Alternative Evaluation Approaches

Effective Tax Rate Analysis

2023 JLARC Review of Food Processing Tax Preferences

Pete van Moorsel | WA Joint Legislative Audit and Review Committee

November 2022

Tax preference reviews: JLARC directed to address five key areas

Public policy objectives:

Intent of the preference and is it being achieved?

Beneficiaries:

What entities are affected and what are their savings?

Revenue and economic impacts to the taxpayers and to the government?

Do **other states** have a similar tax preference?

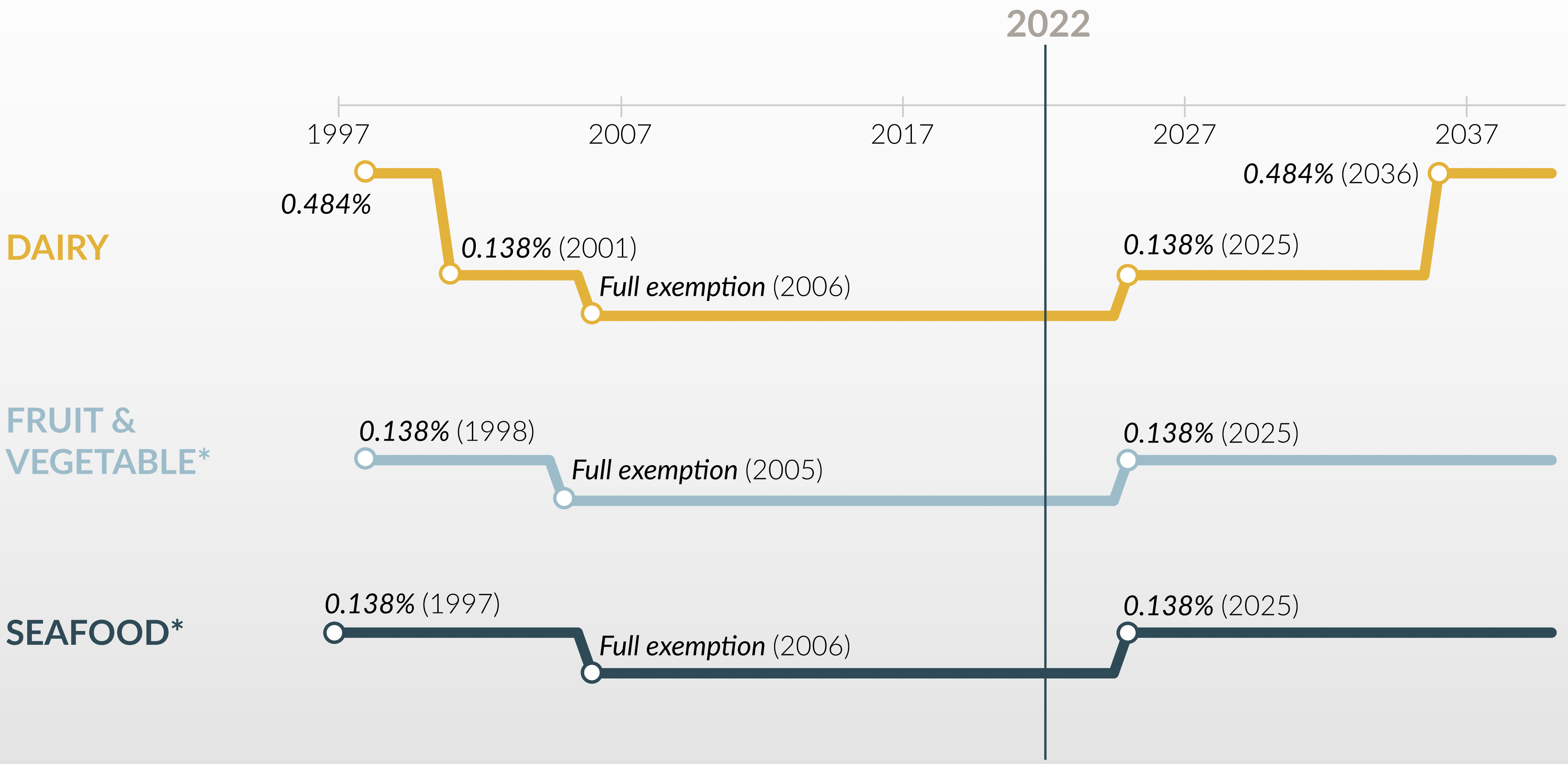
Required to make **recommendation** to Legislature.

B&O tax exemptions for processors of:

Dairy products | Fruit & vegetables | Seafood products

- **Manufacturing products:** Yogurt and cheese, frozen French fries, wine, and frozen fish fillets.
- **Sales of products by the manufacturer:** to in-state buyers for transport out of state.
- **Estimated 2023-25 beneficiary savings:**
  - Dairy: $10.5 million
  - Fruit & vegetable: $22.7 million
  - Seafood: $4.9 million

When exemptions expire, replaced with preferential rates.



Seafood and fruit & vegetable processors have paid varying preferential B&O tax rates since 1959 and 1965, respectively.

Does an industry in Washington pay more or less tax than in other states?

2015 Legislature stated two objectives:

- Create and retain jobs.
- Provide tax relief (**interstate tax competitiveness**).

Tax savings = tax relief.

Do preferences improve WA's rank vs. competitor states? California, Oregon, Idaho, Alaska (seafood only).

Interstate comparison of tax burdens complicated by different tax structures.

Effective tax rate can provide an “apples to apples” comparison.

