2011 Report

Of the

Incentive Review Committee

Submitted to:

The Honorable Mary Fallin
Governor of the State of Oklahoma

The Honorable Todd Lamb
Lieutenant Governor

The Honorable Brian Bingman
President Pro Tempore
Oklahoma State Senate

The Honorable Kris Steele
Speaker
Oklahoma House of Representatives

The Honorable Jeffrey Hickman
Speaker Pro Tempore
Oklahoma House of Representatives

April 18, 2012

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Speaker Of The House
Oklahoma House of Representatives

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Speaker Pro Tempore
Oklahoma House of Representatives

Dear Governor Fallin, Lieutenant Governor Lamb, Senator Bingman and Representatives Steele and Hickman:

The Incentive Review Committee (IRC) has taken the charge delegated to the committee by Senate Bill 1516 enacted during the 2004 legislative session to select a specific tax type each year and conduct a thorough analysis of specific tax preferences within that tax.

In 2011, the committee studied key incentive elements, verification data needed, and incentives of neighboring states. In addition, the committee followed task force activities, purposes and uses of tax credits. The following report outlines the findings of the IRC. The committee wishes to express its thanks and appreciation for the extensive services in the preparation of this report to Lesli D. Walsh, Research Analyst, Oklahoma Department of Commerce.

Respectfully Submitted,

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Bruce Crum

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Jonathan Forman

Michael Laird

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Larkin Warner, Ph.D.

Don Wood

I. Introduction & Committee Background

In the summer of 2003, Governor Brad Henry convened the Economic Development Generating Excellence (EDGE) Commission to examine issues facing Oklahoma across the economic and political landscape and recommend a plan of action to address those issues. One of the recommendations of the team that was adopted into the formal EDGE Action Plan was as follows:

> "Putting in place a system to quantify the costs and benefits of existing incentives and tax credits. The state should systematically quantify the costs and benefits of all current and proposed business incentives and tax credits to determine whether they effectively encourage the type of business behavior they seek to stimulate."

As a result of this recommendation, the Oklahoma State Legislature enacted Senate Bill 1516 (SB1516) in the 2004 legislative session. SB1516 created the Incentive Review Committee (IRC) and charged it with conducting a review of existing tax incentives in Oklahoma. To this end, the bill directs the IRC to annually select a particular section of the state tax code, and within that code to choose which incentives it will review in the given year. The review is required to include the following information.

1. An identification of the purpose of the tax incentive;
2. A determination of whether the potential revenue impact on the state can be quantified and if so, an estimate of the potential revenue impact on the state;
3. A determination of whether the economic gain to the state can be quantified and if so, an estimate of the economic gain measured in jobs, wages, investments, or other economic criteria;
4. An estimate of the effect on the distribution of the tax burden;
5. An estimate of the number of taxpayers receiving the benefit;
6. A determination of the growth potential of the industry eligible to claim the incentive;
7. A determination of the effectiveness in achieving the desired objective;
8. A determination of whether the tax incentive is the most fiscally effective means of achieving its stated purpose;
9. An analysis of the costs and burdens of administration;
10. An analysis of the competitive position of Oklahoma relative to other states with similar incentives;
11. A determination of the effectiveness of evoking a change in taxpayer behavior; and
12. A public hearing, at which persons receiving the incentives reviewed, or other interested parties, may testify.

The committee consists of nine members, with three each appointed by the Governor, the Pro Tempore of the Senate, and the Speaker of the House. Organizational support for the committee is provided by the Oklahoma Department of Commerce. Important basic information and financial data are provided by the Oklahoma Tax Commission and Department of Commerce. The committee has no specific budget for staff or research projects.

II. Incentives Reviewed in 2011

Included as *Appendix A* to this report, are the committee's Principles of Sound Tax Incentives. Included as *Appendix B* to this report, is the November 3rd, 2011 Report summarizing the IRC recommendations for 2005-2010.

In April 2011, the committee voted and approved study of the following in 2011:

- Key elements of the structure of a model incentive review department or committee
- A list of the types of data necessary for, and staffing needs of such a model department, for it to perform an intelligent assessment of various incentives and tax expenditures
- State regional comparison of how other states review their incentives benefits

A. In May 2011, the committee reviewed the May 2011 Report from the Center on Budget and Policy Priorities entitled "Promoting State Budget Accountability Through Tax Expenditure Reporting" (See *Appendix C*).

