Legislative Fiscal Bureau
One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873
Email: fiscal.bureau@legis.wisconsin.gov • Website: http://legis.wisconsin.gov/lfb

2017 Joint Committee on Finance Paper #293

Potential Changes Regarding Refundable Business Tax Credits
(General Fund Taxes -- Income and Franchise Taxes)

[LFB 2017-19 Budget Summary: Page 181, #15; Page 182, #17; Page 183, #18, Page 184, #20]

CURRENT LAW

Business Tax Credits

Under current law, the Wisconsin Economic Development Corporation (WEDC) is responsible for allocating tax benefits under the business development tax credit and the enterprise zone tax credit programs. Both of these credits are refundable. If the amount of 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.

Beginning in calendar year 2017, there is an annual cap of $22 million on the amount of business development tax credits that WEDC may allocate; however, WEDC may reallocate unused angel and early stage seed investment credits to the business development credit, with approval of the Joint Committee on Finance. There are no annual or aggregate limits on the amount of enterprise zone tax credits that WEDC may award.

Business development credits may be awarded throughout the state. Enterprise zone credits may be awarded only to businesses that conduct specified economic activities in geographical zones designated by WEDC. Current law allows WEDC to designate up to 30 enterprise zones. Although WEDC is responsible for allocating the tax credits to eligible businesses, the credits must be claimed on tax returns filed with the Department of Revenue (DOR).

Pass-through entities (partnerships, limited liability companies, and tax-option corporations) may not claim the credits directly, but the eligibility for, and the amount of, the credit are 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, members of limited liability companies, and shareholders of tax-option corporations may claim the credit in proportion to their ownership interest.

Other Economic Development Programs

In addition to allocating tax credits, the WEDC Board of Directors is required to develop and implement economic programs to provide business support and expertise and financial assistance to companies that are investing and creating jobs in Wisconsin and to support new business start-ups and business expansion and growth in Wisconsin. The Board may also develop and implement any other programs related to economic development in Wisconsin. Budgeted revenues available in 2016-17 for WEDC's administration and economic development programs total $39.3 million ($12.5 million GPR, $22.8 million SEG, and $4.0 million from revenue sources other than state appropriations). In addition to this funding, it is anticipated that WEDC will spend $10.8 million in 2016-17 from a fund balance that accumulated in prior years.

For each of WEDC's programs, the Board must establish clear and measurable goals that are tied to statutory or programmatic policy objectives and establish at least one quantifiable benchmark for each program goal. The Board must also establish a method for evaluating the projected results of the program with actual outcomes, as determined by evaluating these goals and benchmarks.

Further, the Board must require that each recipient of a grant or loan under the program submit a report. Each contract with a recipient must specify the frequency and format of the report and the performance measures to be included in the report. The Board must also establish a method for evaluating the projected results of the program with actual outcomes as determined by evaluating the information annually and independently verify, from a sample of grants and loans, the accuracy of the information required to be reported.

The Board must require that each recipient of a grant or loan of at least $100,000 submit, within 120 days after the end of the recipient's fiscal year in which any grant or loan funds were expended, a schedule of expenditures of the grant or loan funds, including expenditures of any matching cash or in-kind match, signed by the director or principal officer of the recipient to attest to the accuracy of the schedule of expenditures.

Such recipients must engage an independent certified public accountant (CPA) to perform procedures, approved by WEDC and consistent with applicable professional standards of the American Institute of CPAs, to determine whether the grant or loan funds and any matching cash or in-kind match were expended in accordance with the grant or loan contract. The Board must also require the recipient of such a grant or loan to make available for inspection the documents supporting the schedule of expenditures. The Board must include these requirements in the grant or loan contract.

In addition, if a recipient of a grant or loan under the program submits false or misleading information or fails to comply with the terms of a grant or loan contract, without providing a satisfactory explanation for the noncompliance, the Board must recoup payments made to the recipient, withhold future payments, and impose a financial penalty on the recipient.

