Joint Legislative Budget Committee
Staff Memorandum

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DATE: December 22, 2021

TO: David Livingston, Chairman of Senate Finance Committee
Shawnna Bolick, Chairman of House Ways and Means Committee

FROM: Hans Olofsson, Chief Economist

SUBJECT: 2021 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 2021 review schedule.

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 4 credits scheduled for review in 2021, 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.

Each of the credits listed above was included on the 2016 review schedule. While the JLBC Staff prepared background materials for the credits in 2016, the Joint Legislative Income Tax Credit Review Committee did not meet that year.

(Continued)

Limitations

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).

Moreover, 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. For example, while the amount of certified angel investments is reported, there is no data reported on the number of new jobs associated with these investments.

2021 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 can 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 fiscal year on the number of claims and the amount of credit used. In addition, the review includes similar information by tax year.

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

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

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

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

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

HO:kp
Attachment
xc: Fletcher Montzingo, Director of Fiscal Policy, Senate
Sean Laux, Senior Policy Advisor, Senate
Molly Graver, Analyst, Senate Finance Committee
Ryan Sullivan, Director of Fiscal Policy, House
Paulino Valerio, Senior Policy Advisor, House
Vince Perez, Analyst, House Ways and Means Committee

Credit for Investment in Qualified Small Businesses ("Angel Investment Credit")

Credit for Investment in Qualified Small Businesses ("Angel Investment Credit")

Summary

- The credit is limited to individual income taxpayers and applies to investments of between $25,000 and $500,000.
- From FY 2022 through FY 2031, the Arizona Commerce Authority (ACA) can authorize a total of $2.5 million in credits per year.
- Through calendar year (CY) 2020, ACA authorized a total of $30 million in credits since the inception of the program on July 1, 2006, representing $93.4 million in qualified investments.
- Through TY 2019, $12.8 million in credits were used to offset tax liability. No later data is available by tax year.
- The credit reduced individual income tax collections by $1.0 million in FY 2021 and $1.6 million in FY 2021.
- The credit was claimed by 268 taxpayers in FY 2021 at an average of $6,200 per recipient.
- As of November 2021, a total of 970 investors have made qualified investments in 202 businesses under the program.

Statute

A.R.S. § 41-1518 and A.R.S. § 43-1074.02 (Individual Income Tax)

Description

This credit is provided to investors who make investments in targeted small businesses certified by the Arizona Commerce Authority (ACA). A qualified ("angel") investor must be either an individual, or a limited liability company, sub-chapter S corporation, or partnership. C corporations are not eligible for the credit.

An investor that wants to obtain tax credits under this program must submit an application for authorization to ACA for each investment in a qualified small business. To qualify for the credit, the investment in a qualified small business must be at least $25,000. Additionally, the angel investor, along with his affiliates, cannot possess more than 30% of the total voting power of all equity securities of the qualified small business.

The tax credit is equal to 30% of the qualified investment unless the investment is made in a rural or bioscience company, in which case the credit is 35%. The credits must be claimed over 3 years and cannot exceed the percentages (of the qualified investment amount) shown in the table below.

Qualified Investment in:	1st Year	2nd Year	3rd Year	Total Credit
Rural or Bioscience Company	12%	12%	11%	35%
Any Other Company	10%	10%	10%	30%

The tax credits, which are authorized by ACA on a first come, first served basis, are currently limited to a total of $2.5 million per fiscal year (plus any unused credit carried over from the prior fiscal year) from July 1, 2021 through June 30, 2031. Taxpayers are allowed to claim authorized credits through December 31, 2034. For an individual investor (and his affiliates), the credit is applied to investment amounts of up to $500,000 in a single calendar year for investments in one or more qualified small businesses. Investment amounts in excess of $500,000 do not generate tax credits.

Any firm that wants to receive qualified angel investments must submit a separate request for certification to ACA. To be a "qualified small business," the firm can be any type of business entity except a sole proprietor. Additionally, the business is required to maintain a portion of its operations in the state and have at least two non-administrative full-time employees who are Arizona residents. The business is neither allowed to engage in activities involving human cloning or embryonic stem cell research, nor have assets exceeding $10 million. Once a firm has received a total of $2 million in qualified investments, it is no longer allowed to receive credit-eligible angel investments.

Refundable

Refundable

The credit is not refundable.
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Carry Forward

The tax credit may be carried forward for 3 taxable years.

History and Rationale

This credit was created by Laws 2005, Chapter 316 and became effective for use on January 1, 2007 for qualified investments made beginning July 1, 2006. The credit was originally limited to $20 million over the life of the program and ACA was disallowed to authorize any credits after June 30, 2011. The program was extended by Laws 2011, 2nd Special Session, Chapter 1 through June 30, 2016 while retaining the $20 million credit limit. Laws 2017, Chapter 319 permitted ACA to authorize an additional $10 million in credits from July 1, 2017 to June 30, 2021. Of the $10 million in additional credits, ACA could approve up to $2.5 million for each year. Laws 2021, Chapter 430 extends ACA's credit authorization of $2.5 million per year through June 30, 2031. Any unused portion of the $2.5 million annual cap may be authorized in the following years of the program. Since the credit must be claimed over 3 years, taxpayers can claim authorized credits on their tax returns through TY 2034. Laws 2005, Chapter 316 includes a purpose statement that the credit is intended to "encourage taxpayers to invest capital in businesses that are in the early stages of development."

