General Fund Taxes

Refundable Tax Credits and Other Payments

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June, 2021 Joint Committee on Finance Paper #330

Veterans Property Tax Credit for Renters
(General Fund Taxes -- Refundable Tax Credits and Other Payments)

[LFB 2021-23 Budget Summary: Page 229, #12]

CURRENT LAW

Under current law, the veterans and surviving spouses property tax credit is equal to 100% of the real and personal property taxes paid on a principal residence by an eligible veteran or their spouse, or the unremarried surviving spouse of an eligible veteran. An eligible veteran is defined as a person who: (a) served on active duty in the U.S. armed forces; (b) was a resident of this state at the time of entry into that service or had been a Wisconsin resident for any consecutive five-year period after entry; (c) is a resident of the state for purposes of receiving veterans benefits; and (d) has a service-connected disability rating (set forth under federal law) of 100% or a 100% disability rating equivalent based on individual unemployability.

An eligible unremarried surviving spouse includes persons meeting certain service-related criteria relative to the deceased spouse, as verified by the Department of Veterans Affairs (DVA). Eligible unremarried surviving spouses receiving dependency and indemnity compensation from the federal government based on a deceased spouse's service-connected death are also able to claim the credit under current law.

The credit is refundable, such that if the amount of the credit exceeds a claimant's tax liability, a check is issued to the claimant for the difference. An individual cannot claim the credit if they also file a claim for the nonrefundable school property tax rent credit (PTRC), the farmland preservation credit (refundable), or the homestead credit (refundable) in the same tax year. A renter may claim the credit if they make property tax payments directly to the municipality (if the landlord does not remit such payments on their behalf).

BACKGROUND

The veterans and surviving spouses property tax credit was created under 2005 Act 25, the 2005-07 biennial budget act. The credit was initially available to eligible disabled veterans who were at least age 65 and their spouses, and to unremarried surviving spouses of certain veterans who died while on active duty. In the first year of its enactment (tax year 2005), the credit increased state GPR expenditures by $0.9 million. Since that time, credit expenditures have increased each year, totaling $35.8 million in tax year 2019. The table below displays total credit expenditures on a tax year basis since 2005. As shown in the table, annual growth in total claimants and the amount of credits claimed has exceeded 6% each year over the fifteen-year period.

Historical Claims Data for the Veterans Property Tax Credit

Tax Year	Count of Claimants	Percent Change	Credit Amounts	Percent Change	Average
2005	301		$866,255		$2,878
2006	382	26.9%	1,138,738	31.5%	2,981
2007	458	19.9	1,345,822	18.2	2,938
2008	577	26.0	1,713,587	27.3	2,970
2009	3,665	535.2	10,921,315	537.3	2,980
2010	5,047	37.7	14,893,638	36.4	2,951
2011	5,892	16.7	17,257,777	15.9	2,929
2012	6,634	12.6	19,287,913	11.8	2,907
2013	7,129	7.5	21,017,003	9.0	2,948
2014	8,103	13.7	23,540,861	12.0	2,905
2015	8,730	7.7	25,322,908	7.6	2,901
2016	9,305	6.6	27,458,070	8.4	2,951
2017	10,036	7.9	30,045,149	9.4	2,994
2018	10,665	6.3	32,014,280	6.6	3,002
2019	11,404	6.9	35,819,255	11.9	3,141

Eligibility for the credit was significantly expanded under 2007 Act 20, beginning in tax year 2009. The requirement that an eligible veteran had to have been a Wisconsin resident at the time of entry into active duty service was modified so as to also make eligible those veterans who lived in Wisconsin for any consecutive five-year period following their entry into active duty. Prior to Act 20, an eligible veteran must have attained the age of 65 in order to claim the credit (or in the case of a surviving spouse, their deceased spouse must have been at least age 65 at the time of death, unless they died while on duty). Act 20 removed these age requirements, such that any otherwise eligible veteran or surviving spouse could claim the credit regardless of age. Finally, Act 20 provided that veterans with a 100% disability rating equivalent based on their individual unemployability status could claim the credit. As shown in the table, total credit expenditures and the count of claimants increased considerably in tax year 2009 following Act 20.

Under 2013 Act 20, eligibility for the credit was further expanded to include unremarried surviving spouses of certain individuals, if the U.S. Department of Veterans Affairs verified that the individual met the following criteria: (a) the individual had served on active duty under honorable conditions in the U.S. armed forces or in forces incorporated as part of the U.S. armed forces; (b) the individual was a resident of Wisconsin at the time of entry into that service or had been a resident of Wisconsin for any consecutive five-year period after entry into that active duty service; (c) the individual was a resident of Wisconsin at the time of death; and (d) following the individual's death, the individual's spouse began to receive, and continues to receive, dependency and indemnity compensation, as defined under federal law. This expansion took effect beginning in tax year 2014.

Under Department of Revenue (DOR) administrative practice, an eligible veteran or surviving spouse who is a renter may claim the credit only if they meet all of the following conditions: (a) the rental unit is their principal dwelling; (b) the principal dwelling is located in Wisconsin; (c) they are required to pay the property taxes under a written agreement with their landlord; and (d) they remit property tax payments directly to the municipality.

DISCUSSION POINTS

1. The Committee could consider expanding the veterans and surviving spouses property tax credit by providing the credit to eligible renters beginning in tax year 2021 (Alternative 1a). An eligible claimant could claim the credit for 100% of their rent constituting property taxes. "Rent constituting property taxes" would have the same definition as under the current law property tax rent credit (generally 25% of rent if heat is not included in rent, or 20% of rent if heat is included). For married-separate filers, each spouse could claim the credit based on 50% of the total rent constituting property taxes paid during the taxable year for the eligible veteran's principal dwelling. Under this proposal, state GPR expenditures would be estimated to increase relative to current law by $4.9 million in 2021-22 and $5.1 million in 2022-23.

Such a proposal was included in Assembly Bill 68/Senate Bill 111 (AB 68/SB 111). However, when it was initially introduced as part of AB 68/SB 111, the estimated fiscal effect of Alternative 1a did not include an increase in individual income tax collections associated with these claimants who could no longer claim the nonrefundable PTRC (for which they are currently eligible). As a result, the fiscal effect of Alternative 1a also includes an estimated increase in individual income tax revenues of $0.5 million on an annual basis. The net increased cost of the credit would be $4.4 million in 2021-22 and $4.6 million in 2022-23.

2. Based on 2019 aggregate taxpayer data from DOR, an estimated 2,389 additional claimants would have been eligible for the veterans property tax credit in that year if the credit had been extended to renters. These claimants would have represented 17.3% of all individuals claiming the credit in tax year 2019. These data were used to calculate the fiscal effects of each of the alternatives presented in this paper. A distributional table of tax year 2019 credit claimants is included as an attachment to this paper. The attachment displays total veterans property tax credit claimants and amounts claimed by Wisconsin adjusted gross income (AGI) in tax year 2019.

3. In the Budget in Brief published by the Department of Administration (DOA), the administration states that expanding the veterans property tax credit to renters would provide financial

assistance to lower- and middle-income taxpayers. U.S. Census Bureau data compiled by the National Multifamily Housing Council show that median household income among all households who own their own home was $77,523 (in 2018 dollars). These same data report that median household income for all renter households (in 2018 dollars) was $41,515, or 53.6% of the median income for owner households. According to a 2017 report delivered to Congress by the U.S. Department of Housing and Urban Development, 64% of renters in the U.S. had incomes at or below 80% of the area median income, and 26% had incomes at or below 30% of the area median income.

4. The administration posits in its Budget in Brief that these lower/middle-income individuals have been disproportionately impacted by the adverse economic effects of the COVID-19 pandemic. A survey conducted by the Pew Research Center found that 26% of middle-income households and 33% of lower-income households experienced job loss in their household due to the COVID-19 pandemic, compared to only 14% of upper-income households. The survey also reported that 32% of lower-income individuals had difficulty making rent/mortgage payments since the onset of the pandemic, compared to only 3% of upper-income households.

5. According to Opportunity Insights, a nonpartisan research organization based at Harvard University, rates of employment at higher-income jobs (those that pay $60,000 or more per year) are lower by 2.0% as of February 1, 2021, relative to January, 2020. By contrast, for jobs that pay $27,000 or less per year, employment rates are nearly 30% lower as of February 1, 2021, compared to January, 2020. In Wisconsin, employment rates for higher-income workers are 3.6% higher, and employment rates for lower-income workers are 12.7% lower, over this same period. Because median incomes for renters are considerably lower than median incomes for homeowners, and because lower-income individuals are more likely to have experienced adverse economic effects from the pandemic, it could be argued that providing the veterans property tax credit to renters for tax year 2021 can help mitigate these negative economic impacts for these individuals.

6. According to 2019 American Community Survey data from the U.S. Census Bureau, an estimated 5.6% of veterans in Wisconsin earn incomes at or below the federal poverty line. Although disabled veterans comprise an estimated 28.3% of the overall veteran population in Wisconsin, an estimated 40.1% of veterans living at or below the federal poverty line in Wisconsin are disabled veterans. These data suggest that veterans who are disabled (and are thereby eligible for the veterans property tax credit) are disproportionately likely to live in poverty. It could be argued, therefore, that one goal of the credit is to provide property tax relief to those with a lower ability to pay property taxes. As noted above, median incomes for homeowners are nearly twice those for renters, so extending the credit to renters would expand the credit to lower-income veterans with disabilities.

7. DOA also promotes expanding the credit to renters as a way to promote tax equity. The concept of horizontal equity holds that tax policy should generally provide for the equal treatment of equals. In other words, individuals with comparable levels of income should generally be treated similarly for tax purposes. Under current state law, an eligible disabled veteran with $40,000 of annual income who owns her own home would receive a refundable credit for the full amount of property taxes paid on that home. By contrast, the same disabled veteran under current law would receive a lower level of property tax relief if she rented an apartment (such as through the nonrefundable PTRC). This differing tax treatment of otherwise similarly situated individuals under current law

violates the concept of horizontal equity.

8. Moreover, explicitly allowing the veterans property tax credit for renters would be in line with similar tax benefit programs provided to renters elsewhere in the state tax code, such as through the PTRC and the homestead credit. Unlike these other credits, the veterans property tax credit for renters under Alternative 1a (as for homeowners under current law) would not be income-limited nor limited to a certain amount of rent constituting property taxes. Similar to the credit for homeowners, the veterans property tax credit for renters would be disallowed if the claimant claimed a homestead, farmland preservation, or PTRC in the same tax year.

