# Joint Legislative Budget Committee
# Staff Memorandum

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DATE: December 4, 2009

TO: Members, Joint Legislative Income Tax Credit Review Committee

FROM: Hans Olofsson, Chief Economist

SUBJECT: 2009 INCOME TAX CREDIT REVIEW

This memo transmits background materials for the December 10**,** 2009 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 2009 include:

- Agricultural Pollution Control Equipment Tax Credit
  - A.R.S. § 43-1081.01 (Individual)
  - A.R.S. § 43-1170.01 (Corporate)
- Agricultural Water Conservation System Tax Credit
  - A.R.S. § 43-1084 (Individual)
- Healthy Forest Enterprise Tax Credit
  - A.R.S. § 43-1076 (Individual)
  - A.R.S. § 43-1162 (Corporate)

The 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. Based on statute (A.R.S. § 43-221), the standard for evaluation of the credits may include: 1) the history, rationale and revenue impact; 2) the benefit to the state in various economic terms; and 3) the complexity in the use and administration of the credit.

The Committee last reviewed the agricultural pollution control equipment tax credit and agricultural water conservation system tax credit in 2004. The healthy forest enterprise tax credit will be reviewed for the first time in 2009.

Limitations

There are several limitations that affect the evaluation of income tax credits. For example, based on Department of Revenue (DOR) interpretation of Arizona law (A.R.S. § 43-2001), the department is generally prohibited from releasing company-specific tax credit data. While DOR provides tax credit information in aggregate form, in some cases so few companies take a particular credit, there is no financial data available related to the credit.

A second limitation is the timeliness of data that is available. Because tax credit data must generally be compiled manually from actual hard-copy tax returns, credit data is currently available only through tax year 2007. The 2007 tax credit data is preliminary and as such is subject to revision.



(Continued)

And finally, there is generally a lack of performance measures for tax credits. Some credits have stated performance measures or goals, but most of the credits do not have objectives included in statute. Chapter 238, however, requires any new credit to include a clause that explains the rationale and objective of the credit (A. R. S. § 43-223).

2009 Review

Attached are summaries for each of the income tax credit categories that are included in the 2009 review. The following information is provided (where applicable) for each of the credit categories:

*Description* – the definition of the tax credit, and how the credit is calculated.

*Refundable* – whether or not the credit is refundable. A nonrefundable credit is one in which, when the credit exceeds the taxpayer's tax liability, the amount of credit that is greater than the liability may be carried forward to future tax years (as provided in statute). If a credit is refundable, the amount of credit that exceeds the taxpayer's liability is refunded to the taxpayer in each tax year. All of the credits included in the current review are nonrefundable.

*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 it was implemented, and relevant information regarding the intended purpose of the credit.

*Revenue Impact* – based on information from DOR, information for each tax year on the number of claimants, the amount of new credit identified, total credit identified, credit used, and credit carried forward to a subsequent tax year. In addition, we provide data specific to each tax credit (where applicable), and more detailed definitions of the above terms.

*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 agency administering the credit (generally DOR), trade associations, and representatives of the businesses and/or individuals that claim the credits.

*Potential Performance Measures* – a listing of potential measures that might be used to evaluate each of the income tax credits.

Information under the above headings from each income tax credit category was obtained from a variety of sources. 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.

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

HO:ss
Attachment
xc: Michael Hunter, Senior Policy Advisor, Senate
Carolyn Atwater, Policy Advisor, Senate
Barbara Barzee, Senate Finance Committee Analyst
Grant Nulle, Director of Fiscal Policy, House
Mark Bogart, Senior Economist, House
Jennifer Anderson, House Ways and Means Committee Analyst

# Agricultural Pollution Control Equipment Tax Credit

**Summary**

- The cost of the individual credit was $32,500 in tax year 2002, the last year for which data has been released.
- The cost of the corporate credit was $0 in tax year 2007, the last year for which data has been released.
- There were a total of at least 30 claims for the individual credit between 1999 and 2007.
- The number of claims for the corporate credit has been too few to legally permit the Department of Revenue to release such data.

**Statute**

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

**Description**

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

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

**Refundable**

The credit is not refundable.

