Benefits of Tracking WV Business Tax Credits Over 25 Years

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Economic Growth: What Matters More, Tax Structure or Level of Investment Tax Credits?

- **Business & Occupation Tax: Gross Receipt Tax**
  - #1 source of tax revenue prior to 1987
  - Investment Tax Credits average $40 million per year 1980-85
  - 1970-1985 second slowest growth rate [GDP]

- **Business Tax Reform (1985): Effective July 1, 1987**
  - Corporate Net Income Tax @ 9.75%
  - Business Franchise Tax on net equity @ 0.55%
  - Gross receipt tax retained on public utilities & severance

- **Individual Income Tax Reform (1987)**
  - Top rate reduced from 13% to 6.5%
  - Itemized deductions eliminated
New Administration: Some Tax Policy Variances

- **Investment tax credits to be less of factor after reform**
  - Unused 10-year investment credits applied to franchise tax
  - Franchise tax smaller in scale compared to B&O Tax

- **However: Enactment of new tax credits 1985-1987**
  - Super Credit: 50%-90% investment tax credit for job creation
    - Liberal construction language & applications to “jobs saved” projects
    - Non-refundable - multiple party projects allowed
  - Industrial Expansion & Revitalization
  - Research and Development
  - Venture Capital Company
  - Enterprise Zones
  - Residential Housing Development
State Nears Bankruptcy: New Taxes

Tax Increases Imposed: 1988-1990

- Sales Tax from 5% to 6% with broader base
  - Food for home consumption
  - Broad business exemption goes to direct use only
  - No pass-through exemption for contactors

- Severance Tax rates from 4% to 5%
- Business Franchise Tax rate from 0.55% to 0.75%
- Tax on Electric Power Generation increased 90%
- Tax on Natural Gas Storage activities
Time To Review Tax Credit Policies

  - Jobs saved projects undercutting tax base—Should be given only to rescued insolvent Taxpayers
    - Net 1,000 jobs lost among claimants accounting for 90% of credit
    - Definition of full-time equivalent employee needed enhancement

- Liberal construction language should be replaced with reasonable construction

- 50% to 90% investment credit a bit over generous
  - Outcome: eliminate new credit applications against severance tax
  - Grandfathered investment rules
Size of Investment Tax Credit Expenditures
Source: Survey of 50 states by WV Tax Department 1993

Ratio Of Investment Tax Credits to State Tax Collections-FY1990

WV, ID, NE, NY, AR, MA, OR, MO, KS, WY, KY, WA, MT, IL, CO, MN, IN, OK, RI, CA
The Changing World of Investment Tax Credits

**WV Tax Credit Reform Legislation**

- **1990 – Super Credit**
  - New credits do not apply to severance tax
  - Tightened job creation requirements
  - Mandated a credit application prior to use of credits

- **1993 – Super Credit**
  - New credits restricted to certain industries
  - Must defer 20% of credit until use in 13\textsuperscript{th}-15\textsuperscript{th} years

- **2002 – Investment Tax Credit Program Overhaul**
  - Terminated more than 12 tax credits at the end of 2002
  - Created 3 replacement tax credits – Economic Opportunity, Manufacturing Investment and Strategic Research & Development
### Current Programs

1. Economic Opportunity
2. Manufacturing Investment
3. Strategic R&D  
   - Refundable-Small R&D
4. Industrial Expansion-Electric
5. Coal-Loading Facilities
6. Historic Preservation - 2
7. Tourism Development
8. Apprenticeship Training (New)
9. Film Industry (New)
10. Commercial Patent Credits (New)
11. Alt Fuel Infrastructure (New)
12. Mine Safety Technology (New)

### Terminated Programs

1. Super Credit
2. Industrial Expansion-Mfg.
3. Research & Development
4. Capital Company
5. Aerospace Industry
6. Coal-Based Liquids Conversion
7. Residential Housing
8. Employment  
   - Colin Anderson
   - Wood Mfg.
   - Steel Mfg.
   - Aluminum or Polymer Mfg.
Tax Credit Review & Accountability Reports
Three Year Cycles

- Review of 3 Major Investment Credits Created in 2003
  - # of Claims and Value
  - Net jobs created and cost per job
  - Data on employee benefits paid
  - Comparison with industry as a whole

- Economic Opportunity—20% over 10-13 years
  - 17 claims & $4.0 million claimed 2003-2006
  - 3,234 projected new jobs

- Manufacturing Investment Credit—5% over 10 years
  - 90 claims & $2.4 million in 2006
  - On average, claimants had employment increase of 3.8%+ per year v sector decline of 2.9%/year

- Strategic R&D—Higher of 3% or 10% of Excess
  - 15 claims and $1.7 million claimed in 2006
  - Median employment increase per firm was 3 & average pay in excess of $60,000
Benefits of Tracking - Lessons Learned

- Tax credits borrowed from other states may not work
  - WV adopts KY Enterprise Zone Incentives in 1986
  - No geographic zone meets enterprise zone definitions

- Some tax credits have no fiscal impact
  - Credits designed to attract some type of business not in State
  - Lack of interest by Taxpayers due to marginal benefits
  - Tracking yields information useful in preparation of fiscal notes for new programs

- Rule of thumb: minimum of 3 years of ramp up time for New Tax Credit

- Tracking credits yields compliance revenue
  - Failure to meet the qualifying requirements
  - Credit recapture due to failure to maintain investment
  - Discovery of Taxpayers who created their own tax credit
Credit Recapture Programs

