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Assessing the Impact of Missouri's Tax Credits An Update

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Talking Points

- Governor Nixon has for some time given high priority to tax credit reform, having requested two reports from a review commission and indicated in his State of the State address that reducing tax credit expenditures would fund bond repayments for major capital projects.
- One of IPP's own priorities is to see changes in how tax credit programs are assessed for cost-effectiveness. The Missouri Tax Credit Review Commission acknowledged this issue in its latest report.
- However, there appears to be little interest in comprehensive tax credit reform but a preference for piecemeal changes that cap the largest programs, extend the life of sunsetted programs, and add new ones. Most of the other issues discussed in the IPP Policy Brief have yet to be addressed.

Introduction

In October 2012, the Institute of Public Policy prepared a report for the Missouri Tax Credit Review Commission. The report, *Assessing the Impact of Missouri's Tax Credits*, by B. Dabson, T.G. Johnson, A Wesemann, M. Figueroa-Armijos, and J.I. Stallmann, was published as a Policy Brief (03-2013) in January 2013. It concluded that:

- Missouri's tax credits have been authorized over several decades with widely different goals, controls, and success.
- Tax credits negatively affect the state's general revenue budget in unpredictable ways, may not yield the expected benefits, and may not be the most useful tool to advance supporters' underlying goals.
- Economic development tax credits can and should be assessed on their costs and benefits in strictly economic terms. However, tax credits designed for other purposes, such as housing or historic buildings, should be assessed against broader criteria and their cost effectiveness.

Since October there have been a number of developments in Jefferson City which have prompted this update.

The Governor's Priority

Governor Nixon in his 2013 State of the State address called for a major bond issuance to modernize K-12 classrooms and college research labs, mental hospitals and state parks.

> "The way to pay for the bond issuance is to finally get our tax credit system under control. We've worked on reining in tax credits for years. In 2010, I appointed a statewide, bipartisan, tax credit commission to study the issue. That commission tapped the expertise of Missouri leaders in business, education, labor and government. They recommended a series of pragmatic, fiscally responsible reforms to rein in tax credit expenditures and ensure these programs provide a strong return on taxpayers' investment. But two years later, these reforms have yet to pass, and the costs of inaction continue to grow. Last year tax credit redemptions grew to a staggering $629 million - one-twelfth of our entire general revenue budget. That's not fiscally responsible. This is the year to get comprehensive, fiscally responsible tax credit reform legislation to my desk, and get smart, strategic investments in our state moving forward."

The 2012 Commission Report

The Missouri Tax Credit Review Commission submitted its second report to the Governor on December 15, 2012. The Commission had been charged with reviewing its 2010 recommendations and determining the extent to which they should be supplemented, amended, or rescinded.

The Commission's report made a number of general and specific recommendations. The general recommendations focused on issues relating to sunsets, related party transactions, bidding and procurement, stacking, and importantly from the Institute's viewpoint, return on investment. To restate some of the Institute's recommendations:

- Tax credit programs are intended to achieve certain purposes, primarily stimulating investment and encouraging different types of development, across a wide range of sectors and activities. Their individual impact and effectiveness should be measured according to the extent to which they achieve their specific purpose.

- The purpose of tax credit programs is not to increase state revenues, and their impact should not be measured in those terms.

- Economic development programs should be evaluated on their economic costs and benefits. The application of an evaluation model is appropriate if it is used to calculate net improvements in the state's economy – i.e. growth in Gross State Product – and includes the opportunity costs of tax credit funds in the analysis.

- However, for other programs where the benefits are less amenable to measurement in monetary terms, such as tax credits for historic preservation or low-income housing, cost-benefit analysis is not possible. Broader indicators of benefits are required in these cases, and measures of cost-effectiveness are necessary. This means being clear at the outset about a program's desired outcomes, appropriate measurements for determining success, and the design of monitoring protocols.

The Institute's perspectives were considered by the Commission, which made its own recommendations on this topic:

> The Commission recognizes the availability of additional tools by which to measure tax credits in addition to a cost benefit measure. The Commission recommends that the General Assembly evaluate cost effectiveness measures that may depict the performance and efficiency of a tax credit program in addition to the fiscal cost and return to the state. The Commission also recognizes that different measures may be more applicable to different kinds of credits and the value of specifically tailored effectiveness measures may provide more usefulness to policy makers than any one common measure.

On the individual programs, the Commission recommended two significant changes:

- For the Historic Preservation Tax Credit, reduce the annual cap from $140 million to $90 million (previously recommended $75 million). There were also a number of statutory and administrative changes recommended.
- For the Low Income Housing Tax Credit, reduce the cap on 9 percent tax credits to $115 million over 10 years and on 4 percent tax credits to $20 million over 10 years. The Commission also made an alternative proposal for changing the tax credit from 10 years to 5 years.