9. As displayed in the table above, veterans property tax credit expenditures have grown each year from tax year 2005 to 2019. During this span, the number of credit claimants has increased each year. More recently, the average credit has also increased, by a comprehensive annual average growth rate of 2.1% from $2,951 in 2016 to $3,140 in 2019. For the upcoming biennium, GPR expenditures for the credit are estimated at $41 million in 2021-22 and $42 million in 2022-23 under current law. If the Committee is concerned about the rising cost of the credit, it could consider imposing a cap on the amount of property taxes (or rent constituting property taxes) that may be claimed (Alternatives 2a and 2b). Such an approach would bring the credit in line with other property tax relief credits, such as the PTRC and homestead credits, which both employ a limit on the amount of property taxes that may be claimed.

10. If the Committee desired to limit the cost of the credit in this way, it could select a limit of $3,000 on the amount of property taxes or rent constituting property taxes that may be claimed, which approximates the average credit claimed in tax year 2018. Currently, the credit pays the full property tax bill of all eligible veterans without regard to their economic circumstances. Alternative 2a considers the net fiscal effect of expanding the credit to eligible renters and imposing the aforementioned limit of $3,000 of property taxes or rent constituting property taxes that may be claimed for all claimants, while Alternative 2b displays just the fiscal effect of imposing a property tax cap of $3,000 on the credit for homeowners that exists under current law (and not expanding the credit to renters). Alternative 2a would reduce the cost of the credit by an estimated $3.5 million in 2021-22 and $3.6 million in 2022-23 relative to current law. Alternative 2b would reduce the cost of the credit by an estimated $7.5 million in 2021-22 and $7.8 million in 2022-23.

11. Critics might counter that a credit which does not limit the amount of property taxes that may be claimed encourages eligible claimants to purchase more expensive homes than they otherwise would, with the knowledge that their full property tax bill will be paid by the state. Opponents of the current credit structure might worry that the unlimited property tax allowance under the current credit will cause credit expenditures to increase unchecked.

12. Another mechanism to control the cost of the credit would be to impose an income limit for claiming the credit (Alternatives 3a and 3b). Sound tax policy would suggest that such an income limit include a phase-out over a range of incomes in order to avoid a severe cliff effect. Such an effect is most severe when a tax benefit is fully disallowed as soon as income reaches a certain dollar amount, because this creates a significant and immediate increase in the marginal effective rate of tax paid by an individual with income over the relevant threshold. Alternative 3a considers the net fiscal effect of providing the credit to eligible renters and imposing a phase-out provision on renters and

homeowners. If the Committee chose not to extend the credit to renters, Alternative 3b considers applying the phase-out provision to the credit under current law.

13. As shown in the attachment, in tax year 2019, 883 veterans property tax credit claimants with Wisconsin AGI of $80,000 or more claimed $4.1 million of credits, for an average credit of $4,678 (49% higher than the average credit for all claimants). Such individuals comprised 7.7% of all credit claimants, and claimed 11.5% of total credits, in tax year 2019.

14. Also in tax year 2019, 509 credit claimants with Wisconsin AGI of $100,000 or more claimed $2.6 million of credits. Their average credit equaled $5,047, which is 61% higher than the average credit among all claimants. They comprised 4.5% of all claimants, and claimed 7.2% of total credits in tax year 2019.

15. Of all veterans property tax credit claimants in 2019, 172 (1.5% of all claimants) had Wisconsin AGI of $150,000 or more. These individuals claimed approximately $1.0 million of credits (2.8% of total credits), for an average credit of $5,741 (83% higher than the average credit among all claimants).

16. Under Alternatives 3a and 3b, the credit would phase out for married-joint filers with Wisconsin AGI between $100,000 and $150,000, for married-separate filers with Wisconsin AGI between $50,000 and $75,000 (half the threshold for married-joint filers), and for all other filers with Wisconsin AGI between $75,000 and $100,000. The phaseout would be structured such that the amount of property taxes the claimant could otherwise claim would be reduced by the amount by which their AGI exceeds the phase-out threshold over the total threshold amount. For example, a single filer with $85,000 of Wisconsin AGI would experience a 40% reduction in their creditable property taxes (excess = $85,000 - $75,000 = $10,000. Total threshold amount = $100,000 - $75,000 = $25,000. Reduction = $10,000 / $25,000 = 0.4, or 40%).

17. If the Committee chose to expand the veterans property tax credit to renters and adopt the phase-out provision described above, the cost of the credit would increase by $2.55 million in 2021-22 and $2.65 million in 2022-23 relative to current law (Alternative 3a). If the Committee chose not to expand the credit to renters but wished to adopt the income phaseout for eligibility for the credit, the cost of the credit would be reduced by $1.55 million in 2021-22 and $1.65 million in 2022-23 relative to current law (Alternative 3b).

18. Alternatives 2a and 3a could be adopted together. In this case, the credit would be extended to renters, limited to property taxes/rent constituting property taxes of $3,000, and would phase out for married-joint filers with Wisconsin AGI between $100,000 and $150,000, for married-separate filers with Wisconsin AGI between $50,000 and $75,000, and for all other filers with Wisconsin AGI between $75,000 and $100,000 (Alternative 4a). If Alternative 4a were adopted beginning in tax year 2021, it is estimated that the cost of the credit would decline relative to current law by $4.55 million in 2021-22 and $4.75 million in 2022-23.

19. On the other hand, if the Committee chose not to extend the credit to renters, Alternatives 2b and 3b could be adopted together, such that the current law credit would be limited to property taxes of $3,000, and would phase out for married-joint filers with Wisconsin AGI between $100,000

and $150,000, for married-separate filers with Wisconsin AGI between $50,000 and $75,000, and for all other filers with Wisconsin AGI between $75,000 and $100,000 (Alternative 4b). If Alternative 4b were adopted beginning in tax year 2021, the cost of the credit is estimated to decline relative to current law by $8.35 million in 2021-22 and $8.75 million in 2022-23.

20. From a tax policy perspective, adopting the phaseout and the property tax (or rent constituting property tax) cap together has the advantage of lowering the effective marginal rate of tax paid by individuals with incomes inside the phase-out range, relative to the tax rate they would pay if only the phaseout were adopted. This would apply to individuals who could otherwise claim property taxes (or the rent equivalent) in an amount greater than the proposed cap of $3,000. For example, a single filer with Wisconsin AGI of $90,000 and a property tax bill of $5,000 would face a steeper marginal rate of tax if only the phaseout were adopted. Under Alternative 3a or 3b, this filer would report the full $5,000 of property taxes initially, but could only claim $2,000 pursuant to the phase-out provision ($3,000 reduction in their credit). Conversely, under Alternatives 2 and 3 combined, this filer would only report the maximum allowable property taxes of $3,000 initially, and could then claim $1,200 pursuant to the phase-out provision ($1,800 reduction in their credit). This larger credit reduction under only Alternative 3 translates into a higher marginal effective tax rate in the phase-out range than the rate paid on the same income under Alternatives 2 and 3 together.

21. The Committee could reason that imposing a cap like the one described under Alternative 2 and 3 would cause undue economic consequences for veterans who currently claim the credit. As noted above, in order to claim the credit under current law, the veteran must have incurred a service-connected disability or died as a result of their service. It could be argued that the credit structure that exists under current law (no cap on the allowable amount of property taxes that can be claimed) is an appropriate response to the disabilities incurred by these veterans, and to the unmarried individuals who lost their spouse, in service to their country.

22. Critics of tax credits in general may argue that they are flawed as a mechanism to provide economic support to a particular group. They might worry that the veterans property tax credit disguises what is functionally an economic assistance program for disabled veterans and surviving spouses as simply a tax reduction. In their view, this practice can obfuscate the underlying goals of these support programs, which can complicate the ability of lawmakers and citizens to make informed decisions on the policy merits of such programs. If the Committee desires to provide economic assistance to disabled veterans and surviving spouses independent of the tax code, it could opt to convert the current law veterans property tax credit into a disabled veterans and surviving spouses grant program jointly administered by DOR and DVA (Alternative 5). Such a program would retain all the eligibility criteria and other relevant provisions that exist under the current law credit. Claimants could submit to DOR/DVA the same property tax and eligibility information they are required to submit under current law, and the agencies could then issue the associated grants. The Committee could also choose to adopt any of the other alternatives in this paper and incorporate those provisions into the rebate program under Alternative 5.

23. If the Committee chooses to create a disabled veterans and surviving spouses grant program to reimburse eligible veterans and surviving spouses for their property taxes incurred, the grant amounts and administrative costs incurred by DOR and DVA could be paid from a sum

sufficient miscellaneous GPR appropriation beginning in 2021-22. The Committee could require that, prior to issuing a rebate or incurring an expenditure under this appropriation, DOR and DVA submit a plan to the Committee for implementing the program within 90 days of the bill's effective date, including associated costs and positions needed to implement the program and to review applications received under the program. After receiving the plan, the Co-chairpersons of the Committee could either: (a) direct DOR and DVA to implement the plan; or (b) convene a meeting of the Committee within 14 days after the plan is submitted to approve, or modify and approve, the plan. DOR and DVA would be required to implement the plan as approved by the Committee, and could not utilize the sum sufficient appropriation to pay for administrative costs beyond the amount authorized by the Committee.

ALTERNATIVES

Provide the Veterans Property Tax Credit to Eligible Renters

1a. Expand the veterans and surviving spouses property tax credit by providing the credit to eligible renters beginning in tax year 2021. Permit an eligible claimant to claim a credit equal to 20% of rent if heat is included, and 25% of rent if heat is not included. Estimate increased GPR expenditures of $4,900,000 in 2021-22 and $5,100,000 in 2022-23 and annually thereafter. Estimate increased individual income tax collections of $500,000 on an annual basis, beginning in 2021-22.

ALT 1a	Change to Base
GPR	$10,000,000
GPR-Tax	1,000,000

1b. Take no action.

Limit Claimable Property Taxes to $3,000

2a. In addition to expanding the veterans property tax credit to renters under Alternative 1a, limit the total property taxes/rent constituting property taxes that could be claimed for purposes of the credit to $3,000. Estimate decreased GPR expenditures relative to current law of $3,000,000 in 2021-22 and $3,100,000 in 2022-23. Estimate increased individual income tax collections relative to current law of $500,000 on an annual basis, beginning in 2021-22.

ALT 2a	Change to Base
GPR	- $6,100,000
GPR-Tax	1,000,000

2b. Take no action on providing the credit to renters under Alternative 1a. However, limit the total property taxes that could be claimed for purposes of the credit under current law to $3,000 beginning in tax year 2021. Estimate decreased GPR expenditures relative to current law of

$7,500,000 in 2021-22 and $7,800,000 in 2022-23.

