

# Benefits of Tracking WV Business Tax Credits Over 25 Years

FTA Revenue Estimation & Tax Research Conference  
Charleston, WV

October 18, 2011

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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 contractors
- 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

- First Report on Super Credit (1989-1990)
  - 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



# 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<sup>th</sup>-15<sup>th</sup> 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

# Investment Tax Credits

## 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

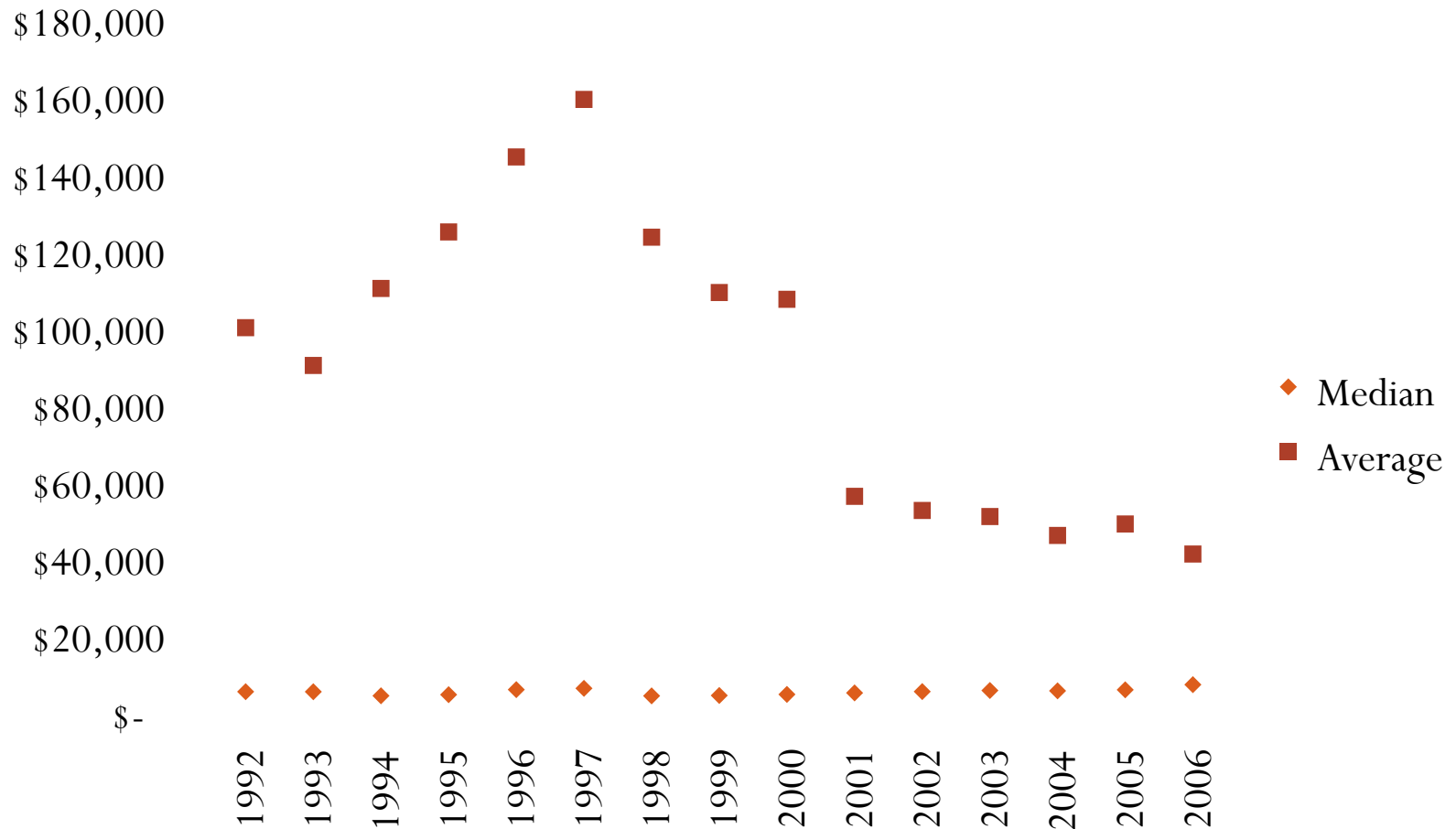
# Credit Recapture Programs

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

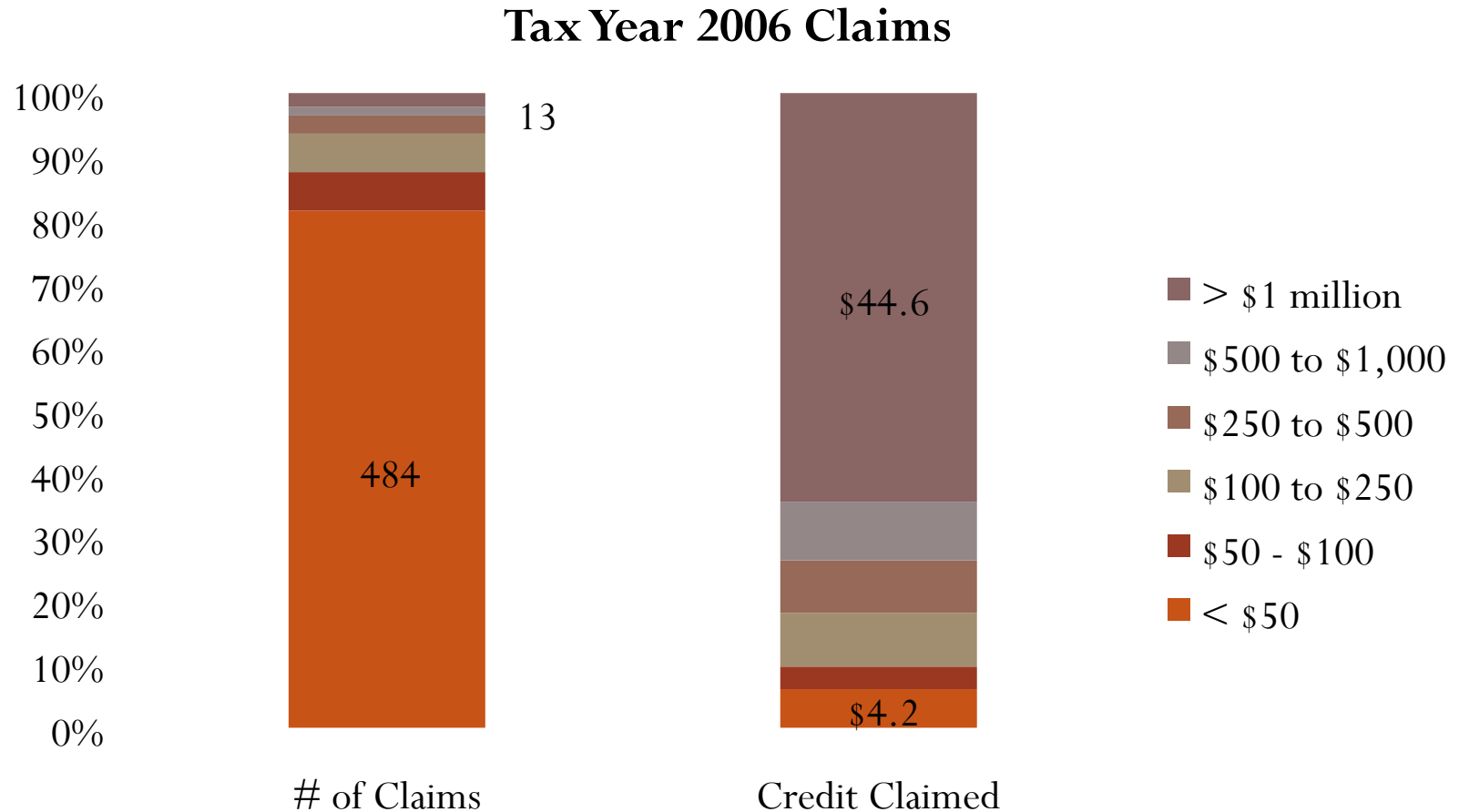
- Failure to create min # jobs within 3 years
- Property removed from service too soon
  - Economic Useful Life Calculations