Discounted cash flow model programmed with financial features of each industry and each state’s relevant tax features and rates.

Effective tax rate (ETR): the % reduction in a hypothetical firm’s rate of return due to taxes over 30-year period.

Pre-tax rate of return		5%
After-tax rate of return	–	4%
Reduction due to taxes		1%

$$\frac{\text{Reduction due to taxes} \quad 1\%}{\text{Pre-tax rate of return} \quad 5\%} = \boxed{20\%\ \text{ETR}}$$

ETR compared before and after including tax preferences.

$$\frac{\text{Reduction due to taxes after incentives} \quad 0.5\%}{\text{Pre-tax rate of return} \quad 5\%} = \boxed{10\%\ \text{ETR}}$$

Hypothetical small and large manufacturing firms for each industry.

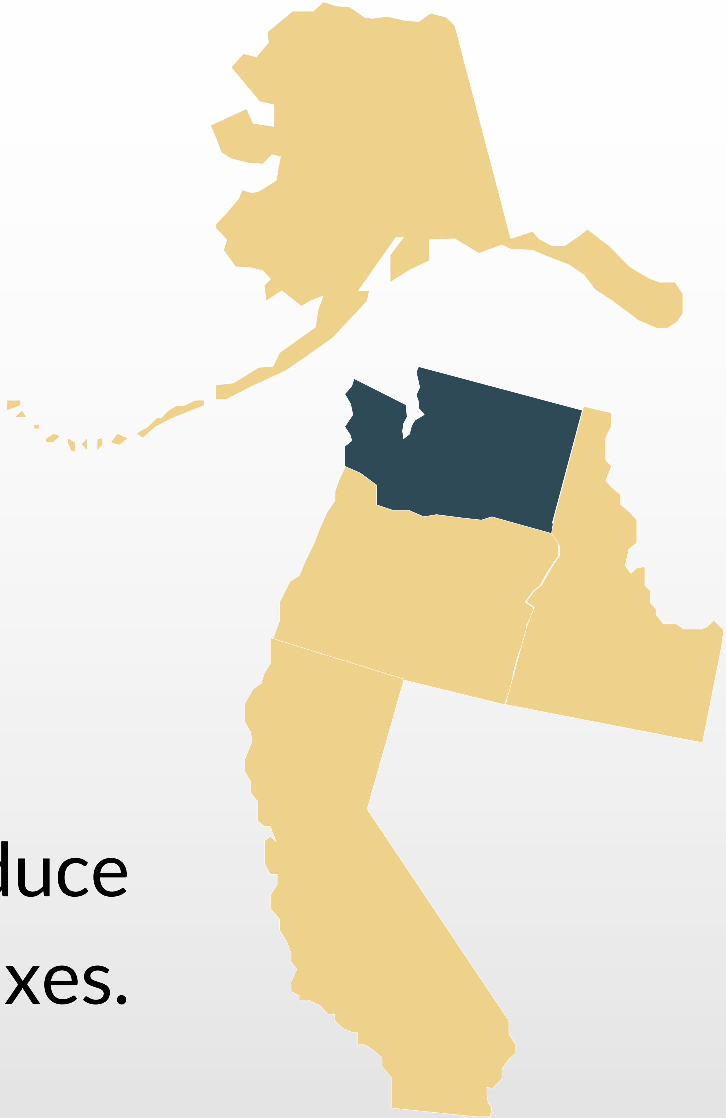
Financial Profile:

- Employment: based on distribution of industry firms by size.

Industry	Small firm employment	Large firm employment
Fruit & vegetable preserving and specialty food manufacturing	45	250
Dairy product manufacturing	20	235
Seafood product preparation and packaging	15	165

- Location: county based on highest location quotient.
- Other metrics: wages, business assets, income, and expenses based on public data.

Tax systems of comparison states



Evaluate tax systems in each state.

- Corporate income tax.
- Gross receipts taxes (WA’s B&O tax).
- Sales and use tax (state & local) on business inputs.
- State and local property tax.
- Franchise tax.

Tax liability totaled to estimate how much they reduce the hypothetical business's rate of return due to taxes.

Incentives per state.

Availability of incentives, impact on firm ETR.

Statutory Incentives:

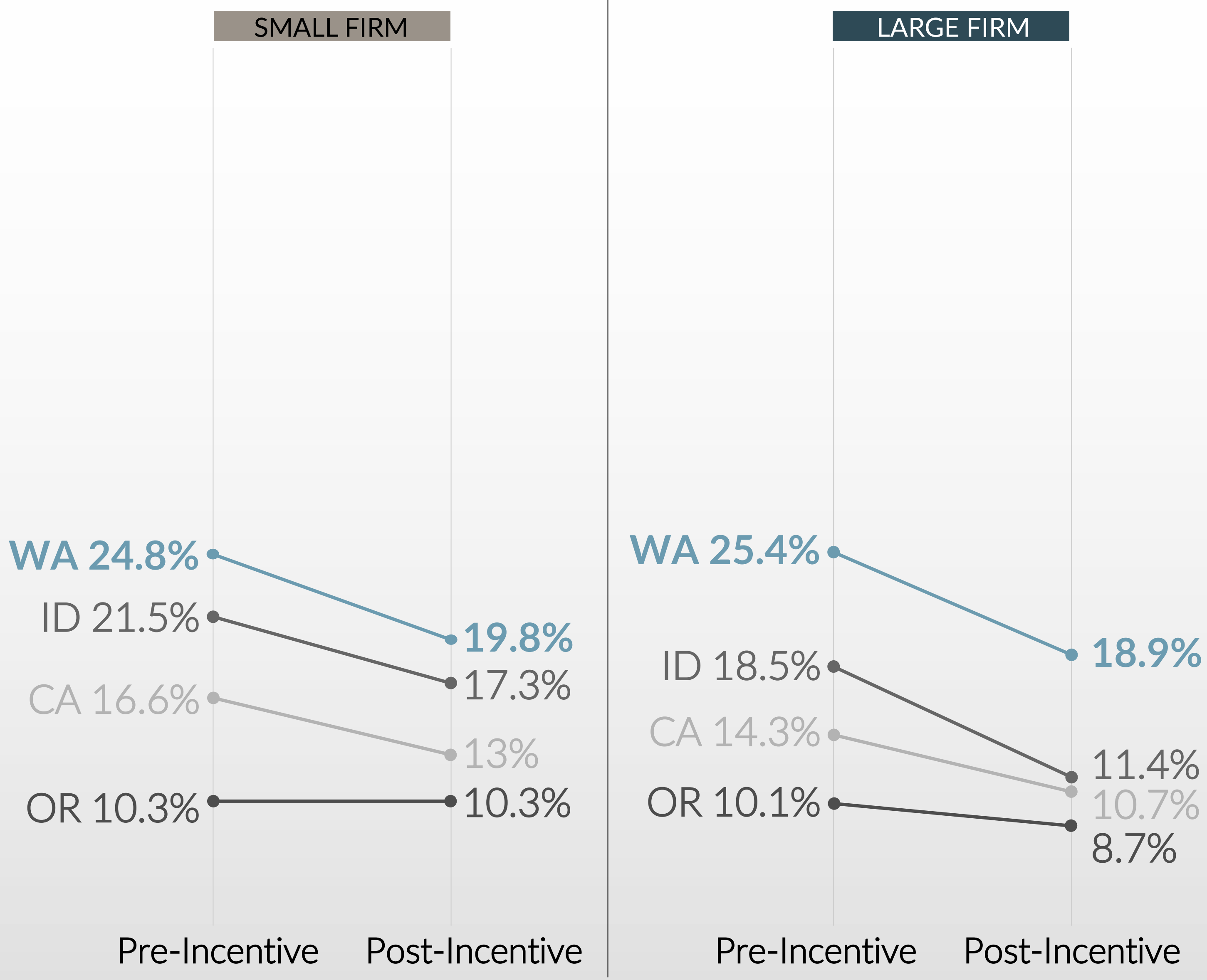
- Tax credits: job creation, investment, R&D spending.
- Wage rebates.
- Preferential tax rates.
- Sales and use tax exemptions on capital investments.

Discretionary or **negotiated incentives** that may be available.

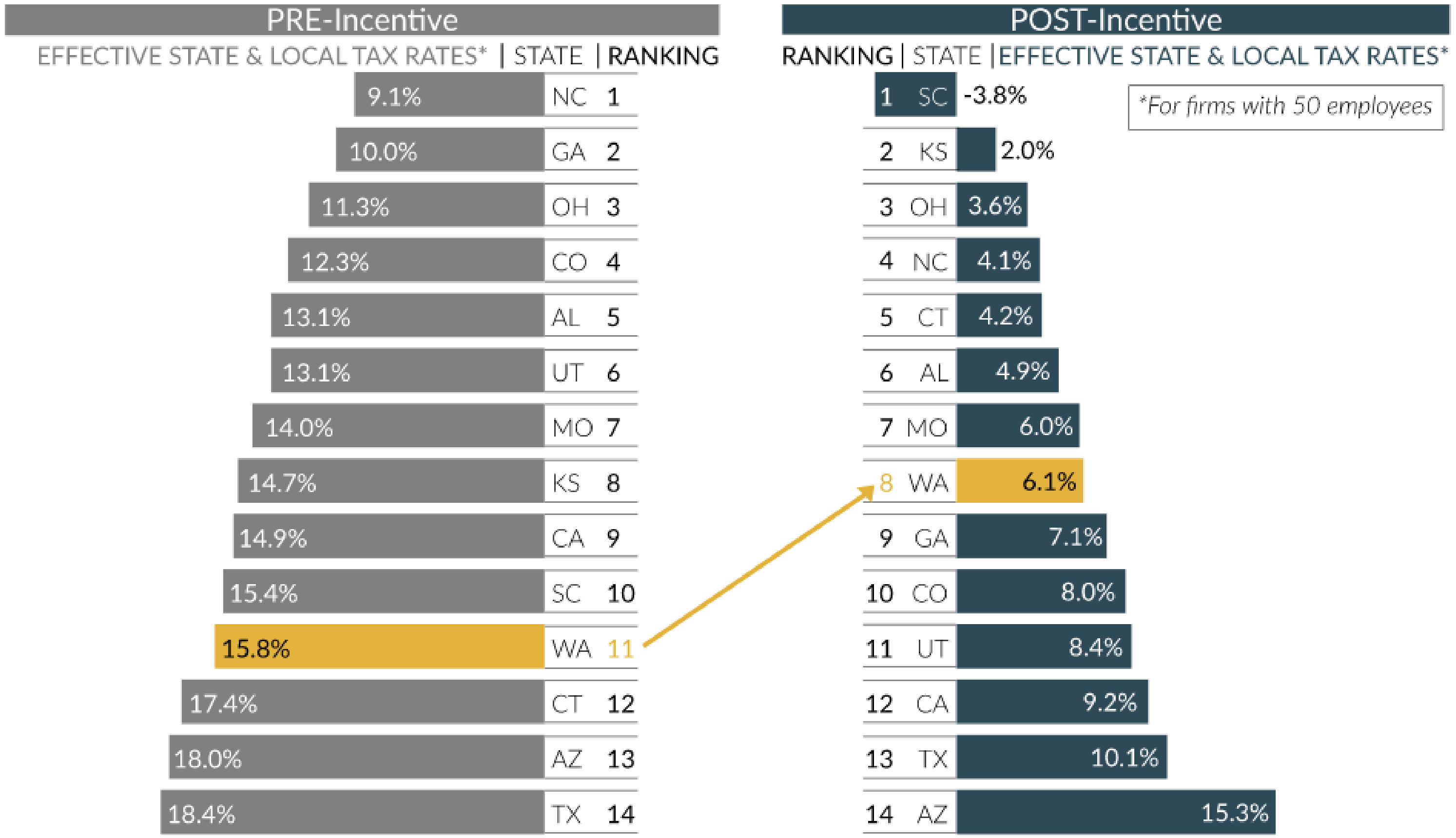
For each industry, Washington had highest ETR, pre- and post-incentive