B. In June 2011, the committee reviewed the 2011 Oklahoma Academy Town Hall article about the Incentive Review Committee written by Drs. Larkin Warner and Robert Dauffenbach (See *Appendix D*).

C. In July 2011, the committee heard a presentation and reviewed an "Update to the Oklahoma Quality Jobs Program Triennial Report" dated March 2011 from Dave Lopez, Oklahoma Secretary of Commerce & Tourism (See *Appendix E*).

D. In June and July 2011, the committee voted and approved the following decision based on studies and discussion:

►**COMMITTEE DECISION:** The following goals for tax incentives were determined:

1. They should result in increased employment and income within the state
2. Incentive recipients should ultimately produce increased revenue to the state or local government
3. They should increase capital growth
4. They should be competitive with other neighboring states
5. They should encourage an educated workforce

The committee created a list of potential items necessary to determine the impact of an incentive to the following:

1. Company payroll and wage data before receiving credit
2. Company payroll and wage data after receiving credit
3. Employee benefit package
4. Company investment dollars in the state
5. Company's capital expenditure budget in Oklahoma
6. Company sales, assets and net income
7. In-state and Out-of-state purchases
8. Oklahoma sales and use taxes paid
9. Company NAICS Code
10. Property taxes paid in Oklahoma
11. Regional average wage data
12. Regional unemployment data

E. In September 2011, the committee heard from Mr. Steven Barker, Senior Research Analyst with the Oklahoma Department of Commerce, regarding other states comparison of how incentives are reviewed (See *Appendix F*). Also included in *Appendix F* is a regional state comparison of taxes and credits.

F. October 2011 through January 2012, the committee followed the activities of two Oklahoma Legislative Task Forces; one on Tax Incentives, and one on Comprehensive Tax Reform. The committee heard from Mr. Melvin Mungai, Legislative Liaison with the Oklahoma Department of Commerce on some of these activities (See both task force final reports – *Appendices G and H*).

G. In November 2011, the committee heard from Representative David Dank with the Oklahoma House of Representatives on the Tax Incentives Task Force activities and conclusions.

H. In December 2011, the committee heard from Mr. Gary Jones, State Auditor on his department's thoughts about tax credits/incentives.

I. In January 2011, the committee discussed the final reports of two legislative task force reports:

1. The Task Force on Comprehensive Tax Reform Final Report (Senator Mike Mazzei and Representative David Dank) (See *Appendix G*); and

2. The Task Force on Tax Credits and Economic Incentives (Representative David Dank and Senator Mike Mazzei) (See *Appendix H*).

J. In February 2011, the committee heard from Mr. Melvin Mungai, Legislative Liaison with the Department of Commerce about various legislative issues.

K. In March 2011, discussed various legislative issues. The committee also reviewed and made changes to its draft report and to Appendix F on Regional Taxes & Credits (See *Appendix F).*

M. In April 2011, the committee again discussed various legislative issues and again reviewed and made changes to its draft report.

III. Committee Recommendations

The Incentive Review Committee offers recommendations about the goals for economic development tax incentives, about the design of these tax incentives, and about the evaluation of these tax incentives. The Incentive Review Committee believes that properly structured and monitored tax incentives can be useful tools for promoting economic development in Oklahoma.

The Incentive Review Committee offers the following goals for Oklahoma's economic development tax incentives:

1. Tax incentives should generally result in increased employment and income within the state.
2. Incentive recipients should ultimately produce increased revenue to state and local governments.
3. Tax incentives should increase capital growth in Oklahoma.
4. Oklahoma's tax incentives should be competitive with other neighboring states.
5. Tax incentives should generally result in a more skilled and educated workforce.