ALT 2b	Change to Base
GPR	- $15,300,000

Phase Out the Credit at Higher Incomes

3a. In addition to expanding the veterans property tax credit to renters under Alternative 1a, stipulate that the credit phases out for married-joint taxpayers with Wisconsin AGI between $100,000 and $150,000, for married-separate filers with Wisconsin AGI between $50,000 and $75,000, and for all other filers with Wisconsin AGI between $75,000 and $100,000. Estimate increased GPR expenditures relative to current law of $3,000,000 in 2021-22 and $3,100,000 in 2022-23. Estimate increased individual income tax collections relative to current law of $450,000 on an annual basis, beginning in 2021-22.

ALT 3a	Change to Base
GPR	$6,100,000
GPR-Tax	900,000

3b. Take no action on providing the credit to renters under Alternative 1a. However, stipulate that the current law credit phases out for married-joint taxpayers with Wisconsin AGI between $100,000 and $150,000, for married-separate filers with Wisconsin AGI between $50,000 and $75,000, and for all other filers with Wisconsin AGI between $75,000 and $100,000, beginning in tax year 2021. Estimate decreased GPR expenditures relative to current law of $1,600,000 in 2021-22 and $1,700,000 in 2022-23. Estimate decreased individual income tax collections relative to current law of $50,000 on an annual basis beginning in 2021-22.

ALT 3b	Change to Base
GPR	- $3,300,000
GPR-Tax	- 100,000

Adopt Property Tax Limit and Phaseout

4a. In addition to expanding the veterans property tax credit to renters under Alternative 1a, limit the total property taxes/rent constituting property taxes that could be claimed for purposes of the credit to $3,000. Stipulate that the credit phases out for married-joint taxpayers with Wisconsin AGI between $100,000 and $150,000, for married-separate filers with Wisconsin AGI between $50,000 and $75,000, and for all other filers with Wisconsin AGI between $75,000 and $100,000. Specify that these changes take effect beginning in tax year 2021. Estimate decreased GPR expenditures relative to current law of $4,100,000 in 2021-22 and $4,300,000 in 2022-23. Estimate increased individual income tax collections relative to current law of $450,000 on an annual basis, beginning in 2021-22.

ALT 4a	Change to Base
GPR	- $8,400,000
GPR-Tax	900,000

4b. Take no action on providing the credit to renters under Alternative 1a. However, limit the total property taxes that could be claimed for purposes of the credit under current law to $3,000. In addition, stipulate that the current law credit phases out for married-joint taxpayers with Wisconsin AGI between $100,000 and $150,000, for married-separate filers with Wisconsin AGI between $50,000 and $75,000, and for all other filers with Wisconsin AGI between $75,000 and $100,000. Specify that these changes take effect beginning in tax year 2021. Estimate decreased GPR expenditures relative to current law of $8.4 million in 2021-22 and $8.8 million in 2022-23. Estimate decreased individual income tax collections relative to current law of $50,000 on an annual basis, beginning in 2021-22.

ALT 4b	Change to Base
GPR	- $17,200,000
GPR-Tax	- 100,000

Create Disabled Veterans and Surviving Spouses Grant Program

5. Sunset the current law veterans and surviving spouses tax credit, beginning in tax year 2021. Create a disabled veterans and surviving spouses grant program, jointly administered by DOR and DVA, beginning in tax year 2021. Specify that the eligibility criteria for claiming the rebate, and other relevant provisions of the rebate program, are identical to those that exist under the current law veterans and surviving spouses property tax credit. Create a sum sufficient miscellaneous GPR appropriation for this purpose. Maintain the current law prohibition that an individual claiming a disabled veterans and surviving spouses grant cannot use the same property taxes paid (or rent constituting property taxes paid) to claim the school property tax rent credit, homestead credit, or farmland preservation credit. Require DOR and DVA to submit a plan to the Committee for implementing the program, including associated costs and positions needed to implement the program and to review applications received under the program. Require the Co-chairpersons of the Committee, after receiving the plan, to either: (a) direct DOR and DVA to implement the plan; or (b) convene a meeting of the Committee within 14 days after the plan is submitted to approve, or modify and approve, the plan. Require DOR and DVA to implement the plan as approved by the Committee, and prohibit DOR and DVA from utilizing the sum sufficient appropriation to pay for administrative costs beyond the amounts authorized by the Committee. Alternative 5 can be adopted together with any other alternative presented above. In this case, the provisions of the other alternative would be incorporated into the grant program.

Prepared by: Dan Spika
Attachment

ATTACHMENT

Distribution of Veterans Property Tax Credit Claimants and Amounts Claimed by Wisconsin AGI, Tax Year 2019

Total Adjusted Gross Income	Count	% of Count	Amount	% of Amount	Average
Under $5,000	4,095	35.9%	$10,804,111	30.2%	$2,638
5,000 - 10,000	982	8.6	2,873,769	8.0	2,926
10,000 - 15,000	683	6.0	2,035,229	5.7	2,980
15,000 - 20,000	670	5.9	1,977,879	5.5	2,952
20,000 - 25,000	599	5.3	1,852,921	5.2	3,093
25,000 - 30,000	578	5.1	1,787,572	5.0	3,093
30,000 - 40,000	1,013	8.9	3,277,454	9.1	3,235
40,000 - 60,000	1,219	10.7	4,431,516	12.4	3,635
60,000 - 80,000	682	6.0	2,647,934	7.4	3,883
80,000 - 100,000	374	3.3	1,561,870	4.4	4,176
100,000 - 150,000	337	3.0	1,581,575	4.4	4,693
150,000 - 200,000	108	0.9	601,231	1.7	5,567
Over 200,000	64	0.6	386,194	1.1	6,034
Total	11,404	100.0%	$35,819,255	100.0%	$3,141

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June, 2021 Joint Committee on Finance Paper #331

Refundable Research Tax Credit
(General Fund Taxes -- Refundable Credits and Other Payments)

[LFB 2021-23 Budget Summary: Page 227, #9]

CURRENT LAW

A tax credit is an amount that is subtracted from the gross income tax liability of the taxpayer in a given year, resulting in a dollar-for-dollar reduction in gross tax liability. In general, businesses may be eligible to claim a business tax credit when preparing and filing the required individual and corporate income/franchise tax forms with the Department of Revenue (DOR).

If a nonrefundable credit exceeds tax liability, any amounts claimed that cannot be used to offset tax liability are identified so that the taxpayer can carry the unused amount forward for use in a future tax year. In general, unused tax credits may be carried forward for up to 15 years. Conversely, if the credit is refundable and the amount of the credit exceeds the claimant's tax liability, the state issues a check for the excess amount or the claimant may apply the credit against the next year's tax liability. Nonrefundable credits are counted as revenue reductions in the state's accounting system. Refundable credits are paid from appropriations and counted as state expenditures.

The state provides research tax credits to businesses equal to a percentage of the increase in a business's qualified research expenses, as defined under the Internal Revenue Code (IRC), for research conducted in Wisconsin. This includes expenses for wages, supplies, and renting or sharing computers owned and operated by another person. In general, qualifying expenses are non-capital, and thus, do not include spending for buildings and equipment. The credits can be claimed against the individual income tax and the corporate income/franchise tax. For most businesses, the credit equals 5.75% of the amount by which the claimant's qualified research expenses for the taxable year exceed 50% of the average qualified research expenses for the three taxable years immediately preceding the tax year in which the claimant claims the credit. If the taxpayer had no qualified research expenses in any of the three preceding tax years, the credit is equal to 2.875% of the claimant's qualified research expenses for that tax year.

For businesses that engage in certain types of research activities, the same calculation of the credit applies, but the credit percentages are equal to 11.5% (rather than 5.75%) and 5.75% (rather than 2.875%). The higher percentages apply to: (a) designing internal combustion engines (including substitute products such as fuel cell, electric, and hybrid drives) for certain vehicles; and (b) designing and manufacturing energy efficient lighting systems, building automation and control systems, or automotive batteries for use in certain hybrid-electric vehicles.

For taxable years beginning prior to January 1, 2018, the credits were 100% nonrefundable, and any unused portion of the credit claimed could be carried forward to offset future tax liabilities for up to 15 years. Pursuant to 2017 Act 59, for taxable years beginning on or after January 1, 2018, the amount of the credit is calculated in the same manner; however, up to 10% of the amount may be claimed as a refundable credit. The refundable portion of the research tax credit is equal to the lesser of: (a) 10% of the tax credit claimed in the current year; or (b) the credit remaining after subtracting the amount of credit used in the current year to offset the tax owed. Any unused portion of the nonrefundable tax credit may be carried forward for up to 15 years. Unused credits that were carried forward from taxable years beginning prior to January 1, 2018, remain nonrefundable.

As adopted by the Committee under LFB Paper #102 (sum sufficient estimates), expenditures under current law for refundable research tax credit claims are estimated at $15,300,000 GPR in 2021-22 and $18,400,000 GPR in 2022-23.

The Wisconsin Economic Development Corporation (WEDC) is responsible for certifying and verifying eligible claimants under certain refundable tax credit programs, including the business development tax credit, enterprise zones tax credit, and electronics and information technology manufacturing (EITM) zone tax credit programs. WEDC will generally enter into a contract with a business to create or retain jobs and/or to make a capital investment in the state for which the business may claim the awarded tax credits. Pursuant to the terms of the contract, a business may receive a verification letter from WEDC upon completion of the Wisconsin investment to claim the credits from DOR.

DISCUSSION POINTS

Purpose of the Research Tax Credit

1. Technological innovation is an important driver of economic growth and has wide social benefits. Long-run economic growth and improved living standards are driven by the accumulation of knowledge-based factors of production, such as human capital, learning-by-doing, research and development (R&D), and innovation.

2. A number of economists have found that, on average, the social returns to R&D investment exceed the private returns from such investments. For example, a 1998 study conducted

by John C. Williams and Charles I. Jones found that the optimal R&D investment is at least twice the actual investment, and possible higher.

3. The excess in the social returns to R&D investments, compared to the private returns, is an external benefit of R&D (spillover effect). Positive externalities or spillovers include reducing the costs of other firms' innovative activities by creating technological knowledge and showing the dead ends in research. In addition, an important part of innovative output is creating new and improved products and services at lower prices.

