory employment and training program for work-eligible individuals in households receiving TANF cash assistance.)

The credit is equal to:

- One-fourth of the taxable wages paid to a qualified employee up to a maximum of $500 in the first year of employment.
- One-third of taxable wages up to a maximum of $1,000 in the second year of continuous employment.
- One-half of taxable wages up to a maximum of $1,500 in the third year of continuous employment.

**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**

TANF is a federal block grant administered by the Department of Economic Security to provide a variety of assistance to low-income recipients, who are defined by A.R.S. § 46-101 as those who are granted assistance under Section 403 of Title IV of the 1996 Personal Responsibility and Work Opportunity Reconciliation (PRWORA) Act.

The state's TANF employer tax credit was created by Laws 1997, Chapter 300 and became effective January 1, 1998. The statutes creating the tax credits do not include a specific statement of purpose or a rationale. The likely intent was to encourage employers to hire TANF recipients into permanent jobs and reduce their reliance on public assistance.

The state's TANF tax credits were enacted during a time when the federal government was also creating tax incentives to promote the hiring of public assistance recipients. The U.S. Department of Labor, Employment and Training Administration (DOLETA), administers programs related to the Work Opportunity Tax Credit (WOTC), which is authorized by the Small Business Job Protection Act of 1996.

The WOTC is a federal income tax credit that encourages employers to hire 9 targeted groups of job seekers by reducing employers' tax liability by as much as $4,000 per qualified worker in their first year of employment. Two of the targeted groups are Short-Term and Long-Term TANF recipients. Short-Term TANF recipients are those that have received TANF benefits for any 9-month period during the 18-month period ending on the hiring date. Long-Term TANF recipients are individuals that have received TANF benefits for at least 18 consecutive months ending on the hiring date.

The available federal credit is 40% of qualified wages for the first year of employment, up to $4,000 and 50% for the second year, up to $5,000. The WOTC credit, which was extended through the end of 2014, has been continuously renewed since its inception. The credit is currently in a hiatus period awaiting Congressional reauthorization through 2015. Notwithstanding the title of the enacting legislation, the WOTC is not restricted to small businesses.

**Revenue Impact**

In 2013, the last year for which reasonably complete data is available, 6 employers hired 72 TANF recipients and claimed $111,500 in related <u>corporate</u> tax credits. The number of companies claiming the credit has remained stable over the past 5 years, ranging between 6 and 12 per year. The number of employees for which the credit was claimed decreased by 18% over the same period, from 88 to 72.

According to DOR, use of the <u>individual</u> tax credit has been negligible. There were no claimants of the individual credit in 2014 or 2013, only 1 claimant in 2012 and 2011, and 3 claimants in 2010 that used $20,800 in credits.

The caseloads for TANF Cash Benefits recipients have decreased markedly from 120,327 in FY 2003 to 25,878 in FY 2015. This is due in part to policy changes during that time period that reduced the lifetime limit for receiving TANF Cash Benefits from 60 months to 24 months. Laws 2015, Chapter 18 further reduces that limit to 12 months starting in FY 2017.

The following table summarizing the corporate income tax impact of this credit was provided by the Arizona Department of Revenue (DOR).

| Tax Year | # of Claimants | Total Credit Available | Credit Used | Carry Forward |
|---|---|---|---|---|
| 1998 | 3 | $35,325 | $35,325 | $0 |
| 1999 | 5 | $49,653 | $47,189 | $2,464 |
| 2000 | 6 | $41,996 | $27,598 | $14,398 |
| 2001 | 6 | $84,354 | $57,851 | $26,503 |
| 2002 | 8 | $184,997 | $173,600 | $11,397 |
| 2003 | 9 | $472,478 | $466,392 | $6,086 |
| 2004 | 14 | $491,175 | $485,190 | $3,771 |
| 2005 | 13 | $122,183 | $99,575 | $22,608 |
| 2006 | 11 | $51,548 | $40,754 | $10,794 |
| 2007 | 12 | $51,014 | $45,014 | $6,000 |
| 2008 | 10 | $57,956 | $28,956 | $29,000 |
| 2009 | 12 | $129,448 | $43,128 | $86,320 |
| 2010 | 7 | $117,119 | $61,239 | $56,480 |
| 2011 | 8 | $131,480 | $64,500 | $66,980 |
| 2012 | 9 | $161,978 | $87,498 | $74,480 |
| 2013 | 6 | $210,760 | $111,498 | $90,762 |

*# 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**

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

The economic development or new investment related to this credit cannot be measured with the data available. While 72 jobs qualified for the credit in 2013, it is difficult to establish a direct link between the credit and subsequent economic development.