The Incentive Review Committee offers the following recommendations about the design of Oklahoma's economic development tax incentives:

1. The purpose of each credit/incentive (both current and future) should be clearly defined in the legislation (See the 2010 Report of the Incentive Review Committee, at p. 14).
2. The committee believes that economic development tax credits should serve a public purpose, be supported by adequate consideration, and have adequate controls and safeguards (See the 2010 Report of the Incentive Review Committee, at p. 14).
3. Tax incentives should be transparent so that interested persons and policymakers can evaluate their effectiveness.
4. Tax Incentive legislation should:
    a. State why the special tax rule is needed to help meet a specified goal;
    b. Why the rule is better than an overall tax rate reduction;
    c. Why non-tax alternatives are not pursued;
    d. Which taxpayers will benefit and their income level; and
    e. The direct and indirect costs of the tax incentive.[1]
5. Principles of tax policy, including equity, simplicity, neutrality, efficiency, and transparency should be considered in the design of any tax incentive.
6. The legislature should create a "unified budget" that includes both direct spending and the spending that is part of the tax law (tax incentives and tax expenditures).
7. Those incentive systems that utilize tax credits should consider the costs of those tax credits to the State and seek to structure credits in a manner that will maximize the dollars flowing to the intended purpose per dollar of state expenditures on the tax credit. Thus, all tax credits should be designated as directly transferable, given that (i) even when designated to be "non-transferable" by the enabling legislation, the benefits of tax credits can be bought and sold nonetheless, and (ii) the derivative transfers of non-transferable tax credits significantly increases the costs to the State thereby decreasing the overall economic benefit to Oklahoma. See *Appendix A* (Principles of Sound Tax Incentives, Principle 9). For a detailed explanation of the need for tax credits to be transferable, see *Appendix I* (which builds upon Recommendation No. 1 from the 2008 Report of the Incentive Review Committee, at pp.4-7).
8. All newly enacted economic development tax incentives should include minimum eligibility requirements; such as an agreement to build new facilities in Oklahoma, hire new employees, or invest a minimum amount of capital in projects located here. [2]

[1] See, e.g., Annette Nellen, "How To Assess California's Tax Expenditures and Ensure Their Effectiveness" (testimony for the California Legislature, February 22, 2012), http://arev.assembly.ca.gov/sites/arev.assembly.ca.gov/files/TaxExpEffectiveness2-22-2012_Nellen.pdf.
[2] See, e.g., Andy Nichols, "Every Dollar Counts: Why it's Time for Tax Expenditure Reform" [Washington State Budget & Policy Center, February 8, 2011], http://budgetandpolicy.org/reports/every-dollar-counts-why-its-time-for-tax-expenditure-reform.

9. Oklahomans should not subsidize businesses that move jobs out-of-state. Therefore, in addition to filing annual surveys and reports detailing their use of tax incentives, businesses should remain eligible for tax incentives only if they continually maintain a minimum number of employees in Oklahoma, continue using Oklahoma-based facilities (especially those built with tax incentive dollars), and make future investments in Oklahoma.

The Incentive Review Committee offers the following recommendations about the evaluation of Oklahoma's economic development tax incentives:

1. Accountability measures should be included for any new tax incentive. The enacting legislation should also specify what data is needed to enable a review of the provision's effectiveness, how that data will be collected and analyzed, and how and who will monitor and analyze that data.

2. The following data may be necessary to determine the effectiveness of an economic development tax incentive:
    a. Company payroll and wage data before receiving credit,
    b. Company payroll and wage data after receiving credit,
    c. Employee benefit package,
    d. Company investment dollars in the state,
    e. Company's capital expenditure budget in Oklahoma,
    f. Company sales, assets and net income,
    g. In-state and Out-of-state purchases,
    h. Oklahoma sales and use taxes paid,
    i. Company NAICS Code,
    j. Property taxes paid in Oklahoma,
    k. Regional average wage data,
    l. Regional unemployment data.

3. Additional resources are needed for the proper evaluation of tax incentives. Any agency charged with evaluating tax incentives will need resources for staff and research.

Appendices

Appendix A

Principles of Sound Tax Incentives

A review of the literature on economic development incentives provides a basis for identifying various principles that are widely agreed to. These principles can be used to guide the specification of a new program. They can also be used as a means for evaluating an existing program. Below we list 9 principles that the committee deems as important.

Principle 1. The costs of the incentive system should be less than the benefits.