<u>Qualified Life</u>	<u>Qualified Investment</u>
● 4 to 6 year property:	33.3%
● 6 to 8 year property:	66.7%
● 8 year + property:	100%

# Median Tax Credit Far Below Average



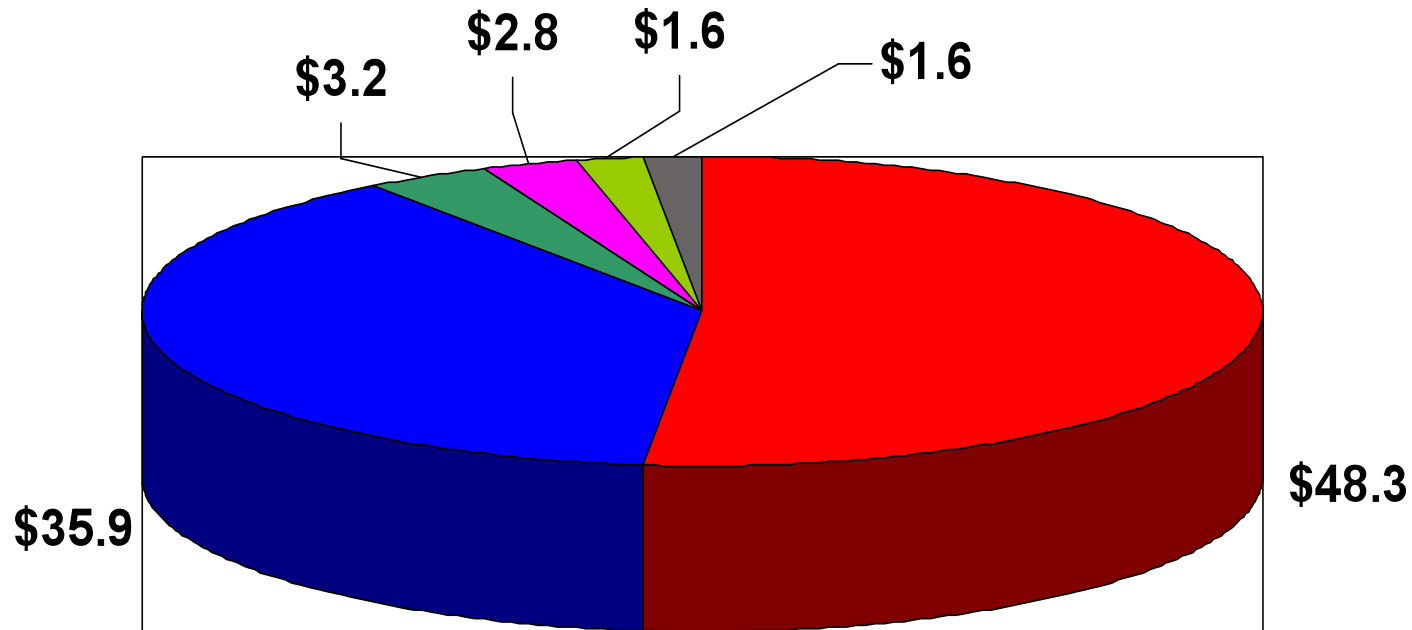
# Few Taxpayers - Large Benefit Most Taxpayers - Small Benefit