GOVERNOR

The bill would provide estimated funding of $24,250,000 GPR in 2017-18 and $22,000,000 GPR in 2018-19 for the business development credit and $37,600,000 GPR in 2017-18 and $36,900,000 GPR in 2018-19 for the enterprise zone tax credit. The bill would also modify the statutes regarding reallocations of unused angel and early stage seed investment credits to the business development credit and allow WEDC to re-designate enterprise zones that have expired or been cancelled by WEDC.

LFB Papers #297 and #294 address budget related issues regarding the business development tax credit and enterprise zone tax credit, respectively. The estimated funding level for the enterprise zone tax credit was revised higher in 2018-19 to $43,000,000 GPR under LFB Paper #295.

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 credit and enterprise zone 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.

3. As noted, the business development credit and enterprise zone credit are refundable. Refundable tax credits are not affected by a claimant's tax liability and are recorded as state expenditures, instead of as revenue offsets. Therefore, they are very similar to grants in this respect as well. According to DOR, in tax years 2012 and 2013, claims for WEDC-certified refundable credits totaled $88.1 million. Of this amount, $11.2 million (12.7%) was used to offset the claimants' tax liability and $76.9 million (87.3%) was refunded to the claimants.

4. After a person is certified for tax benefits by WEDC, several years may pass before WEDC verifies that the person has completed the required activities, and additional time may elapse before the credit is actually claimed on a tax return. In fiscal year 2015-16, WEDC entered into contracts to award refundable tax credits totaling $45.8 million, which can be earned and claimed

over the next several years. When a tax credit is verified by WEDC, a business (or its owners) may or may not reduce their quarterly estimated tax payments in anticipation of receiving the credit. These factors make it difficult to determine when and by how much the tax credits will affect state revenues and expenditures. In addition, the enterprise zone credit program is funded with a sum sufficient appropriation, and there are no annual or aggregate limits on the amount of credits that WEDC may authorize. A grant program with specific annual funding amounts would provide more certainty in budgeting.

5. The difficulty in budgeting for the current credits is evident in recent estimates of expenditures under of the enterprise zone program. In January, 2017, program expenditures were estimated at $31.9 million GPR in 2016-17, a decrease of 45.6% from the previous estimate of $58.6 million for that year. The prior estimate was prepared one year earlier, in January of 2016.

6. Tax credits require DOR to process additional information on tax returns, impose additional record-keeping and filing requirements on claimants, and also may have cash flow implications for 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. 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. Instead, the costs of the enterprise zone credit and the business development credit appear in separate GPR appropriations under "Shared Revenue and Tax Relief" in the appropriation schedule. The value of these credits exceeds $60 million per year and is larger than WEDC's base funding level for its operations and other economic development programs. The budgetary impact of WEDC's activities would be more transparent if the existing tax credits were converted to grants.

8. In recent years, in an effort to simplify state tax laws, the Legislature has repealed a number of business tax credits, converted one tax credit to a grant program, and amended a number of state tax provisions so that they now conform to federal law. Converting additional tax credits to direct grants would continue the state's progress toward tax simplification.

9. The existing tax credits may be claimed if pass-through entities conduct eligible economic activities in the state. However, 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 tax returns. 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.

10. As noted, the current enterprise zone program does not have any annual or aggregate limits on the amount of tax benefits that may be awarded. This provides a great deal of flexibility

for WEDC in allocating tax benefits. Although it would result in greater certainty in preparing the state budget, a direct grant program with specific funding amounts would reduce this flexibility. Further, because several years may pass between the time when a business is certified to receive tax benefits and when the tax credits are actually claimed, the use of a grant program with specific funding amounts could make it more difficult for WEDC to manage these programs. However, both of these concerns could be addressed by using a sum sufficient appropriation to fund the grants.

11. Four 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 and enterprise zone credits. In addition, the budget bill provisions allowing re-designation of expired or cancelled enterprise zones would be deleted. Instead, GPR funding would be provided to WEDC in a new continuing appropriation for economic development grants and payments of claims for business development tax credits or enterprise zone 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. 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.

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.

14. The third and fourth alternatives are the same as the first two, except that the grants would be funded with a sum sufficient appropriation instead of a continuing appropriation.