4. Private sector investment in R&D is likely to fall short of its overall economic and social benefit because a firm will not invest in a project if it knows that it cannot appropriate the potential revenues from that investment. Investment in R&D, and knowledge in general, are not fully appropriable, because once produced, at least part of the research can be obtained at no cost. Once invented, an idea can be imitated by others, although patent protection and delays in the dissemination of new ideas enable the innovator to appropriate a share of revenues from the new idea. If some portion of revenues from the investment is appropriable, the firm will invest only to the level where revenues are sufficient to make the investment profitable. In this case, the firm's investment is based on its private rate of return, which is lower than the social rate of return.

5. Tax credits for qualified research are intended to incent the private sector to increase R&D investments by lowering the after-tax cost of R&D. This is meant to correct for the market's failure to reward firms for the spillover effects that would result from their increased investment. Further, compared to other states, the state research credit may induce researchers to conduct their activities in Wisconsin instead of another location.

6. In addition, research tax credits may assist Wisconsin businesses that compete against national firms to attract and retain talent by enabling them to increase the compensation they can offer to researchers. Thus, the research tax credit can boost long-term productivity in a number of sectors and help to attract or retain well-educated, highly compensated engineers and researchers in Wisconsin who may otherwise leave the state for employment opportunities elsewhere.

Use of Nonrefundable Research Credit

7. As noted, for tax years beginning prior to January 1, 2018, the research tax credit was 100% nonrefundable. It is estimated that a significant amount of the nonrefundable research tax credit went unused each year because the claimants' taxable income was exceeded by the available tax benefits earned.

8. Based on aggregate statistics provided by DOR through tax year 2016, and tax sample data for tax years 2017 and 2018 (the most recent for which data is available), the amount of research credits claimed under the corporate income/franchise tax has grown significantly since tax year 2009. New and carried forward research expense credit claims, including engine research and energy efficient research, totaled $129.8 million in tax year 2009, but increased to $600.5 million in tax year 2018 (363% growth over nine years). For comparison, the amount of credits used under the corporate income/franchise tax increased from $8.3 million in 2009 to $52.4 million in 2018 (531% growth), counting both the nonrefundable portion ($43.9 million) and refundable portion ($8.5 million) used

in 2018. Because credit claims grew by more than use of the credit in absolute terms, the overall balance of unused credits grew from $121.5 million in 2009 to $595.1 million in 2016 (390% growth).

9. It is estimated that the amount of research credits claimed by corporate filers continued to grow to $690.6 million in tax year 2019, comprised of $46.9 million nonrefundable credits used, $13.6 million refundable credits used, and $630.1 million unused.

10. The research credit was not available under the individual income tax until tax year 2013. However, DOR's aggregate statistics through tax year 2019 for the individual income tax show a similar pattern. The amount of credits claimed increased from $10.7 million nonrefundable credits in 2013 to $49.8 million nonrefundable credits and $1.6 million refundable credits in 2019 (380% overall growth over six years). For comparison, the amounted used grew from $8.7 million nonrefundable credits in 2013 to $23.2 million nonrefundable and $1.6 million refundable in 2019 (growth of 185%). The balance of unused credits in tax year 2019 was $26.6 million for individual filers.

11. Overall, it is estimated that more than 63% of the annual amount of new research tax credit claims between tax years 2009 and 2018 were not actually used by taxpayers during that time period. It is estimated that claimants used the research tax credit in the amount of $341.7 million to reduce their tax liability from tax year 2009 through tax year 2018, including $10.1 million of refundable credits). For comparison, unused, carried-forward credits grew by $572.8 million over that period.

12. Two factors may explain the underutilization of research tax credits. First, most multistate corporations apportion income to Wisconsin using a single sales factor apportionment formula. Federal law limits each state's taxing jurisdiction such that each state only requires businesses to pay tax on the portion of the profits fairly attributable to its activities in that state, such as its property, payroll, and sales. Generally, for purposes of the Wisconsin corporate income/franchise tax, a corporation apportions income to the state based on the ratio of its total sales or receipts in Wisconsin compared to the total sales or receipts everywhere. As a result, even though a company may manufacture a product in Wisconsin, its overall tax liability is limited by the portion of sales made within Wisconsin.

13. Second, the state offers other tax benefits to manufacturers, and manufacturers conduct the majority of the types of research expenses which qualify for the research tax credit. According to the 2018 Business Enterprise Research and Development Survey by the National Center for Science and Engineering Statistics, companies in manufacturing industries performed 62% ($274 billion) of all the domestic research and development nationwide and 69% ($3.7 billion) of the research and development in Wisconsin. Because Wisconsin provides the manufacturing and agriculture tax credit (MAC), these businesses may already be able to greatly reduce (or eliminate) any income or franchise taxes they owe the state, by using the MAC rather than the research tax credit.

14. Based on guidance published by DOR, taxpayers have the option to use all, part, or none of their nonrefundable credits based on the statutory language within each credit, which states that a claimant may claim a credit. If more than one nonrefundable credit is used, the computation order provided in statute must be followed. Thus, the nonrefundable portion of the research credit must be

used before the MAC if both credits are being used to offset tax in the statutory computation order. Taxpayers may choose to forgo using the research credit and use the MAC instead, or they can use some of the nonrefundable portion of the research credit and then use the MAC to offset the remaining tax liability. [A special rule applies for combined group members, which requires them to use all available credits to offset liability prior to sharing nonrefundable research credit. Thus, by applying the computational order, the entire nonrefundable research credit would need to be used before using the MAC.]

15. For example, according to tax return data for tax year 2018, of those filers who claimed both the MAC and a research credit, 85% of claimants carried forward unused research tax credits (for an average credit of $935,000 carried forward). Those claimants that did not carry forward research tax credits had an average tax liability of $81,000 remaining.

16. By contrast, the refundable portion of the research credit is applied after the computation of the claimant's Wisconsin net tax. Thus, the refundable portion is not subject to, nor impacted by, the computational order.

Alternatives to Change the Refundable Portion of the Research Tax Credit

17. Because a significant portion of the nonrefundable research tax credit is unused each year, it is likely that the incentive provided by the research tax credit to invest in additional qualified research expenses is significantly reduced.

18. If a firm has no taxable income prior to accounting for tax benefits from the research credit, it cannot use a nonrefundable credit in that tax year. If the firm cannot use the credit, additional nonrefundable credits provide no incentive to invest in additional R&D expenses. This is especially the case if the unused credit amount is expected to be carried forward indefinitely.

19. For example, new and expanding firms that heavily invest in R&D may lack profit in the short term because their start-up and expansion costs exceed their revenues. Such firms are not able to rely on the nonrefundable portion of the credit unless and until they realize taxable income in a future tax year.

20. As another example, businesses are more likely to have net operating losses (NOLs) during and after a recession. During such times, businesses may be unable to use the research credit simply because they have no profit against which to use the credit. Further, NOLs may be carried forward for up to 20 years. Due to the depth of the 2008-09 recession and slow recovery period, some firms carried forward significant losses between tax years 2009 and 2019. The accumulation of unused research tax credit may be partially the result of the use of NOLs.

21. Due to the time value of money, the value of credits carried forward is discounted to account for the uncertainty of when (or if) the claimant will have taxable income to offset in the future. Thus, assuming that firms eventually do use the credits they claim, these firms will ultimately realize a reduced value compared to when the credit was initially claimed.

22. It is anticipated that the majority of the credit will not be used in the current tax year.

Under current law, based on the above information and including previously unused credits that have carried forward, it is estimated that individual and corporate tax filers will claim $921.9 million in research tax credits in tax year 2021, of which only $70.7 million will be used as nonrefundable tax credits and $18.4 million used as refundable credits.

23. Under current law, if the current trends in claiming and using the research credit were to continue, the amount of unused credit is expected to increase to $832.8 million in tax year 2021.

24. Assembly Bill 68/Senate Bill 111 (AB 68/SB 111) would modify the partially refundable research tax credit (including the engine and energy efficiency credits), as computed under current law, to increase the refundable portion from 10% of the credit amount to 20% of the credit amount. These provisions would first apply to new research credit claims for tax years beginning after December 31, 2020. AB 68/SB 111 estimates the fiscal effect of the provision to be $10.6 million GPR annually, beginning in 2021-22. However, based on more recent tax data, it is estimated that this provision would increase expenditures by $4,600,000 GPR in 2021-22 and by $18,400,000 GPR in 2022-23 and annually thereafter (Alternative A1).

25. In the Department of Administration's Budget in Brief, the administration indicates that expansion of the refundable portion of the credit will provide a meaningful incentive for R&D investment by Wisconsin businesses to improve their competitiveness and help develop new products. Further, the administration indicates that the credit is meant to aid start-up companies that do not have tax liability to offset with the nonrefundable portion of the credit.

26. Alternatively, in order to reduce the cost of the proposed expansion, the Committee could expand the credit to up to 15% of the credit amount, as opposed to 20% (Alternative A2). It is estimated that expenditures would increase compared to current law by $2,300,000 GPR in 2021-22 and by $9,200,000 GPR in 2022-23 and annually thereafter.

27. On the other hand, the Committee could decide that it is unnecessary to expand the refundable portion of the credit for two reasons (Alternative A5).

28. First, the research tax credit is not targeted to any specific type of claimant or research activity. Any business having qualified research expenditures may claim it, regardless of the size or age of the business. Further, the credit is not targeted to certain areas of research that are directed to developing new products in Wisconsin or that are otherwise more likely to generate social or economic value. For example, the credit makes no distinction between investments in applied research as opposed to more basic research, even though the latter is much less likely to produce immediate economic returns for the business (and hence businesses are less likely to engage in absent the subsidy). As a result, the stated goals of the administration may not be served by increasing the refundable portion of the credit amount.

29. If the Committee seeks to target investment into new start-up firms that conduct research in Wisconsin, it could, instead, provide funding for other tax credit programs or for economic development programs administrated by WEDC, such as technology development loans or grants for companies that conduct research activities in Wisconsin. For this reason, the Committee could, instead, provide WEDC with additional funding of $4,600,000 GPR in 2021-22 and $18,400,000

GPR in 2022-23 and direct WEDC to create and administer a research grant program for the purposes of incenting research and development in this state and for attracting and retaining engineers and other researchers (Alternative A3).

30. Second, because a significant amount of credits claimed over the previous eight tax years have not yet been used, it is likely the case that many claimants would continue to claim more credits than they can use against their taxable income in future years. If that trend continued, the great majority of the expanded refundable portion of the credit would be paid to current claimants, rather than to induce additional research activities. As discussed, the total credit amount is computed based on qualified expenditures in the current year compared to the average expenditures in the three previous years. Thus, claimants may continue to earn credits for approximately half of their research spending simply by maintaining their current R&D expenditures. It follows that many claimants would be able to claim the full refund for 20% of the credit amount (under Alternative A1) without actually increasing their current planned investments into R&D.