**Carry Forward**

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

**History and Rationale**

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

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

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

**Revenue Impact**

<u>Corporate:</u> The cost of the credit was $0 in 2007, the last year for which data has been released. The table below, which was provided by DOR, summarizes the corporate income tax impact of the credit.

| Tax Year | # of Claimants | Total Credit Available | Credit Used | Carry Forward |
|---|---|---|---|---|
| 1999 | Not Releasable | Not Releasable | Not Releasable | Not Releasable |
| 2000 | Not Releasable | Not Releasable | Not Releasable | Not Releasable |
| 2001 | Not Releasable | Not Releasable | Not Releasable | Not Releasable |
| 2002 | Not Releasable | Not Releasable | Not Releasable | Not Releasable |
| 2003 | Not Releasable | Not Releasable | Not Releasable | Not Releasable |
| 2004 | Not Releasable | Not Releasable | Not Releasable | Not Releasable |
| 2005 | 0 | $0 | $0 | $0 |
| 2006 | Not Releasable | Not Releasable | Not Releasable | Not Releasable |
| 2007 | 0 | $0 | $0 | $0 |

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

Individual: The cost of the credit was $32,542 in 2002, the last year for which data has been released. The table below shows the individual income tax impact of the credit.

| Tax Year | # of Claimants | Total Credit Available | Credit Used | Carry Forward |
|---|---|---|---|---|
| 1999 | 1 | Not Releasable | Not Releasable | Not Releasable |
| 2000 | 9 | $77,096 | $15,218 | $61,878 |
| 2001 | 9 | $54,870 | $17,500 | $37,370 |
| 2002 | 6 | $47,706 | $32,542 | $15,164 |
| 2003 | 1 | Not Releasable | Not Releasable | Not Releasable |
| 2004 | 1 | Not Releasable | Not Releasable | Not Releasable |
| 2005 | 2 | Not Releasable | Not Releasable | Not Releasable |
| 2006 | Not Available | Not Available | Not Available | Not Available |
| 2007 | 1 | Not Releasable | Not Releasable | Not Releasable |

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

**Economic Benefits**

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

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

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

*Other*

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

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

**Complexity**

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

**Potential Performance Measures**

Performance measures could include:

1. A requirement to report on pollution reduction resulting from the installation of new equipment. However, such a measure may not be meaningful as it is difficult, if not practically impossible, to ascertain the impact on the environment.
2. Type of equipment purchased and its related environmental impact. However, in practical terms, it may be difficult to quantify such impact.
3. Number of states where a farmer or rancher receives a comparable credit.

**Prior Review**

The agricultural pollution control equipment tax credit was last reviewed by the JLITCRC in 2004. The Committee recommended to continue the credit without any changes or modifications, and to place the credit back on the income tax credit review schedule for 2009.

# Agricultural Water Conservation System Tax Credit

**Summary**

- The cost of the credit was $1.7 million in tax year 2007, the last year for which data is available.
- Based on preliminary data, a total of 130 taxpayers claimed the credit in tax year 2007.
- The corporate credit was repealed as of January 1, 2000.

**Statute**

A.R.S. § 43-1084 (Individual)

**Description**

The agricultural water conservation system credit is provided for the purchase and installation of systems primarily designed to substantially conserve water on land used to produce agricultural products or sustain livestock. The credit is available only as an individual income tax credit, and not as a corporate income tax credit.

The credit is equal to 75% of the expenses incurred during the taxable year for the purchase and installation of the system. The expenses must be consistent with a conservation plan that the taxpayer has filed and is in effect with the U.S. Department of Agriculture (USDA).

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

**Refundable**

The credit is not refundable.

**Carry Forward**

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

**History and Rationale**

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

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

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

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

**Revenue Impact**

Individual: Pursuant to Laws 1999, Chapter 318, this credit is available to individuals only. The cost of the credit was $2,784,783 in 2004, the last year for which complete data is available. The table below, which was provided by DOR, summarizes the individual income tax impact of the credit.

