EVALUATING TAX EXCEPTIONS AND INDUCEMENTS

EXECUTIVE APPROPRIATIONS COMMITTEE
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ISSUE BRIEF

SUMMARY

Utah offers more than 170 exceptions to tax code and inducements to behavior change. They can be roughly divided into four categories – Tax Policy, Economic Efficiency, Public Goods, and Economic Development. Of the 170, about 111 are of unknown dollar value. Many of the 59 whose size can be measured in dollars lack clearly defined purposes and goals.

Yet, states across the nation trend towards greater accountability for tax exceptions. They strive for better information structured in a way that determines potential returns on investment. Doing so allows policymakers to measure effectiveness across multiple and varied incentives.

This report – with its accompanying interactive dashboard - creates an inventory of Utah tax exceptions and inducements. It recommends first steps that could facilitate a uniform analysis of all tax exceptions and inducements. Such an analysis would allow legislators to compare exceptions and inducements and determine which are the most effective. Similarly, it would allow policymakers to decide which exceptions are duplicative and which complement one another.

RECOMMENDATIONS

1) Articulate clear purposes and goals for each tax exception/inducement.
2) Establish common definitions for key measures.
3) Set baselines and targets for each measure, and then collect observations.
4) Address data limitations that hamper evaluation.
5) Create a 3 to 5 year review cycle for those not currently reviewed.

BACKGROUND

An economic exception or inducement is an exemption, deduction, credit, preferential rate, or other tax benefit that reduces a taxpayer's state or local tax liability or results in a tax refund. An economic incentive may also include a program where revenue is dedicated to pay for aspects of development, i.e. community revitalization, enterprise zones, or a tax increment financing district. Because incentives use state resources, lawmakers want to know if the economic incentives provided accomplish the stated goals of the incentive.

Tax exceptions and inducements in Utah can be roughly divided into four categories. Each category has its own set of characteristics and requires its own unique approach to evaluation. The four categories are as follows:

- Tax Policy: includes credits and exemptions that are associated with a broader principle of good tax policy including simplicity, certainty, equity, neutrality, transparency, and visibility.
- Economic Efficiency: includes credits and exemptions that intend to improve the efficiency of the tax system by reducing impediments to growth and minimizing administrative costs.
- Public Good: includes credits and exemptions that intend to provide tax relief to targeted groups in order to achieve a desired public benefit.

- Economic Development: credits, exemptions, and cash payments explicitly intended to induce economic development in Utah. These are programs for which the Governor's Office of Economic Development has oversight.

HIGH QUALITY EVALUATIONS

A concern related to evaluation of state incentives is that a study, which considers only tax incentives offered by a state and ignores local incentives, could lead to faulty conclusions. Research has shown local and nontax incentives can easily account for more than half the value of an incentive package. That said however, this report highlights only on the state exceptions or inducements offered. A broader study may be needed to evaluate the full impact of incentives.

Nationwide the best incentive evaluation reports have focused on comparing the effectiveness of incentives to one another to help policymakers invest in the programs with the strongest return on investment. Good incentive evaluations consider a variety of available resources including academic literature, historical data, common sense, and economic models. A high quality incentive starts with a clearly defined purpose. Next, it will have key goals for the incentive. Some of the basic goals states use for economic development incentives include the following:

1) Job and Wage creation
2) Business Investment
3) Specific Industry Growth
4) Revenue Growth
5) Specific Region Growth

A high quality incentive will also have metrics established that measure progress toward a goal. Each metric will have a baseline against which to measure, forward-looking targets, and actual observed values measured after the fact. All of these should align with the purpose and goals.

To implement an effective monitoring and evaluation system, the incentive evaluation should answer five key questions:

1) What is the basic policy problem that the incentive is trying to address?
2) What are the best approaches for measuring the incentive program's progress?
3) What is the best strategy for assessing the program's progress, given budgetary and other constraints?
4) What is the best approach to collecting the information needed?
5) What is the best way to analyze the information?