# Investment Tax Credits Pie is Changing (2003)

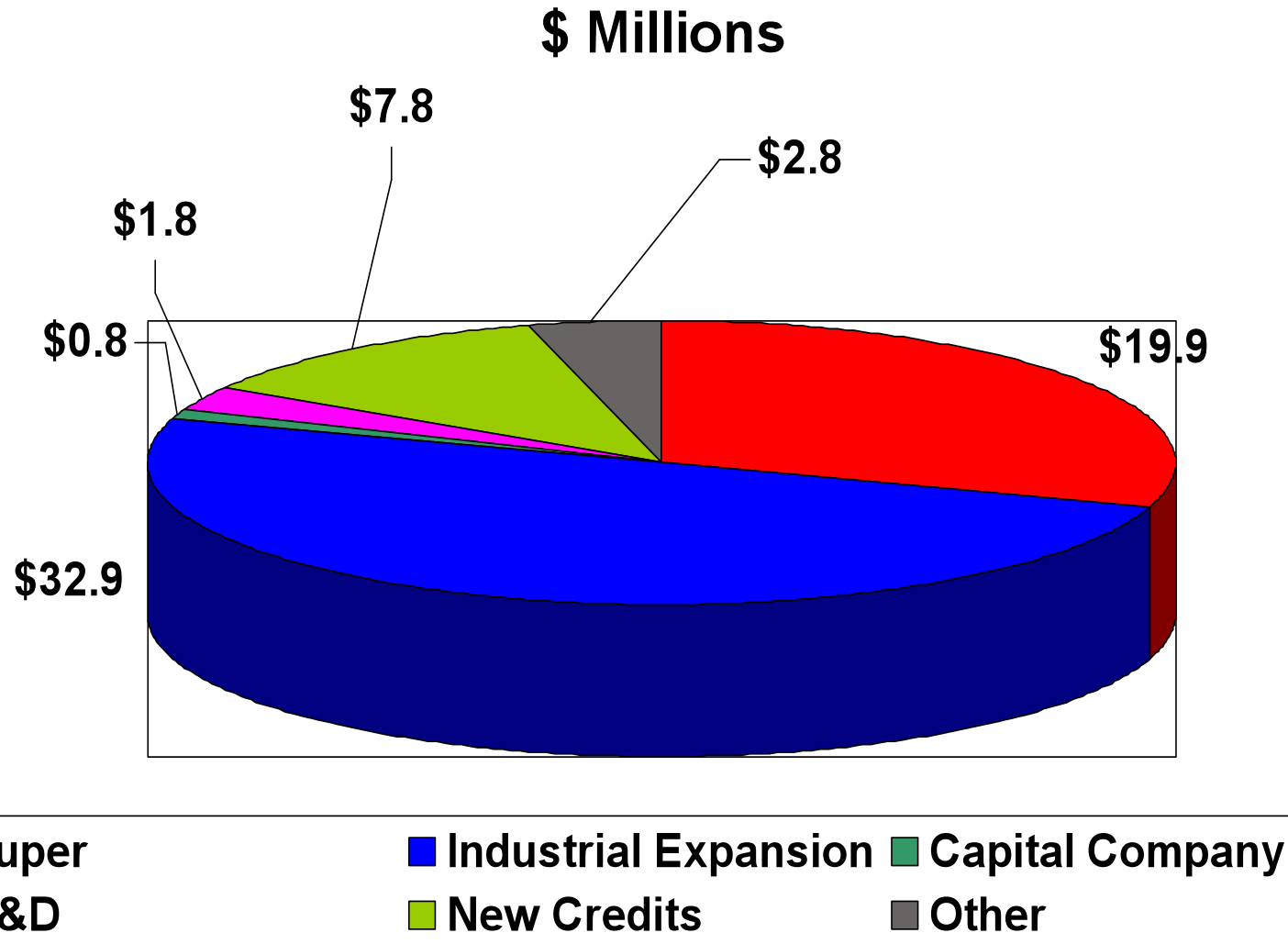
Terminated Credits represent > 67% of \$93.4 Million Total

**\$ Millions**



# Investment Tax Credits Pie is Changing (2006)

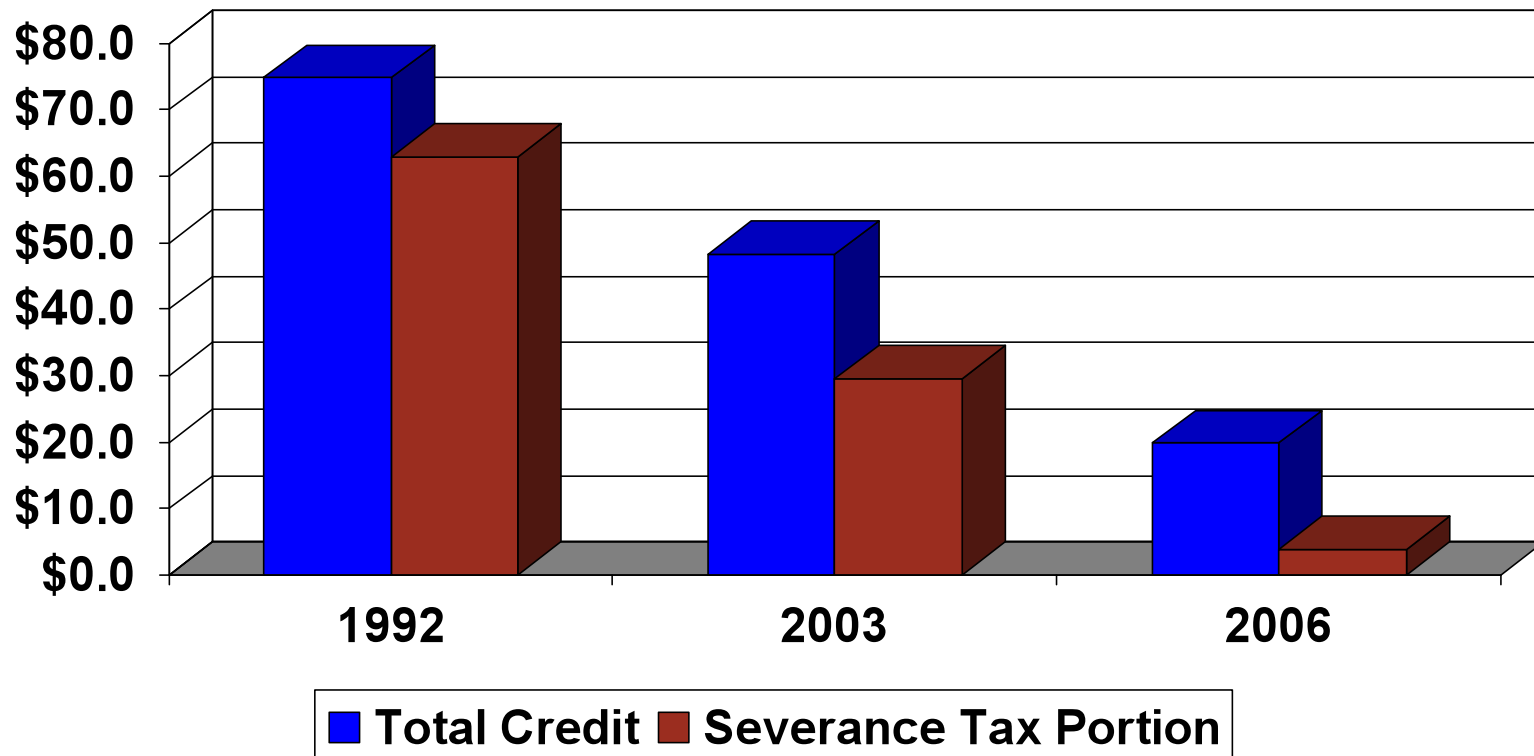
Terminated Credits represent > 44% of \$65.9 Million Total