31. Finally, the Committee could sunset the refundable portion of the research tax credit beginning in tax year 2022 (Alternative A4). Based on survey data from the National Science Foundation's Business R&D and Innovation Survey for 2018, private sector expenditures for R&D research in Wisconsin were $5,334 million in 2018. Among the 50 states and the District of Columbia, Wisconsin private sector research expenses were 12th highest on a per capita basis. It could be argued that the research credits available under current law were already incenting private companies to conduct research in Wisconsin, compared to other states, even before enactment of the 10% refundable credit.

32. In the U.S. economy, where barriers to the free flow of information across state borders are essentially nonexistent, encouraging firms to locate R&D in a particular state might not result in economic benefits that are easily confined to the state. Thus, even assuming that the state credit efficiently induces additional investment in the state over and above the level induced by the federal credit, the benefits of that research may not accrue solely in, or at all in, Wisconsin. For example, the intellectual property created due to research activities in Wisconsin may generate income taxable in other states where a firm may choose to locate its factory or headquarters.

33. Further, the efficiency of the credit and to what extent state tax credits for R&D actually cause private sector firms to increase and/or relocate their R&D activities remains a matter of controversy in economic literature. For example, one study suggests that credits increase in-state R&D investment, but almost exclusively from attracting investment from other states as opposed to causing an overall national increase in R&D. Wilson, D. J. *Beggar Thy Neighbor? The In-State, Out-of-State, and Aggregate Effects of R&D Tax Credits*. Review of Economics and Statistics, 91(2), 431–436 (2009). Other surveys of research have found a $1 to $1 increase in R&D expenses from subsidies. Bronwyn H. Hall and John van Reenen, *How Effective Are Fiscal Incentives for R&D? A Review of the Evidence*, working paper 7098 Cambridge, MA: National Bureau of Economic Research (April 1999); *see also* Bronwyn H. Hall and John Van Reenen, *How Effective are Fiscal Incentives for R&D? A Review of the Evidence* (2000).

34. Given that taxpayers in aggregate currently claim more research tax credits than they can use, the Committee could reasonably conclude that it is unnecessary to provide further cash

payments to companies without taxable income in Wisconsin in the form of refundable credits. It is estimated that sunsetting the refundable portion of the research credit, beginning in tax year 2022, would reduce expenditures for credit claims by $4,600,000 GPR in 2022-23 and $18,400,000 GPR in 2023-24 and annually thereafter (Alternative A4). The Committee could sunset the refundable credit in conjunction with providing funding to WEDC for the research grant program under Alternative 3.

Qualified Research Expenses

35. Qualified research expenses eligible for the state research tax credit include in-house and contract research expenses for research conducted in Wisconsin. This includes wages and supplies used in the conduct of qualified research. Under the IRC, qualified research means research expenditures that may be treated as expenses which are undertaken for the purpose of discovering information, which: (a) is technological in nature; (b) is intended to be useful in the development of a new or improved business component of the taxpayer; and (c) constitutes elements of a process of experimentation relating to a new or improved function, performance, reliability, or quality.

36. Under current law, in-house research expenses do not include compensation used in computing credits under the development zone tax credit program. However, AB 68/SB 111 would not prohibit claimants under other WEDC administered tax credit programs, including the business development, enterprise zone, and EITM zone tax credit programs, from claiming or using the nonrefundable or refundable portions of the research tax credit. Eligible businesses are certified by WEDC for these credits based on their qualifying payroll and capital expenditures, which may include wages paid to researchers and other expenses that qualify for the state research tax credit.

37. For example, based on DOR tax return information, it is estimated that, in tax year 2018, 176 individual filers and 19 corporate filers claimed both the refundable portion of the research credit and a refundable credit under either the enterprise zone tax credit program or the business development tax credit program for wages. These claimants claimed $1.6 million of refundable research credits in tax year 2018. Although it is unclear whether the same wages were used by any of these filers to compute and claim both tax credits, current law would have allowed them to do so.

38. Given the significant tax incentives already available under WEDC administered refundable tax credit programs, the Committee could find that providing additional tax incentives for potentially the same expenditures under the research tax credit, such as the wages of researchers, would be duplicative. Thus, the Committee could modify current law to define qualified research expenses as not including compensation and other expenditures used in computing credits under the business development, enterprise zone, and EITM zone tax credit programs (Alternative B1). Under this alternative, claimants of these credits would be treated similar to claimants under the development zone tax credit program, such that they could not use either the refundable portion or the nonrefundable portion of the research tax credit for wage amounts they use to compute other refundable tax credit claims. These claimants could continue to claim research tax credits to the extent that their qualified research expenses are not claimed under these other programs. It is estimated that redefining qualified research expenses in this manner would increase state revenue collections by a minimal amount annually.

ALTERNATIVES

A. Refundable Portion of the Research Tax Credit

1. Modify the partially refundable research tax credit (including the engine and energy efficiency credits), as computed under current law, to increase the refundable portion from 10% of the credit amount to 20% of the credit amount for tax years beginning after December 31, 2020. Increase estimated expenditures for refundable research credit claims of $4,600,000 GPR in 2021-22 and by $18,400,000 GPR in 2022-23.

ALT A1	Change to Base
GPR	$23,000,000

2. Adopt Alternative A1, but with the modification to expand the refundable portion from up to 10% to up to 15% of the amount claimed. Increase estimated expenditures for the refundable research credit by $2,300,000 GPR in 2021-22 and by $9,200,000 GPR in 2022-23.

ALT A2	Change to Base
GPR	$11,500,000

3. Create a sum certain appropriation under WEDC and provide $4,600,000 GPR in 2021-22 and by $18,400,000 GPR in 2022-23. Specify that WEDC must use funding provided to create and administer a research grant program for the purposes of incenting research and development in this state and attracting and retaining researchers in this state.

ALT A3	Change to Base
GPR	$23,000,000

4. Repeal the refundable portion of the research tax credit effective for tax years beginning after December 31, 2021. Relative to current law, estimate reduced expenditures of $4,600,000 GPR in 2022-23 and $18,400,000 GPR in 2023-24 and annually thereafter. [This alternative could be adopted in conjunction with Alternative A3.]

ALT A4	Change to Base
GPR	-$4,600,000

5. Take no action.

B. Definition of Qualified Research Expenses

1. Specify that, beginning in tax year 2022, qualified research expenses do not include compensation and other expenses used in computing credits under the business development, enterprise zone, and electronics and information zone tax credit programs. Estimate that the change would increase revenue collections by a minimal amount on an annual basis.

2. Take no action.

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June, 2021 | Joint Committee on Finance | Paper #332

Business Development Tax Credit for Renewable Energy
(General Fund Taxes -- Refundable Tax Credits and Other Payments)

[LFB 2021-23 Budget Summary: Page 229, #14]

CURRENT LAW

The refundable business development tax credit can be claimed against the individual income tax and the corporate income/franchise tax equal to a portion of eligible expenses for increased employment, retention of employees, employee training, capital investment, and corporate headquarters location or retention in Wisconsin. The Wisconsin Economic Development Corporation (WEDC) is responsible for certifying businesses as eligible to receive credits, verifying eligible activities to claim credits from the Department of Revenue (DOR), and performing other general administrative activities related to the business development tax credit program.

In order to be certified to receive any of the business development tax credits, a person must operate, or intend to operate, a business in this state and enter into a contract with WEDC. Certifications can remain in effect for up to 10 years. A certified business is eligible to receive tax benefits if, in each year the business claims the credit, it increases net employment in Wisconsin above the level during the year before the person was certified, as determined by WEDC under its policies and procedures. There is no limit on the number of businesses that may be certified as eligible to receive business development tax credits.

State law permits WEDC to allocate up to $22 million in business development tax credits annually. Any unused allocation can be carried forward to future years. WEDC may request from the Joint Committee on Finance an increase of up to $10 million annually for the amount of business development credits that may be allocated.

Under the credit for capital investment, WEDC can certify businesses to earn a credit for up to 3% of the business's personal property investment and for up to 5% of a new real property investment that is made in a capital investment project of $1 million or more. For projects involving a capital investment of less than $1 million, the investment must be equal to at least $10,000 per eligible employee employed in the project for the business to be eligible to receive a capital investment credit.

DISCUSSION POINTS

1. According to the Governor's Task Force on Climate Change report, climate change is projected to have significant economic costs as a result of extreme heat events, flooding, tornadoes, and polar vortexes. For example, extreme swings in weather negatively impact Wisconsin's agricultural and livestock sectors, which depend on predictable weather patterns. The report cites the National Oceanic and Atmospheric Administration's Billion-Dollar Weather and Climate Disasters database, indicating that there were 19 severe storms, two floods, and six drought-related disasters that affected Wisconsin between 2000 and 2020, causing $100 billion in economic costs.

2. The Task Force made several policy recommendations to address the effects of climate change, including the creation of a WEDC green grant and loan program to support: (a) Wisconsin businesses that focus on energy efficiency and green technology; and (b) businesses that use sustainable materials to make their products.

3. Assembly Bill 68/Senate Bill 111 (AB 68/SB 111) would create a new tax credit under the refundable business development tax credit program, administered by WEDC, equal to up to 25% of the claimant's energy efficiency or renewable energy project expenditures on real or personal property located in Wisconsin. When making an award, WEDC would have to ensure that the percentage of expenditures taken into account positively correlates to the scale of the project. According to the administration, WEDC would award larger credit percentages for larger projects, up to a maximum of 25%. The credit would first apply to awards made on and after January 1, 2022. It should be noted that AB 68/SB 111 contains no fiscal estimates of the effect of the recommendation.

4. In the Department of Administration's Budget in Brief, the administration indicates that the new tax credit would incent businesses to generate more renewable energy on-site and reduce energy consumption, thereby improving Wisconsin's competitive standing for renewable energy projects and addressing climate change.

5. The Committee could choose to create a refundable credit equal to up to 25% of energy efficiency or renewable energy project expenditures for the following reasons (Alternative A1). As part of this alternative, an awardee would not be able to claim the same expenditures under both the capital investment credit and the new credit for energy efficiency or renewable energy project expenditures (and thus the total credit would be up to 25%, rather than up to 3% or 5% for the existing refundable credits for personal property and real property investments, respectively).