| Tax Year | # of Claimants | Total Credit Available | Credit Used | Carry Forward |
|---|---|---|---|---|
| 1994 | 35 | $1,800,000 | $382,000 | $1,400,000 |
| 1995 | 54 | $2,600,000 | $923,000 | $1,700,000 |
| 1996 | 75 | $4,247,392 | $721,093 | $3,524,790 |
| 1997 | 63 | $3,752,833 | $430,131 | $3,323,906 |
| 1998 | 94 | $4,567,632 | $625,676 | $3,941,314 |
| 1999 | 129 | $8,484,744 | $970,210 | $7,213,521 |
| 2000 | 130 | $8,157,000 | $1,578,411 | $6,527,281 |
| 2001 | 136 | $8,442,943 | $1,484,014 | $6,160,791 |
| 2002 | 133 | $7,984,544 | $1,256,346 | $6,157,459 |
| 2003 | 154 | $9,170,688 | $1,611,457 | $7,273,813 |
| 2004 | 141 | $10,366,257 | $2,784,783 | $6,855,589 |
| 2005 | 137 | $8,868,257 | $1,905,338 | $6,409,360 |
| 2006 | 138 | $8,880,517 | $1,873,967 | $6,202,634 |
| 2007 | 130 | $8,585,901 | $1,746,925 | $6,057,981 |

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

**Economic Benefits**

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

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

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

*Other*

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

**Complexity**

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

**Potential Performance Measures**

Performance measures could include:

1. A requirement to report on the savings (in terms of water usage) incurred from the installation of a water conservation system. However, such a performance measure may not be meaningful as it may be difficult to both collect and corroborate such data.
2. Number of states where taxpayers receive a comparable credit.

**Prior Review**

The agricultural water conservation system tax credit was last reviewed by the JLITCRC in 2004. The Committee recommended to continue the credit without any changes or modifications, and to place the credit back on the income tax credit review schedule for 2009.

# Healthy Forest Enterprise Tax Credit

**Summary**


- There were no claims of the corporate credit in tax years 2005 and 2006. The credit began in 2005.
- The first year in which the corporate credit was claimed was 2007. However, tax year 2007 data is not releasable due to the state's confidentiality laws.
- There were no claims of the individual credit in tax years 2005, 2006, and 2007. The credit began in 2005.
- Tax year 2008 data for the individual credit is not yet available.


**Statute**

A.R.S. § 43-1162 (Corporate)
A.R.S. § 43-1076 (Individual)

**Description**

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

The tax credit is one of several incentives provided under the healthy forest enterprise program originally enacted in 2004. The other incentives currently offered under the program are:

- use fuel tax reduction
- sales tax exemption on purchased, leased, or rented equipment
- sales tax exemption on construction contracts
- use tax exemption on equipment purchased out of state.
- property tax reduction

The table below, which is based on information furnished by the Department of Commerce, shows the number of businesses applying for and/or using a particular type of incentive in each year between 2006 and 2008.

Number of Businesses Using the Different Incentives under the Healthy Forest Enterprise Program

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

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

A business that wants to use the tax credit or any of the other tax incentives under the program must obtain certification as a qualified healthy forest enterprise by the Department of Commerce. As indicated in the table above, a total of 7 businesses were certified for the incentives program in 2008. A business is also required to enter into a *memorandum of understanding* with Commerce. The business must submit a copy of the certification to the Department of Revenue (DOR) for final approval before any tax incentives under the program can be used. The certified business is required to submit an annual report to Commerce and apply for recertification each year. If the certification is terminated or revoked, the incentives under the program are subject to recapture.

The credit, which is available from tax year 2005 through tax year 2014, is based on the net increase in the number of qualified employment positions that are created and filled by a qualified healthy forest enterprise. The amount of the credit per employee is based on the employee's wage and year of employment. For a qualified employment position, the credit is equal to:

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

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

To be eligible for the tax credit, a business must employ at least 3 new full-time employees in qualified employment positions in the first year the credit is claimed. To be a "qualified employment position," statute requires that the position:

- is filled by an individual who resides in Arizona on the date of hire and was not employed by the business in the prior 12 months
- is for an employee who was employed for at least 90 days during the first taxable year
- is a full-time permanent job (at least 1,550 hours per year)
- primarily involves or directly supports the harvesting, initial processing, or transporting of qualifying forest products
- pays an hourly wage above the "Wage Offer by County" (currently between $7.94 and $17.08 depending on the county in which the business is located)
- provides health insurance to the employee and for which the employer pays at least 25% to 50% of the cost depending on the year in which the credit is claimed

**Refundable**

The credit is not refundable.