Based on a bill summary (SB 1335) issued by the House of Representatives on May 16, 2005, the angel investment credit was created based on a recommendation by the *Capital Formation Committee* within the *Governor's Council of Innovation and Technology*. Committee Minutes indicate that sponsors of the legislation argued that the credit would encourage investment in the high-tech sector by offering incentives to those who wish to invest in start-up companies in Arizona.

Revenue Impact

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

Table 1
Angel Investment Credit by Fiscal Year

Fiscal Year	# of Claimants	Credit Used
2015	208	$844,941
2016	363	$1,664,342
2017	337	$1,344,614
2018	250	$944,389
2019	219	$742,056
2020	188	$1,033,806
2021	268	$1,649,990

# 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 <u>tax year</u> basis. This data is available from when the credit was first established. It should be noted that this data differs from credit use by fiscal year for several reasons, including the filing of extended and amended tax returns. *Table 2* shows the cost of the credit by tax year since the credit's inception.

Not all credits authorized by ACA will necessarily be claimed by the taxpayers. In addition, there is a delay between the time of the investment and the time the credit can be claimed. The first year an investor can claim a credit is the tax year following the calendar year in which the investment was made. As an example, for an investment made in calendar year 2020, ACA would authorize the tax credit to be claimed over 3 consecutive

Table 2

Angel Investment Credit Use

Tax Year	# of Claimants	New Credit	Total Credit Available	Credit Used	Carry Forward
2007	84	$415,766	$415,766	$296,115	$119,736
2008	128	$747,953	$867,689	$411,156	$456,644
2009	208	$1,398,414	$1,823,783	$574,434	$1,249,498
2010	220	$1,475,990	$2,746,899	$766,806	$1,980,385
2011	223	$1,172,210	$3,100,066	$849,766	$1,980,384
2012	281	$1,217,879	$3,198,263	$1,069,297	$1,536,819
2013	297	$1,553,274	$3,191,923	$1,064,348	$1,517,517
2014	364	$2,064,419	$3,581,936	$1,716,442	$1,555,344
2015	349	$2,234,185	$3,789,529	$1,455,096	$2,193,668
2016	297	$1,174,101	$3,367,769	$1,204,816	$1,980,885
2017	213	$983,597	$3,797,145	$652,369	$1,393,627
2018	219	$716,125	$3,610,139	$1,085,055	$2,525,084
2019	234	$1,563,115	$3,927,017	$1,636,707	$2,290,310

# of Claimants – the number of taxpayers who claimed the credit in each year.
New Credit - the amount of additional claimable credit 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 $10,000 of the credit identified in tax year 2007, use $5,000 of this amount in 2007 and leave $5,000 as a carry forward. If this taxpayer did not identify or claim the credit in 2008, the $5,000 carry forward would not be included in the credit carry forward total for 2008.

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

According to ACA, from CY 2006 through CY 2020, 970 unique investors made 1,426 qualified investments that totaled $93.4 million under the program. *Table 3* lists the number of qualified investments made by year and the amount invested. A total of 202 certified small businesses received qualified investments during this time, an average of approximately $462,400 per business.

ACA hired Elliott D. Pollack and Company (EDP) to prepare an economic impact estimate of the credit for the period from CY 2014 through CY 2020. In preparing the estimates, EPD used company information from program applications as inputs to estimate the wages and jobs created by recipients of the credit. The study assumes that all of the active ACA-certified businesses had the same number of employees in each year of operation.

According to EDP's Economic Impact Study, ACA-certified companies that received credits directly employed 1,200 workers in 2020 and had operations that directly contributed $199.9 million in output to the state's economy that year.

In CY 2020, the direct contributions from the recipient companies' operations were estimated to indirectly spur an additional 1,200 jobs and $202.8 million of economic output through contracts with Arizona suppliers and spending by company employees. Estimates of indirect and induced economic activity are subject to greater uncertainty than estimates of direct impacts, as they are calculated based on economic multipliers provided by IMPLAN, a company that has developed software to quantify regional economic impacts of various programs and policies.
The study also estimates the fiscal impact of the credit at the state, county, and city level. In 2020, EDP estimates the credit generated $35.7 million in total tax revenue, $21.6 million of which was at the state level. According to ACA, these fiscal impacts do not account for revenue from corporate income tax collections or transaction privilege tax (TPT) on utilities. The JLBC Staff is not able to independently verify the reasonableness of these estimates.

Table 3

Qualifying Investments

Calendar Year	# of Investments	Amount ($ in Millions)
2006	72	$4.2
2007	65	3.4
2008	108	6.5
2009	91	5.1
2010	123	7.2
2011	150	7.7
2012	142	7.6
2013	149	9.5
2014	89	7.4
2015	55	3.4
2016	0	0.0
2017	106	7.8
2018	104	7.8
2019	82	7.9
2020	90	7.9
Total	**1,426**	**$93.4**

Source: Arizona Commerce Authority

The impacts mentioned above represent total estimated economic activity in the state associated with companies that received a certified investment under the Angel Investment Credit program. However, the net economic impact of the credit program depends on the extent to which investment, job creation and economic output were directly attributable to the incentive. It is difficult to determine from available data how much of the increase in economic activity was attributable to the incentive and how much would have occurred in its absence.

According to the Angel Capital Association, Arizona is one of 29 states nationwide that offers some type of tax incentive targeted to angel investors. To some extent, the credit enhances Arizona's competitiveness relative to other states by increasing incentives for investors.