The administrators of the state's welfare-to-work programs believe that the federal and state tax credits are important tools in placing TANF recipients into jobs. The state tax credit does not provide a large incentive for prospective employers. However, it may influence a favorable hiring decision on the margin and help to overcome employers' reluctance to provide employment to program participants. By using both the federal WOTC tax credit and the state tax credit, a company could claim up to $4,500 in credit for a new hire in their first year of employment, $6,000 in the second year, and $1,500 in the third year.

The following illustrates the financial impact for a taxpayer claiming the TANF employer credit:

The gross wages paid to an employee meeting the law's minimum requirements would be approximately $4,186, which is equivalent to the state minimum wage for full-time work over a 90-day (13-week) period.

The corresponding minimum annual wage would be approximately $16,744 for the first and subsequent years. If a company retained an employee (who was a TANF recipient) for 3 full years and paid $50,232 in gross wages, it could claim the maximum of $3,000 in state income tax credits, which is 6.0% of the wages paid and a smaller percentage of total compensation including health insurance and other benefits. If the new hire was retained for 3 years and also qualified for the federal WOTC income tax credit, the employer's federal tax liability would be reduced by as much as $9,000, or 17.9% of gross wages.

The credit allowed is in lieu of any wage expense deduction taken for federal and state income tax purposes. The net cash value of the credits would be reduced by the company's marginal federal corporate income tax rate (which ranges from 15% to 35%) plus the Arizona income tax rate (6.0% for corporations). Any wages paid that are claimed for a tax credit cannot also be claimed as a tax-deductible business expense. By assuming a marginal federal corporate income tax rate of 35% and applying Arizona's tax rate, the net value of the credits after taxes is reduced by approximately (41)% after adjusting for the lost business expense. For a company claiming the maximum federal and state credits, the net value of the credits per new employee would be approximately $2,800 ($2,600 federal, $200 state) in the first year of employment. This amount reflects the gross credit of $4,500 less the lost business expense of $1,700. The net value of the credit in the second year is $3,900 ($3,300 federal, $600 state), and $1,400 in the third year (state only).

DOR has provided some job retention estimates related to the tax credit:

- 42 corporate taxpayers have claimed the credit since it was created.
- From 1998 through 2013, corporate taxpayers reported that 2,045 positions were eligible for a total of $2.1 million in credits, or $1,008 per job.

DOR did not provide data on retention rates.

The data indicates that the number of new hires claimed for the tax credit increased significantly in 2002 through 2004 as the economy emerged from a recession, but decreased dramatically in 2005 and never recovered. This coincides with a similar trend in overall TANF caseloads over the same time period. TANF caseloads are expected to decrease in the near future after the implementation of a new 1-year lifetime limit on TANF Cash Benefits starting in FY 2017. The new cap on benefits will continue to limit participation in the tax credit program.

To fully assess the net costs and benefits to the state associated with the tax credit, the value of TANF benefits paid to former recipients must be taken into account. In FY 2015, TANF recipients received an average of $90 per month for an average duration of 22.2 months, or a total of about $2,000.

There would appear to be some savings to the state due to the reduction in TANF expenditures. However, it cannot be determined how many former TANF recipients would have found employment without the existence of the state tax credit. Moreover, as economic conditions change and affect the labor market, some former TANF recipients may return to apply for benefits.

**Complexity**

The TANF recipient employer credit does not appear to be unusually complex in its description, calculation or application. However, employers are required to keep additional records on qualifying employees and to complete another form to submit with their Arizona tax returns.

**Potential Performance Measures**

Performance measures could include:

1. 2- and 3-year retention rates for employees claimed under the credit. It appears that DOR has the data needed to make these calculations.

2. The value of wages and benefits paid to TANF recipients that are employed by companies claiming the credit. While the companies would have this information readily available, this measure would require them to compile and report additional data that is not currently required.

3. The growth in compensation for eligible employees that are retained for 2 or more years. This measure also could be obtained from the employers' payroll records but would be an additional reporting burden.

4. The length of unemployment of TANF recipients that are hired by companies claiming the credit. This measure could indicate whether the new hire may or may not have found employment without the benefit of the tax credit.

The statute does not impose any requirements related to these measures.

**Prior Review**

The credit was last reviewed by the JLITCRC in 2010. The Committee recommended the continuation of the credit without change.

# Contributions to Qualifying Charitable Organizations Tax Credit

## Contributions to Qualifying Charitable Organizations Tax Credit

**Summary**

- The cost of the credit was $28.2 million in tax year 2014, the last year for which data is available.
- The credit was claimed by 105,539 taxpayers in tax year 2014.
- Beginning in the 2013 tax year, taxpayers no longer needed to itemize their deduction to claim this credit.
- The credit was expanded in 2013 and 2015 to include charitable organizations that serve foster children and under-21-year-old former foster youth, respectively. These changes allow a maximum credit of $400 for individuals and $800 for married couples.
- The requirement that charitable organizations declare if they promote or provide referrals for abortion was eliminated in 2012.
- There are currently more than 600 charitable organizations, including 25 foster care organizations, that qualify for credit eligible donations.

