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May 27, 2015 | Joint Committee on Finance | Paper #328

Convert Refundable Business Tax Credits to Direct Grants (General Fund Taxes -- Income and Franchise Taxes)

[LFB 2015-17 Budget Summary: Page 175, #5; and Page 176, #6 thru #9]

CURRENT LAW

Business Tax Credits

Under current law, the Wisconsin Economic Development Corporation (WEDC) is responsible for allocating tax benefits under the economic development tax credit, jobs tax credit, and enterprise zones tax credit programs. The economic development tax credit is nonrefundable, which means that the amount of credit claimed in a year cannot exceed the claimant's tax liability. However, unused credits may be transferred to another taxpayer or carried forward and used to offset tax liability in subsequent years. The jobs credit and enterprise zones credit are refundable. With refundable credits, 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.

There is a lifetime cap of $203.4 million on the amount of economic development tax credits that WEDC may award. The amount of jobs tax credits that may be awarded is capped at $10.0 million per year; however, WEDC may reallocate unused angel and early stage seed investment credits to the jobs 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.

Economic development credits and jobs 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 20 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). Additional detail regarding these credits is provided in Paper #327, prepared by the Legislative Fiscal Bureau.

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. Base level funding for WEDC's administration and economic development programs is $54.6 million ($32.8 million GPR and $21.8 million SEG from the economic development surcharge).

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

Sunset the existing jobs tax credit and economic development tax credit programs for taxable years beginning after December 31, 2015. Instead, create a refundable business development tax credit, and increase the number of enterprise zones that may be designated from 20 to 30. More detail about the enterprise zone program and the business development credit is presented Paper #327.

The bill would also modify the reporting requirements for recipients of economic development assistance by WEDC. The bill would require an attestation that the assistance was expended in accordance with the terms of the grant or loan contract, instead of a schedule of expenditures, and also eliminate the requirement that a CPA review the expenditures for grants or loans of less than $500,000. These changes are addressed in Paper #302.

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 current economic development credit, jobs tax credit, and enterprise zone programs, beginning on the effective date of the budget bill. In addition, the provisions of the bill that would create a new business development credit would be deleted. In place of these tax credits, GPR funding would be provided to WEDC for direct economic development grants to state businesses.

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 bill would replace the nonrefundable economic development credit with a refundable business development credit. The jobs credit and enterprise zone credit are already 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 year 2012, claims for the jobs credit and enterprise zones credits totaled $42.4 million. Of this amount, $2.3 million (5.5%) was used to offset the claimants' tax liability and $40.1 million (94.5%) 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 2013-14, WEDC certified economic development, jobs, and enterprise zones credits totaling $74.4 million, which will likely be claimed over the next several years. When a tax credit is verified by WEDC, a business may or

may not reduce its 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, under current law (and under the budget bill), 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 illustrated in Paper #318, which presents revised estimates for the enterprise zone program. The Governor's bill estimated that the enterprise zone credits would cost $91.8 million GPR in the 2015-17 biennium. The revised estimates, prepared a few months later, total $105.6 million, an increase of 15%.

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, as noted in a separate paper (Paper #323), communication difficulties between WEDC and DOR have made it impossible 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 the Corporation is responsible for nearly all aspects of awarding the credits. Instead, the revenue loss associated with the economic development credit is subsumed in income and franchise tax collection data and is not readily apparent. The costs of the current jobs credit and enterprise zone credit (and the proposed business development credit) appear in separate GPR appropriations under "Shared Revenue and Tax Relief" in the appropriation schedule. The value of these credits exceeds $50 million per year and is larger than WEDC's base funding level for its other programs. The budgetary impact of WEDC's activities would be more transparent if the existing tax credits were converted to grants.

8. In 2013 Act 20, in an effort to simplify state tax laws, the Legislature 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 (partnerships, limited liability companies, and tax-option corporations) 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. DOR is not notified by WEDC as to who the individual owners are, which makes it difficult to determine if a credit claim is valid without further review of the pass-through entity's tax return. 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. The remainder of this paper presents four options for replacing the refundable tax credits administered by WEDC with a revenue-neutral direct grant program.

12. The first alternative would sunset the existing jobs tax credit, economic development credit, and enterprise zones credits. In addition, the budget bill provisions increasing the number of enterprise zones and creating a business development credit would be deleted from the bill. Instead, GPR funding would be provided to WEDC in a new continuing appropriation for economic development grants and payments of claims for jobs 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 WEDC's 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.

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 program and the proposed criteria and procedures for the business development tax credit under the bill.

14. The last two 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.

ALTERNATIVES

1. Prohibit WEDC from certifying persons for tax benefits under the existing jobs tax credit, economic development tax credit, and enterprise zones tax credit programs after the effective date of the budget bill. Delete the provisions of the bill that would create a business development credit and that would increase the number of enterprise zones that WEDC may designate. Instead, provide WEDC with $67,500,000 GPR in 2015-16 and $58,300,000 GPR in 2016-17 in a new continuing appropriation for payments of claims for jobs tax credits and enterprise zones 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 jobs tax credits and enterprise zones credits made after August 31, 2015, 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 jobs tax credit and enterprise zones credit. [The funding amounts identified above are equal to the sum of the appropriations under the bill for the refundable jobs credit, enterprise zones credit, and business development credit. As under the bill, DOR would continue to process remaining claims for the economic development tax credit that are filed after the sunset date.]

ALT 1	**Change to Bill GPR**
Shared Revenue and Tax Relief	- $125,800,000
WEDC	125,800,000
Total	$0

2. Prohibit WEDC from certifying persons for tax benefits under the existing jobs tax credit, economic development tax credit, and enterprise zones tax credit programs after the effective date of the budget bill. Delete the provisions of the bill that would create a business development credit. Instead, provide WEDC with $67,500,000 GPR in 2015-16 and $58,300,000 GPR in 2016-17 in a new continuing appropriation for payments of claims for jobs tax credits and enterprise zones credits made after that date and for direct enterprise zone grants and business development grants. Convert the existing statutes regarding the enterprise zones program from a tax credit program to a direct grant program, with up to 30 enterprise zones. In addition, convert the proposed statutes regarding the business development tax credit to a direct grant program. Specify that enterprise zones 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 criteria and procedures recommended by the Governor in the budget bill for the business development tax credit. Require any claims for jobs tax credits and enterprise zones credits made after August 31, 2015, 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 jobs tax credit and enterprise zones credit. [The funding amounts identified above are equal to the sum of the appropriations under the bill for the refundable jobs credit, enterprise zones credit, and business development credit. As under the bill, DOR would continue to process remaining claims for the economic development tax credit that are filed after the sunset date.]

ALT 2	**Change to Bill GPR**
Shared Revenue and Tax Relief	- $125,800,000
WEDC	125,800,000
Total	$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 Bill GPR**
Shared Revenue and Tax Relief	- $125,800,000
WEDC	125,800,000
Total	$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 Bill GPR**
Shared Revenue and Tax Relief	- $125,800,000
WEDC	125,800,000
Total	$0

5. Maintain these programs as tax credits.

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