Too often, we consider only the benefits, not the costs. Too often, we view the effect of incentives in a partial equilibrium sense, not general. For example, a highly successful incentive program might raise the cost of doing business for firms not receiving the incentive, necessitating a reduction in employment. States with balanced budget requirements must recognize that less revenue from one source creates greater burdens on existing firms and citizens. Similarly, when estimating the benefits and costs of an incentive program, the time value of money should be considered. That is, if the benefits of an incentive all occur many years in the future, the current benefit is significantly lessened and this impact must be accounted for in estimates of both costs and benefits.

Principle 2. An individual incentive program should fit well within the broad strategic framework of state economic objectives.

Individual programs should fulfill at least one key role in a broad portfolio of state economic development policy initiatives that focus on business attraction, business retention, new business start-up, high technology, efficient land use, geographic balance, and training to improve productivity. In addition, the state's objectives include a tax system characterized by equity and distributive justice. An overarching consideration in the choice and design of economic development incentives is the need to compete effectively with other jurisdictions which also offer incentives. Tax incentives for economic development are inherently selective and not available to all competitors within an industry (see Principle 4 below). To the extent possible, tax incentives should have minimum negative impacts on existing competitors unable to take advantage of the incentives' benefits.

Principle 3. The objectives of the program should be clearly identified.

Incentive programs have as their purposes (a) expansion of business activity that exports outside the regional economy, (b) substitution for imports to the regional economy, (c) increased productivity, (d) improved resource utilization, i.e., reduction of unemployment and underemployment. Just how a program is going to yield specific results should be clearly specified.

Principle 4. Incentive programs should be targeted to firms where the program will clearly make a difference.

Firms are not equal in their ability to contribute to the economic well-being of a region, as is evident by substantial variation in industry output, income, employment multipliers and emerging sectors wherein special competencies and competitive advantages rooted in regional research experience exist.

This is a basic fact of economic expansion that needs to be heeded. Targeting may also be necessary in order to compete with incentives offered by other jurisdictions.

The epitome of targeting is a “deal-closing” fund which is used by many jurisdictions to provide the marginal difference to a business making the location decision. “Deal-closing” funds are commonly used to create incentives to create or retain jobs by defraying costs for infrastructure, employee training or tax incentives.

Carefully administered targeting programs can reduce the overall cost to a state of its incentive programs. Targeting can avoid turning economic development incentives into generalized business “entitlements” which cost the state money but which do not change the behavior of business firms and thus do not promote economic development.

Principle 5. Incentive programs should be neutral with respect to the types of industries that qualify for the program.

Service industries are dominating growth in US businesses. If a firm's application meets the tests of export expansion, import substitution, or other enhancements to resource utilization, it should not matter what industry the firm is identified with.

Principle 6. Incentive programs should have built-in evaluation mechanisms.

Without the capability to evaluate the benefits and costs of a program, there is little or no rationale for undertaking the program in the first place. Evaluation programs and generation of the appropriate data sources for evaluation need to be specified before the program is undertaken. The evaluation process needs to be followed closely according to plan.

Principle 7. Incentive programs should have sunset provisions and other features that enhance accountability.

Sunset provisions focus attention on the evaluation process and outcomes, and, thus, should be components of these programs. Industry is probably more mobile now than it has ever been, historically. Economic development initiatives should not fall into the trap of attempting to attract footloose industries and other copy-cat initiatives.

Principle 8. Incentive systems should be based on rules versus discretion.

Basing decisions on who gets incentives on a set of well-defined guidelines of eligibility is imperative to the ultimate potential for favorable evaluation.

Principle 9. Incentive systems using tax credits should seek to maximize the dollars flowing to the intended purpose.

Those incentive systems that utilize tax credits should consider the costs of those tax credits to the State and seek to structure credits in a manner that will maximize the dollars flowing to the intended purpose per dollar of state expenditures on the tax credit. Thus, all tax credits should be designated as directly transferable, given that (i) even when designated to be "non-transferable" by the enabling legislation, the benefits of tax credits can be bought and sold nonetheless, and (ii) the derivative transfers of non-transferable tax credits significantly increases the costs to the State thereby decreasing the overall economic benefit to Oklahoma.