In each scenario, Ernst & Young noted a significant factor in the results was **Washington's** relatively high combined state/local sales tax.

ETR detail for fruit and vegetable processors, NAICS 3114.



2019 analysis: aerospace tax preferences



N.B.- Includes SUT exemption for construction of manufacturing facility.

Other considerations

Analysis reflects taxes only. Other factors influence location:

- Proximity to inputs, such as raw products.
- Labor availability and costs.
- Transportation infrastructure.
- Energy availability and costs.

Cost.

- Preferences with large tax savings.
- Limited # of states, limited industries.

Well received by legislative members.

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Downloaded Software Sales Tax Exemption

James Taurman

What to do when you really don’t know?

Answers still help.

Background

- Sales tax exemption for software that is downloaded
  - Includes software delivered electronically, manually loaded by a vendor (load and leave), and provided by an application service provider all qualify.
    - Not eligible is software that is delivered on a physical medium, governed by a tear open license agreement, and is canned and pre-written for repeated sale.

Background

EXHIBIT 1. TAXATION OF SOFTWARE AND DIGITAL GOODS

Under statute, tangible personal property is generally subject to sales tax.[1]
The definition of an item as tangible personal property, therefore, determines its taxability.

Item	Description	Delivery method	Tangible property subject to sales tax?
Operating system (Windows, OSX, Linux, etc.)	The internalized instruction code that controls the basic operations of the computer, acting as the intermediary between programs and the hardware and integral to the operation of the device.	Preinstalled on the device at purchase	Yes
		Downloaded as an upgrade	Yes
		Run from a physical medium (live disc, external drive, etc.)	Yes
Prepackaged, or "canned" software	A pre-written standardized software product for repeated sale or license with no modifications.	Physical medium	Yes
		Delivered Electronically	No
		Load and leave	No
		ASP	No
Custom software	A software product created or modified to fit the needs of the user.	Physical Medium	No
		Delivered Electronically	No
		Load and Leave	No
		ASP	No
Media streaming service	A media distribution platform allowing users stream audio or video content for a fee. Some platforms allows users to download and store media locally, but the user does not own the content.	Website or application.	Yes
Media download for purchase	Media files purchased by the user through a marketplace, such as iTunes.	Download to local device storage or cloud storage	Yes

SOURCE: Office of the State Auditor analysis of Colorado statute.

[1] All tangible personal property sold or used in Colorado is subject to Colorado sales and use tax unless a specific exemption applies.

OSA

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Estimating the Cost

We had to assume a few things

The Small Assumption

- We used the US Census Bureau's Service Annual Survey estimate that companies spent $133 billion on software.
- We then used the Census Bureau's Annual Business Survey to determine that about 2.4 percent of employer firms are in CO.
- So, CO firms spent about $3.2 billion.

The Big Assumption

- We assumed that 90 percent of this software was downloaded.
- So, CO business spent $2.9 billion on software.
- At a 2.9 percent sales tax rate, this comes out to a exemption for $83 million.

Two Opinions Better Than One

- Another legislative agency used Bureau of Economic Analysis publishing industry’s GDP (includes software) as part of a fiscal note for a bill to change the exemption.
- Used Bureau of Labor Statistics employment data to estimate software as share of industry whole.
- Estimated that CO households probably spend about $3.5 billion on software and downloaded 75 percent, so save closer to $104 million.

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Just in Case We Were Wrong

- We offered the disclaimer, “Although our estimate provides a general indication of the relative scale of the exemption, it likely does not represent the actual value of the revenue impact due to several data constraints, which likely result in an underestimate.”

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We Were Probably Wrong

- CO Department of Revenue now has taxpayers report the use of the exemption on its own line, so we should know the truth soon.
  - Preliminary results aren't looking good for us!

Estimating Its Use

A Plethora of Potential Payers Poses Problems

You Can't Talk to Everyone

- When everyone is a potential beneficiary and there are a lot of sellers, it's hard to know who to talk to.
- We selected a sample of online vendors and went shopping.
  - We found that of the 21 vendors we looked at, 18 applied the exemption.

We Set the Standard for Good Government

And You Can Please Fewer of Them

- During a hearing to change the expenditure, an industry representative thought that if we had looked at more, we would have found more weren’t applying the exemption.
  - They argue the industry is confused now and any changes would cause further confusion.