# Super Credit Expenditures Decline

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

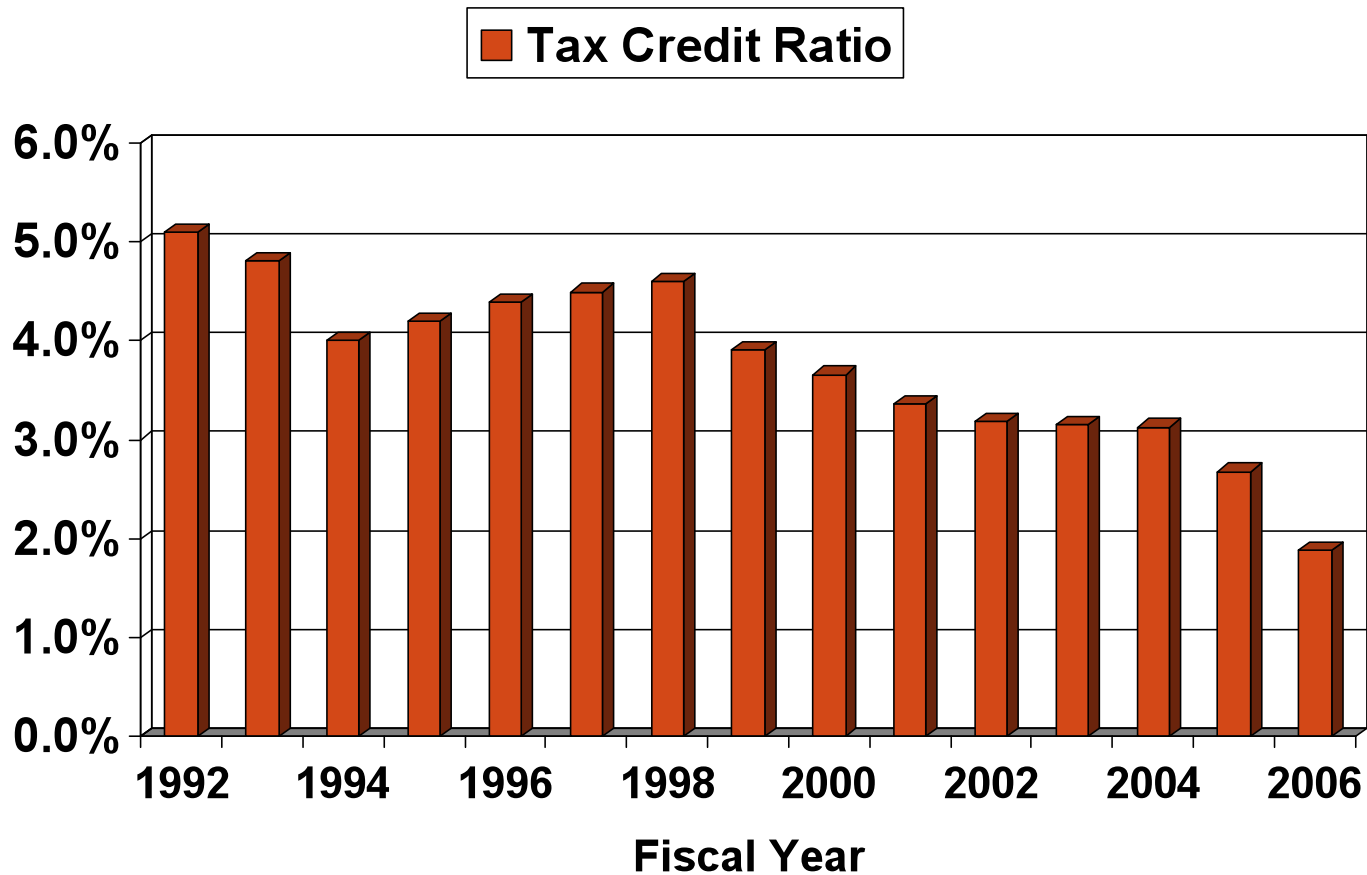
**\$ Millions**





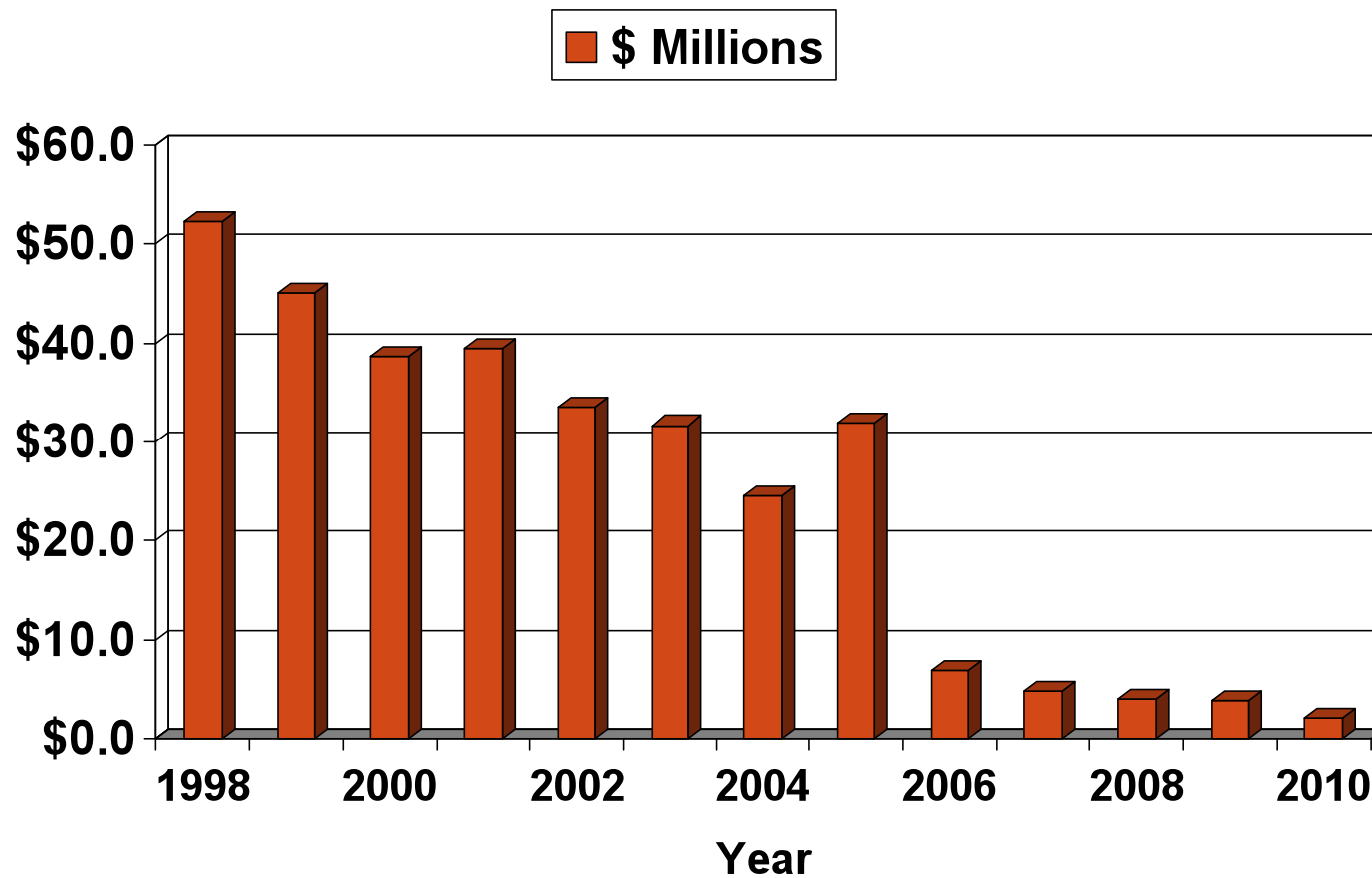
# Tax Credit-General Revenue Fund Ratio

Compares Disclosed Tax Credit Values with General Revenue Fund Collections