Appendix B

Incentives Reviewed

Based on the above direction, the IRC has reviewed the following incentives:

- 2005 - Investment/New Jobs Tax Credit
- 2006 - Ad Valorem Tax Exemptions and Tax Increment Financing Districts
- 2007 - Small Business Capital Credit, Rural Small Business Capital Credit, Venture Capital Credit
- 2008 - Cash Rebate Incentives, Income tax and Insurance Premium Tax Credits & Transferability
- 2009 - Income Tax and Insurance Premium Tax Credits
- 2010 - Insurance Premium Tax Credits and Quality Jobs and Related Programs
- 2011 - Key Incentive Elements, Verification Data Necessary For Review, Incentives Of Neighboring States, State Task Force Activities and Purposes And Uses Of Tax Credits

All committee reports can be viewed on the Department of Commerce website at:

http://www.okcommerce.gov/Data-And-Research/Downloads/Incentive-Review-Committee-IRC

Center on Budget and Policy Priorities

PROMOTING STATE BUDGET ACCOUNTABILITY THROUGH TAX EXPENDITURE REPORTING

By Michael Leachman, Dylan Grundman, and Nicholas Johnson*

May 2011

*Jason Levitis and Jeremy Koulish contributed to the original version of this report in 2009.

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I. EXECUTIVE SUMMARY

Each year states spend tens, maybe hundreds, of billions of dollars through "tax expenditures." Tax expenditures are tax credits, deductions, and exemptions that reduce state revenue. They can include everything from poverty-reducing tax credits, to middle-class benefits, to corporate subsidies. Tax expenditures cost state treasuries money in much the same way as direct spending for schools, health care, or road construction. And like direct spending, tax expenditures are a tool states can use to accomplish policy goals.

There is a key difference, however, between direct spending and tax expenditures. States typically require extensive documentation of how much direct spending they do each year, and their budget processes entail evaluation of each item. Tax expenditures usually receive far less scrutiny. For the most part, policymakers do not regularly examine tax expenditures, nor do states document their effectiveness the same way they do for on-budget expenditures.

This is a serious problem. Most tax expenditures are written into the tax code and thus will continue indefinitely — regardless of how costly they may become over time — unless the legislature acts to discontinue them. (Appropriated expenditures, by contrast, typically last only as long as the one- or two-year budget cycle.) Without information on a particular tax expenditure's costs and benefits, lawmakers cannot make an informed decision on whether its continuation is in the state's interest.

More broadly, if policymakers, the media, and the general public lack information about tax expenditures, they cannot fully participate in decisions about how to allocate state resources. In fact, in many states the policy debate encompasses little more than *half* of the state's total expenditures because expenditures made through the tax code are not part of the conversation.

A state can address this lack of transparency by regularly publishing a *tax expenditure report,* also called a *tax expenditure budget.* A tax expenditure report lists the state's tax breaks and how much each one costs, along with other relevant information that helps policymakers and others evaluate them.

If properly designed and produced, a tax expenditure report makes tax expenditures more transparent by telling policymakers and the public how the state is spending its money and what it is accomplishing through those expenditures. A tax expenditure report also encourages accountability by enabling policymakers and voters to evaluate individual tax expenditures and decide whether to continue them. In addition, a tax expenditure report saves money by enabling policymakers to monitor the costs of tax expenditures and rein in their cost if necessary.

Forty-four states (counting the District of Columbia as a state) produce some form of tax expenditure report.[1] Unfortunately, many of these reports have significant shortcomings that limit their usefulness:

- Ten of the 44 states omit major taxes from their tax expenditure report, and six others fail to publish a report at least once every two years.

[1] All of the data in this report reflect tax expenditure documents released through March 2011.

Tax Expenditure Report Checklist

To achieve its goals of improving transparency, encouraging accountability, and saving money, a tax expenditure report should have the features listed below.

Accessibility. The report should be:

- ✓ Published regularly.
- ✓ Incorporated into the budget process.
- ✓ Available on the Web.

Scope. The report should include:

- ✓ Tax expenditures related to all taxes.
- ✓ All tax expenditures, including those with lower costs or those benefitting few taxpayers.
- ✓ Explicit and implicit tax expenditures.
- ✓ Tax expenditures enacted by the state that affect local government.