Complexity

According to ACA, there has been no feedback from the industry to date that would indicate that the credit is unnecessarily complex in terms of its application, administration, and approval process.

Potential Performance Measures

Performance measures could include:

1. A requirement to annually report on the number of jobs created by firms that received qualified investments.
2. A requirement to annually report on the number of firms that have received qualified investments that remain active.
3. A requirement to report on the allocation of qualified investments by industry.

Prior Review

The credit was last reviewed in 2016. However, since the Joint Legislative Income Tax Credit Review Committee did not meet that year, no recommendations were made by the Committee. When the credit was reviewed in 2011, the Committee recommended that the credit be continued. The Committee did not recommend the JLBC Staff performance measures.

Credit for Corporate Contributions to School Tuition Organizations

Credit for C Corporation Contributions to School Tuition Organizations

Summary

- Current law authorizes tax credits for 4 different types of corporate or insurer contributions to school tuition organizations (STOs). This review specifically addresses C corporation contributions to STOs awarding "low-income scholarships" (A.R.S. § 43-1183).
- C corporations claimed $20.1 million of the STO low-income credit in FY 2021.
- C corporations, S corporations, and insurers claimed a combined $95.9 million in STO low-income credits in FY 2021.
- The credit may impact K-12 Basic State Aid costs if STO scholarship recipients would have otherwise decided to attend a public school in the absence of a scholarship. In that circumstance, there would be foregone General Fund costs of $7,200 per student.
- Overall, taxpayers claimed $215.7 million in the 4 STO tax credits in FY 2021.

Statute

A.R.S. § 43-1183 and A.R.S. § 43-1504

Description

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

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

This review specifically addresses the **C** Corporation portion of "corporate/low-income" contributions made pursuant to A.R.S § 43-1183, but also indirectly addresses "insurer/low income" contributions made pursuant to A.R.S. § 20-224.06 because the Arizona Department of Revenue (DOR) typically reports combined data for those two programs. The statutory income tax credit review schedule requires review of the **S** Corporation STO low-income credit in a different year. The Insurance Premium tax credits are not subject to the review process.

This C-Corp credit is provided to corporations for voluntary contributions to STOs. A STO is a nonprofit organization that is exempt from federal taxation and that is required to allocate at least 90% of its revenue for educational scholarships or tuition grants to children to attend non-governmental elementary or secondary schools (A.R.S. §43-1502). A STO may use up to 10% of corporate contributions for administration expenses.

Total corporate plus insurer contributions to STOs for "low-income scholarships" are capped at approximately $142.1 million for FY 2023 pursuant to A.R.S. § 43-1183C1. Because of the cap, STO contributions from corporations and insurers must be pre-approved by DOR to be eligible for a tax credit. For FY 2022, the most recent year for which such data is available, DOR has pre-approved halfway through the year $112.0 million in combined corporate and insurer contributions to STOs for "low-income scholarships." Contributions, however, do not always result in the taxpayer using the credit. For example, the taxpayer may lack sufficient liability to take the credit (see *Table 2*).

Contributions from this credit must only be made available for scholarships or tuition grants to students whose family income does not exceed 185% of the income limit required for a student to qualify for reduced-price lunch under the National School Lunch and Nutrition Acts. In FY 2021, the maximum annual income for a family of four for purposes of STO scholarship eligibility is $90,696 ($49,025 X 185%). To qualify for a STO scholarship, a student must meet one of the following criteria:

- Was homeschooled or attended public school in the prior school year.
- Moved to Arizona from another state before enrolling in a qualified school.
- Participated in an Arizona Empowerment Scholarship Account (ESA) without accepting or renewing the scholarship.
- Entering kindergarten in the upcoming school year.
- Received tuition assistance from a STO during the prior school year.

The maximum scholarship amounts for 2021 are $5,600 for grades K-8 and $7,500 for grades 9-12. Those amounts increase by $200 annually pursuant to A.R.S. § 43-1504C. Lastly, a corporation may not use a tax credit for any contribution if a corporation designates the scholarship for a particular student.

Refundable

The credit is not refundable.

Carry Forward

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

Transferable

The credit is not transferable.

History and Rationale

The C-Corp STO "low-income scholarship" tax credit was created by Laws 2006, Chapter 14 and became effective starting in FY 2007. The purpose of the program is to encourage corporate contributions to STOs that award "low-income scholarships" that enable students to attend non-governmental elementary and secondary schools.

As originally enacted, total corporate tax credits to STOs for "low-income scholarships" was capped at $5 million and included a sunset date of June 30, 2011. Laws 2006, Chapter 325 raised the cap to $10 million and by an additional 20% annually, beginning in FY 2008.

In September 2006, the Arizona School Boards Association and the Arizona Chapter of the American Civil Liberties Union filed suit against the state regarding this tax credit. In *Green v. Garriott*, plaintiffs alleged that corporate contribution "set asides" in the associated laws violated the "general and uniform" provision of the state's public education system. The Maricopa County Superior Court ruled in favor of the state in a ruling that was later upheld by the Arizona Court of Appeals. The plaintiffs appealed to the Arizona Supreme Court, but in 2009 it declined to review the case, making the Maricopa County Superior Court ruling stand.