Because of data limitations we were unable to answer many of these questions for Utah tax exceptions. We started the analysis by considering if the 170 exceptions and inducements offered by the state have clearly established purposes, goals and metrics. Of the 170 exceptions and inducements, 59 can be measured, and have an estimated aggregate value of $1.7 billion. Of the 59 measurable exceptions or inducements, only 10 had a clearly defined purpose. We cannot measure the values of an additional 111 exceptions and inducements because the state does not collect the necessary data.

ECONOMIC DEVELOPMENT INCENTIVES

Economic Development exceptions or inducements can create economic growth that would not have occurred otherwise. Specifically, these incentives may work to convince businesses to relocate, hire, and/or invest in the state economy. However, much of the research assessing the effectiveness of these incentives across the nation has been inconclusive or unsatisfactory, in part because of methodological flaws and inadequate data.

Business exceptions and inducements for economic development intend to attract and encourage business expansion within the State of Utah. They include:

1) Direct payments using such funds as the Industrial Assistance Fund;
2) Rebating through tax credits a portion of new tax revenue (Economic Development Tax Increment Financing (EDTIF);
3) Cash rebates for economic activity generated;
4) Offering exemptions, such as exemption from sales tax liability for certain industries; and
5) Offering alternative corporate income tax apportionment for select industries.

In the process of reviewing the exceptions and inducements offered in statute, we discovered that the Economic Development category has at least some elements of the best practices incorporated into their evaluations. The Economic Development incentives we reviewed for best practices were:

- Outdoor Recreation Grants
- Technology Commercialization Innovation Grants
- Life Science Tax Credits
- Economic Development Tax Increment Financing
- Motion Picture Incentive
- Procurement Technical Assistance
- New Market Tax Credit
- Tourism Marketing Performance
- Business Expansion and Retention
- Rural Fast Track
- Enterprise Zones
- Economic Opportunities
- Recycling Market Development Zones

Several data elements were identified that were common to multiple economic development incentives but not all. They include:

- Jobs
- Wages
- Capital Investment
- Full-Time Employees
- Part-Time Employees
- Incremental Jobs
- New State Revenues
- Gross Domestic Product

Recommendation: The Legislature may want to consider incorporating these data points, and develop common definitions of these elements as a starting point for data collections as they begin establishing clearly defined purposes and goals.

Currently, the State collects a variety of data to aid in the evaluation process for existing economic development exceptions or inducements. The data elements include both state and national sources:

1) GOED collects the maximum incentive offered by company, industry, and timeline; projected new revenue from each incentive; type of incentive; actual incentives authorized and earned by year for the Economic Development Tax Increment Financing Program;
2) Tax Commission is able to determine the actual incentive taken by year by company by type of incentive for the Economic Development Tax Increment Financing Program. However they are currently unable to report the amounts claimed by company to GOED;
3) Tax Commission also collects data related to business and individual income tax returns.

4) Workforce Services collects detailed employment and wage data for companies required to report. Employment and wage data is collected, through the Quarterly Census of Employment and Wages.
5) Good Jobs First collects incentives offered by year, state, by company, and amount across states; For many economic development exceptions and inducements, we receive information from the company receiving the incentive.

EXAMPLES OF CURRENT PROCESSES FOR EVALUATING ECONOMIC DEVELOPMENT INCENTIVES

For two of the GOED economic development incentives we have attempted to show how best practices are applied and where improvements may be warranted.

Example 1: Business Expansion and Retention (BEAR, a subset of the IAF)

The Business Expansion and Retention Program awards grants to county economic development entities and other entities to provide business outreach services to local businesses.

Purpose of the Incentive:

BEAR has no clearly defined statutory purpose.

Goals of the Incentive:

BEAR has no clearly defined goals.

Metrics and Reporting

The BEAR program has developed a number of metrics that could be used to determine a solid purpose with corresponding goals they include:

- The number of BEAR visits conducted
- New businesses identified by the grant recipient that are in the target industries
- Private and Public Investments in the client business that was the direct result of the referrals made by the grant recipient
- Jobs created of filled as a direct result of the referrals made by the grant recipient
- Jobs retained by the client business as a direct result of the referrals made by the grant recipient
- Economic Gardening
- Workshops and Business Training
- UCAN business participation
- BEAR team meetings
- Closed Referrals

Optional Reporting includes: increased participation by client businesses in BEAR, calls made to other economic development offices, requests made by the grant recipient to other state programs on behalf of the client, success stories.