6. Tax incentives can support environmental and economic development policy goals and correct market failures that undervalue energy efficiency and renewable energy. For example, electricity and gas prices may not adequately account for the negative externalities associated with

energy production, such as pollution and greenhouse gas emission. Thus, although a business can reduce its energy costs by investing in energy efficiency and renewable power generation on an ongoing basis, energy prices may not adequately account for the true cost of energy production and the societal savings from making such "up-front" investments. Providing refundable credits for energy efficiency and clean energy generation would increase the incentives for businesses to invest.

7. The proposed tax incentives would leverage private construction spending to deliver energy efficiency and renewable energy generation. The eligible businesses are already venturing to undertake a capital investment project, and thus, a state investment through the 25% credit may ultimately have an outsized impact. Further, the tax benefits may have a spillover effect that influences other persons to pursue such investments without being certified as eligible to claim the credit, such as by increasing the size of the market for, and increasing awareness of, energy efficiency and renewable energy generation projects. Government policies that support research, development, and deployment of renewable energy may drive down costs and spur innovations in the energy sector.

8. On the other hand, the Committee could decide to take no action on the proposal for the following reasons (Alternative A5). First, businesses already have a long-term financial incentive to reduce their energy costs. As a result, tax incentives for energy efficiency and renewable energy generation may award tax benefits to businesses that were already planning to make some or all of such investments. Awarding tax credits to such businesses would not improve the overall energy efficiency or renewal energy generation in the state.

9. Second, WEDC is not an environmental protection agency and generally does not develop its rules and procedures based on environmental impacts or studies. Aside from requiring WEDC to scale the proportion of the credit with the size of the project, the proposal would not provide any standards or guidance for WEDC to determine what sorts of projects should qualify for the tax incentive or what particular policy goals the incentive should seek to achieve. The Committee could reasonably conclude that WEDC lacks the expertise needed to develop the policies and procedures to administrate or assess the effectiveness of the program.

10. Finally, fluctuations in energy prices may provide clearer incentives than the tax benefits provided under the proposed tax credit. Generally, businesses will be more sensitive to energy costs when they are higher and less so when they are lower. Thus, energy price fluctuations may become the incentive to increase usage of the proposed tax credit. The Committee could conclude that the program cost is vulnerable to unpredictable swings in energy prices that would undermine its usefulness in incenting businesses to undertake energy efficiency and renewable power generation projects.

11. Rather than creating a new tax credit program, the Committee could, instead, create a new sum certain GPR appropriation to provide WEDC with $2,400,000, annually, beginning in 2022-23 to administer a green grant and loan program (Alternative A4). According to the Task Force report, the grant program could draw environmentally friendly businesses to Wisconsin, lessen the state's reliance on imported energy, create jobs, and retain students graduating from the state's higher education systems. Under this alternative, WEDC would be directed to implement a grant and loan program for energy efficiency and renewable energy generation projects to fund businesses related to clean energy, zero-waste, or green technologies. Awards could be up to 25% (or a percentage the

Committee chooses) of an awardee's energy efficiency or renewable energy expenditures on real or personal property located in this state. WEDC would be directed to reinvest any loan repayments back into the program.

Fiscal Effect of the Governor's Proposal and Maximum Allocation of Credits

12. The administration did not provide an estimated cost for the proposed refundable credit. However, the creation of a new tax credit for real and personal property investment related to energy efficiency and generation of renewable energy under the business development program would allow WEDC to certify persons to claim tax benefits for which they previously would not have qualified. Thus, the fiscal effect of the credit, and alternatives to increase the funding available for it, are discussed below.

13. As adopted by the Committee under LFB Paper #102 (sum sufficient estimates), it is estimated that the amounts that will be claimed for business development tax credits under current law are $12,900,000 in 2021-22 and $14,700,000 in 2022-23. However, WEDC can allocate up to $22 million of credits annually.

14. Based upon information supplied by WEDC regarding the allocation of business development credits for capital investment, data from the U.S. Census Bureau's Annual Capital Expenditures Survey for 2019, and industry data on investment into energy efficiency and renewable power generation from the international energy agency, it is estimated that WEDC could allocate an additional $2,400,000 annually in credits for energy efficiency and generation of renewable energy under the business development tax credit program.

15. The new credit that would be first available to businesses in 2022 would not be claimed at DOR until 2022-23 at the earliest. The estimated fiscal effect of the Governor's proposal is $600,000 GPR in 2022-23 and $2,400,000 GPR in 2023-24 and annually thereafter. Because WEDC would need time to establish policies and procedures for the new credit and would need additional time to review new applications to certify newly eligible applicants, and because applicants would need to finish their capital investment projects before WEDC could review and verify the amounts to be claimed at DOR, it is estimated that the fiscal effect of the proposal would be fully phased-in beginning in 2023-24.

16. Alternatively the Committee could decide to adopt the proposed tax credit, but reduce the percentage from 25% to 10% of the claimant's energy efficiency or renewable energy project expenditures on real or personal property located in Wisconsin (Alternative A2). The estimated fiscal effect of the 10% credit is $200,000 GPR in 2022-23 and $700,000 GPR in 2023-24 and annually thereafter.

17. As discussed above, current law limits the amount of credits WEDC may allocate to $22.0 million each year, unless a requested increase is approved by the Committee. If less than that maximum amount is allocated, the shortfall carries forward to be allocated in a future year.

18. The table below shows the business development tax credit amounts WEDC allocated by contract year compared to its statutory limit on allocations. The ending balance corresponds to the amounts carried forward to be allocated in contracts executed in a future year. WEDC has not requested that the Joint Committee on Finance provide an additional credit allocation increase since 2016.

Business Development Tax Credits Allocated Under Contracts by Calendar Year
(as of April 21, 2021)

	2016	2017	2018	2019	2020	2021
Opening Balance	$0	$2,715,000	$3,470,200	$2,255,200	$8,900,200	$23,055,200
Limit	25,000,000*	22,000,000	22,000,000	22,000,000	22,000,000	22,000,000
Tax Credits Contracted	22,285,000	21,244,800	23,215,000	15,355,000	7,845,000**	3,370,000
Ending balance	$2,715,000	$3,470,200	$2,255,200	$8,900,200	$23,055,200**	$41,685,200

* In 2016, the limit on contracting tax credits was $17,000,000. The Committee approved an increase of $8,000,000 in its June, 2016, meeting.
** WEDC indicates that additional contracts may be finalized for awards of more than $1,000,000 which certify recipients for tax credits based upon payroll and activities conducted in 2020.

19. As shown in Table 1, WEDC allocated credits in an amount that was more than, or close to, $22 million in 2016, 2017, and 2018. WEDC indicates that contract awards and performance slowed significantly afterwards due to economic disruptions caused by the COVID-19 pandemic.

20. Assuming that WEDC would revert to allocating approximately $22 million in future years for business development credits under current law, it follows that the estimated cost of $2,400,000 annually for the energy efficiency and renewable power generation credit may either require WEDC to refrain from issuing the newly-created credit or to reduce awards of the other business development credits under current law. Therefore, the Committee could also choose to increase the allocation limit to $24,400,000 annually, beginning in 2022, to account for the estimated increase in credits that would be allocated under the proposed energy efficiency and renewable power generation credit (Alternative A3). This provision is not estimated to increase the cost of the proposed credit in the 2021-23 biennium because WEDC is not currently allocating up to its current law limit. However, it would provide WEDC with statutory authority to allocate more business development tax credits in future years.

21. On the other hand, the Committee could find that it is unnecessary to increase the allocation limit because WEDC has not allocated the maximum amount of business development credits allowed under current law since 2018. As shown in Table 1, WEDC can allocate up to $45.1 million in credits in 2021. It is likely that WEDC would be able to allocate additional tax credits without increasing the limit under current law during the 2021-23 biennium. If needed, WEDC could request the Committee to increase the limit by up to $10,000,000 in each year. Thus, the Committee could choose to retain the current limit of $22,000,000.

Reporting of Unallocated Business Development Tax Credits

22. Because the maximum amount of business development tax credits WEDC may allocate each year may change, the maximum amount that may be claimed by recipients at DOR will also vary from year to year. The flexibility provided under current law for WEDC to allocate tax benefits also makes it more difficult to predict the amounts that will be claimed under the program in a given year. For example, as shown in the table, more than double the $22 million annual limit is available for contract awards in 2021. For this reason, LFB Paper #333, discusses the alternative to recast the business development tax credit program as a grant program with a sum certain continuing appropriation.

23. Alternatively, the Committee could require WEDC to identify the amount of unallocated tax credits carried forward into the current year on or before January 31 of each calendar year (Alternative B1). Under current law, WEDC must submit an annual report to the Legislature on January 1 regarding the economic development projects that the Board intends to develop and implement during the current fiscal year. However, current law does not specifically require WEDC to identify the amount of unallocated business development tax credits that were carried forward from the previous year for allocation in a future year as part of that report. Providing a reporting requirement would clarify the amount of tax credits available to be allocated and inform the Legislature of the funding likely to be required in the current and subsequent years.

24. Finally, in order to provide for more oversight of the program, the Committee could, instead, sunset the provision which allows unallocated amounts to carry forward after December 31, 2021 (Alternative B2). In the event WEDC required additional authority to allocate credits, WEDC would retain the ability to request that the Committee increase its annual allocation limit by up to $10,000,000 in any given year. While this alternative is not expected to lower estimated expenditures under the bill, this would provide for more certainty over the maximum cost of credits allocated under the program each year because Committee approval would be required for WEDC to allocate more than the limit in any given year.

ALTERNATIVES

A. Tax Credits for Energy Efficiency and Generation of Renewable Energy

1. Create a new tax credit under the refundable business development tax credit program, administered by WEDC, equal to up to 25% of the claimant's energy efficiency or renewable energy project expenditures on real or personal property located in Wisconsin. Specify that, when making an award, WEDC would have to ensure that the percentage of expenditures taken into account positively correlates to the scale of the project. The credit would first apply to awards made on and after January 1, 2022. Further, specify that an awardee would not be able to claim the same expenditures under both the existing capital investment credit and the new credit for energy efficiency or renewable energy project expenditures. Estimate increased expenditures for credit claims of $600,000 GPR in 2022-23 and $2,400,000 in 2023-24 and annually thereafter.

ALT A1	Change to Base
GPR	$600,000

2. Adopt Alternative A1, but reduce the credit percentage to 10% of the claimant's energy efficiency or renewable energy project expenditures on real or personal property located in Wisconsin. Estimate increased expenditures for credit claims of $200,000 in 2022-23 and $700,000 in 2023-24 and annually thereafter.

ALT A2	Change to Base
GPR	$200,000

3. Adopt Alternative A1, with the modification to increase the statutory limit for allocations of business development tax credits from $22,000,000 annually to $24,400,000 annually, beginning in 2022.