Detail. The report should include:

- ✓ The cost of the tax expenditure, using current data.
- ✓ The cost in future years, to allow comparison with other proposed expenditures.
- ✓ A description of the tax expenditure.
- ✓ The relevant legal citation and year of enactment.
- ✓ Detail on the taxpayers who benefit from the tax expenditure.
- ✓ Separate reporting for the state and local revenue losses, where applicable.

Analysis. The report should:

- ✓ Classify tax expenditures using the same categories as direct spending.
- ✓ State the purpose of each tax expenditure.
- ✓ Evaluate the extent to which that purpose has been accomplished.
- ✓ Analyze the distribution of benefits by income level and size of business.

- Almost every state's report omits some essential information, such as the law that mandates a given tax expenditure or the number of households or businesses that benefit. Some reports even omit the cost of many tax expenditures.

- Two states, **Arkansas** and **New Hampshire**, fail to make their report accessible to the public through means such as posting it on the Internet.

Some state tax expenditure reports are much better than others, but every state could improve its practices in this area. **Oregon**, **Minnesota**, and the **District of Columbia** publish relatively comprehensive and informative reports that could serve as a model for other states. Among the least useful reports are those issued by **Arkansas**, **Colorado**, and **Utah**, because they omit major taxes, fail to provide cost estimates and other key information for many tax expenditures, and/or are not available online.

Seven states produce no regular tax expenditure report, meaning that citizens have no way of knowing on an ongoing basis what the state is spending or what policies it is pursuing through the tax code. These states are: **Alabama, Alaska, Indiana, Nevada, New Mexico, South Dakota,** and **Wyoming**.

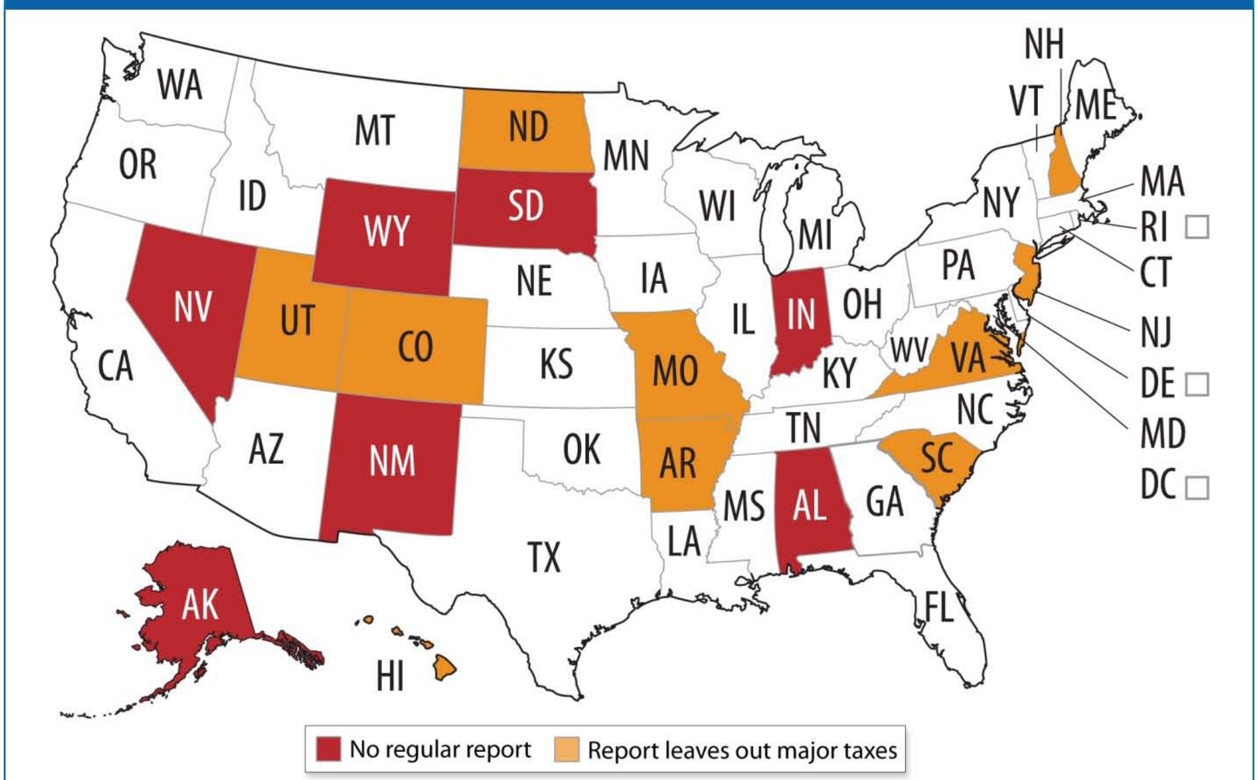
Recent Developments in Tax Expenditure Reporting