Laws 2009, Chapter 168 expanded the credit by making it available to insurers and repealed the June 30, 2011 sunset date. Laws 2015, Chapter 301 expanded the credit to include businesses classified as Subchapter S corporations. Laws 2019, Chapter 281 limits the annual increase of the credit cap to 15% in FY 2021, 10% in FY 2022, and 5% in FY 2023. Beginning in FY 2024, the increase of the credit cap is limited to the greater of 2% or the annual change of the Metropolitan Phoenix consumer price index. In dollar terms, Chapter 281 limits the credit to $123.0 million in FY 2021, $135.3 million in FY 2022, and $142.1 million in FY 2023.

Revenue Impact

Relative to their shared statutory limitation, *Table 1* summarizes C-Corp, S-Corp, and insurer contributions to STOs for "low-income scholarships" since FY 2007. In most years, DOR approves the use of credits at or near the cap level. Taxpayers, however, may not fully claim their available credit in the year approved and may carry it forward for 5 years.

Table 1

Corporate Contributions to School tuition Organizations for "Low-Income Scholarships"

Fiscal Year 1/	Statutory Limitation 2/	# of Corporations 3/	$ Approved by DOR
2007	$10,000,000	108	$9,740,800
2008	$12,000,000	73	$12,116,000
2009	$14,400,000	98	$10,816,006
2010	$17,280,000	60	$8,121,508
2011	$20,736,000	68	$11,365,351
2012	$24,883,200	83	$19,587,037
2013	$29,859,840	114	$30,041,114
2014	$35,831,808	99	$36,571,808
2015	$42,998,170	95	$42,997,170
2016	$51,597,804	203	$51,597,804
2017	$61,917,365	371	$61,917,164
2018	$74,300,838	662	$74,300,838
2019	$89,161,006	704	$89,161,006
2020	$106,993,207	880	$106,983,528
2021	$123,042,188	N/A 4/	$122,717,188
2022	$135,346,407	N/A 4/	$112,014,130 5/
2023	$142,113,727	N/A 4/	N/A 4/

1/ DOR reports contributions on a fiscal year rather than tax year basis, since the statutory limitation on such contributions in A.R.S. § 43- 1183C is per fiscal year. DOR, however, reports corresponding tax credit data on a tax year basis.
2/ Increased 20% annually through FY 2020. Laws 2019, Chapter 281 limits the increase to 15% in FY 2021, 10% in FY 2022, and 5% in FY 2023.
3/ Includes insurers starting in FY 2010 and S Corporations starting in FY 2016.
4/ DOR has not reported these amounts as of publication.
5/ This amount is preliminary midway through the fiscal year.

Table 2 includes 6 fiscal years of data on credit use for C corporations, S corporations, and insurers. During those years, C-Corp usage has declined while S-Corp and insurer usage has increased significantly.

Table 2

Low-Income STO Tax Credit Use by Fiscal Year

Fiscal Year	# of C-Corp Claimants	C-Corp Credit Used	# of S-Corp Claimants	S-Corp Credit Used	Insurers' Credit Used*	Total Credit Used
2016	71	$28,065,303	73	$967,990	$22,786,396	$51,819,689
2017	76	$21,849,744	145	$1,344,614	$23,246,639	$46,440,997
2018	98	$32,977,938	354	$4,411,353	$30,785,353	$68,174,644
2019	98	$18,282,920	637	$16,616,451	$26,910,421	$61,809,792
2020	97	$22,465,054	855	$31,461,005	$45,419,852	$99,345,911
2021	114	$20,058,461	918	$29,258,009	$46,610,732	$95,927,202

# of Claimants- the number of taxpayers who claimed the credit
Credit Used- the total value of credits claimed
* The Department of Insurance and Financial Institutions does not report the number of claimants for the insurer portion of the credit

The tax credit may impact state K-12 education costs because some students receiving the scholarships may have otherwise enrolled in public schools if the scholarship had not been available. Currently each pupil added to the statewide K-12 Average Daily Membership (ADM) count costs the state General Fund on average about $7,200. Each pupil switching to a private school in response to the availability of the STO scholarship could therefore generate a corresponding General Fund Basic State Aid savings of $(7,200). The total magnitude of the K-12 savings, however, is unknown because the number of students who decide to attend private school based primarily on the availability of the STO scholarship is unknown.

Economic Benefits

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 2000 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.

In FY 2020, STOs distributed $87.3 million in scholarships (29,829 scholarships to 281 schools) from C-Corps, S-Corps, and insurance premium tax "low-income scholarship" contributions (last available data, see *Table 3* below). The average "low-income" scholarship was $2,928. Individual students may receive scholarships from more than one STO.

Between FY 2007 and FY 2020, the number of low-income scholarships grew from 1,940 to 29,829. At the same time, the total amount of dollars distributed grew from $4.6 million to $87.3 million.

Complexity

According to DOR, it is administratively simple for corporations to donate to STOs and claim the tax credit, but administratively complicated for the STOs to request pre-approval and for DOR to process the applications. DOR believes that a majority of STOs are not staffed by full-time employees, which can add to the difficulty of preparing the reporting requirements. DOR reviews the annual reports and verifies statutory compliance for all STOs, which is a lengthy process due to the number of STOs.

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. The amount of STO scholarship money spent per student.

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

Prior Review

The credit was last reviewed in 2016. However, since the Joint Legislative Income Tax Credit Review Committee did not meet that year, no recommendations were made by the Committee. When the credit was reviewed in 2011, the Committee recommended that the credit be continued.

