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WEDC Tax Credits and Other Economic Development Awards and Reporting Requirements (General Fund Taxes -- Income and Franchise Tax)

[LFB 2019-21 Budget Summary: Page 145, #22; Page 146, #25; and Page 454, #13]

CURRENT LAW

The Wisconsin Economic Development Corporation (WEDC) is a public-private entity created under state law as the state's lead authority in promoting economic development. The WEDC Board of Directors (Board) is required to: (a) develop and implement economic programs to provide business support, expertise, and financial assistance to companies that are investing and creating jobs in Wisconsin; and (b) support new business startups, expansion, and growth in the state. WEDC's economic development programs offer a number of tax credits, loans, grants, and technical assistance programs to eligible Wisconsin companies.

WEDC is responsible for certifying and verifying eligible claimants under certain tax credit programs, including the business development tax credit and enterprise zones tax credit programs, which are described below. WEDC will generally enter into a contract with a business to create or retain jobs 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 the Department of Revenue (DOR).

Enterprise Zone Tax Credit. The enterprise zone tax credit program provides refundable tax credits that can be claimed for eligible expenses for increased employment, retaining employees, employee training, capital investment, and purchases from Wisconsin vendors. A zone designation cannot last more than 12 years. WEDC is responsible for designating enterprise zones, certifying businesses as eligible to receive credits, allocating and verifying tax credits, and performing other general administrative functions related to the enterprise zone program.

The enterprise zone tax credit for job creation can be claimed for a percentage of the increase in wages resulting from creating full-time jobs in the zone. Specifically, the credit is an amount equal to a percentage (up to 7% as determined by WEDC) multiplied by: (a) the number of the claimant's new full-time employees; and (b) the creditable wage amount. New full-time employees are equal to the number of employees in the zone in the taxable year minus the number of employees in the base year (or, if the difference is smaller, the new employees in the state minus base year employees in the state). The creditable wage amount is the average zone payroll minus the average eligible wage amount. The average zone payroll is the total wages of full-time employees employed in the zone whose wages exceed the average eligible wage threshold in the taxable year, excluding wages in excess of $100,000, divided by the number of these full-time employees employed in the zone in the taxable year. The average eligible wage amount is currently $22,620 for Tier 1 and $30,000 for Tier 2 counties and municipalities. Counties and municipalities are designated as Tier 1 or Tier 2 by WEDC, based on certain economic indicators.

The enterprise zone tax credit for job retention can be claimed for an amount equal to the percentage, up to 7% as determined by WEDC, of the claimant's zone payroll (excluding wage amounts that are over $100,000) paid in the tax year to full-time employees who were employed in the enterprise zone in the tax year and whose annual wages were greater than the eligible wage amount (described above). Wages paid to employees that are used to claim the enterprise zone job creation credit cannot be used to claim the job retention credit. In general, the total number of employees must be equal to or greater than the number of employees in the base year.

Business Development Tax Credit. The refundable business development tax credit can be claimed equal to a portion of certain expenses for increased employment, retaining employees, employee training, capital investment, and corporate headquarters location or retention in Wisconsin. WEDC is responsible for certifying businesses as eligible to receive credits, verifying eligible activities to claim credits from 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. Certified businesses can earn a business development tax credit for up to 10% of the amount of wages paid to an eligible employee (full-time job) in a tax year. If the employee is employed in a full-time job at the claimant's business in an "economically distressed area," as determined by WEDC, an additional credit may be awarded for up to 5% of such wages. Further, under WEDC's policies and procedures, a certified business can earn corporate headquarters credits for up to 10% of the annual wages of eligible positions created or retained in connection with a corporate headquarters location or retention in Wisconsin.

GOVERNOR

Specify that a recipient of a WEDC grant, loan, or tax credit may not use the grant, loan, or tax credit to reduce net employment in this state or relocate jobs outside this state.

Further, require recipients of a grant, loan, or tax credit to report to WEDC each full-time job in this state that the recipient eliminates or relocates outside this state within seven business days after the job is eliminated or relocated and describe in detail the circumstances of that job elimination or relocation. The bill would specify that, if extenuating circumstances make it impossible for the recipient to submit the report within seven business days, the recipient may submit the report within 30 days after the full-time job is eliminated or relocated.

DISCUSSION POINTS

1. The Governor's recommended changes are intended to increase accountability and transparency by recipients of state funded grants, loans, and tax credits under WEDC's economic development programs and to prevent recipients of state support from relocating jobs outside the state As stated in the administration's Budget in Brief, "economic development awards should only be used to enhance economic opportunity in Wisconsin."

2. For example, in its May, 2019, audit of WEDC programs (Report 19-6), the Legislative Audit Bureau (LAB) conducted a review of 10 of WEDC's tax credit contracts. In relevant part, LAB found that WEDC "awarded $462,000 in tax credits for creating jobs to one recipient that created 66 jobs in the first two years of [the] contract but then lost 83 jobs in the third year, for a net loss of 17 jobs." The recipient was contractually required to maintain all existing and newly created jobs over the 60 consecutive months of the contract. As of February, 2019, WEDC had not revoked the $462,000 in tax credits, even though the contract ended in October, 2017.

3. Report 19-6 also indicated that WEDC did not consistently comply with statutes and its contracts because it "awarded tax credits to recipients that created or retained jobs filled by individuals who did not perform services in Wisconsin or were non-Wisconsin residents."

