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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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