Table 3

FY 2020 Low-Income Scholarships by School Tuition Organization

	# of Recipients	Total Scholarships	Average Scholarship
AAA Scholarship Foundation	2,386	$11,959,912	$5,013
Academic Opportunity of Arizona	17	73,359	4,315
Arizona's Scholarship Konnection Inc.	210	607,923	2,895
Arizona Education and Scholarship Opportunity Program	550	1,507,212	2,740
Arizona Education First	2	11,000	5,500
Arizona Education Scholarship Foundation	258	94,630	367
Arizona Episcopal Schools Foundation	114	563,257	4,941
Arizona Independent Schools Scholarship Foundation	150	914,805	6,099
Arizona International Academy Scholarship Fund	12	31,500	2,625
Arizona Leadership Foundation	6,548	30,216,697	4,615
Arizona Lutheran Scholarship Organization	120	73,435	612
Arizona Private Education Scholarship Fund Inc	906	2,366,902	2,612
Arizona Private School Tuition Organization	224	203,248	907
Arizona School Choice Trust	482	1,384,631	2,873
Arizona Tax Credit	224	384,852	1,718
Arizona Tuition Connection	1,958	5,552,928	2,836
Arizona Tuition Organization	141	67,519	479
Arizona Waldorf Scholarship Foundation	92	98,383	1,069
Arizona's Catholic Tuition Support Organization (CTSO)	2,006	3,950,371	1,969
Best Student Fund	70	243,300	3,476
Brophy Community Foundation	2,569	6,056,382	2,357
Catholic Education Arizona	3,599	5,880,280	1,634
Chabad Tuition Organization	69	337,500	4,891
Christ Lutheran School Tuition Organization	38	28,139	741
Christian Scholarship Fund of Arizona	11	29,212	2,656
Cochise Christian School Tuition Organization	25	7,003	280
Community Tuition Grant Organization, Inc	162	240,250	1,483
Corporate Tax Foundation	137	702,098	5,125
Financial Assistance for Independent Schools	32	182,176	5,693
Greater Arizona, Inc.	100	413,444	4,134
Independent Schools Corporate Tax Foundation	220	884,586	4,021
Institute for Better Education (IBE)	1,649	1,533,583	930
Jewish Education Tax Credit Organization (JETCO)	59	189,050	3,204
Jewish Tuition Organization	247	1,098,963	4,449
Montessori Scholarship Organization	26	72,510	2,789
Northern Arizona Christian School Scholarship Fund	79	49,639	628
Pappas Kids Schoolhouse Foundation	683	1,453,338	2,128
Private School Tuition Fund 123	72	104,177	1,447
School Choice Arizona, Inc.	1,700	4,346,951	2,557
School Tuition Association of Yuma	617	1,580,647	2,562
School Tuition Organization 4 Kidz	224	256,109	1,143
Students First Foundation	89	70,708	794
Tuition Organization for Private Schools	769	978,299	1,272
Valley Tuition Organization	117	461,200	3,942
White Mountain Tuition Support Foundation	18	31,336	1,741
Yuma's Education Scholarship Fund for Kids	48	45,089	939
TOTAL	**29,829**	**$87,338,533**	**$2,928**

Residential Solar Energy Device Tax Credit

Residential Solar Energy Device Tax Credit

Summary

- The credit is restricted to individual income taxpayers.
- The credit is equal to 25% of the cost of the solar energy device, up to maximum of $1,000.
- The credit reduced individual income tax collections by $8.9 million in FY 2020 and $11.0 million in FY 2021.
- The credit was claimed by 17,998 taxpayers in FY 2021 at an average of $614 per claim.

Statute

A.R.S. § 43-1083 (Individual)

Description

This credit was last reviewed in 2016. The description of the credit as well as other sections of the credit review have been updated from our 2016 report when relevant.

The statute provides an individual with an income tax credit for installing a solar energy device in the taxpayer's Arizona residence. Solar energy devices are defined in A.R.S. § 42-5001 as systems or mechanisms that provide heating, cooling, electrical and mechanical power, daylighting, and energy storage.

The solar energy credit is equal to 25% of the cost of the device, up to maximum of $1,000. The maximum credit in a taxable year cannot exceed $1,000, and the total solar energy credits allowed for a single residence cannot exceed $1,000. The maximum credit a taxpayer may take for all solar energy devices installed in the same residence cannot exceed $1,000.

This credit is 1 of 4 different Arizona renewable energy tax credits, which are described in the appendix to the Renewable Energy Production Tax Credit.

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 federal government first introduced individual solar energy tax credits with the Energy Tax Act of 1978. Arizona created its first solar energy tax credit in 1979. The federal tax credit expired in 1985 and Arizona's tax credit expired in 1987. The Energy Policy Act of 2005 established a federal tax credit of 30% of expenditures on qualified residential solar water heaters and solar panels (photovoltaic systems) purchased on or before December 31, 2007. The credit was capped at $2,000. The Energy Improvement and Extension Act of 2008 extended the federal residential credit through December 31, 2016 and removed the credit cap of $2,000.

The Federal Consolidated Appropriations Act, signed in December 2015, extended the expiration date for the residential credits through December 31, 2021. The credit percentage remained at 30% through December 31, 2019 and decreased to 26% in 2020 and 22% in 2021. The Consolidated Appropriations, 2021, signed into law in

December 2020, extends the federal residential solar energy tax credit through 2023. Under the extension, the credit is 26% for systems installed in 2020 through 2022 and 22% for systems installed in 2023. Unless extended, the federal tax credit expires, beginning in 2024.

