



Legislative Fiscal Bureau

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May 6, 2014

TO: Members
Joint Committee on Finance

FROM: Ron Shanovich, Fiscal Analyst

SUBJECT: Reallocation of Early Stage Business Investment Tax Credits -- Agenda Item X

REQUEST

The Wisconsin Economic Development Corporation (WEDC) requests that \$10,000,000 in unallocated early stage business investment tax credits be reallocated for use as jobs tax credits under s. 238.15 (3) (d) of the statutes.

BACKGROUND

Early Stage Business Investment Tax Credits. The early stage business investment program includes the angel investment tax credit, which can be claimed under the state individual income tax, and the early stage seed investment tax credit, which can be claimed under the state individual income and corporate income and franchise taxes, and the insurance premiums tax.

Angel Investment Tax Credit. The angel investment tax credit equals 25% of the claimant's bona fide angel investment made directly in a qualified new business venture (QNBV) certified by WEDC. The maximum aggregate amount of angel investment tax credits that can be claimed for a tax year is \$20 million, plus an additional \$250,000 for tax credits claimed for investments in nanotechnology businesses.

Early Stage Seed Investment Tax Credit. The early stage seed investment tax credit is equal to 25% of the claimant's investment paid in the tax year to a certified fund manager that the fund manager invests in a QNBV certified by WEDC. The maximum aggregate amount of early stage seed investment tax credits that can be claimed for a tax year is \$20.5 million, plus an additional \$250,000 for tax credits claimed for investments in nanotechnology businesses.

If the demand for angel or early stage seed investment tax credits exceeds the annual aggregate limit, WEDC may reserve tax credits from the following year for qualifying investments.

Conversely, the Corporation, in consultation with DOR, is authorized to carry forward unclaimed angel and early stage investment tax credits to future tax years.

WEDC can also reallocate unused angel and early stage seed investment tax credit amounts to increase the credit amounts that may be claimed under the refundable jobs tax credit. The proposed reallocation is subject to a 14-day passive review by the Joint Committee on Finance.

Jobs Tax Credit. A refundable tax credit can be claimed under the state individual income and corporate income and franchise taxes, for up to 10% of the eligible wages paid to an eligible employee and/or the amount of costs incurred to undertake training activities in a tax year, as determined by WEDC. Specifically, WEDC can award tax benefits equal to the lesser of 10% of the wages paid to an employee or \$10,000, if the employee earned wages in the year for which the tax credit is claimed equal to one of the following: (1) at least the amount determined by multiplying 2,080 by 150% of the federal minimum wage (\$22,620) in a tier I county or municipality; or (2) at least \$30,000 in a tier II county or municipality. WEDC can also award tax credits in an amount determined by the Corporation for costs incurred to undertake training activities in a tier I or tier II county or municipality that: (1) improve the job-related skills of any eligible employee; (2) train any eligible employee on the use of job-related new technologies; or (3) provide job-related training to any eligible employee whose employment represents the employee's first full-time job. Eligible training costs include: (1) cost of the trainer; (2) cost of the training materials; (3) wages of the trainee in a classroom setting; and (4) either the cost of the trainer or wages of the trainee in an on-the-job or job shadowing setting. Eligible training costs do not include travel expenses, food, and lodging.

In order to claim the credit, a claimant must be certified by WEDC. The Corporation may certify a claimant to receive tax credits for up to 10 years if: (1) the person is operating, or intends to operate a business in this state; and (2) the person applies and enters into a contract with WEDC, prior to certification of tax credits, that includes penalties for non-compliance. A person that is certified can only receive tax credits for each year that the following apply: (1) the person increases net employment in Wisconsin in the business above the net employment in Wisconsin during the year before the business was certified ; (2) the person pays the eligible employee the required wages for a tier I (2,080 x 150% of the federal minimum wage) or tier II (\$30,000) county or municipality and/or provides the required training to an employee in a tier I or tier II county or municipality. The Corporation must also issue a notice of eligibility to receive tax benefits that reports the amount of tax benefit for which the claimant is eligible . A business is required to maintain for five years any positions for which credits are claimed, and may be required to repay any tax credits claimed for a year in which the claimant fails to maintain employment at a level required under the contract with the Corporation.

The maximum amount of tax credits that WEDC can allocate in a calendar year is \$10 million. As noted, WEDC is also authorized to reallocate angel investment and early stage seed investment tax credits that are unused in any calendar year to persons eligible for the jobs tax credit, subject to 14-day passive review by the Joint Committee on Finance. These reallocated amounts are not subject to the \$10 million annual limit on jobs tax credit claims.