**Carry Forward**

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

**History and Rationale**

The federal Healthy Forests Initiative was launched in 2002 with the stated purpose of protecting United States' forests from wildfire by increasing hazardous fuel reduction efforts. In response to federal efforts, the Arizona Legislature appointed the Joint Legislative Healthy Forest Task Force and the Governor established the Forest Health Oversight Council. Both of these groups were responsible for making recommendations promoting forest health in Arizona.

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

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

**Revenue Impact**

Corporate: Unknown. However, according to DOR, tax year 2007 was the first year for which the corporate credit was claimed. However, no data for tax year 2007 can be released due to existing confidentiality laws.

| Tax Year | # of Claimants | Total Credit Available | Credit Used | Carry Forward |
|---|---|---|---|---|
| 2005 | 0 | $0 | $0 | $0 |
| 2006 | 0 | $0 | $0 | $0 |
| 2007 | Not Releasable | Not Releasable | Not Releasable | Not Releasable |

*# 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.

Individual: Unknown. According to DOR's annual tax credit reports, no individual credits were claimed in tax years 2005, 2006 and 2007. Data for tax year 2008 is not available.

| Tax Year | # of Claimants | Total Credit Available | Credit Used | Carry Forward |
|---|---|---|---|---|
| 2005 | 0 | $0 | $0 | $0 |
| 2006 | 0 | $0 | $0 | $0 |
| 2007 | 0 | $0 | $0 | $0 |
| 2008 | Not Available | Not Available | Not Available | Not Available |

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

**Economic Benefits**

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

Pursuant to Laws 2004, Chapter 326, Section 19, the individual and corporate tax credits were enacted to help to establish "commercial enterprises that promote forest health and reduce the risk of catastrophic wildfire and destructive insect infestation in the forested areas in this state." However, due to the limited use of the credit, as reported by DOR, it is not clear to what extent the incentives program has achieved these objectives. For the same reason, it seems unlikely that the tax credit has had more than a negligible impact on new investments, job creation and retention, and the development of commercial infrastructure.

The Department of Commerce reports that most companies that have answered the program evaluation section of the annual report have indicated that the incentives program has been an important factor in the decision to locate, expand, or remain in the state.

The reasons that so few businesses have used the credit to date are not fully understood. Based on feedback received by the Department of Commerce when advertising the program in certain areas of the state, one explanation is that the 3 full-time employee requirement under the program may be too restrictive. As a result, there are a significant number of one-person operated forestry businesses in the state that are not able to take advantage of the program due to this requirement.

**Complexity**

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

The Department opines that although the program requires a significant amount of paperwork for the agency to review and process, it does not consider this to be "unnecessarily complex." Additionally, the 3 agencies involved in the processing of paperwork (Department of Commerce, Revenue, and Transportation) have all been able to successfully streamline this process.

**Potential Performance Measures**

Performance measures could include:

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

# 2009 Income Tax Credit Review

**Joint Legislative Income Tax**
**Credit Review Committee**

**December 10, 2009**

**JLBC**

# Joint Legislative Income Tax Credit Review Committee

- Annually reviews credits as determined in statute.
- This year's review includes:
  - Agricultural Pollution Control Equipment Credit
  - Agricultural Water Conservation System Credit
  - Healthy Forest Enterprise Credit
- Agricultural pollution and agricultural water conservation credits were last reviewed in 2004.

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# Role of the Committee

- Determine original purpose of tax credit.
- Establish standards for evaluating and measuring success or failure.
- Recommend changes.