Arizona's current solar energy device tax credit was signed into law in June 1994 (Laws 1994, Chapter 117) and became effective for the 1995 tax year. It has been substantively amended once. Laws 1997, Chapter 218 amended the list of qualifying solar energy devices to exclude "a solar hot water heater plumbing stub-out that was installed by the builder of a house or dwelling unit before title was conveyed to the taxpayer." This law also created a separate tax credit for these devices (A.R.S. § 43-1090), which was in effect through TY 2017.

The statute creating the tax credit does not include a specific statement of purpose or a rationale. The credit was included as a floor amendment to SB 1523 in the 1994 Regular Session. that was passed by the House Committee of the Whole. An earlier bill, HB 2440, which included provisions for the solar energy device tax credit, was heard by the House Ways and Means Committee. At that time, the bill's sponsor stated that the purpose of the solar energy tax incentives was to restore Arizona to a position of leadership in the solar energy field and to promote energy efficiency.

The credit was intended to promote the growth of the solar energy industry and the development of sustainable solar technologies. A related goal would be to reduce the consumption of non-renewable fuels that would otherwise be used to generate electricity.

By itself, the credit creates an incentive to purchase solar energy systems by reducing the cost. Initially, the credit was used mostly to purchase solar water heaters and daylighting systems. Currently, the credit is primarily used for purchases of photovoltaic (PV) solar energy devices.

Arizona's two largest public utilities, Arizona Public Service (APS) and the Salt River Project (SRP), do not currently offer residential PV installation incentive programs. Both utilities do, however, offer incentive programs for residential solar water heating. Tucson Electric Power (TEP) used to offer a residential PV installation incentive for many years. This program, however, has been discontinued.

Revenue Impact

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

Table 1

Fiscal Year	# of Claimants	Credit Used
2015	7,147	$4,049,556
2016	7,818	$4,412,227
2017	7,977	$4,705,716
2018	11,078	$7,182,855
2019	12,731	$7,895,700
2020	14,235	$8,912,932
2021	17,998	$11,048,439

DOR also reports credit use on a tax year basis. This data is available from when the credit was first established. It should be noted that this data differs from credit use by fiscal year for several reasons, including the filing of extended and amended tax returns. *Table 2* shows the cost of the individual tax credit by tax year since the credit's inception. As indicated in *Table 2*, both the number of taxpayers claiming the credit as well as the amount of the credit used has steadily increased over time.

Table 2

Tax Year	# of Claimants	Total Credit Available	Credit Used	Carry Forward
1995	1,924	$655,000	$593,000	$63,000
1996	1,651	$591,611	$517,750	$73,876
1997	1,861	$644,057	$527,518	$116,529
1998	2,144	$783,799	$673,892	$109,420
1999	2,765	$1,065,616	$903,738	$152,877
2000	2,560	$1,032,948	$889,508	$143,012
2001	2,273	$1,021,789	$866,027	$155,194
2002	2,336	$1,131,895	$920,767	$210,656
2003	2,687	$1,315,181	$1,050,632	$251,310
2004	3,049	$1,485,693	$1,211,632	$274,061
2005	3,729	$1,945,208	$1,588,034	$356,337
2006	4,172	$2,709,957	$2,090,315	$595,777
2007	2,699	$1,724,349	$1,304,830	$421,078
2008	5,255	$3,357,696	$2,579,148	$777,204
2009	8,528	$6,289,654	$5,065,150	$1,224,169
2010	9,147	$7,188,710	$5,763,107	$1,463,817
2011	9,212	$6,840,408	$4,918,762	$1,921,646
2012	7,754	$5,626,964	$3,874,538	$1,713,779
2013	7,716	$5,530,662	$3,824,470	$1,670,356
2014	7,931	$5,872,740	$4,142,240	$1,640,412
2015	7,961	$5,833,443	$4,166,795	$1,574,175
2016	7,798	$5,997,206	$4,596,644	$1,345,036
2017	11,422	$9,367,906	$7,449,654	$1,868,706
2018	12,772	$10,369,192	$7,896,075	$2,393,485
2019	15,591	$13,256,106	$9,759,385	$3,426,775

# 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, an individual could have $500 in credit identified in tax year 2020, use $400 of it in 2020 (leaving $100 as a carry forward). If that individual did not identify or claim that credit in 2021, that $100 carry forward would not be included in the carry forward total for 2021.

Economic Benefits

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

Data on the magnitude of economic development, new investment, or the creation or retention of jobs related to this credit is not available.

The credit also serves to incentivize consumers to purchase residential solar energy devices, which increases demand for solar installations. With this increased demand comes a more robust labor market for the installation sector of the Arizona solar industry, where solar photovoltaic installers made a median hourly wage of $23.23 in 2020, according to Occupation Employment Survey (OES) data provided by the Arizona Office of Economic Opportunity. The median hourly wage for all occupations in Arizona was $19.35 in 2020.

In the 2020 Solar Jobs Census, 55% of all solar installations were residential projects. The installation sector, which installs PV, solar water heating and other solar technologies, comprises 48.2% of all solar employment in Arizona. This sector experienced a 10.7% increase in employment from 2018 to 2019, which is the most recent year for which this data is available.

Complexity

The solar energy device credit does not appear to be unusually complex in terms of its application, administration, and approval process.