Process

BEAR recipients throughout the state submit a BEAR quarterly report where they are required to complete the “Quarterly Report Form”, a spreadsheet where the BEAR participants document the number of businesses visited, jobs created/retained, public investment, private investment, NAICS codes, etc.

To receive funding, grant recipients must:

1) Have a working knowledge of BEAR team members that work in the grant recipient’s community, and shall cultivate and develop relationships with the BEAR team members and other entities in the grant recipients’ community over the period of the contract.
2) Perform business visits and trainings including: targeted industries, perform a guided survey, identify potential for referral or introductions, make referrals, conduct follow-up business visits

with the client company, record the BEAR visit in the computer database or system in a format prescribed by the state.
3) Data must be at least 80% complete to be counted.

Potential Problems:

Because the incentive has no clearly defined purpose, or goals it is difficult to know what to measure metrics against. Ideally, with a purpose and goals we could take the data points generated by the metrics and run them through a variety of econometric models to determine the value of the incentive to the state economy.

Example 2: Economic Development Tax Increment Financing

The Economic Development Tax Increment Financing incentive provides refundable tax credits for up to 30% of new state revenues (sales, corporate, and withholding taxes from employees paid to the state) over the life of the project, but, not to exceed 20 years. Tax credits certificates are awarded only when recipients meet performance targets.

Purpose of the Incentive:

The purpose of the EDTIF as defined in statute is detailed below:
1) To foster and develop industry in the state, to provide additional employment opportunities for Utah's citizens, and to improve the state's economy;
2) To address the loss of prospective high paying jobs, the loss of new economic growth, and the corresponding loss of incremental new state and local revenues to competing states caused by economic incentives offered by those states;
3) To provide tax credits to attract new commercial projects and new jobs in economic development zones in the state; and
4) To provide a cooperative and unified working relationship between state and local economic development efforts.

Goals of the Incentive:
1) Acceleration of high paying job creation and capital investment.
2) Assist local communities in achieving their economic development goals
3) Diversify economy by providing incentives across industries
4) Convert tax payers to full paying tax payers earlier

Metrics:
1) New state revenue,
2) Capital investment,
3) Jobs created,
4) New state wages, and
5) Average wages

Process

A company applies for an incentive through GOED. The Economic Development Tax Increment Financing incentive provides refundable tax credits for up to 30% of new state revenues (sales, corporate, and withholding taxes from employees paid to the state) over the life of the project but not to exceed 20 years. Tax credits certificates are awarded only when recipients meet performance targets.

GOED determines a company baseline to measure new jobs, new state wages, capital investment, and new state revenue. The baseline for the company, includes: annual State of Utah taxes generated, paid and receipted at the project less a 25% deduction on employee state income taxes withheld by the Project. The baseline also includes corporate income taxes generated, paid, and receipted from the Project and the State's portion of actual sales and use taxes generated, paid and receipted to vendors for goods and services contracted for the Project during that calendar year which are indirectly paid and receipted to the Utah State Tax Commission.

Under the current process, the GOED Board authorizes or denies an incentive request after a comprehensive review of the viability of the company's proposal. The company must meet established criteria including potentially jobs and wages over baselines, capital investment, and wages that exceed 110% of the county average wage. If a company meets its commitments for a tax year, GOED issues a tax certificate.

The Income Tax year ends in December. A company submits their EDTIF rebate application, GOED certifies the data after the end of the tax year. GOED collects employment and wage data from DWS and Tax Commission data on withholding and other taxes. GOED then verifies the data a company submits against information collected from DWS and Tax and issue the rebate for eligible costs up to maximum. For most companies, they file their return in September for the prior tax year and claim the credit.