# Total Tax Credits Claimed on Coal Severance Tax Returns 1998-2010\*

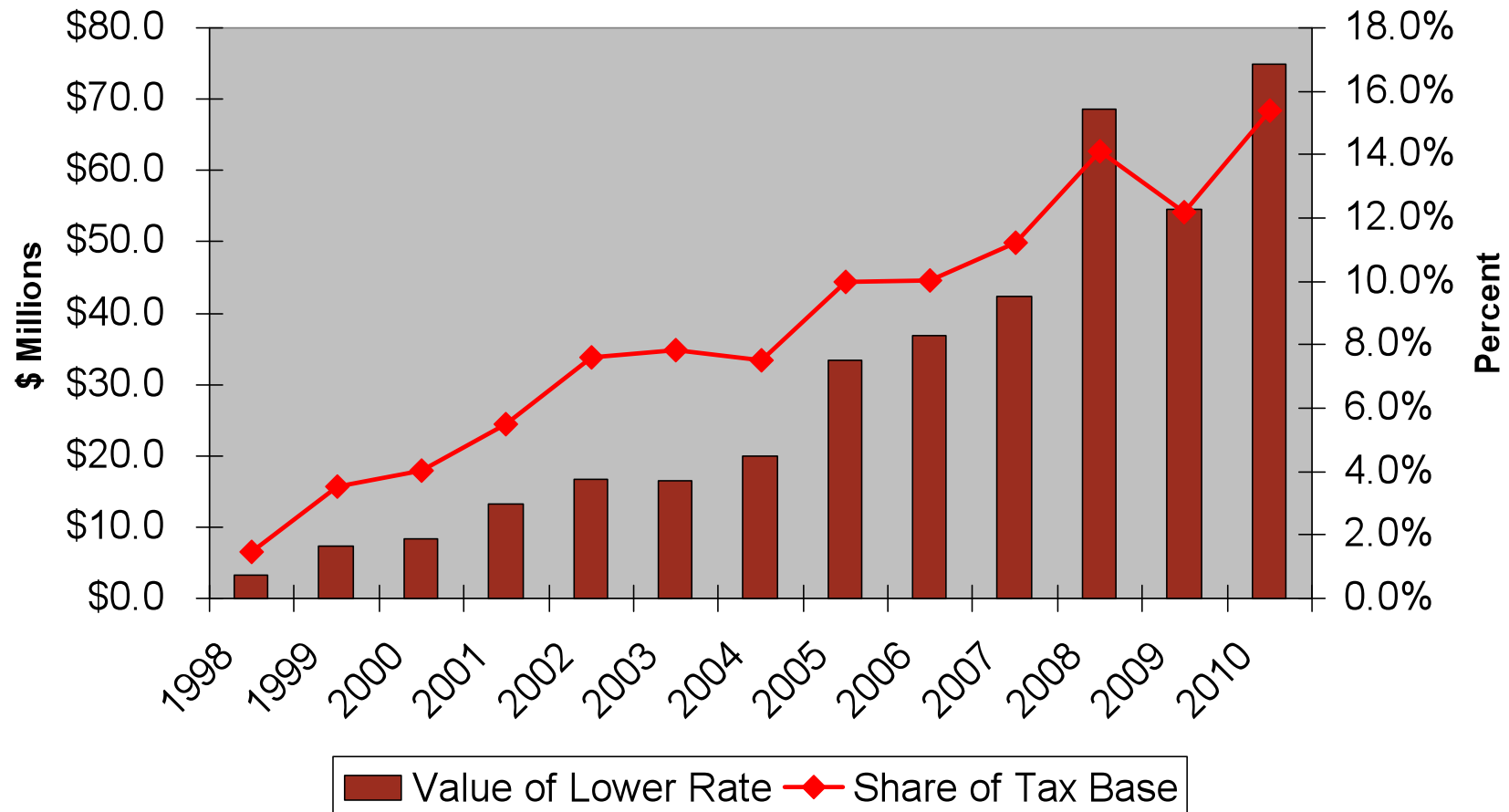
\* Preliminary Data for 2010 – Includes Annual \$500 Credit



# Promotion of Thin-Seam Underground Coal

Tax Rate Preference: < 37" (80%); 37"-45" (60%)