ANALYSIS

The angel investment tax credit was created by 2003 Wisconsin Act 255. The credit could be claimed under the individual income tax, and was equal to 12.5% of the claimant's bonafide angel investment made directly in a QNBV. The 12.5% credit could be claimed for two years. The maximum aggregate amount of angel investment tax credits that could be claimed for a tax year was \$3.0 million, and the maximum total amount of angel credits that could be claimed was \$30.0 million. The early stage seed credit was also created by Act 255. The maximum amount of early stage seed investment tax credits was set at \$3.5 million for each tax year, and \$35 million in total. Since being enacted, both credits have been modified and increased several times. The angel investment tax credit was consolidated into the current credit of 25% of eligible investments made in the tax year under 2009 Wisconsin Act 2. Under provisions of 2009 Wisconsin Act 265, the maximum annual amount of angel and early stage seed investment tax credits that could be claimed in a tax year were increased to \$20 and \$20.5 million, respectively. The total credit limit of \$52.5 million for early stage seed investment credits was eliminated by Act 2, while the total limit of \$47.5 million on angel investment tax credits was eliminated by 2013 Wisconsin Act 20.

2009 Act 265 also included the statutory provision that allows WEDC to reallocate unused early stage business investment tax credits, in any year, to persons eligible for jobs tax credits, subject to 14-day passive review by the Joint Committee on Finance. Since the authority to reallocate unused early stage business investment credits was enacted in May, 2010, unused credits have been reallocated three times under the passive review process. Specifically, \$3,091,400 was reallocated in 2010 (from 2009), \$6,836,300 was reallocated in 2011 (from 2010), and \$7,000,000 was reallocated in January 2013 (from 2011).

Attachment 1 shows the amount of early stage business investment tax credits authorized, verified, carried over to future years and reallocated for the jobs tax credit (including the current request of \$10 million to be reallocated from 2012). The attachment shows that, historically, the amount of early stage seed investment credits verified has been substantially less than the annual amount authorized. In addition, the increased statutory annual limits of \$20 and \$20.5 million for the angel and early stage seed credits are likely to continue to generate large annual amounts of unused credits.

The jobs tax credit is a refundable tax credit and is based on the amount of eligible wages paid or training costs incurred in the tax year. However, jobs tax credits are generally allocated over a number of years, up to a maximum of 10 years, although most allocations are for five years or less. Training and job creation usually occur over a number of years. Allocations are based on the expected number of jobs created, quality of jobs, number of employees receiving training, and the type of training, and similar factors. Annual allocations are governed by the \$10 million annual limit on jobs tax credits to ensure that actual credit claims do not exceed the limit. Over \$83 million in jobs tax credits has been allocated to 52 businesses from 2010 through 2023. Amounts allocated to each business range from \$89,000 to \$4.5 million, with an average allocation of about \$1.6 million.

Businesses are required to submit annual project reports documenting expenditures, job

creation, as well as other contract deliverables. WEDC verifies the annual performance information submitted by the business. The verified information is the basis on which the notice of eligibility and amount of tax benefits is determined. Actual credits claimed can vary from amounts originally allocated.

Attachment 2 shows information about current annual jobs tax credit allocations for 2010 through 2023, including credit allocations, early stage business credit reallocations, annual jobs credit limits, and the amount of reallocated credits used. Any unused annual jobs tax credit allocations expire at the end of each year. However, reallocated early stage business investment credits are carried forward if not fully allocated in any given year. The attachment shows that total jobs tax credits allocated for 2014 through 2016 exceed the \$10 million annual limit by \$10,760,800. In addition, the allocation for 2012 exceeded the \$5 million annual limit by \$1,241,400. (For 2010 through 2012 the total amount of credits that could be claimed was limited to \$14.5 million, and \$5 million annually.) A total of \$16,927,700 in unused early stage business tax credits have been reallocated. As a result \$4,925,500 in reallocated credits will remain after credits in excess of the annual limits are offset. This is all that would be available for any additional jobs tax credit applications for 2014 through 2016, unless a reallocation of unused early stage business investment tax credits is approved. Approval of the request would allow over \$14.9 million to be allocated through 2016 (through this amount could be increased if future transfers were approved by Joint Finance).

Economic development research indicates that it is difficult to determine if an incentive will prove decisive in business expansion and location decisions. One study found that a tax reduction was effective in three out of 10 business location decisions (Fisher and Peters, 2002). From this perspective, it could be argued that limiting available jobs credits to the \$4.9 million remaining reallocated early stage business credits will ensure that WEDC provides credits to projects that most require the tax benefits to proceed. However, in awarding all jobs tax credits, WEDC is required to consider whether the project might not occur without the tax credits. In addition, jobs credits can only be claimed for net increases in employment and actual training expenses. Limiting available credits could reduce the number of jobs that otherwise might be created in the state.

FISCAL EFFECT

Under the request, \$10,000,000 in unused early stage business investment tax credits would be reallocated in 2014 for jobs tax credits. In order to claim jobs credits based on the reallocated credits, businesses would be required to apply to WEDC, be certified, hire new employees and make the eligible expenditures, submit documentation to WEDC, and receive notice of eligibility from the Corporation, and file a tax return claiming the credits. In addition, credit allocations would be spread over a number of years. Based on the projected timing of these jobs tax credit claims, the estimated fiscal effect for 2014-15 would be minimal. However, since the jobs tax credit is refundable, the reallocated credits would increase GPR expenditures by \$10 million in future years.