GOED has Authorization to Disclose (ATD) signed by the company and a MOU with DWS and the Tax Commission to collect required data to check against. GOED has run into issues with the Tax Commission when trying to reconcile rebates issued against rebates claimed. The Tax Commission has said they don't have the statutory authority to the amount claimed by company.

Summary of Best Practices Used for EDTIF

The EDTIF program utilizes many of the best practices identified in the report. The incentive has a clearly defined purpose, goals that support the purpose, metrics to measure success, observed values for the data elements and a baseline. The problem that GOED has run into in evaluating this incentive relates to data limitations. They are able to access the necessary data to authorize an incentive, and to determine the credits earned. However, when they try to access credits claimed by company and tax year through the Tax Commission they are unable to access the data due to confidentiality restrictions. As a result, we are able to measure the impact of the incentive through authorization but not the final impact on state tax revenues.

DATA LIMITATIONS IDENTIFIED

In selecting the data to use in an evaluation it is important to consider data availability, cost of obtaining data, data validity and quality, and timeframes in which the data is reported. We identified several problems with data collection by practice, in the literature, and by states attempting to implement incentive evaluations processes including:

1) Federal law restricts how states can use data they receive from the IRS.
2) For sales tax exemptions, no data collection has been required.
3) Confidentiality issues limit access to data.
4) Rural/Urban differentials have prevented consistent definition of key terms.
5) Many of the incentives have unique but unrelated purposes.
6) Research that relies on firms receiving help could be biased but may also be the only data available.
7) Econometric models may be more difficult to explain to lawmakers and more complex to administer.
8) Generally, we look at a specific incentive offered rather than a package of incentives targeted at a specific company, which may bias the results.
9) The state does not have access to local data sources.
10) Lack of adequate reporting requirements for the various incentives.
11) The data elements currently being collected may not be appropriate measures of program effectiveness.

Utah could address some of the data limitations by implementing procedures used in other states. For example, Illinois doesn't grant auditors access to tax returns, but Good Jobs First rates it among the best at tax credit disclosures because of a law that requires companies to report subsidies, where the company located, how much it received, and what the results were in terms of job creation and wages.

Other states such as Oklahoma have developed strong Memorandums of Understanding (MOU) between the evaluating agency, the Tax Commission, and the Department of Workforce Services to allow data sharing. Utah currently has MOU's between the Governor's Office of Economic Development, the Department of Workforce Services, and the Utah Tax Commission, which have improved the state's ability to measure the success of certain incentives, i.e. the EDTIF. However, the MOU's still do not allow the Tax Commission to share the amount of the credits claimed with GOED. As a result, we are not able to measure the success of the program beyond the amount earned.

An additional element that states have used to improve reporting is to require companies receiving a sales tax exemption to self-report the benefit amount they are receiving from the exemptions.

Recommendations: below we have listed two recommendations related to improvements in data collection efforts.

1) Require a reporting of sales tax exemption or establish a methodology for estimating from economic data.
2) Modify UCA 59-1-403 to allow the Tax Commission to share small data sets with the Legislative Fiscal Analyst for exception and inducement evaluations.

H.B. 3001 – TAX CREDIT REVIEW AMENDMENTS

In the 2016 Third Special Session the Legislature started the evaluation by implementing H.B. 3001 – Tax Credit Review Amendments, which established a three-year evaluation process for all corporate and individual income tax credits currently in statute. The legislation requires the following information from the Revenue and Taxation Interim Committee:

1) A recommendation to continue, modify or repeal the credits reviewed.
2) A determination of the cost of the credits to the state.
3) Identification of the purpose and effectiveness of the tax credits.
4) A determination of the extent to which the state benefits from the tax credit
5) Any other review efforts as directed by the chair of the committee.

Recommendation: As the committee goes through review process, they may want to consider modifying statutes to add the primary elements required under best practices including clearly defined purposes, goals and metrics. Doing this would establish the framework for evaluating an additional 45 exceptions and inducements.

The only data collected currently for these exceptions and inducements is the number of taxpayers claiming the credit and the amounts claimed. In defining the purpose and goals, the committee could begin to generate metrics that allow an evaluation of the success of the program when compared to the purpose of the program.