Value is 15% of the Gross Tax Base

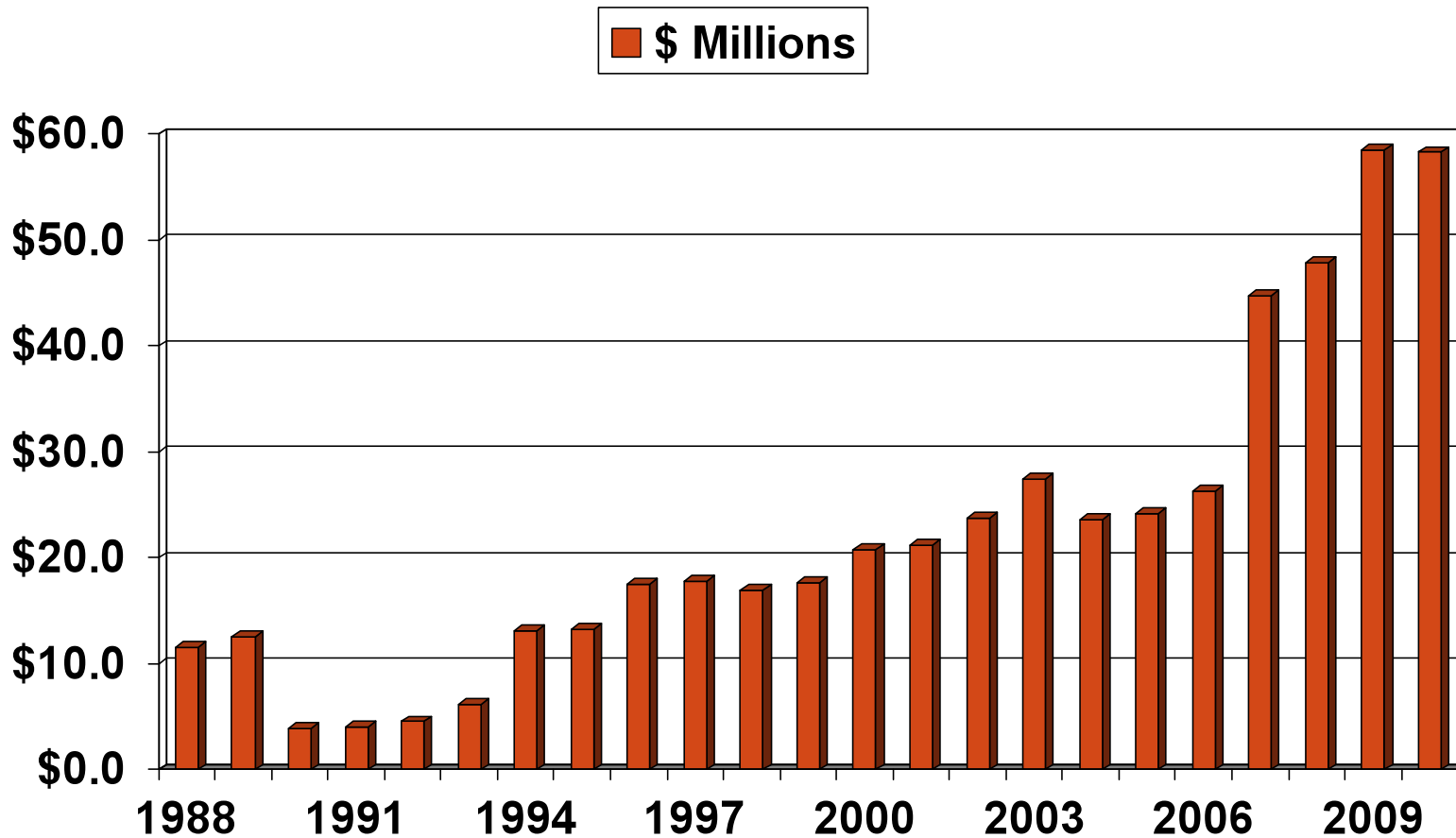


# Electric Power Generation Industry

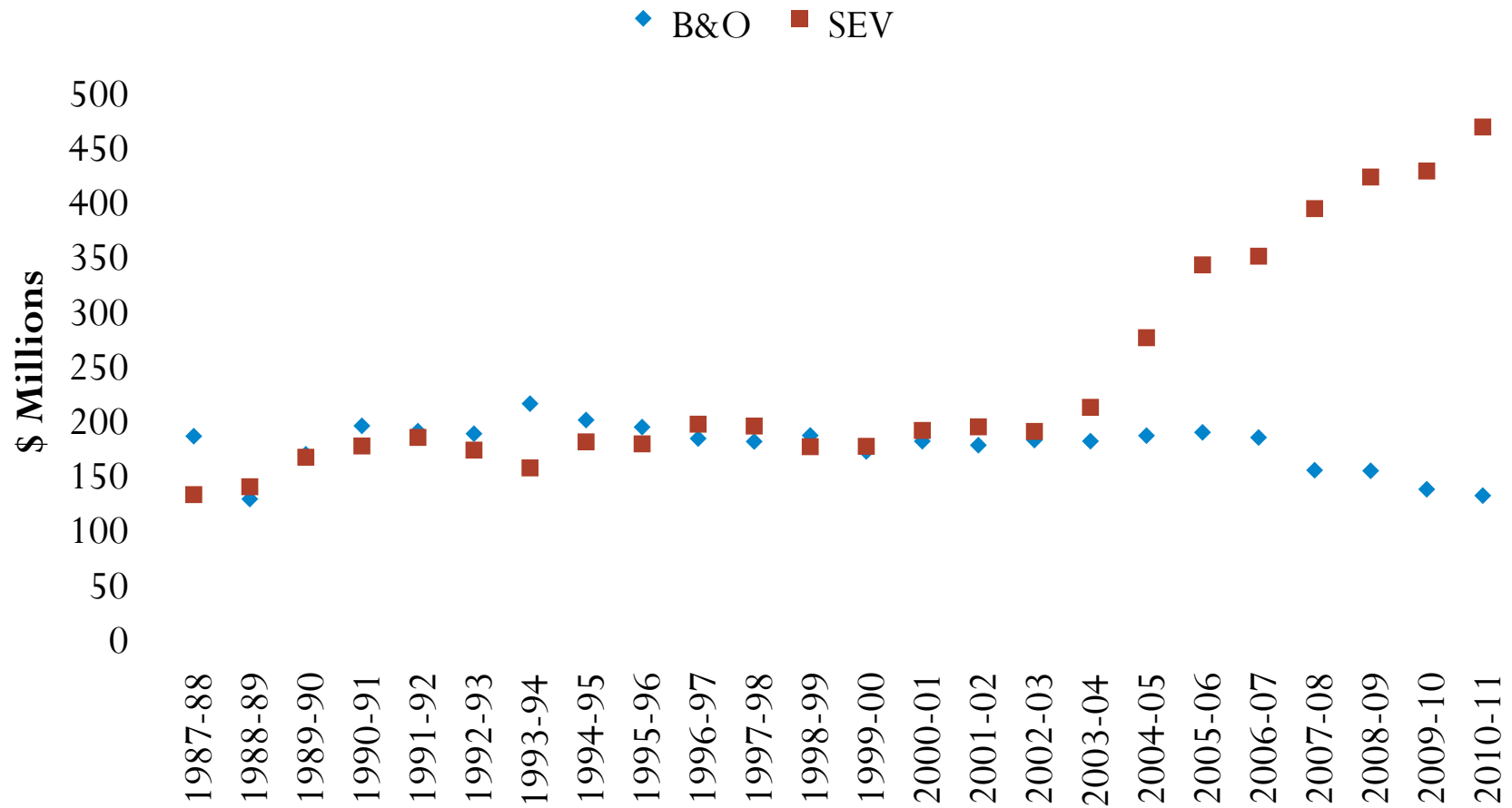
40% to 75% of Investment Tax Credits – B&O Tax

