FISCAL IMPACT REPORT

SPONSOR	Trujillo, CA / Sweetser	**ORIGINAL DATE** / **LAST UPDATED**	1/29/18 / 2/9/18	**HB**	200
SHORT TITLE	High-Wage Jobs Tax Credit Eligibility			**SB**	
				ANALYST	Clark

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	**FY19**	**FY20**	**FY21**	**FY22**		
$0.0	Minimal	($3,750.0)	($6,250.0)	($10,000.0)*	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

*The large loss in FY22 is partly due to the extension of the delayed repeal date (see Fiscal Implications); however, TRD notes fiscal impacts should rise significantly over time

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

House Bill 200 amends the high-wage jobs tax credit, which was changed in numerous ways during the 2016 special session to reduce the skyrocketing cost of the credit. The changes made by this bill reduce the value of the credit per job per year (see Fiscal Implications), extend the maximum length of the credit from four years to eight, remove all business eligibility requirements other than eligibility for the Job Training Incentive Program (JTIP), reduce the number of weeks a job must be held from 48 to 44, and make minor modifying language.

The bill also removes most of the current restrictions preventing businesses from using the credit if they shed other jobs or previously ceased business operations.

The bill allows a high-wage job to qualify for the credit in future periods (if it meets the requirements in those periods) even if it does not qualify for the credit in a period following the initial period. Current statute requires that once a job falls out of qualification, it cannot qualify for any potential remaining periods.

The bill removes the qualifiers related to the time the Taxation and Revenue Department (TRD) has to process applications, requiring a determination in 180 days.

The bill extends qualifying periods for the credit from the current termination of 2020 to 2028.

The provisions of the bill apply to qualifying periods beginning on or after January 1, 2018.

FISCAL IMPLICATIONS

Several provisions of the bill have a negative fiscal impact by making the credit available to more potential applicants. In addition, the bill extends the lifetime of the credit from a maximum of four years to eight years and effectively raises the cap on wages to which the credit is applied – from a cap of essentially $120 thousand in annual wages per employee to $150 thousand.

However, the bill also has a provision with a positive fiscal impact. The bill reduces the value of the credit from 10 percent multiplied by the employee's wages to the current highest personal income tax (PIT) rate multiplied by those same wages. The current highest PIT rate is 4.9 percent, therefore cutting the value by about half for any positions paid $120 thousand or less per year, with a value gradually rising above half for positions paid more than that and up to the new cap of $150 thousand. This results in a change in the maximum cost per job from $12 thousand per year to $7,350 per year, albeit for twice as many possible qualifying years in this bill.

There would likely be a minimal impact on revenues for FY19 because the bill only applies to qualifying periods beginning on or after the start of 2018. These qualifying periods would close in 2019, and the eligible companies would claim a credit for those periods in the following calendar year. Assuming they file soon after the start of that year (2020), and TRD is required to process applications within 180 days, it is reasonable to project a significant portion of the annual impact would occur in FY20. The impact would then grow each year as the initial qualifying periods continue as subsequent qualifying periods and as companies file for more initial qualifying periods that would have been ineligible under current statute.

The Taxation and Revenue Department (TRD) provided the following analysis.

> Fiscal impacts are uncertain because over time, because the number of eligible claims has fluctuated and because this bill seeks to change eligibility rules. The bill would remove several restrictions that have reduced eligible credit claims in recent years, therefore resulting in the increase in the estimated impact to the general fund. The fiscal impacts shown assume a 100% increase in the number of qualifying jobs. Partially offsetting these negative impacts in the short run is the lower rate of credit per job. However, after year four, the savings per job are gradually reduced by the longer eligibility period. Thus, fiscal impacts rise significantly, potentially to as much as $40 million per year.

The Economic Development Department (EDD) provided the following analysis.

> The bill potentially reduces the initial amount of the eligible credit for one job (by changing the percentage from 10 to 4.9), but extends the period for which the credit may be taken from four to eight years. These changes may reduce the total impact of the credit over time. The reduced rate should lower the cost upon enactment. While the total cost over eight years could be mathematically comparable, the potential for the position to not

remain eligible for a complete eight years should reduce the total payout over time. In other states, the multi-year, post-performance tools are structured in a similar way where the rate is closely tied to the personal income tax rate and extended over several years. One of Oklahoma's incentives is paid out over a 10-year period.

The fiscal impact shown is a very rough estimate; there is no way to accurately estimate the impact without a detailed analysis of new applications – an analysis only TRD would be able to perform on claims and awards data. The cost to the general fund is smaller in FY19 due to a partial-year impact; it rises in FY22 to reflect that current statute does not allow qualifying periods for the credit after July 1, 2020. However, note this is due to a recommended delayed repeal date to allow for periodic review and discussion and does not necessarily represent legislative intent for the credit to expire on that date.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

The high-wage jobs tax credit is a refundable credit intended to incentivize urban and rural businesses to create new, high-wage economic-based jobs. It requires the state to pay companies even if they have no tax liability through a credit to the employer of 10 percent (4.9 percent through this bill and under current PIT rates) of an employee's wages.

Use of this credit exploded for several years from a cost in FY10 of $4.6 million to $66 million in FY15 and $58 million in FY16, but many of the companies claiming the credit were receiving refunds due to loopholes in the statute. Legislation enacted during the 2016 special session closed the known loopholes and imposed additional reporting and eligibility requirements. These requirements reduce the projected cost of the credit and help prevent exploitation of the credit by companies that do not continue to add net new employees.

However, economic developers report the new requirements were too stringent and make the credit almost unusable, and TRD recently reported the value of new, approved claims had fallen to the smallest levels in many years. This credit was often cited as one of the best tax incentive tools for recruiting businesses, along with the JTIP and state grant money.

While some provisions being repealed in this bill can be argued were too limiting, they were put in place to stop some of the most egregious exploitations of the credit, and removing them and leaving company eligibility solely in the hands of the JTIP board significantly impairs the statutory protections. Instead of repealing the provisions, perhaps they could be amended to maintain protection of state revenues and also make the credit more useful.

It does not appear this bill was vetted by appropriate interim legislative committees. LFC tax expenditure policy principles recommend new or expanded tax expenditures be vetted to review fiscal, legal, and general policy parameters. Given the explosive growth in the cost of this tax expenditure in the past, it is strongly recommended any bill changing this credit be vetted by interim committees and by the legal staff at TRD.

EDD provided the following analysis.

> When EDD uses this credit in its efforts to attract new business to the state, it advises the business that it may be eligible for the credit. Granting EDD the authority to determine a business' eligibility (by striking all company eligibility requirements other that being JTIP eligible per rules established by EDD) will prevent potential conflicts in this determination.
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> Since this credit was established, there have been issues relating to interpretations of the language used in the legislation. This bill seeks to resolve these issues by eliminating confusing language and making the statute clearer. For example, "economic-base" has no explicit definition (only as part of "high-wage economic base job" with only a subsequent explanation of the wage reference), so it is removed. Language restricting the use of the credit a second time in five years due to a reduction in total employment is also removed.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	**Met?**	**Comments**
Vetted	✘	It does not appear this bill was vetted
Targeted		
Clearly stated purpose	✓	
Long-term goals	✘	
Measurable targets	✘	
Transparent	✘	
Accountable		
Public analysis	✘	
Expiration date	✘	
Effective		
Fulfills stated purpose	?	
Passes "but for" test	?	
Efficient	?	
Key: ✓ Met ✘ Not Met ? Unclear		

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