4. The Joint Committee on Finance could approve the Governor's recommendation and prohibit WEDC economic development award recipients from using those awards to reduce net employment in Wisconsin or to relocate jobs outside the state (Alternative 1). Under this alternative, recipients would be required to report to WEDC each full-time job in this state that the recipient eliminates or relocates and describe in detail the circumstances of that job elimination or relocation for further consideration by WEDC's Board.

5. Further, based on the concerns raised in Report 19-6, the Committee could also modify the bill to clarify that: (a) business development tax credits may not be awarded for jobs filled by individuals performing services outside of Wisconsin; and (b) WEDC may not certify a business to claim tax benefits under the enterprise zone program for services performed outside this state (Alternative 2).

6. In Report 19-6, LAB noted that the statutes related to the business development tax credit program do not specifically require services to be performed in Wisconsin. Current law states only that WEDC may award business development tax credits for wages paid to an "eligible employee,"

which is defined as a person employed in a full-time job by a person certified for the credit. Thus, WEDC stated in its response to Report 19-6 that it may award business development tax credits to recipients for creating or retaining jobs filled by individuals who perform services outside of Wisconsin.

7. Examples of such situations may include employees paid by businesses located within Wisconsin, but who are physically located outside the state due to various reasons such as business travel by a salesmen, being embedded within a customer worksite, or working remotely from a residence outside the state.

8. Report 19-6 found that WEDC's Board approved policies for the business development tax credit program that allow WEDC to award tax credits to recipients based on the wages of employees that do not perform services in Wisconsin. For example, according to Report 19-6, WEDC awarded a recipient a total of $5,500 in business development tax credits in April, 2018, for one job filled by an individual in Texas and another job filled by an individual in Arizona.

9. LAB identified that the Legislature could modify the statutes relating to the business development tax credit program to require WEDC to award program tax credits to recipients for creating or retaining jobs filled only by individuals performing services in Wisconsin.

10. Further, Report 19-6 found that WEDC's written procedures for the enterprise zone tax credit program allow WEDC to award tax credits for "any employee that does not live in Wisconsin and is designated as 'remote,' 'working at home,' or 'sales'" as long as these employees are paid out of a location within an enterprise zone. For example, in September 2018, WEDC determined that a recipient had created 967 jobs, including 261 jobs filled by individuals who lived in 36 states not contiguous with Wisconsin. Based on its written procedures, WEDC awarded this recipient $61,100 in job creation tax credits for these 261 jobs. LAB questioned whether these individuals actually performed services in the enterprise zone, as required by statutes and WEDC's contract.

11. WEDC may certify a business for enterprise zone tax credits for creating or retaining jobs, which, as described above, are based on zone payroll, which include eligible wages of full-time employees employed in the enterprise zone. "Full-time employee" means an individual who is employed in a regular, nonseasonal job and who, as a condition of employment, is required to work at least 2,080 hours per year, including paid leave and holidays. "Zone payroll" means the amount of state payroll that is attributable to wages paid to full-time employees for services that are performed in an enterprise zone. "State payroll" means the amount of payroll apportioned to this state.

12. LAB recommended in Report 19-6 that WEDC comply with current law by modifying its written enterprise zone tax credit program procedures to require it to award tax credits only for the wages of employees who perform services in an enterprise zone.

13. However, WEDC indicates that its written policies and procedures for the enterprise zone tax credit program comply with current law. WEDC states that enterprise zone tax credits are calculated based on Wisconsin payroll reported on corporate income/franchise tax forms, which is determined using a six-factor, statutory payroll factor test which DOR previously used to apportion employee compensation to Wisconsin or to another state under corporate income/franchise tax

apportionment statutes under prior law. According to WEDC, under this test, the services performed by employees who physically reside in other states may be fairly apportioned to Wisconsin, and hence may also fairly qualify as being performed in the zone for purposes of the enterprise zone tax credit program.

14. WEDC indicates that a similar analysis does not apply to the electronics and information technology manufacturing (EITM) zone tax credit program because the statutes explicitly state that WEDC "may not certify a business to claim tax benefits. . . for services performed outside this state." This explicit restriction is absent from the statutes related to the enterprise zone program.

15. Alternative 2 would treat the credits for job creation and retention under the enterprise zone and business development programs similar to the treatment of payroll credits under the EITM zone program.

16. Based on LAB's findings and Report 19-6, the Committee could conclude that providing refundable tax credit incentives for applicants to create and retain jobs for services that are performed outside the state runs counter to the purpose of the business development and enterprise zone tax credit programs. As stated in WEDC's program guidelines, the goal of the business development tax credit is to incent new and expanding businesses in the state of Wisconsin and the goal of the enterprise zone tax credit is to incent projects involving expansion of existing Wisconsin businesses or relocation of major business operations from other states to Wisconsin. Awarding tax credits for jobs created outside the state advances neither goal.

17. Finally, the Committee could find that it is unnecessary to modify current law because WEDC's Board already has the statutory authority necessary to properly administrate the business development and enterprise zone tax credit programs and to determine when such credits are properly available (Alternative 3).

ALTERNATIVES

1. Approve the Governor's recommended modifications regarding notifications requirements for job elimination and relocation under WEDC's grant, loan, and tax credit programs.

2. Adopt Alternative 1, but with a modification to clarify that: (a) business development tax credits may not be awarded for jobs filled by individuals performing services outside of Wisconsin; and (b) WEDC may not certify a business to claim tax benefits under the enterprise zone program for services performed outside this state.

3. Take no action.

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