**Statute**

A.R.S. § 43-1088 (Individual Income Tax)

**Description**

This credit is provided to taxpayers that make voluntary contributions to qualifying charitable organizations (QCO).

To qualify for credit eligible contributions, the charity must be either a tax-exempt 501(c)(3) charitable organization or a designated community action agency that receives community services block grant monies. Additionally, the organization is required to spend at least 50% of its budget on services to Arizona residents who are either: (1) Temporary Assistance for Needy Families (TANF) benefit recipients, (2) low income persons, or (3) chronically ill or disabled children. (Statute defines "services" as cash assistance, medical care, child care, food, clothing, shelter, job placement, job training, or any other assistance that meets immediate basic needs.) The maximum general QCO tax credit is $200 for individuals and $400 for joint returns.

To qualify for credit eligible donations, the charity is required to provide the Department of Revenue (DOR) with a written certification that it meets all of the statutory requirements of a QCO. The written certification, which is signed under penalty of perjury, must include a copy of the organization's financial statements showing 50% of its budget is spent on qualifying recipients and a federal (501)(c)(3) tax-exempt letter (or status as a community action agency receiving block grant monies). The charity must also provide a statement indicating that it does not provide, pay for or provide coverage of abortions and does not financially support any other entity that provides, pays for or provides coverage of abortions.

Beginning in 2013, the tax credit was expanded to include qualifying foster care charitable organizations (QFCO). To qualify for this credit, a QFCO must meet all the requirement of a general QCO and spend at least 50% of its budget providing services to at least 200 foster children in Arizona. For donations to foster children, the maximum credit is $400 for individuals filing as single or head of household and $800 for married couples filing joint returns, or twice that of general QCOs.

The credit is available to individuals but not to corporations. Partnerships cannot pass the credit through to their partners, and S corporations cannot pass through the credit to their shareholders. Taxpayers do not need to itemize their deductions to claim this credit.

For those who donate to both a QCO and a QFCO, the total combined maximum credit is $400 for individuals filing as single or head of household and $800 for married couples filing joint returns. DOR provides the following hypothetical scenario illustrating how an individual and a married couple would calculate their combined general QCO and QFCO tax credit:

*Mr. Smith, a single person, donates $250 to a QCO and $150 to a QFCO. Mr. Smith would qualify for a credit of $350 ($200 for the QCO donation and $150 for the QFCO donation). Mr. and Mrs. Johnson, a married couple filing jointly, donated $500 to a QCO and $300 to a QFCO. The Johnsons would qualify for a credit of $700 ($400 for the QCO donation and $300 for the QFCO donation).*

**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 1997, Chapter 300 and became effective on January 1, 1998. According to historical records, the credit was added as an amendment in Conference Committee to the omnibus welfare bill (SB 1357) that redesigned Arizona's welfare system to comply with federal welfare reform laws enacted in 1996.

Laws 2005, Chapter 334 increased the maximum credit for married taxpayers filing joint returns from $200 to $400. The maximum credit for single and head of household filers was left unchanged at $200.

Laws 2009, Chapter 80 expanded the credit to include donations to charitable organizations that provide services to chronically ill or disabled children. Additionally, the act restricted the credit to taxpayers itemizing their deductions and eliminated the requirement that a baseline year be established before the credit can be claimed. To qualify for the credit prior to 2009, taxpayers had to itemize their deductions (and specifically include deductions for charitable contributions) on a prior year's state tax return at least once in order to establish a "baseline" year and amount. The credit was calculated based on charitable contributions over and above the baseline amount.

Chapter 80 established a new certification process for QCO as outlined in the *Description* section above. Prior to 2009, charities were not required to submit any supporting documents to DOR, such as financial statements or verification of tax-exempt status. Instead, charities "self-certified" themselves by merely sending a letter to DOR stating that they met all the criteria of a QCO. According to information made available on DOR's website, there are currently more than 600 QCOs in the state and 25 QFCOs.

Laws 2009, Chapter 167 provided that individual income taxpayers can authorize their employers to reduce their withholding tax amounts by the amount of the credit claimed. The act became effective in 2010.

Laws 2011, Chapter 55 required a statement that the QCO does not provide, pay for, promote, provide coverage of or provide referrals for abortions and does not financially support any other entity that provides, pays for, promotes, provides coverage of or provides referrals for abortions.

Laws 2012, Chapter 271 amended Laws 2011, Chapter 55 by removing the requirement that charitable organizations declare if they promote or provide referrals for abortion for purposes of the tax credit.