- 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

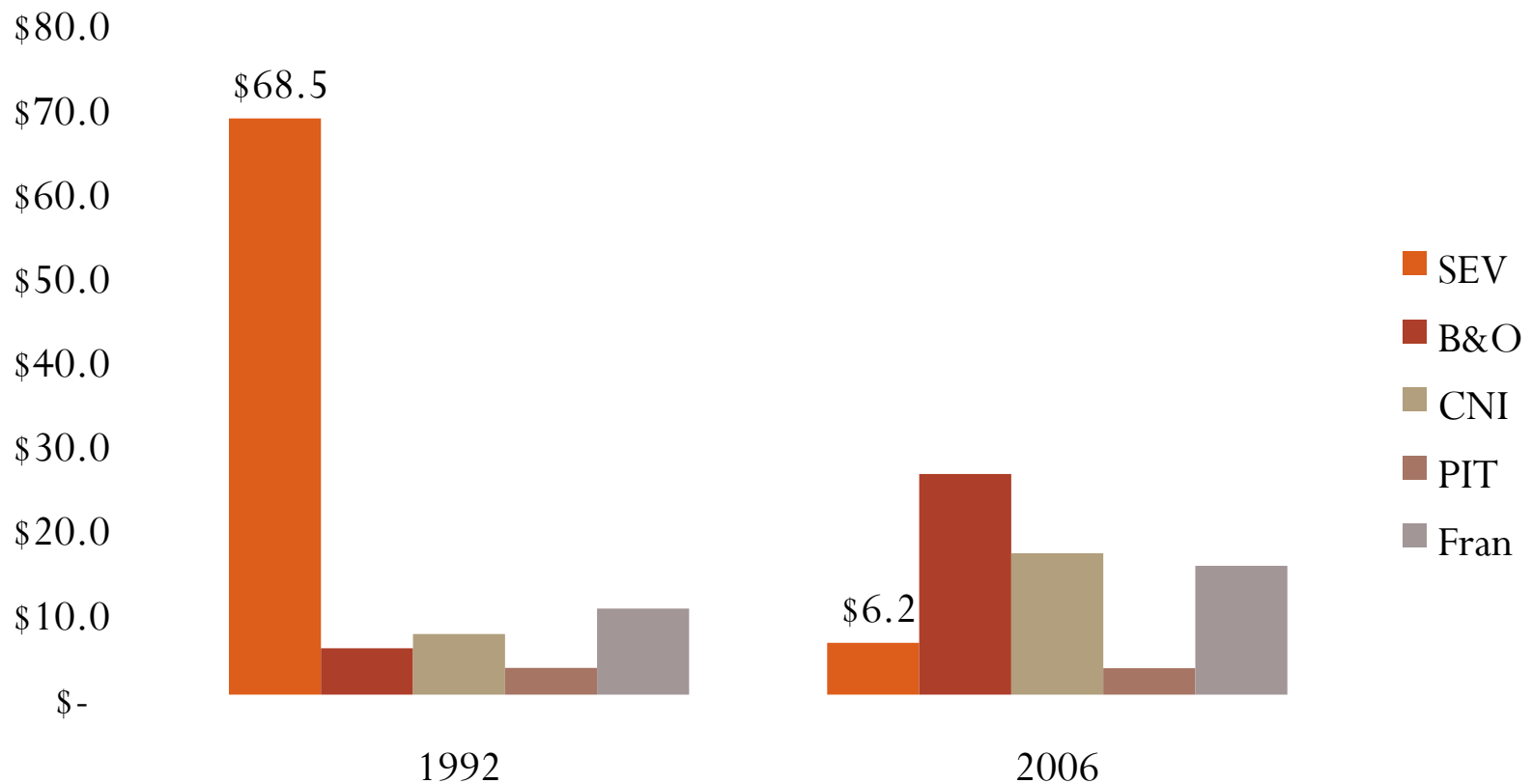


# B&O and Severance Tax Collection Trends

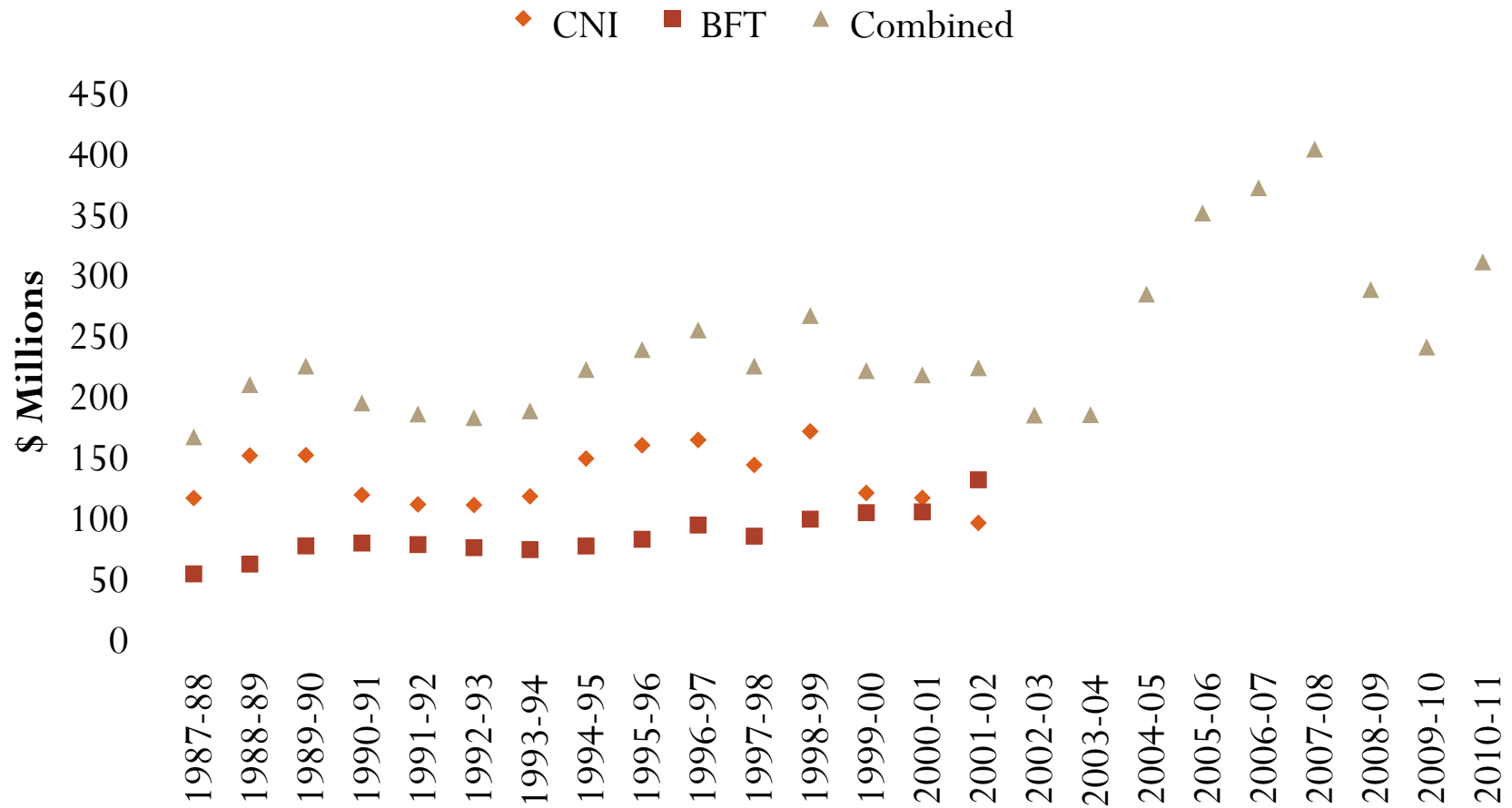


# Incentive Tax Credit Costs Decrease Due to Tax Type Restrictions

**\$ Millions**



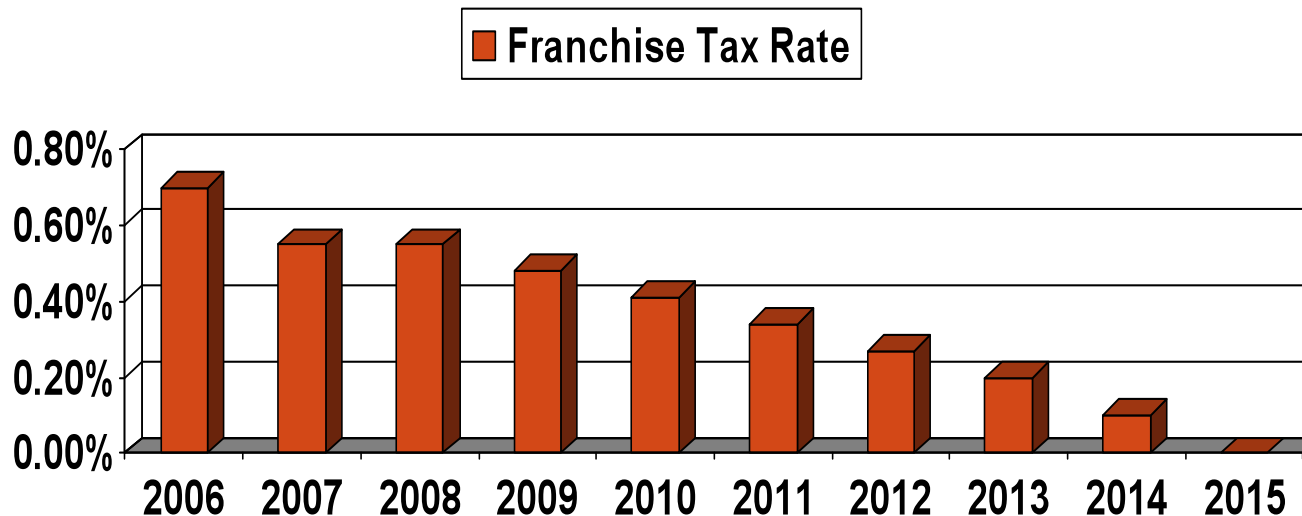
