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June, 2019 Joint Committee on Finance Paper #329

# Business Development Tax Credit Program
# (General Fund Taxes -- Income and Franchise Taxes)

[LFB 2019-21 Budget Summary: Page 147, #26]

## 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, retaining 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 tax years. WEDC may request the Joint Committee on Finance for 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.

The business development credit was created under 2015 Wisconsin Act 55, which consolidated aspects of the nonrefundable economic development credit and the refundable jobs credit. Act 55 sunset the jobs and economic development credits for taxable years beginning after December 31, 2015, and the business development credit took effect for taxable years beginning in 2016.

## GOVERNOR

Authorize WEDC, for a project that satisfies the current law requirements under the business development tax credit program to earn the 5% capital investment credit for a real property investment, to award an additional tax credit in an amount equal to up to 5% of the person's real property investment in a capital investment project if the investment is made for purposes of energy efficiency or the generation of energy from renewable resources. Thus, the combined total credit would be 10% of the real property investment in that capital investment project.

Further, WEDC would be required to include in any contract for the award of such tax benefits a requirement that the recipient provide documentation to WEDC verifying all expenditures and showing the energy efficiency or renewable energy impacts of those expenditures.

## DISCUSSION POINTS

### Energy Efficiency and Generation of Renewable Energy

1. The bill would authorize WEDC to enter into contracts to award tax credits for energy efficiency and renewable power generation investment as part of the business development tax credit program. As noted, the combined total credit would be up to 10% of the real property investment in that capital investment project.

2. However, the bill does not include a provision that creates such a tax credit under the income or franchise tax statutes.

3. On May 1, 2019, the Department of Administration (DOA) submitted an errata seeking a modification to the bill in order to create such provisions and to properly reflect the intent of the Governor. The administration indicates that the credit was meant to apply to personal property investments, including business equipment and supplies. As amended, the credit would be available for: (a) up to 5% of the amount of a person's real property investment made for purposes of energy efficiency or the generation of energy from renewable resources; and (b) up to 5% of the amount of a person's personal property investment made for purposes of energy efficiency or the generation of

energy from renewable resources. Thus, the combined total credit under the business development tax credit program would be up to 10% of the portion of real property investment and up to 8% of the portion of personal property investment. However, the proposed credit would only be available for the portion of the investment that pertains to energy efficiency or renewable energy generation.

4. The Committee could choose to approve the Governor's recommendation to create tax credits for energy efficiency and the generation of energy from renewable resources under the business development tax credit program, as amended by the errata, for the following reasons (Alternative A1).

5. 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.

6. The tax incentives provided under the bill 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 small investment through the 5% tax benefit may ultimately have an outsized impact. Further, the tax benefits may have a spillover effect that influences other persons to pursue such investments without claiming a tax benefit, such as by increasing the size of the market for, and increasing awareness of, energy efficiency and renewable energy generation projects.

7. On the other hand, the Committee could decide to take no action on the proposal for the following reasons (Alternative A3). 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 a portion of the tax benefits to businesses that were already going 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.

8. Second, WEDC is not an environmental protection agency and generally does not develop its rules and procedures based on environmental impacts or studies. The bill would not provide any standards or guidance for WEDC to determine what sorts of projects should qualify for the tax incentive or what 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 under the bill.

9. Finally, fluctuations in energy prices may provide clearer incentives than the tax benefits provided under the bill. Generally, businesses will tend to 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 reasonably 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.

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

10. The bill would not provide any additional funding for the Governor's proposed credit, and DOA did not provide an estimated cost. 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 cause 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.

11. As discussed in LFB Paper #328, it is estimated that the amounts that will be claimed for business development tax credits that are available under current law are $18,700,000 in 2018-19 and $20,100,000 in 2020-21.

12. Based upon information supplied by WEDC regarding the allocation of business development credits for capital investment, data from the U.S. Census Bureau on capital investment, and industry data on investment into energy efficiency and renewable power generation, it is estimated that WEDC would allocate approximately $2,000,000 annually in credits for energy efficiency and generation of renewable energy under the business development tax credit program.