Potential Performance Measures

Performance measures could include:
1. Total megawatt hours of electricity generated from solar energy devices.
2. Number of persons employed in businesses that manufacture, install or service residential solar energy devices.

Prior Review

The credit was last reviewed in 2016. However, since the Joint Legislative Income Tax Credit Review Committee did not meet that year, no recommendations were made by the Committee. When the credit was reviewed in 2011, the Committee recommended that the credit for the residential solar energy devices be eliminated. The Legislature, however, retained the credit.

Renewable Energy Production Tax Credit

Renewable Energy Production Tax Credit

Summary

- The credit is available to both individual and corporate taxpayers.
- The credit reduced individual income tax collections by $261,146 in FY 2020 and $131,113 in FY 2021.
- The credit reduced corporate income tax collections by $6.9 million in FY 2020 and $1.6 million in FY 2021.
- The credit has an aggregate cap of $20 million per calendar year and is limited to $2 million per facility, for up to 10 consecutive years.
- The corporate credit was claimed by 11 taxpayers in FY 2021 at an average of $148,057 per claim; the individual credit was claimed by 4 taxpayers at an average of $32,778 per claim.

Statutes

A.R.S. § 43-1164.03 (Corporate) and A.R.S. § 43-1083.02 (Individual)

Description

This credit was last review in 2016. The description of the credit as well as other sections of the credit review have been updated from our 2016 report when relevant.

The statutes provide both individuals and corporations with an income tax credit for electricity production by a qualified generator that uses renewable energy sources. Qualified energy generators are defined by the statutes as facilities that produce at least 5 megawatts of capacity using solar light, solar heat, wind or biomass. Qualified energy generators must also be located on land in Arizona that is owned or leased by the taxpayer and must sell electricity to an unrelated entity or to a public service corporation.

The qualified energy generators must first produce electricity after December 31, 2010 but before January 1, 2021. The credit became effective January 1, 2011.

Claimants of this tax credit must first have their qualified energy generator certified by the Department of Revenue (DOR) and include a copy of their Certificate of Renewable Energy Production Tax Credit with their tax return. The total amount of credits is capped at $20 million in any calendar year; therefore, certifications are limited and granted on a first-come, first-served basis. The amount of the credit per facility is limited to $2 million per calendar year, for up to 10 calendar years.

The tax credit for wind and biomass systems equals $0.01 per kilowatt-hour (kWh) for the first 200,000 megawatt-hours (MWh) of electricity produced in a calendar year for a period of 10 years. The tax credit for photovoltaics (PV) and solar thermal electric systems varies depending on the year of electricity production as shown in *Table 1* below.

This credit is 1 of 4 different Arizona renewable energy tax credits, which are described in the attached appendix.

Refundable

This 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 credit was created by Laws 2010, Chapter 312 and became effective January 1, 2011. According to a purpose statement included in the legislation, the credit was enacted to promote investment in renewable energy production using low-emission and zero-emission electricity generation technologies. See *Table 2* below for an overview of the share of electricity generation in Arizona from 2016 to 2019. Coal energy decreased its share of electricity generation in that timeframe from 28.0% to 20.4%, whereas solar energy increased its share from 3.5%

to 4.6% over the same period. Wind and biomass energy have both maintained their share of the energy market since 2016, at 0.5% and 0.0%, respectively.

Table 1

Credit Schedule for PV and Solar Thermal Electric Systems

Calendar Year	Amount of the Credit
1	$0.04 per kWh
2	$0.04 per kWh
3	$0.035 per kWh
4	$0.035 per kWh
5	$0.03 per kWh
6	$0.03 per kWh
7	$0.02 per kWh
8	$0.02 per kWh
9	$0.015 per kWh
10	$0.01 per kWh

Table 2

Arizona Electric Power Industry Generation by Primary Source

	2016	2017	2018	2019
Coal	28.0%	29.7%	27.5%	20.4%
Hydroelectric	6.6%	6.5%	6.2%	5.5%
Natural gas	31.4%	28.0%	33.2%	40.6%
Nuclear	29.8%	30.6%	27.8%	28.1%
Biomass	0.0%	0.0%	0.0%	0.0%
Petroleum	0.0%	0.1%	0.0%	0.1%
Pumped storage	0.1%	0.0%	0.0%	0.0%
Solar	3.5%	4.7%	4.6%	4.6%
Wind	0.5%	0.5%	0.5%	0.5%
Wood	0.2%	0.1%	0.2%	0.2%
Total	**100%**	**100%**	**100%**	**100%**

Source: U.S. Energy Information Administration

The renewable energy production credit was first introduced during the 2009 regular session under HB 2341. According to the House Water and Energy Committee Minutes from February 26, 2009, the bill's sponsor explained that the bill had been 4 years in development and that New Mexico had passed the same legislation in 2008. While HB 2341 passed out of both houses, the Governor vetoed the bill on July 13, 2009. In the veto letter, the Governor noted that while she supported the concepts advanced by the legislation, she wanted a cap to be placed on the amount of credit claimed. In 2010, the bill was introduced again, and this time signed into law with a $20 million annual credit cap.

In addition to Arizona incentives, corporate taxpayers may also receive the federal Renewable Electricity Production Tax Credit (PTC). The federal credit is an inflation-adjusted per-kilowatt hour (kWh) tax credit for electricity generated by qualified renewable energy sources and sold by the taxpayer to an unrelated business entity. Originally enacted in 1992, the PTC has been renewed and expanded multiple times, most recently by the Federal Taxpayer Certainty and Disaster Relief Act of 2020. Under the most recent credit extension, the PTC is phased down by 40% for wind facilities and expires for all renewable energy technologies commencing construction after December 31, 2021.