# WV Corporate Tax Collection Trends





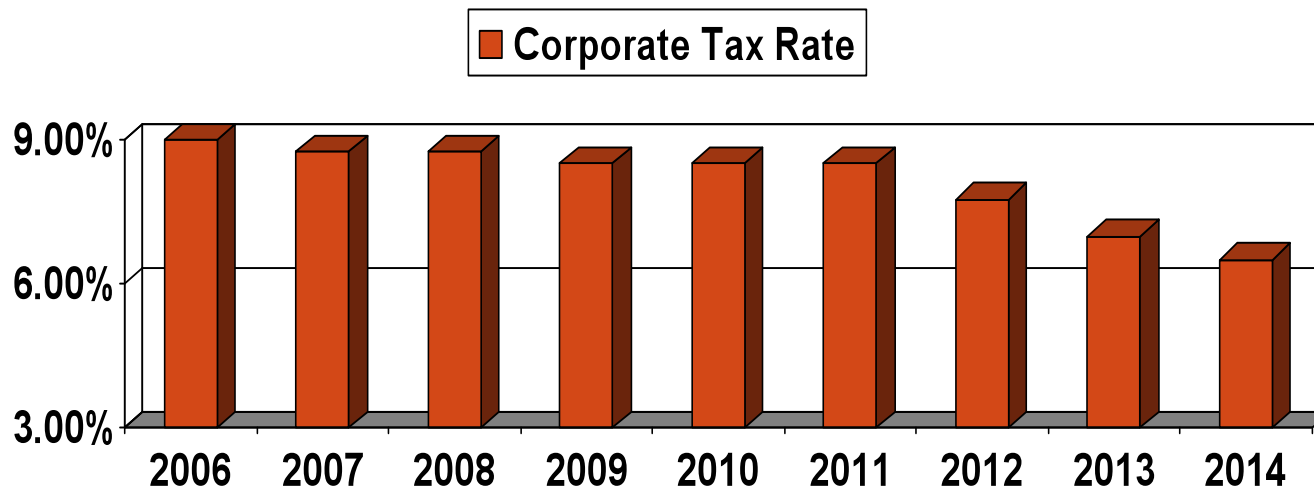
# Value of Tax Credits Decrease With Tax Rate Reductions – Part I

- 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



# 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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