13. Assuming that the amounts allocated in 2019-20 would not be claimed at DOR until 2020-21, the estimated fiscal effect of the governor's proposal, as amended by the technical errata, is $2,000,000 in 2020-21. Because WEDC would need time to establish policies and procedures for the new credit and additional time to review applications to certify 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, claimants are unlikely to claim the new credit during the first year of the biennium.

14. 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.

15. Assuming that WEDC allocates an additional $2,000,000 annually for the estimated fiscal effect of the energy efficiency and renewable power generation credit as discussed above, and allocates a similar amount of tax credits under current law, as discussed below, WEDC would likely allocate approximately $22,000,000 each year. Therefore, in addition to providing increased funding in 2020-21 for the proposed credit, the Committee could also increase the allocation limit to $24,000,000 annually, beginning in 2020, to account for the increase in tax benefits allocated under the proposed energy efficiency and renewable power generation credit (Alternative A2). This provision is not estimated to increase the cost of the Governor's proposed credit, because, as discussed below, WEDC is currently not allocating up to the limit under current law. However, it would provide WEDC with statutory authority to allocate more business development tax credits in future years.

16. 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 over the past few years.

17. Table 1 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. If additional credits are needed, WEDC may ask the Committee to provide an additional amount up to a total of $10,000,000 in any year.

**TABLE 1**

**Business Development Tax Credits Allocated Under Contracts by Calendar Year (as of May 1, 2019)**

| | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|
| Opening Balance | $0 | $2,494,000 | $1,549,200 | $3,769,200 |
| Limit | 25,000,000* | 22,000,000 | 22,000,000 | 22,000,000 |
| Tax Credits Contracted | 22,506,000 | 22,944,800 | 19,780,000 | 2,650,000 |
| Ending balance | $2,494,000 | $1,549,200 | $3,769,200** | |

* 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 which certify recipients for tax credits based upon payroll and activities conducted in 2018.

18. As shown in Table 1, WEDC can allocate up to $25.8 million in credits in 2019. Thus, it is likely that WEDC would be able to allocate additional tax credits without increasing the limit under current law during the 2019-21 biennium. Further, if needed, WEDC could request the Committee to increase the limit by up to another $10,000,000 in each year. Thus, the Committee could choose to retain the current limit of $22,000,000.

**Allocation and Reporting of Business Development Tax Credits**

19. 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. Thus, 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.

20. The Committee could require WEDC to identify the amount of unallocated tax credits carried forward into the current fiscal year as part of its annual report to the Legislature (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. [Under a separate provision of the bill, this report would be submitted on October 1 instead.] Current law does not specifically require WEDC to identify the amount of unallocated business development tax credits that have carried forward for allocation in a future year as part of that report. Providing such a 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 fiscal years.

21. 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, 2019 (Alternative B2). In the event WEDC required additional authority to allocate credits, WEDC would retain the ability to request that the Committee increase the 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 the program 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. Approve the Governor's recommendation to create a 5% tax credit for energy efficiency and renewable energy generation as part of the business development tax credit for capital investment and increase funding for the business development credit appropriation by $2,000,000 GPR in 2020-21. Amend the bill to reflect the Governor's intent to create the credit in the appropriate sections of the individual income and corporate income/franchise tax statutes. In addition, specify that the additional credit be available for up to 5% of the amount of a person's real property investment and personal property investment made for purposes of energy efficiency or the generation of energy from renewable resources.

| ALT A1 | Change to Base | Change to Bill |
|---|---|---|
| GPR | $2,000,000 | $2,000,000 |

2. Adopt Alternative A1, but modify the bill to increase the limit for allocations of business development tax credits from $22,000,000 annually to $24,000,000 annually, beginning in 2020.

| ALT A2 | Change to Base | Change to Bill |
|---|---|---|
| GPR | $2,000,000 | $2,000,000 |

3. Take no action.

## B. Allocation and Reporting of Business Development Tax Credits

1. Modify the bill to require WEDC to identify the amount of unallocated tax credits carried forward into the current fiscal year as part of its annual report to the Legislature on its economic development programs.

2. Modify the bill to prohibit unused allocations for business development tax credits from carrying over to be allocated in a future year after December 31, 2019.

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

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