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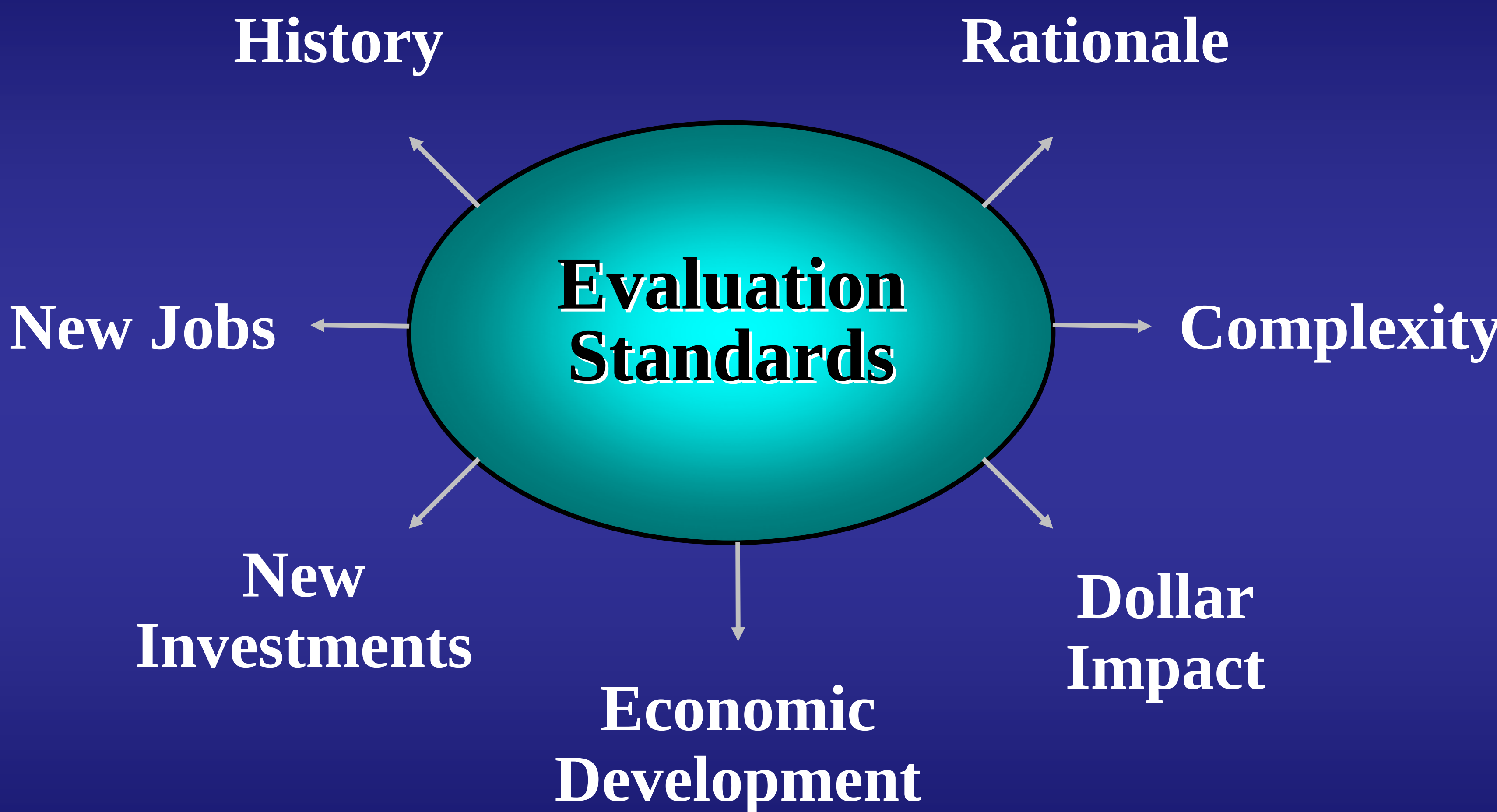
# Statute Provides Possible Standards



# Issues Affecting Evaluation

- Confidentiality.
- Timeliness of data.
- Lack of performance measures.

# Agricultural Pollution Control Credit
## Summary

Cost – $0 in tax year 2007 for the corporate credit and $32,500 in tax year 2002 for the individual credit.

- 30 claims filed by individuals between 1999 and 2007.
- Number of claims by corporations were too few to report.

Purpose – mitigate costs incurred by farmers and ranchers to comply with environmental regulations.

Complexity – simple to use and administer.

Performance Measures – none in statute.

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# Agricultural Pollution Control Credit
## Description of Credit

- The credit is for expenses incurred to acquire agricultural pollution control equipment.
- Example of equipment that may qualify for the credit is dust filters in cattle feed yards.
- The credit is equal to 25% of the cost of equipment up to a maximum of $25,000.
- Credit is nonrefundable.
- Carry forward is 5 years.

# Agricultural Pollution Control Credit
## Amount of Credits Taken & Number of Claimants


**JLBC**

# Agricultural Pollution Control Credit

## Benefits to the Arizona Economy

- Impact on the state's economy is likely negligible due to the limited use of the credit.
- Credit may have a small positive impact on the environment insofar as it induces taxpayers to reduce pollution that would not occur in the absence of the credit.