Revenue Impact

Beginning in FY 2015, the Department of Revenue (DOR) is required to report individual income tax credit use on a fiscal year basis. The same requirement applies to corporate income tax credits, beginning in FY 2016. *Table 3* below shows the cost of the individual credit by fiscal year, going back to FY 2015. *Table 4* shows the same information for the corporate credit, going back to FY 2016. Due to Arizona confidentiality laws, corporate credit data for FY 2018 was not released.

Table 3

Individual Income Tax Credit

Fiscal Year	# of Claimants	Credit Used
2015	0	$0
2016	4	$304,162
2017	4	$222,306
2018	4	$267,925
2019	4	$127,601
2020	4	$261,146
2021	4	$131,113

Table 4

Corporate Income Tax Credit

Fiscal Year	# of Claimants	Credit Used
2016	9	$9,477,269
2017	8	$9,259,887
2018	*	*
2019	10	$10,419,333
2020	7	$6,857,935
2021	11	$1,628,631

* Data not released due to taxpayer confidentiality

DOR also reports credit use on a tax year basis. *Table 5 and Table 6* show the use of the individual and corporate credits by tax year since 2011 and 2013, respectively. It should be noted that credit use by tax year data differs from credit use by fiscal year for several reasons, including the filing of extended and amended tax returns.

Table 5

Individual Income Tax Credit Use

Tax Year	# of Claimants	Total Credit Available	Credit Used	Carry Forward
2011	0	$0	$0	$0
2012	0	$0	$0	$0
2013	0	$0	$0	$0
2014	5	$320,171	$309,243	$10,928
2015	5	$322,936	$241,707	$81,229
2016	5	$386,388	$376,221	$10,167
2017	5	$264,974	$136,023	$128,952
2018	5	$392,247	$262,695	$129,552
2019	4	$304,382	$131,113	$173,269

# 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, an individual could have $500 in credit identified in tax year 2011, use $400 of it in 2011 (leaving $100 as a carry forward). If that individual did not identify or claim that credit in 2012, that $100 carry forward would not be included in the carry forward total for 2012.

Table 6

Corporate Income Tax Credit Use

Tax Year	# of Claimants	Total Credit Available	Credit Used	Carry Forward
2013	8	$24,371,476	$8,869,123	$15,502,353
2014	9	$34,182,183	$9,658,821	$24,523,362
2015	10	$44,211,353	$9,220,860	$34,990,493
2016	10	$54,685,334	$8,742,119	$45,823,716
2017	10	$65,568,908	$9,232,420	$51,409,817
2018	9	$71,097,121	$6,857,935	$56,372,162
2019*	10	$75,276,714	$1,628,631	$64,643,220

# 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, an individual could have $500 in credit identified in tax year 2013, use $400 of it in 2013 (leaving $100 as a carry forward). If that individual did not identify or claim that credit in 2014, that $100 carry forward would not be included in the carry forward total for 2014.
* – TY 2019 credit data is preliminary.

Table 7 summarizes the credit approvals of qualified facilities in Arizona. At the time of this publication, DOR is unable to differentiate between individual and corporate qualified facilities.

The number of qualified facilities with allowable credit and approved credit has increased since the creation of the incentive, first reaching its annual credit cap of $20 million in 2014. As shown in *Table 7*, the amount of credit approved in 2020 was slightly below the $20 million cap.

Table 7

Individual and Corporate Qualified Facilities

Production Year	**# of Qualified Facilities** [1/]	**# of Facilities with Allowable Credit** [2/]	**Credit Approved**
2011	5	5	$1,276,521
2012	12	12	$9,653,594
2013	16	16	$18,421,782
2014	20	16	$20,000,000
2015	22	17	$20,000,000
2016	24	18	$20,000,000
2017	24	19	$20,000,000
2018	25	21	$20,000,000
2019	24	24	$20,000,000
2020	25	25	$19,399,594

1/ Facilities that were certified by DOR to have a renewable energy generator but did not necessarily have their credit approved due to the annual cap of $20 million.

2/ Facilities that were certified by DOR to have a renewable energy generator and had their credit approved.

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

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

According to the Database of State Incentives for Renewables & Efficiency prepared by North Carolina Clean Energy Technology Center at North Carolina State University, at least 4 other states offer a corporate income tax credit for renewable energy production (Colorado, Iowa, Utah and New Mexico), at least 4 other states offer an individual credit (Massachusetts, Iowa, New Mexico and Utah), and at least one other state provides performance-based incentives (Minnesota), where the state offers payments based on energy production to owners of renewable energy facilities.

Complexity
According to DOR, the credit is complex in its application, certification, and administration. The different amount of the credit per kilowatt-hour depending on the year when a solar energy generator first produced electricity, as well as the different types of generators available for the credit, add to the complexity of the certification and application process. When the credit was first implemented, extensive research of the renewable energy industry was required.

Potential Performance Measures
Performance measures could include:
1. Total megawatt hours of electricity generated from qualified energy generators.

2. Number of persons employed in businesses that manufacture, install or service qualified energy generators.

Prior Review

The credit was reviewed for the first time in 2016. However, since the Joint Legislative Income Tax Credit Review Committee did not meet that year, no recommendations were made by the Committee.