Laws 2013, Chapter 236 removed the requirement that an individual income tax filer itemize deductions in order to claim the tax credit.

Laws 2013, 1$^{st}$ Special Session, Chapter 9 expanded (retroactive to January 1, 2013) the tax credit to include qualifying foster care charitable organizations. The maximum credit for cash contributions to qualifying foster care organizations is $400 for individuals filing as single or head of household and $800 for married couples filing joint returns. A qualifying foster care organization must spend at least 50% of its budget providing services to at least 200 foster children in Arizona.

Laws 2015, Chapter 250 expanded the tax credit to include donations made to QFCOs that provide services to under-21-year-old former foster youth in the Transitional Independent Living program.

**Revenue Impact**

As noted above, this credit is only available to individual income tax filers. The cost of the credit was $28,229,214 in 2014, the last year for which data is available. (This figure is still preliminary and thus likely to be revised.) The table below, which was provided by DOR, summarizes the tax revenue impact of the credit.

| Tax Year | # of Claimants | Total Credit Available | Credit Used | Carry Forward |
|---|---|---|---|---|
| 1998 | 2,894 | $481,037 | $476,691 | $4,346 |
| 1999 | 6,725 | $1,168,515 | $1,154,768 | $13,747 |
| 2000 | 10,654 | $1,829,205 | $1,729,123 | $35,581 |
| 2001 | 12,538 | $2,257,673 | $2,196,043 | $41,852 |
| 2002 | 14,226 | $2,687,900 | $2,676,946 | Not Available |
| 2003 | 17,467 | $3,286,100 | $3,259,400 | Not Available |
| 2004 | 20,736 | $3,884,600 | $3,851,700 | Not Available |
| 2005 | 25,587 | $6,637,500 | $6,589,000 | Not Available |
| 2006 | 29,202 | $7,988,039 | $7,939,507 | Not Available |
| 2007 1/ | 18,280 | $5,877,831 | $5,860,953 | Not Available |
| 2008 | 36,568 | $11,077,991 | $11,059,408 | Not Available |
| 2009 | 49,915 | $13,556,228 | $12,889,895 | $666,333 |
| 2010 | 61,602 | $16,899,920 | $16,727,074 | Not Available |
| 2011 | 66,396 | $18,191,993 | $18,012,263 | Not Available |
| 2012 | 78,736 | $22,128,648 | $21,835,458 | Not Available |
| 2013 2/ | 100,398 | $27,457,025 | $24,503,609 | Not Available |
| 2014 2/ | 105,539 | $31,832,977 | $28,229,214 | Not Available |

*Note*: 1/ According to DOR, the significant drop in tax year 2007 data is not real.
2/ Figures labeled as preliminary.
*# 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 $400 in a particular credit identified in tax year 2005, use $300 of this amount in 2005 and leave $100 as a carry forward. If this taxpayer did not identify or claim the credit in 2006 the $100 carry forward would not be included in the credit carry forward total for 2006.

As shown in the table above, the use of the credit has increased significantly over time; from $0.5 million in 1998 to $28.0 million in 2014. The increase of the maximum credit for married couples from $200 to $300 in 2005 and from $300 to $400 in 2006 is evident from the more than 100% increase in credit use over the same 2-year period. Similarly, the elimination of the baseline requirement (for purposes of calculating the credit) in 2009 appears to have resulted in another large increase in credit usage. Most recently, the elimination of the itemization requirement beginning in 2013 appears to have resulted in additional credit growth.

**Economic Benefits**

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

This credit is not directly designed to promote economic development or spur new investments that would result in new jobs. Instead, according to DOR's August 2010 report "Income Tax Credits in Arizona," this credit is one of several tax credits in statutes primarily intended to encourage cash contributions to certain target groups in society, such as the working poor or students in private or public schools.

Although this credit was not directly intended to promote economic growth, it may still provide some economic benefits to society insofar as it generates funding to help move individuals from underemployment to economic self-sufficiency.  There is no data currently available, however, to quantify such benefits.

**Complexity**

The credit does not seem to be unnecessarily complex in terms of its application, administration, and approval process.  The elimination of the baseline year requirement in 2009 and the itemization requirement in 2013 appear to have simplified the use of the credit considerably.

**Potential Performance Measures**

Performance measures could include:

1. A requirement to report on the number of Arizona residents (TANF recipients, low-income persons, chronically ill or disabled children, and foster children) that benefit from the services provided as a result of the credit donations.
2. A requirement to report on the specific type of services provided (e.g., cash assistance as opposed to job training) and the amounts allocated to such services from the credit donations.

**Prior Review**

The credit was last reviewed by the JLITCRC in 2010.  The Committee recommended at that time that the credit be continued.