The current schedule for evaluations income and corporate tax credits provided by the legislation is detailed below.

Before November 30, 2017 the Committee will Review

- Credit of Interest Income from State and Federal Securities
- Low Income Housing Credit (Individual and Corporate)
- Tax Credit for Research Activities Conducted in the State
- Refundable Credit for Hand Tools Used in Farming Operations (Individual and Corporate)

- Motion Picture Tax Credits (Corporate and Individual)
- Cash Contribution to Sheltered Workshops
- Live Organ Donation Expenses
- Investment in Certain Life Science Establishments
- Combat Related Death
- Employing a Recently Deployed Veteran
- Employment of a Person Who is Homeless
- Achieving a Better Life Experience
- Adoption of a Child with Special Needs
- Land for Agricultural Uses

Before November 30, 2018 the Committee will Review

- Historic Preservation Credits (Individual and Corporate)
- Refundable Economic Development Tax Credits (Individual and Corporate)
- Enterprise Zone
- Tax Credit for Employing People who are Disabled
- High Cost Infrastructure Tax Credit (Individual and Corporate)
- Achieving a Better Life Experience Tax Credit
- Non-Refundable Jobs Credit
- At Home Parent Credit
- Research Activities Conducted in the State
- Machinery, Equipment or Both Used in Conducting Qualified or Basic Research
- Capital Gains Transactions
- Amounts Paid Under a Health Benefit Plan
- Capital Gains Transactions on the Exchange of One Form of Legal Tender for Another Form of Legal Tender
- Targeted Business Tax Credit

Before November 30, 2019 the Committee will Review

- Energy Efficient Vehicle Credit
- Recycling Market Development Zones (Individual and Corporate)
- Renewable Energy Systems Tax Credit (Individual and Corporate)
- Alternative Energy Development Tax Credit (Individual and Corporate)
- Alternative Energy Manufacturing Tax Credit (Individual and Corporate)
- Tax Credit Related to Natural Gas Heavy Duty Vehicles (Individual and Corporate)
- Tax Credits Related to Energy Efficient Vehicles
- Utah Educational Savings Plan
- Non-refundable Taxpayer Tax Credits
- Retirement Tax Credits
- Qualifying Solar Projects
- Military Survivor Benefits
- Psychiatrists, Psychiatric Mental Nurse Practitioners and Volunteer Retired Psychiatrists

The cycle will repeat every three years. The committee is authorized to use the Office of the Legislative Fiscal Analyst, the Governor's Office of Economic Development and the Tax Commission to assist in the analysis.

After the review cycle for the income and corporate tax credits is complete, the committee may want to move on to the 90 sales tax exemptions where no data is currently collected.

CONCLUSION

In evaluating incentives, it is important to start with the big picture. First, the incentive should be clear on its purposes and goals because this will determine what the Legislature wants to measure. A primary problem in evaluating current incentives is that many of the incentives and tax credits were codified without clearly stated goals. It is impossible to tell if a program is meeting its policy goals and objectives if they are not spelled out. The Legislature should ensure that all existing and future incentives articulate the specific reasoning behind each program.

For the mature exceptions found under economic development many of the necessary evaluation components are currently collected. For those incentives lacking key best practice elements we recommend that clear purposes and goals be established. Even for those that do have clearly defined purposes and goals there is reason to continue to revisit the statutory purposes, goals and metrics to make sure they remain relevant and that we are able to collect the appropriate data to analyze results.

In order to continue making progress towards a comprehensive evaluation, the legislature should incorporate clear purposes, goals and the establishment of metrics into a regular review cycle so data may be collected going forward.

Coordination between agencies is also critical to the success of any evaluation. The states that have been most successful in evaluating their incentives have clearly established memorandums of understanding on data sharing and open communication.

In selecting the data to use it is important to consider data availability, cost of obtaining data, data validity and quality, and timeframes in which the data is reported.

RECOMMENDATIONS

1) Articulate clear purposes and goals for each tax exception/inducement.
2) Establish common definitions for key measures.
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