**Recapture Tax:** $12.5 million (1987-1996)

- Failure to create min # jobs within 3 years
- Property removed from service too soon
  - Economic Useful Life Calculations
    - **Qualified Life** | **Qualified Investment**
      - 4 to 6 year property: | 33.3%
      - 6 to 8 year property: | 66.7%
      - 8 year + property: | 100%
Median Tax Credit Far Below Average

$20,000
$40,000
$60,000
$80,000
$100,000
$120,000
$140,000
$160,000
$180,000

Median
Average

$-

Few Taxpayers - Large Benefit
Most Taxpayers - Small Benefit

Tax Year 2006 Claims

<table>
<thead>
<tr>
<th># of Claims</th>
<th>Credit Claimed</th>
</tr>
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<tbody>
<tr>
<td>484</td>
<td>$4.2</td>
</tr>
<tr>
<td>13</td>
<td>$44.6</td>
</tr>
</tbody>
</table>

- > $1 million
- $500 to $1,000
- $250 to $500
- $100 to $250
- $50 - $100
- < $50
Investment Tax Credits Pie is Changing (2003)

Terminated Credits represent > 67% of $93.4 Million Total

$ Millions

- Super: $48.3
- Industrial Expansion: $35.9
- Capital Company: $1.6
- New Credits: $2.8
- Other: $3.2

R&D: $1.6
Investment Tax Credits Pie is Changing (2006)

Terminated Credits represent > 44% of $65.9 Million Total

$ Millions

- Super: $19.9
- Industrial Expansion: $32.9
- Capital Company: $2.8
- New Credits: $7.8
- Other: $1.8

Legend:
- Red: Super
- Blue: Industrial Expansion
- Green: Capital Company
- Yellow: New Credits
- Gray: Other

15
Super Credit Expenditures Decline

Credit Terminated for New Investment on or after 1/1/2003

$ Millions

1992

2003

2006

Total Credit

Severance Tax Portion
Tax Credit-General Revenue Fund Ratio

Compares Disclosed Tax Credit Values with General Revenue Fund Collections

![Tax Credit Ratio Chart]

- Year: 1992, Tax Credit Ratio: 5.0%
- Year: 1994, Tax Credit Ratio: 4.5%
- Year: 1996, Tax Credit Ratio: 4.0%
- Year: 1998, Tax Credit Ratio: 4.5%
- Year: 2000, Tax Credit Ratio: 3.5%
- Year: 2002, Tax Credit Ratio: 3.0%
- Year: 2004, Tax Credit Ratio: 2.5%
- Year: 2006, Tax Credit Ratio: 2.0%
Total Tax Credits Claimed on Coal Severance Tax Returns 1998-2010*

* Preliminary Data for 2010 – Includes Annual $500 Credit
Promotion of Thin-Seam Underground Coal Tax Rate Preference: < 37” (80%); 37”-45” (60%)

Value is 15% of the Gross Tax Base
Electric Power Generation Industry

40% to 75% of Investment Tax Credits – B&O Tax

- Investment in New Plant & Modernization
- Pollution Control—Sulfur Dioxide Scrubbers
- Benefits of Investment & Tax Credits
  - Lower total costs for consumers
  - Less environmental pollution
  - Construction jobs & maintenance jobs
  - Ability to use coal from northern West Virginia
  - Additional electric power generation
  - Preservation of local property tax base
Electric Power Industry Tax Credits
Industrial Expansion/Revitalization

![Bar chart showing trend of electric power industry tax credits from 1988 to 2009. The values increase significantly from 2006 onwards.](chart.png)
B&O and Severance Tax Collection Trends

$ Millions

B&O • SEV

Incentive Tax Credit Costs Decrease Due to Tax Type Restrictions

$ Millions

1992

$68.5

2006

$6.2

SEV
B&O
CNI
PIT
Fran
WV Corporate Tax Collection Trends

- CNI
- BFT
- Combined

$ Millions


$ Millions
Value of Tax Credits Decrease With Tax Rate Reductions – Part I

- Business Franchise Tax Rate Phase-Out
  - Moving away from tax on capital to tax on net income
  - Rate phases down from 0.7% in 2006 to 0% by 2015

- Business Franchise Tax Credits
  - $15.3 million in 2006
  - Nearly 23% of total investment tax credits

![Franchise Tax Rate Chart](chart.png)
Value of Tax Credits Decrease With Tax Rate Reductions – Part II

- Corporation Net Income Tax Rate Phased-Down
  - From 9.00% in 2006 to 8.75% in 2007-08 and to 8.50% in 2009
  - To 7.75% in 2012, to 7.00% in 2013 and to 6.50% in 2014

- Corporation Net Income Tax Credits
  - $16.8 million in 2006
  - Nearly 25% of total investment tax credits
Refundable or Transferable Credits

- **Historic Rehabilitated Buildings:**
  - Commercial: $0.9 million in 2006
  - Residential: $0.4 million in 2006

- **Film Industry:** ($10 million limit) < $0.1 million in 2009

- **Strategic Research & Development**
  - Small R&D firms - $100,000 maximum
    - Gross Revenues < $20 million
    - Total Payroll < $2.5 million
Conclusions

- Investment tax credits play smaller role over time in State finances – Some credits-reactions to tax structure issues

- Tax rate reductions effectively reduce the value of tax credits except for refundable/transferable programs

- Major new programs require application & contain recapture provisions

- Tax Credit Review and Accountability Report Every 3 Years

- Participation rates far below 100%; Rate falls as # of alternatives increase
Contact Information/Questions

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