ALTERNATIVES

1. Approve the WEDC request to reallocate \$10 million in early stage seed investment tax credits for use as jobs tax credits.
2. Deny the request.

Prepared by: Ron Shanovich
Attachments

ATTACHMENT 1

May 2014 Early Stage Business Tax Credits

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013*</u>
<i>Angel Investment Tax Credit</i>									
Annual Limit	\$3,000,000	\$3,000,000	\$3,000,000	\$5,500,000	\$5,500,000	\$6,500,000	\$20,000,000	\$20,000,000	\$20,000,000
Prior Year Carryover	<u>0</u>	<u>0</u>	<u>0</u>	<u>949,500</u>	<u>3,343,600</u>	<u>2,997,500</u>	<u>3,074,700</u>	<u>16,374,000</u>	<u>28,165,400</u>
Total Available	\$3,000,000	\$3,000,000	\$3,000,000	\$6,449,500	\$8,843,600	\$9,497,500	\$23,074,700	\$36,374,000	\$48,165,400
Verified Credits	<u>2,989,800</u>	<u>2,418,200</u>	<u>2,050,500</u>	<u>3,105,900</u>	<u>5,529,200</u>	<u>5,032,200</u>	<u>6,700,700</u>	<u>8,208,600</u>	<u>5,449,500</u>
Balance Available	\$10,200	\$581,800	\$949,500	\$3,343,600	\$3,314,400	\$4,465,300	\$16,374,000	\$28,165,400	\$42,715,900
Reallocated for Jobs Tax Credit	0	0	<u>0</u>	<u>0</u>	<u>316,900</u>	<u>1,390,600</u>	<u>0</u>	<u>0</u>	<u>0</u>
Remaining Carryforward	0	0	\$949,500	\$3,343,600	\$2,997,500	\$3,074,700	\$16,374,000	\$28,165,400	\$42,715,900
<i>Early Stage Seed Investment Tax Credit</i>									
Annual Limit	\$3,500,000	\$3,500,000	\$3,500,000	\$6,000,000	\$6,000,000	\$8,000,000	\$20,500,000	\$20,500,000	\$20,500,000
Prior Year Carryover	<u>0</u>	<u>0</u>	<u>0</u>	<u>899,800</u>	<u>2,615,300</u>	<u>2,615,300</u>	<u>2,602,800</u>	<u>11,481,100</u>	<u>18,173,600</u>
Total Available	\$3,500,000	\$3,500,000	\$3,500,000	\$6,899,800	\$8,615,300	\$10,615,300	\$23,102,800	\$31,981,100	\$38,673,600
Verified Credits	<u>125,500</u>	<u>1,423,400</u>	<u>2,600,200</u>	<u>4,284,500</u>	<u>3,225,500</u>	<u>2,566,800</u>	<u>4,621,700</u>	<u>3,807,500</u>	<u>2,784,100</u>
Balance Available	\$3,374,500	\$2,076,600	\$899,800	\$2,615,300	\$5,389,800	\$8,048,500	\$18,481,100	\$28,173,600	\$35,889,500
Reallocated for Jobs Tax Credit	0	0	<u>0</u>	<u>0</u>	<u>2,774,500</u>	<u>5,445,700</u>	<u>7,000,000</u>	<u>10,000,000**</u>	<u>0</u>
Remaining Carryforward	0	0	\$899,800	\$2,615,300	\$2,615,300	\$2,602,800	\$11,481,100	\$18,173,600	\$35,889,500
Total ESBTC Carryforward	\$0	\$0	\$1,849,300	\$5,958,900	\$5,612,800	\$5,667,500	\$27,855,100	\$46,339,000	\$78,605,400

*Preliminary, likely to be revised.

**Current request.

ATTACHMENT 2

May 2014 Jobs Tax Credit Allocation

<u>Year</u>	<u>Annual Limit</u>	<u>Allocated Credits</u>	<u>Annual Balance</u>	<u>Reallocated Credits</u>	<u>Including Reallocated Credit Balance</u>
2010*	\$5,000,000	\$1,871,500	\$3,128,500	\$0	\$0
2011*	5,000,000	4,673,000	327,000	3,091,400	3,091,400
2012*	5,000,000	6,241,400	-1,241,400	6,836,300	8,686,300
2013	10,000,000	7,350,700	2,649,300	7,000,000	15,686,300
2014	10,000,000	11,648,500	-1,648,500	0	14,037,800
2015	10,000,000	14,837,700	-4,837,700	0	9,200,100
2016	10,000,000	14,274,600	-4,274,600	0	4,925,500
2017	10,000,000	8,002,800	1,997,200	0	
2018	10,000,000	6,094,900	3,905,100	0	
2019	10,000,000	2,531,500	7,468,500	0	
2020	10,000,000	2,477,700	7,522,300	0	
2021	10,000,000	1,472,000	8,528,000	0	
2022	10,000,000	860,300	9,139,700	0	
2023	10,000,000	677,000	9,323,000	0	

*Credits were subject to \$5 million annual limit, up to a total of \$14.5 million for 2010 to 2012.