ALT A3	Change to Base
GPR	$600,000

4. Create a new sum certain GPR appropriation to provide WEDC with $2,400,000 annually, beginning in 2022-23, and require WEDC implement a grant and loan program for energy efficiency and renewable energy generation projects. Specify that awards could be up to 25% of the energy efficiency or renewable energy expenditures on real or personal property located in this state. Direct WEDC to reinvest any loan repayments back into the program.

ALT A4	Change to Base
GPR	$2,400,000

5. Take no action.

B. Reporting Unallocated of Business Development Tax Credit

1. Require WEDC to submit a report to the Joint Committee on Finance no later than January 31 each year identifying the amount of unallocated tax credit carried forward as of December 31 of the previous year.

2. Prohibit unused allocations for business development tax credits from carrying over to be allocated in a future year after December 31, 2021.

3. Maintain current law with respect to the allocation and reporting of business development tax credits.

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June, 2021 Joint Committee on Finance Paper #333

Administration of WEDC-Certified Business Tax Credits (General Fund Taxes -- Refundable Tax Credits and Other Payments)

[LFB 2021-23 Budget Summary: Page 224, #1; Page 226, #6; and Page 229, #13]

CURRENT LAW

In general, businesses may be eligible to claim a tax credit when preparing and filing the required individual income and corporate income/franchise tax forms with the Department of Revenue (DOR). A tax credit is an amount that is subtracted from the gross income tax liability of a taxpayer in a given tax year.

For most nonrefundable business tax credits that exceed tax liability, any amounts claimed that cannot be used to offset tax liability are identified so that the taxpayer can carry the unused amount forward for use in a future tax year. Taxpayers claim a refundable credit to reduce taxes otherwise due and/or to receive a check for the amount of the credit in excess of the claimant's tax liability in that year. Alternatively, a business may choose to apply any excess refundable tax credit as a payment towards its tax liability in the next year.

Nonrefundable credits are counted as revenue reductions in the state's accounting system. Refundable credits are paid from appropriations and counted as state expenditures from the general fund.

Pass-through entities (partnerships, limited liability companies (LLCs), and tax-option (S) corporations) may not claim the credits directly, but the eligibility for, and the amount of, the credit is based on their eligible activities. Pass-through entities must compute the amount of credit that each of their owners may claim and provide that information to each of them. Partners of a partnership, members of LLCs, and shareholders of S corporations may claim the credit in proportion to their ownership interest.

Some business tax credits are jointly administered by DOR and the Wisconsin Economic

Development Corporation (WEDC). WEDC is responsible for certifying and verifying eligible claimants under the following tax credit programs: (a) business development; (b) enterprise zones; (c) electronics and information technology manufacturing (EITM) zone; (d) development opportunity zone; (e) historic preservation; and (f) early stage seed and angel investment. Claimants are required to include, with their tax returns, a copy of the certification for tax benefits and verification of expenses from WEDC.

For all tax credits administered by WEDC, DOR must track the amount of credits that have been claimed or used to offset tax liability and the amount of all available unused credits. WEDC is required to provide certain information to DOR by the last day of the first month of each calendar quarter for each of the credits that the two agencies jointly administer, including any credits transferred to another claimant.

In general, when certifying a recipient for a tax credit, WEDC must require the recipient to sign a contract which sets out a compliance schedule of anticipated actions and reporting requirements. WEDC must independently verify, from a sample of tax credits, the accuracy of the information required to be reported. WEDC must revoke a certification for tax benefits if the recipient submits false or misleading information. Further, specific requirements regarding revocation apply for certain tax credit programs.

For other economic development programs developed and implemented by WEDC's Board of Directors, the Board must: (a) establish clear and measurable goals that are tied to statutory or programmatic policy objectives; (b) establish at least one quantifiable benchmark for each program goal; (c) require each recipient of a grant, loan, or tax credit under the program to submit a report to WEDC, and require that each contract with a grant, loan, or tax credit recipient specify the frequency and format of the report and the performance measures to be included in the report; (d) establish a method for evaluating the projected results of the economic development program with actual outcomes, as determined by evaluating the program's objectives and benchmarks; (e) annually and independently verify, from a sample of grants, loans, or tax credits, the accuracy of the information submitted to WEDC; and (f) require each recipient of a grant, loan, or tax credit to submit a statement to WEDC signed by the recipient, or the director or principal officer of the recipient, attesting to the accuracy and truthfulness of the information it submits in the reports.

DISCUSSION POINTS

1. This paper discusses alternatives to replace the refundable tax credits that are administered by WEDC with a revenue-neutral direct grant program. Specifically, the paper presents options to sunset the business development, EITM zone, and enterprise zone tax credit programs, beginning on the effective date of the budget bill. In place of these tax credits, GPR funding would be provided to WEDC for direct economic development grants to state businesses. The paper also presents an alternative to have WEDC pay the tax credits directly to claimants, instead of requiring claimants to file credit claims with DOR, and an alternative to require eligible pass-through entities to file credit claims instead of individual owners of the business.

2. Most state tax deductions and credits do not require prior approval from a state agency;

all eligible persons may claim the tax benefits. In contrast, the credits discussed in this paper are awarded at WEDC's discretion, subject to statutory requirements, and are very similar to grants paid directly by the certifying agency.

3. The business development credit and enterprise zone credit are refundable. Similar to grants awarded by state agencies, refundable tax credit claims are not affected by a claimant's tax liability and are recorded as state expenditures. According to DOR, in tax year 2018, claims for WEDC-certified refundable credits totaled $78.7 million. Of this amount, $17.1 million (21.8%) was used to offset the claimants' tax liability and $61.6 million (78.2%) was refunded in excess of tax liability to the claimants. No EITM zone credits were claimed for tax year 2018.

4. The business development credit, EITM zone credit, and enterprise zone credit may be claimed if pass-through entities conduct eligible economic activities in the state. However, unlike grants awarded by state agencies, the credits are not directly claimed by the business entity that conducted the eligible activities. Instead, the credits are passed through to the individual owners of the entity and claimed on their individual income or franchise tax returns. This is also the case for S corporations, LLCs, and partnerships electing to be taxed at the entity level under the provisions of 2017 Act 368, which compute the credit and pass it through to their owners.

5. Often, owners of pass-through entities are other pass-through entities, which, in turn, may be owned by still other pass-through entities. This makes it difficult to ascertain whether individual credit claims are valid without further review of multiple pass-through entities' tax returns. Also, with this arrangement, the tax benefits only indirectly assist the business entity that received certification from WEDC and conducted the eligible activities. These concerns would be eliminated if the tax credits were replaced with a grant program.

6. Tax credits require DOR to process additional information on tax returns and impose additional record-keeping and filing requirements on claimants. In addition, the current arrangement makes it difficult to track the usage of the existing tax credits. Converting the credits to grants would eliminate these inefficiencies. A direct grant program would also eliminate the possibility of fraudulent claims for tax credits being filed.

7. Furthermore, the tax credit process may have cash flow implications for eligible claimants. After a business is certified for tax benefits by WEDC, several years may pass before WEDC verifies that the business has completed the required activities, and additional time may elapse before the credit is actually claimed on a tax return. When claimed, DOR will not be directly aware of that claimant's performance under its contract with WEDC.

8. Under current law, funding for these tax credits does not appear in WEDC's appropriation schedule, even though WEDC is responsible for nearly all aspects of awarding the credits. The estimated amount appropriated for these credit claims was $100.8 million in 2020-21. Further, the amount appropriated under 2019 Act 9 for the EITM zone tax credit was $212.0 million in 2020-21. These amounts are far larger than WEDC's base funding level for its operations and other economic development programs ($41,550,700 all funds annually).

9. Instead, the costs of the business development credit, EITM zone credit, and enterprise

zone credit appear in separate GPR appropriations under "Shared Revenue and Tax Relief" in the schedule of appropriations. However, appropriations under Shared Revenue and Tax Relief are primarily aids to counties and municipalities and are not related to tax credits for businesses. The following table shows the current sum sufficient estimates for WEDC-administered tax credits. A total of $312.8 million had been appropriated for these three credits for 2020-21. As reestimated under LFB paper #102 (sum sufficient estimates), the estimated cost of the credits is $129.9 million for 2021-22 and $93.1 million for 2022-23.

Appropriated Amounts for WEDC-Administered Refundable Business Tax Credits under Shared Revenue and Tax Relief

	Estimated Cost of Tax Credit Claims	
	2021-22	2022-23
Business Development	$12,900,000	$14,700,000
Enterprise Zone	87,900,000	70,100,000
EITM Zone	29,060,000	8,325,000
Total	$129,860,000	$93,125,000

10. The budgetary impact of WEDC's activities would be more transparent if the funding for these programs was appropriated to WEDC and paid to businesses by WEDC. For example, WEDC recently negotiated a contract amendment for the $2.85 billion EITM zone tax credit award, which reduced the total credit award to $80 million. The change of $2.77 billion will not be reflected in any way within WEDC's appropriation schedule.

11. Options for replacing the refundable tax credits administered by WEDC with a revenue-neutral direct grant program are presented below.

12. The first alternative would sunset the existing business development, EITM zone, and enterprise zone credits for taxable years beginning after December 31, 2020. Instead, GPR funding would be provided to WEDC in a new continuing appropriation for economic development grants and payments of claims for business development and enterprise zone tax credits filed after the effective date of the budget bill. WEDC would be authorized to provide grants to eligible businesses under its existing authority to develop and implement economic development programs. Unless otherwise modified by the Committee, the current requirements regarding WEDC's existing grant and loan programs would apply to the new grant program. As described above, these requirements address program goals, benchmarks, performance measures, evaluations, reports and supporting documents, contracts, CPA review, and penalties.

For EITM zone grants, a separate continuing appropriation would be created for this program. The payroll credit and capital expenditure credit percentages would remain as defined under current law and apply for EITM zone grants. WEDC could not designate more than one EITM zone (which cannot remain in effect for more than 15 years).

As with the existing tax credits, WEDC could structure the grant program to provide funding to eligible recipients only after required activities have been completed. As part of this alternative, WEDC's current FED sum sufficient appropriation could supplement these grant programs, to the extent authorized under federal law.

13. The second alternative is the same as the first, except that it would require the new grants to be based on the existing criteria and procedures for the enterprise zone and business development tax credit programs, similar to how the EITM zone grant program would be treated under Alternative 1.