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# Agricultural Pollution Control Credit

## Potential Performance Measures

- Type of equipment purchased and its related environmental impact.
- Number of other states where a taxpayer receives a comparable credit.
- Last reviewed in 2004.
  - Committee recommended the continuation of the credit with no changes or modifications.

JLBC

# Agricultural Water Conservation Credit

## Summary

Cost – $1.7 million in tax year 2007.

- – 130 claims filed by individual taxpayers in 2007.
- – Corporate credit was repealed in 2000.

Purpose – mitigate costs incurred by farmers and ranchers to comply with water conservation requirements under the Groundwater Management Code.

Complexity – simple to use and administer.

Performance Measures – none in statute.

# Agricultural Water Conservation Credit

## Description of Credit

- The credit is equal to 75% of expenses for the purchase and installation of an agricultural water conservation system.
- Example of a water conservation system that may qualify for the credit is irrigation equipment, such as sprinklers, pipes, and water pumps.
- Taxpayer must have a conservation plan on file with the USDA to qualify.
- Credit is nonrefundable.
- Carry forward is 5 years.

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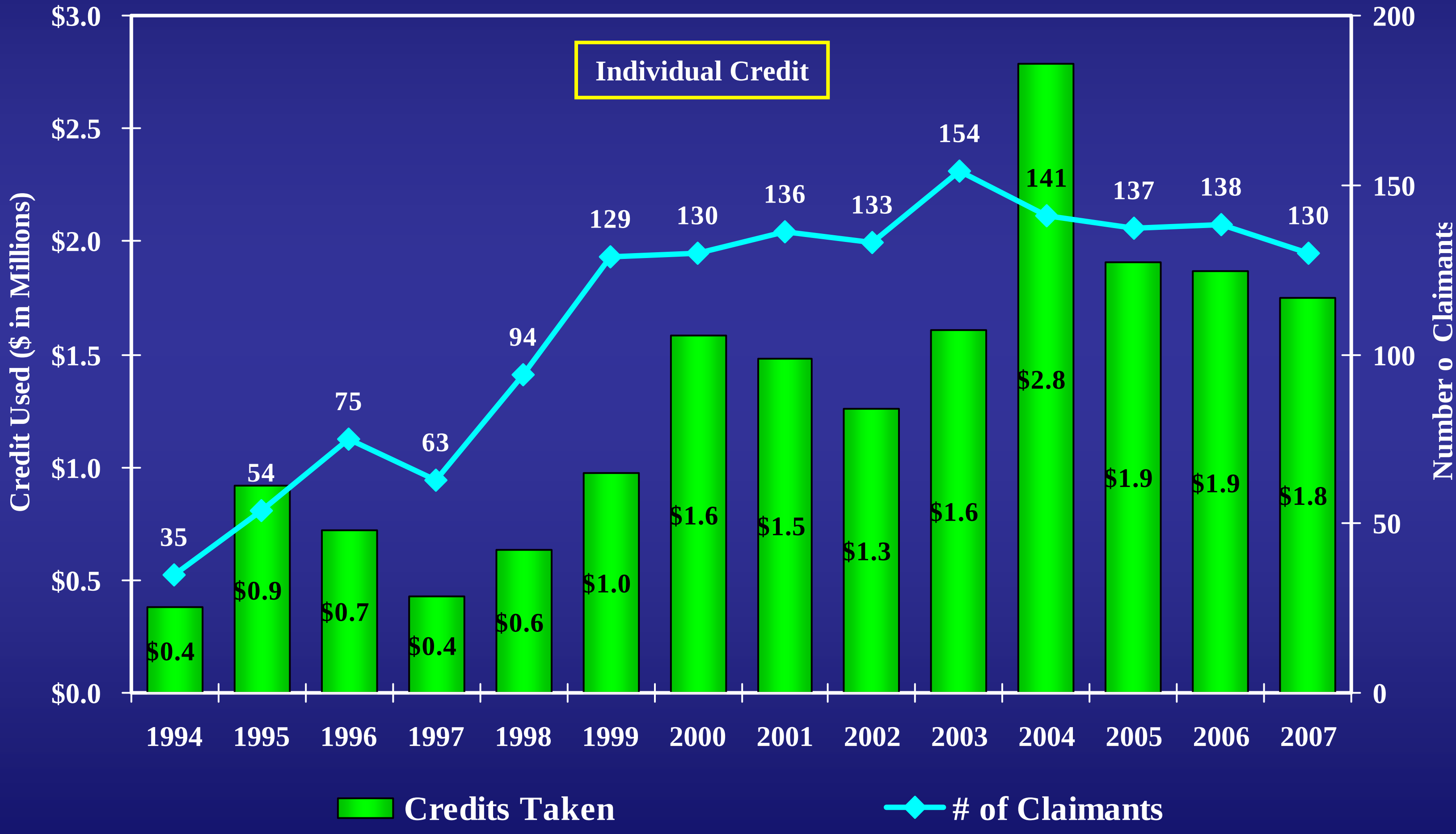
# Agricultural Water Conservation Credit
## Amount of Credits Taken & Number of Claimants