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Go Forth and Estimate

Something Beats Nothing

A Sense of the Truth

- We are naturally cautious and like certainty.
  - And dislike criticism of our work.
- Providing something can be more helpful than nothing.
  - We're trusted sources of information and most legislators get that our estimates are just that.

Colorado Office of the State Auditor

OSA

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LEGISLATIVE AUDITOR GENERAL

A Limited Review of the Utah Rural Jobs Act

Nicole Luscher

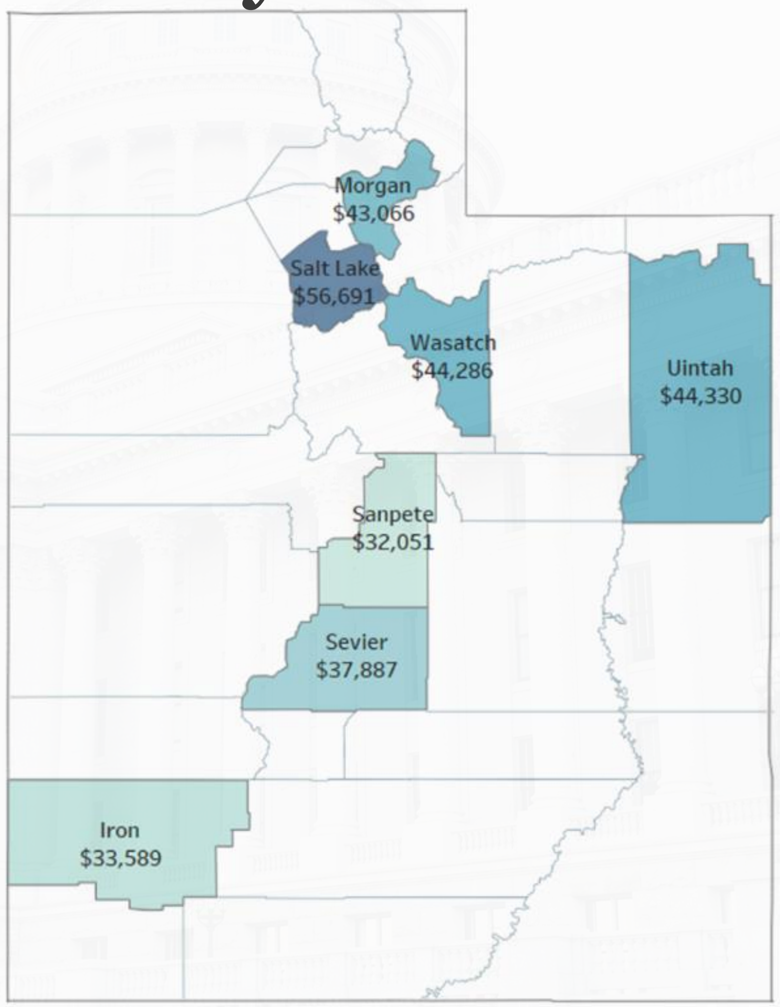
Audit Supervisor

11.3.2022

High Wage Job Classifications Vary by Year and County

REPORT PAGE #6

- “High wage” is at least 100 percent of the county average wage.
- 70 percent of the investment authority is to be invested in rural Utah counties.
- 20 businesses in 7 counties were recipients of the total investment authority.



Determining ROI Will Require Statutory Changes

REPORT

PAGES #10 & 13

- Return on Investment (ROI) =

Tax?

~~Current value~~ ~~$24.36M~~

- Cost of Investment per Job =

$$\frac{\text{Cost of investment } (\$24.36\text{M in tax credits})}{\text{Number of new annual jobs}}$$

Year 4

25% or $6.09M

Years 5-7

75% or $18.27M

	Scenario A: Investment Date Baseline		**Scenario B: Revised Annual Baseline**	
Rural Investment Company	**# of Jobs Reported**	**Tax Credits per Job***	**Net # of Jobs Created**	**Tax Credits per Job***
RIC A	43	$47,200**	27	$75,200
RIC B	217.2	9,300	111.16	18,300
RIC C	14.6	139,000	7.94	255,700
Total	**274.8**	**$22,200**	**146.1**	**$41,700**

Determining ROI Will Require Statutory Changes

REPORT
PAGES #10 & 13

- **Scenario A**
  - New jobs + sustained jobs (current statute)
- **Scenario B**
  - Net new jobs (auditor generated)