14. Third, the Committee could retain the current business development, EITM zone, and enterprise zone tax credits, but require WEDC to pay credit claims directly to the business entity that is eligible for the credit rather than requiring that claims be filed with DOR. Payments would be made to eligible C corporations, pass-through entities, and sole proprietors from GPR appropriations for these tax credits using policies and procedures developed by the WEDC Board. The main advantage of this approach is that WEDC would make a single payment to eligible pass-through entities rather than having multiple individual owners file relatively small credit claims with DOR. This would reduce the potential for fraudulent claims and significantly decrease paperwork and processing requirements for these credits. It would also enhance transparency and accountability for these programs and provide the applicable financial benefits directly to the business entity that conducted the eligible activities.

15. Fourth, the Committee could choose to only eliminate the current provisions regarding pass-through entities and, instead, require eligible pass-through entities to file credit claims with DOR and require credit payments to be made directly to the pass-through entity (Alternative 4). As with the preceding option, this alternative would reduce the potential for fraudulent claims and reduce paperwork and processing requirements for these credits. It would also provide the financial benefits directly to the business entity that conducted the eligible activities to determine how best to allocate the tax benefit. As part of this alternative, current law provisions allowing taxpayers to pay tax at the entity level would be amended to enable such filers to claim the refundable credits at the entity level.

16. A potential drawback of having pass-through entities claim the credit is that individual owners of such entities would no longer be able to reduce their estimated tax payments in anticipation of receiving the credit. Thus, the Committee could choose to maintain current law (Alternative 5).

ALTERNATIVES

1. *Convert Business Development, EITM Zone, and Enterprise Zone Credits to WEDC Grants.* Prohibit WEDC from certifying persons for tax benefits under the existing business development, EITM Zone, and enterprise zone tax credit programs after the effective date of the budget bill. Sunset these tax credit payments for taxable years beginning after December 31, 2020. Instead, provide WEDC with $100,800,000 GPR in 2021-22 and $84,800,000 GPR in 2022-23 in a new continuing appropriation for payments of claims for business development and enterprise zone tax credits and grants made after the bill's effective date, and for direct economic development grants under WEDC's existing authority to develop and implement economic development programs. Provide WEDC with $29,060,000 GPR in 2021-22 and $8,325,000 GPR in 2022-23 in a new continuing appropriation for payments of claims for EITM Zone tax credits and grants made after the

bill's effective date.

Specify that current provisions (except as otherwise modified by the Committee) regarding WEDC economic development program goals, benchmarks, performance measures, evaluations, reports and supporting documents, contracts, CPA review, and penalties would apply to the new grant program. Further, specify that current law provisions regarding the EITM Zone tax credit program would apply to the EITM Zone grant program. Require any claims for business development, EITM Zone, and enterprise zone tax credits made after August 31, 2021, to be made to WEDC rather than to DOR, and require WEDC to pay the credit claims from the new GPR appropriation. Require DOR to refer new credit claims to WEDC beginning on the effective date of the bill. Repeal the current appropriations under Shared Revenue for the business development tax credit, EITM Zone tax credit, and enterprise zone tax credit after 2021-22. Specify that the amounts provided under WEDC's new appropriation would be adjusted downward in 2022-23 by any amounts spent under the current appropriations under Shared Revenue and Tax Relief in 2021-22.

Also, direct that any SFRF monies received under ARPA and allocated by DOA for the purpose of supporting the newly transferred business development, EITM Zone, and enterprise zone grant programs be appropriated under WEDC's existing FED sum sufficient appropriation. [The funding amounts identified above are equal to the sum of the revised estimates approved by the Committee under LFB Paper #102. These amounts would be adjusted for other actions of the Committee, such as providing for a new tax credit under the business development tax credit program, as discussed in LFB Paper #332.]

2. *Convert Refundable Credits to Grants Based on Existing Tax Credit Criteria.* Prohibit WEDC from certifying persons for tax benefits under the existing business development, EITM Zone, and enterprise zone tax credit programs after the effective date of the budget bill. Instead, provide WEDC with $129,860,000 GPR in 2021-22 and $93,125,000 GPR in 2022-23 in a new continuing appropriation for payments of claims for business development, EITM zone, and enterprise zone tax credits and grants made after the bill's effective date and for direct economic development grants under WEDC's existing authority to develop and implement economic development programs. Sunset the business development, EITM Zone, and enterprise zone tax credits for taxable years beginning after December 31, 2020.

Convert the existing statutes regarding these tax credits to direct grant programs. Specify that enterprise zone and EITM zone grants could only be provided to businesses operating in geographical zones designated by WEDC under the existing criteria and procedures for enterprise zone and EITM Zone tax credits. Allow business development grants to be provided statewide using the existing criteria and procedures for the business development tax credit. Require any claims for business development, EITM Zone, and enterprise zone tax credits made after August 31, 2021, to be made to WEDC rather than to DOR and require WEDC to pay the credit claims from the new GPR appropriation. Eliminate the current appropriations for the three tax credits after 2021-22. Specify that the amounts provided under WEDC's new appropriation would be adjusted downward in 2022-23 by any amounts spent under the current appropriations under Shared Revenue and Tax Relief in 2021-22.

Also, direct that any SFRF monies received under ARPA and allocated by DOA for the purpose of supporting the newly transferred business development, EITM Zone, and enterprise zone grant programs be appropriated under WEDC's existing FED sum sufficient appropriation. [The funding amounts identified above are equal to the sum of the revised estimates approved by the Committee under LFB Paper #102. These amounts would be adjusted for other actions of the Committee, such as providing for a new refundable tax credit under the business development tax credit program, as discussed in LFB Paper #332.]

3. *Transfer Appropriations for, and Administration of, Refundable Credits to WEDC.* Maintain the current business development, EITM Zone, and enterprise zone credits, but transfer the existing GPR appropriations for these programs to WEDC and require that credit claims be filed with, and paid by, WEDC, using policies and procedures developed by the WEDC Board, for credit claims made after the effective date of the bill. Provide under WEDC's appropriations, rather than under "Shared Revenue and Tax Relief," $129,860,000 GPR in 2021-22 and $93,125,000 GPR in 2022-23 for the transferred sum sufficient tax credit appropriations. Repeal the existing tax credit appropriations after 2021-22.

Specify that this provision would first apply to credit claims filed on September 1, 2021. In addition, require credits earned by pass-through entities to be claimed by, and paid to, the business entity, instead of the individual owners of the business, effective with credits earned by pass-through entities for taxable years beginning after December 31, 2020. Specify that pass-through entities electing to pay tax at the entity level pursuant to 2017 Act 368 may claim the credits. For credits earned on or after that date, prohibit partners of a partnership, members of LLCs, and shareholders of S corporations from claiming the credits individually. Specify that credits that have been revoked or that are otherwise invalid may be recovered from either the pass-through entity or the individual owners of the entity. [The funding amounts identified above are equal to the revised estimates approved by the Committee for the business development, EITM zone, and enterprise zone tax credits under LFB Paper #102. These amounts would be adjusted for other actions of the Committee, such as providing for a new tax credit under the business development tax credit program, as discussed in LFB Paper #332.]

4. *Require Pass-through Entities to Claim Credits Directly.* Effective with credits earned by pass-through entities in taxable years beginning on January 1, 2021, eliminate the current provisions of the refundable business development, EITM Zone, and enterprise zone tax credits regarding pass-through entities. Instead, require eligible pass-through entities to file claims for these credits with DOR, and require that credit payments be made directly to the pass-through entity. Specify that pass-through entities electing to pay tax at the entity level pursuant to 2017 Act 368 may claim the credits. Prohibit partners of a partnership, members of LLCs, and shareholders of S corporations from claiming the credits individually. Specify that credits that have been revoked, or that are otherwise invalid, may be recovered from either the pass-through entity or the individual owners of the entity.

5. Take no action.

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June, 2021 Joint Committee on Finance Paper #334

Earned Income Tax Credit Reestimate
(General Fund Taxes -- Refundable Credits and Other Payments)

[LFB 2021-23 Budget Summary: Page 224, #2]

CURRENT LAW

The earned income tax credit (EITC) is offered at both the federal and state levels as a means of providing assistance to lower-income workers. The state EITC is calculated as a percentage of the federal credit. The state, therefore, uses federal definitions and eligibility requirements for purposes of the EITC, except that the state does not provide a credit to individuals without children. Both the federal and state credits are refundable, such that if the credit exceeds the amount of tax due, a check is issued for the difference.

The credit is calculated based on family size, filing status, and the amount of the claimant's earned income (although the credit can also be affected by adjusted gross income). Individuals without earned income are not eligible for the credit. The income limits and maximum federal credit amounts are adjusted annually for changes in inflation.

The state EITC is funded with a combination of GPR and federal temporary assistance for needy families (TANF) block grant funding transferred from the Department of Children and Families (DCF). TANF regulations allow states to use TANF funds to support the refundable portion of the state EITC. The GPR portion is provided through a sum sufficient appropriation and covers the balance of the cost of the credit. Base funding for the credit in 2020-21 is $95.9 million ($26.2 million GPR and $69.7 million PR from TANF). Under LFB Paper #102, total funding for the current law credit was estimated at $98.2 million in 2021-22 and $98.6 million in 2022-23.

MODIFICATION

Reestimate the total amount of credit payments at $86,000,000 in 2021-22 and $90,000,000 in

2022-23, which represent decreases of $12,200,000 in 2021-22 and $8,600,000 in 2022-23 relative to the base level, as modified by prior actions of the Committee. Estimate the amount of the GPR appropriation at $22,400,000 in 2021-22 and $23,400,000 in 2022-23 to reflect this reestimate. Set the amount of federal TANF funds transferred by DCF to $63,600,000 in 2021-22 and $66,600,000 in 2022-23 to reflect this reestimate.

Explanation: The modification reflects the change to base level funding as modified by sum sufficient appropriation estimates adopted under earlier actions of the Committee, and reflects estimated decreases in total credit funding relative to these estimates of 12.4% in 2021-22 and 8.7% in 2022-23. The modification would reduce the cost of the credit by $6,100,000 GPR and $6,100,000 PR in 2021-22 and $5,500,000 GPR and $3,100,000 PR in 2022-23. The modification is based on more recent claims data for tax year 2020. The TANF appropriation amounts are based on historical data regarding the percentage of EITC claims that is refunded to the claimant (74% in recent fiscal years).

	Change to Base
GPR	-$11,600,000
PR	-9,200,000
Total	-$20,800,000

Prepared by: Dan Spika

General Fund Taxes -- Refundable Tax Credits and Other Payments

LFB Summary Items for Which No Issue Paper Has Been Prepared

Item #	Title
18	Refundable Tax Credits for Pass-Through Entities