JLBC

# Agricultural Water Conservation Credit

## Benefits to the Arizona Economy

- Credit may enhance Arizona’s competitiveness relative to other states by reducing cost of production.
- Credit may have a positive impact on the environment insofar as it induces taxpayers to reduce water usage that would not occur in the absence of the credit.
- No data is available to quantify potential impact on the state’s economy.

JLBC

# Agricultural Water Conservation Credit

## Potential Performance Measures

- Type of equipment purchased and the reduction in water usage as a result of the credit.
- Number of other states where a taxpayer receives a comparable credit.
- Last reviewed in 2004.
  - Committee recommended the continuation of the credit with no changes or modifications.

JLBC

# Healthy Forest Enterprise Credit
## Summary

Cost – $0 in tax year 2006 for the corporate credit and $0 in tax year 2007 for the individual credit.

- Corporate credit claimed for the first time in 2007.
- No individual credits claimed between 2005 and 2007.

Purpose – provide incentive to help establish commercial enterprises that promote forest health and reduce the risk of wildfires.

Complexity – Not difficult to use but requires significant paperwork for application and reporting purposes.

Performance Measures – none in statute.

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# Healthy Forest Enterprise Credit
## Description of Credit

- Credit is based on the net increase in the number of qualified employment positions created and filled.
- Amount of credit per employee depends on employee's wage and year of employment:
  - 1/4 of employee's wage in the 1st year of employment up to $500
  - 1/3 of wage in the 2nd year of continuous employment up to $1,000
  - 1/2 of wage in the 3rd year of continuous employment up to $1,500
- Taxpayer cannot claim more than 200 qualified employment positions in any given tax year.

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# Healthy Forest Enterprise Credit

## Description of Credit (continued)

- Business must employ at least 3 new full-time employees in "qualified employment positions" in the 1st year the credit is claimed.
- A qualified employment position is one that meets specific requirements related to residency, total hours worked, type of work, wage rate, and health insurance benefits.
- Business must also enter into a "memorandum of understanding" with the Dept. of Commerce.

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# Healthy Forest Enterprise Credit

## Description of Credit (continued)

- Prior to using any tax incentive under the program, a business must first be approved (“certified”) by Commerce. (A total of 7 businesses certified in 2008.)
- Certified business must submit an annual report to Commerce and reapply for certification each year.
- Besides the tax credit, the program also offers other incentives related to use fuel, sales and property taxes.
- Credit is nonrefundable with a 5-year carry-forward.

# Healthy Forest Enterprise Credit

## Amount of Credits Taken & Number of Claimants

- No taxpayers claimed the corporate credit in 2005 and 2006.
- Corporate credit was claimed for the first time in 2007. However, there were too few claimants to allow DOR to release more information.
- No taxpayers claimed the individual credit in 2005, 2006, and 2007.
- Credit data for 2008 is not yet available.

# Healthy Forest Enterprise Credit
## Benefits to the Arizona Economy

- Impact on the state’s economy is likely negligible due to the limited use of the credit.
- Certified businesses have indicated that the incentives program was an important factor in the decision to locate, expand, or remain in the state.

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# Healthy Forest Enterprise Credit

## Potential Performance Measures

- Quantity of qualifying forest products harvested, processed, or transported for commercial use.
- Total statewide number of new jobs created as a result of the program.
- Number of states where a comparable credit is offered.