Year 4
25% or $6.09M

Years 5-7
75% or $18.27M

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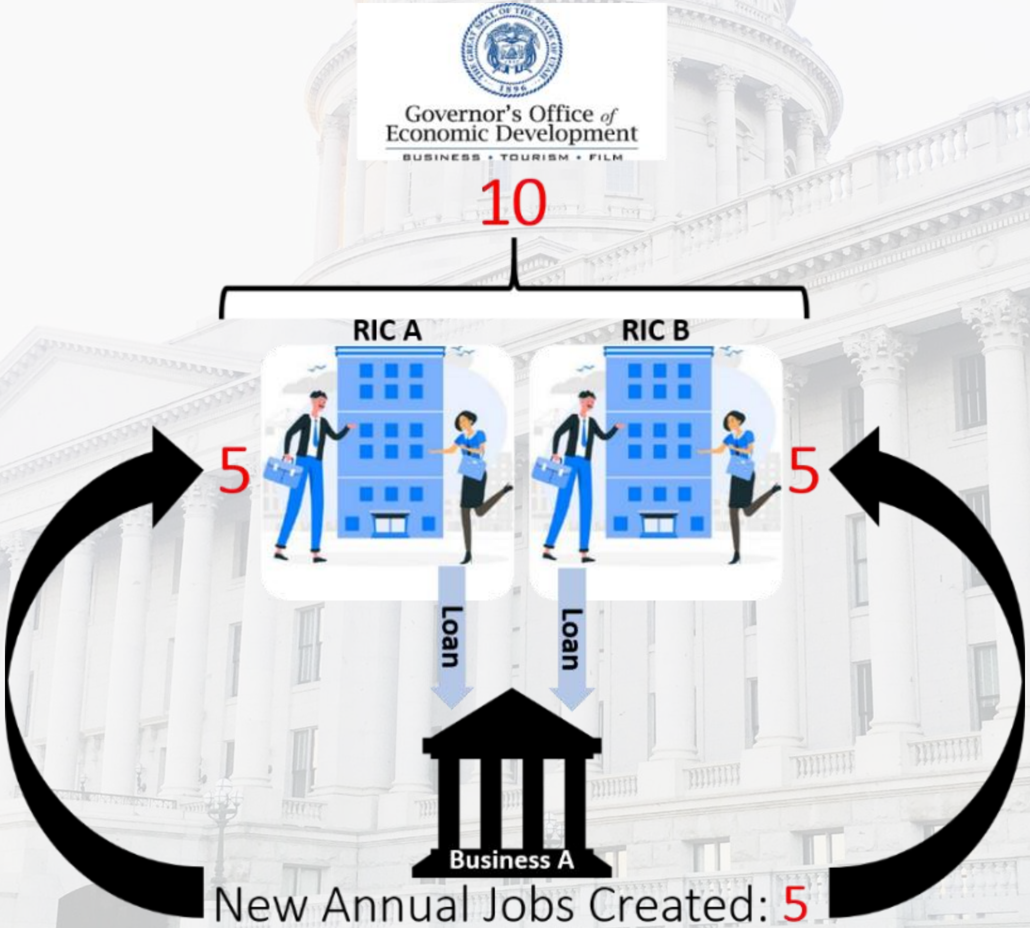
The Potential to Double Count New Annual Jobs Is Created When RICs Invest in the Same Small Business

REPORT PAGE #17



LEGISLATIVE AUDITOR GENERAL

A Performance Audit of Tax Increment Financing (TIF)