Other recommendations included:

- No change to 2010 recommendations for tax credit programs for agriculture and environment, banking and insurance, and property.
- Allow expiration of the Film Production Tax Credit in November 2013.
- Allow rollover of unused tax credits for Brownfield Redevelopment for use in future years.
- Instead of sunsets for Social and Contribution tax credits, subject programs to periodic review and transition arrangements.

However, the Commission was not unanimous in its conclusions, and a supplemental minority report was prepared. The authors of this report objected to (1) the changes to the Low-Income Housing Tax Credit cap, (2) the change in tax credit duration for the Historic Preservation Tax Credit, and (3) the decision to replace sunset provisions with periodic reviews and transitional arrangements. The report also set out a detailed critique of the use, effectiveness, and appropriateness of tax credits.

Tax Credits in the Legislature

At the end of January 2013, the Senate passed three tax credit bills. The first sponsored by Senator Dixon modified provisions related to benevolent tax credits (SB 20):

- **Public Safety Officer Surviving Spouse Tax Credit** – extended sunset from August 28, 2013 to December 31, 2019.
- **Special Needs Adoption Tax Credit** – provisions that authorized use of unused funds for Child in Crisis tax credit eliminated. $2 million cap on in-state adoptions, none for out-of-state.

- **Child in Crisis Tax Credit** – name changed to Champion for Children tax credit, sunset extended from August 28, 2012 to December 31, 2019. Capped at $2 million. Also extends sunset on credit for home modifications to make them accessible to disabled residents from December 2013 to December 2019.
- **Rebuilding Communities Tax Credit** – unused tax credits up to $100,000 can be used for residential dwelling accessibility.
- **Donations to Pregnancy Resource Centers** – extended sunset from August 28, 2012 to December 31, 2019.
- **Donations to Food Pantries** – extends sunset form August 28, 2011 to December 31, 2019 and capped at $1.25 million (from $2 million)

Senators Schmitt and Parson sponsored two new tax credit bills (**SB 10 &25**):

- **Amateur Sporting Events Attraction Tax Credit** – refundable income and financial institutions tax credit for sporting commissions, some nonprofits, counties and municipalities to offset expenses in attracting amateur sports events to the state. Credits for the lesser of $5 per admission ticket or 100% of costs incurred. Cap of $3 million per fiscal year through August 2019.
- **Donations to Sporting Events Tax Credit** – non-refundable income, financial institutions, and corporate franchise tax credit at 50 percent of donation. Sunset at August 2019.

On February 27, 2013 the Senate approved modifications to the Missouri's tax credits and tax incentives. SB 120, sponsored by Senator Eric Schmitt, chairman of the Senate Jobs, Economic Development and Local Government Committee. The bill proposes two new tax credits:

- **Data Storage Centers Tax Incentives** – permits municipalities to enter into loan agreements or sell, lease or mortgage municipal property for the development of a technology business facility project. It also provides state local sales and use tax exemptions for all machinery, equipment, computers, electrical energy, gas, waste and other utilities used in new and existing data storage center facilities. New facilities will have to result in at least $37 million of new facility investment, and create 30 new jobs with wages of at least 150 percent of county average wage; for existing, the requirement is $5 million and five new jobs. These incentives will expire on September 1, 2019.
- **Missouri Export Incentive Act** – beginning July 1, 2013, authorizes refundable air export tax credits for freight forwarders of ¢40 per kilo shipped out of an airport owned and operated by City of St. Louis. The amount to be issued is capped at $7.5 million each year, and $60 million over 8 years.

It also places stricter caps on three existing programs:

- **Low-Income Housing Tax Credits** – introduces a cap of $100 million fiscal year cap for authorizations of 9 percent low-income housing tax credits beginning FY 2014; for 4 percent credits are capped at $10 million.
- **Historic Preservation** – caps issuing of tax credits to $75 million per year (from $140 million) beginning FY 2014. Projects receiving less than $275,000 in credits are capped at $10 million. Also prohibits issuance of credits of more than $125,000 per project for non-income producing residential rehabilitation projects.
- **Brownfield Remediation Tax Credits** – caps tax credits at $30 million beginning FY 2014. If Distressed Areas Land Assemblage tax credits are authorized, the BRTC are increased to$40 million.

The Neighborhood Preservation Act and the Self-Employed Health Insurance Tax Credit are no longer authorized.

According to Senator Schmitt, overall savings will be $800 million over 15 years due to the cumulative effect of lower limits on housing and historic building programs. SB 20 is already in process in the House of Representatives, and SB 10, 25, and 120 will follow soon.

Commentary

Since the Institute completed its report in October 2012, the purpose, scale, and scope of tax credits have been scrutinized by the Missouri Tax Credit Review Commission and discussed in the Governor's State of the State Address. Yet, in the legislature, there appears to be little interest in comprehensive tax credit reform; rather, preferences for piecemeal changes that cap the largest programs and extend the life of sunsetted programs, as well as introduce some new tax credits.

The Institute's research pointed to some significant challenges associated with the use of tax credits. These included concerns over opportunity costs, additionality, distortion, and measurement, which have still to be addressed.

References

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