15. An additional option would be to retain the current enterprise zone and business development programs as tax credits, but require WEDC to pay credit claims directly to the business entity that is eligible for the credit rather than requiring claims be filed with DOR. Payments would be made to eligible C-corporations, pass-through entities, and sole proprietors from the existing 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.

16. A final option would be to 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. 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.

17. A potential drawback of having pass-through entities claim the credit directly (under the last two alternatives) is that individual owners of such entities would no longer be able to reduce their estimated tax payments in anticipation of receiving the credit.

ALTERNATIVES

1. Prohibit WEDC from certifying persons for tax benefits under the existing business development tax credit and enterprise zone tax credit programs after the effective date of the budget bill. Delete the provisions of the bill that would allow WEDC to re-designate enterprise zones that have been cancelled or have expired. Instead, provide WEDC with $61,850,000 GPR in 2017-18 and $65,000,000 GPR in 2018-19 in a new continuing appropriation for payments of claims for business development and enterprise zone tax credits 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. 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. Require any claims for business development tax credits and enterprise zone tax credits made after August 31, 2017, 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 business development tax credit and enterprise zone tax credit. [The funding amounts identified above are equal to the sum of the appropriations for the business development and enterprise zone credits with the revised estimates described in LFB Paper #295.]

ALT 1	**Change to**	
	Base	**Bill**
Shared Revenue and Tax Relief	- $126,850,000	- $126,850,000
WEDC	126,850,000	126,850,000
Total	$0	$0

2. Prohibit WEDC from certifying persons for tax benefits under the existing business development tax credit and enterprise zones tax credit programs after the effective date of the budget bill. Instead, provide WEDC with $61,850,000 GPR in 2017-18 and $65,000,000 GPR in 2018-19 in a new continuing appropriation for payments of claims for business development and enterprise zone credits made after that date and for direct enterprise zone grants and business development grants. Convert the existing statutes regarding these tax credits to direct grant programs. Adopt the provisions of the bill that would allow WEDC to re-designate enterprise zones that have been cancelled or have expired. Specify that enterprise zone grants could only be provided to businesses operating in geographical zones designated by WEDC under the existing criteria and procedures for enterprise 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 and enterprise zones tax credits made after August 31, 2017,

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 two tax credits. [The funding amounts identified above are equal to the sum of the appropriations under the bill for the business development and enterprise zones credits with the revised estimates described under LFB Paper #295.]

ALT 2	**Change to**	
	Base	**Bill**
Shared Revenue		
and Tax Relief	- $126,850,000	- $126,850,000
WEDC	126,850,000	126,850,000
Total	$0	$0

3. Adopt Alternative 1 with a modification to fund the program with a sum sufficient appropriation instead of a continuing appropriation.

ALT 3	**Change to**	
	Base	**Bill**
Shared Revenue		
and Tax Relief	- $126,850,000	- $126,850,000
WEDC	126,850,000	126,850,000
Total	$0	$0

4. Adopt Alternative 2 with a modification to fund the program with a sum sufficient appropriation instead of a continuing appropriation.

ALT 4	**Change to**	
	Base	**Bill**
Shared Revenue		
and Tax Relief	- $126,850,000	- $126,850,000
WEDC	126,850,000	126,850,000
Total	$0	$0

5. Maintain the current enterprise zone and business development tax credits, but require that credit claims be filed with, and paid by, WEDC from the existing GPR appropriations using policies and procedures developed by the WEDC Board. Specify that this provision would first apply to credit claims filed on August 31, 2017. 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 on January 1, 2018. For credits earned on or after that date, prohibit partners, members of limited liability companies, and shareholders of tax-option corporations from claiming the credits individually. Specify that WEDC may recover such credits that have been revoked or that are otherwise invalid from either the pass-through entity or the individual owners of the entity.

6. Effective with credits earned by pass-through entities in taxable years beginning on January 1, 2018, eliminate the current provisions of the refundable business development tax credit,

enterprise zone tax credit, and jobs tax credit 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. Prohibit partners, members of limited liability companies, and shareholders of tax-option corporations from claiming the credits individually. Specify that DOR may recover credits that have been revoked or that are otherwise invalid from either the pass-through entity or the individual owners of the entity.

7. Maintain current law.

Prepared by: Rob Reinhardt