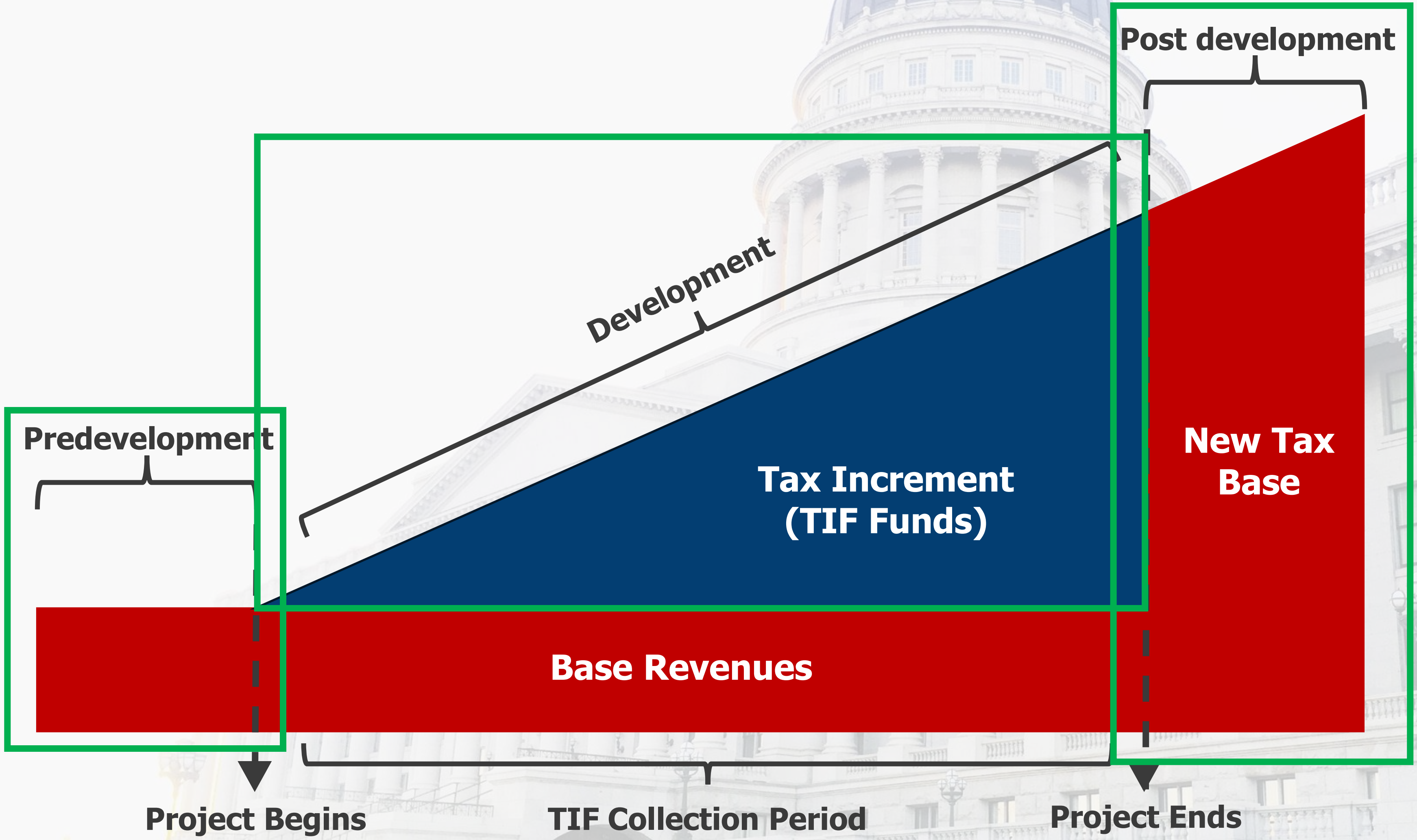
Nicole Luscher

Audit Supervisor

11.3.2022

TIF Introduction

REPORT
PAGE #5



Transparency

REPORT PAGE #12

- **Concern**: TIF project areas have significant fund balances.

- **Recommendation**: Consider revising statute to include guidance on managing unexpended TIF funds once a collection period expires.

Transparency

REPORT
PAGE #16

- **Concern**: The level of TIF expenditure reporting varies by redevelopment agency.

- **Recommendation**: Consider revising statute to require local governments to make financial information publicly available for each project area.

Transparency

REPORT PAGE #19

- **Concern**: Utah statute does not require a justification analysis.

- **Recommendation**: Consider revising statute to require local governments to conduct a robust justification analysis that adequately justifies the use of TIF funds.

Accountability

REPORT PAGES #26

Redevelopment Agency	Increased Property Value?	Evidence Project Area Plan Objectives Tracked?	Evidence Developer Objectives Tracked?
Holladay City	Y	N	Y
Ogden City	Y	N	N
Riverdale City	Y	N	N
West Jordan City	Y	N	Y
West Valley City	Y	N	N
West Bountiful City	Y	N	N
St. George City	Y	N	N
Sandy City	Y	N	Y
Spanish Fork City	Y	N	N
Orem City	Y	N	Y


Thank You!
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Maine’s Office of Program Evaluation and Government Accountability

Limited Scope Review of

Pine Tree Development Zone Program

November 2020

PTDZ Limited Review Project Scope

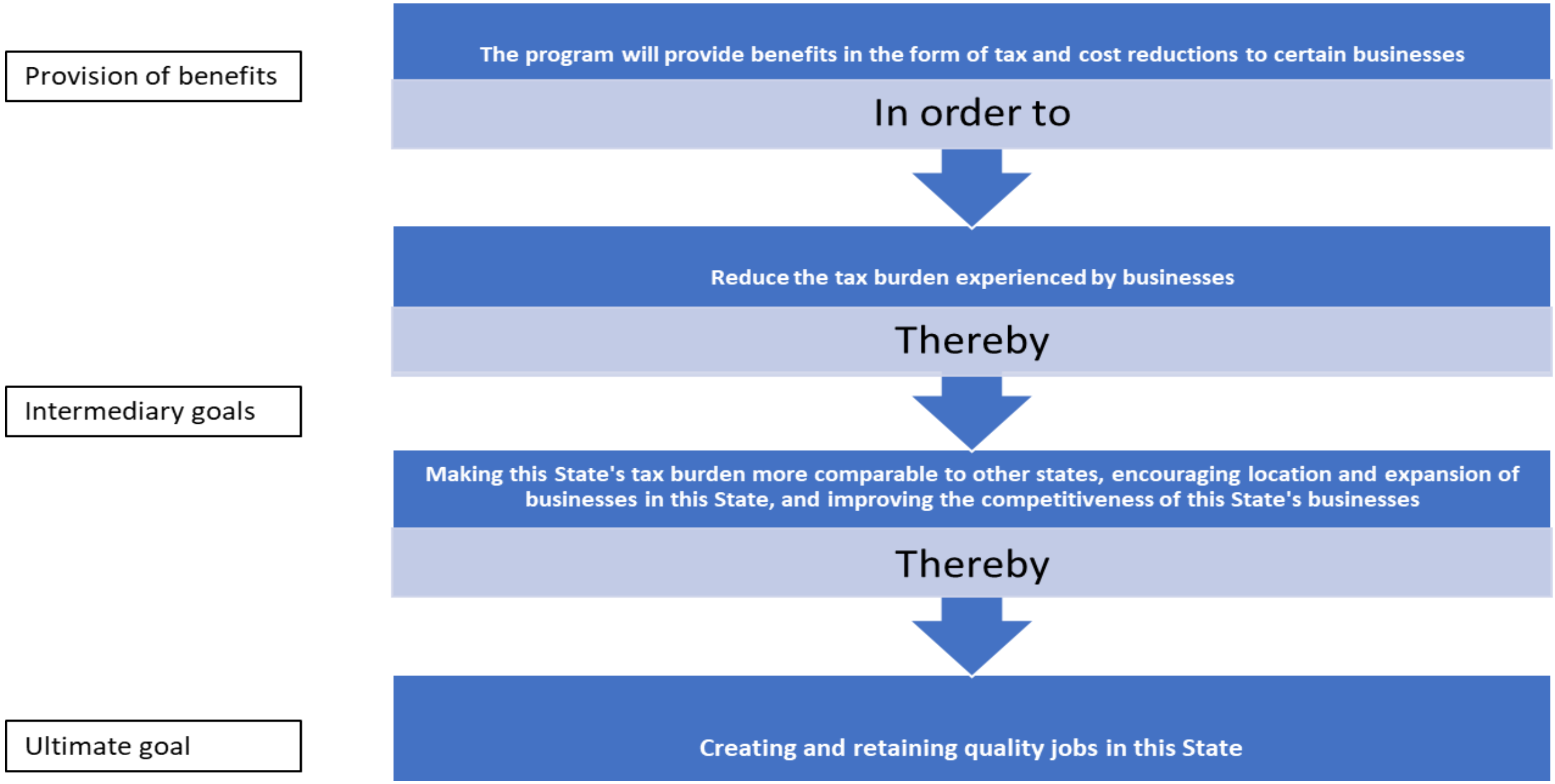
Support legislative oversight of the PTDZ program by providing information about:

1. Changes to the PTDZ program since OPEGA’s 2017 report;
2. How effectively PTDZ’s current design targets the program’s newly stated objectives; and
3. The alignment of the PTDZ program with Maine’s new Statewide Strategic Economic Development Plan.

The Takeaways of THIS Presentation
November 2022

- A state-wide economic development plan is another lens through which to view the design and effectiveness of tax incentives – HOWEVER:
- The standard of measurement in Maine’s plan is at times so general, people can see what they want to see.
- Comparing a program’s design to the specific legislative goals for that program is more effective for evaluating of the efficacy of a program.

PTDZ’s ultimate goal is the creation and retention of quality jobs



Excerpted from 30-A MRSA §5250-P(2):

“… the specific public policy objective of the Pine Tree Development Zone program established by this subchapter is to create and retain quality jobs in this State by reducing the tax burden experienced by businesses and thereby making this State's business tax burden more comparable to other states, encouraging location and expansion of businesses in this State and improving the competitiveness of this State's businesses;”

PTDZ Program at a Glance – Benefits

Benefits that reduce business taxes	Benefit that reduce other business costs
Income Tax Credits Insurance Premium Tax Credits Sales Tax Exemptions Sales Tax Reimbursements	Enhanced Employment Tax Increment Financing (ETIF) Payments Discounted Utility Rates Line Extension Benefits Electricity Sales Benefits* Exclusion from Municipal Tax Increment Financing (TIF) Limitations* Conservation Program Benefits**

*These benefits are not provided directly to PTDZ participating businesses, but may benefit them indirectly.

**Conservation benefits have never been defined or accessed. As such, they have never directly impacted a PTDZ business's taxes or costs; however, it is possible that they could.

PTDZ Program at a Glance – Eligibility

To be eligible for PTDZ, a business must:

- Be a for-profit business operating in a PTDZ targeted sector.
- Hire at least one new, full-time employee to work directly in its qualified business activity in Maine.
- Provide a signed statement certifying that it would not go forward with the expansion or location project in Maine absent the program’s benefits. (Commonly referred to as the “but for” requirement.)

PTDZ Targeted Sectors

- financial services
- manufacturing
- biotechnology
- information technology
- aquaculture and marine technology
- precision manufacturing technology
- composite materials technology
- environmental technology
- advanced technologies for forestry and agriculture
- call centers in Aroostook or Washington Counties

Sources: 30-A MRSA §5250-I(16) & (18); 5 MRSA §15301(2)

PTDZ Conclusions #1: Design Compared to Statutory Goals

- Amendments to PTDZ’s design ensure that program benefits go only to businesses that create and retain at least one qualifying job in Maine.
- It remains unclear whether PTDZ will cause businesses to create more quality jobs than would be created without the program.
- Strong, proactive management of the program can increase the likelihood of achieving the desired program outcomes.

Economic Development Strategies

Overview of Maine’s Statewide Strategic Plan

Strategic Plan 10-Year Goals

(1) Grow the average wage by 10% to the benefit of workers at all income levels

(2) Increase the value of what Maine sells per worker by 10%

(3) Attract 75,000 people to Maine’s workforce from within and outside the State

Strategic Plan Strategy Areas

Strategy A: Grow Local Talent

Strategy B: Attract New Talent

Strategy C: Promote Innovation in Areas of Maine Strength

Strategy D: Connectivity

Strategy E: Supporting Infrastructure

Strategy F: Maintain Stable Business Environment

Strategy G: Promote Hubs of Excellence

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Actions of the Strategy for Promoting Innovation

Action C1: Increase R&D Investment Levels in Maine

Action C2: Raise the Investment Cap of the Maine Seed Capital Credit

Action C3: Revitalize the Maine Innovation Economy Advisory Board

Action C4: Promote Exports in Order to Strengthen the Climate for Start-ups

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PTDZ’s Conclusions #2: Alignment with the Statewide Strategic Plan

- While PTDZ is generally in line with the overarching goals of Maine’s Statewide Strategic Plan, it does not speak to the specific actions outlined in the Plan.
- The Statewide Strategic Plan’s best use may be as a communication tool to enable pulling in the same direction, but not necessarily as a tool to evaluate individual incentives and programs.

The Takeaways of THIS Presentation

- A state-wide economic development plan is another lens through which to view the design and effectiveness of tax incentives – HOWEVER:

- The standard of measurement in Maine’s plan is at times so general, people can see what they want to see.

- Comparing a program’s design to the specific legislative goals for that program is more effective for evaluating of the efficacy of a program.

Thank you!

Maine's Strategic Plan: https://www.maine.gov/decd/strategic-plan

Maine OPEGA website: https://legislature.maine.gov/opega/

OPEGA email: OPEGA@legislature.maine.gov