In the last two years, **New Jersey** and **Georgia** have passed tax expenditure reporting requirements and produced their first reports. The **District of Columbia's** report has been drastically improved, and several other states have made significant enhancements, including **North Carolina, Rhode Island**, and **Vermont**.

Missouri, on the other hand, has discontinued its tax expenditure report, now providing only an extremely limited report on economic development tax credits. In **New Mexico**, a bill to create a tax expenditure budget was passed unanimously by both legislative houses in 2011, but vetoed by the governor.

This report lays out best practices for tax expenditure reports — ways to make the reports maximally useful to policymakers and to the public. (For a list of the features a report should contain, see the box on page 2.) It also describes other steps, beyond producing a tax expenditure report, states can take to better manage their tax-side spending. The goal is not to eliminate tax expenditures, which are neither good policy nor bad policy per se. Tax expenditures are one of a policymaker's tools for achieving policy goals; like other tools, they can be put to good use or abused, and like other tools, their use should be transparent and accountable. A well-designed tax expenditure report can help accomplish that, especially when accompanied by other reforms that allow legislatures to regularly review and better manage tax-side spending.

Tax Expenditure Reporting Lagging In Many States



Appendix D

(Note: This is prepared for inclusion in the "Economic Development Primer" section of the background material document for the 2011 Town Hall session of the Oklahoma Academy.)

OKLAHOMA'S INCENTIVE REVIEW COMMITTEE

Larkin Warner and Robert C. Dauffenbach

Meet the Authors

Larkin Warner and Bob Dauffenbach are academic economists who have served on the Incentive Review Committee since it was established by the Oklahoma Legislature in 2004. Warner is Regents Professor Emeritus, Oklahoma State University's Spears School of Business, and Dauffenbach is Associate Dean for Research and Graduate Studies at the University of Oklahoma's Price College of Business.

Financial incentives are a principal tool that Oklahoma state government uses to promote private economic development expanding jobs and investment. These incentives often include modifications in the tax system. In one way or another, the incentives reduce state revenues or increase state outlays. At the time of their adoption, the legislature and governor are convinced that a particular action will have a positive impact on the bottom line of business enterprise in Oklahoma. They assume that the incentive actually will have a significant impact on business behavior. They also assume that the change in behavior will have a sufficiently large impact on the state's economy to justify the application of state government financial resources.

After the incentives have become operational, assessment of their effectiveness is often initially made by enterprises and organizations with an interest in promoting and expanding the incentive. To one degree or another, legislative committees and staff have also assessed effectiveness. The 2004 session of the Oklahoma Legislature created an Incentive Review Committee (IRC) to assist in this evaluation process. The following discussion introduces the scope and structure of the IRC, sets forth the guiding principles by which it operates, lists a selection of the incentives examined, and reflects on the challenges encountered in this area of policy evaluation.

The Incentive Review Committee: Scope and Structure

Senate Bill 1516 of the 2004 session of the Oklahoma Legislature set forth a broad classification of state government incentives to be potentially reviewed by the IRC. These incentives include "special exclusions, credits, exemptions, or deductions" applying to a particular tax. Also included is any measure "that provides direct payment incentives and other measures designed to entice businesses to locate or expand in Oklahoma."

A nine member committee is appointed to undertake these reviews. The Governor, President Pro Tempore of the Senate, and the Speaker of the House each appoint three members. The members serve terms of four years and may be reappointed up to three times. Staff support for the IRC is provided by the Oklahoma Tax Commission and the Oklahoma Department of Commerce.

The overarching challenge is set forth. "The Committee shall annually conduct a review of existing tax incentives in an individual tax code and may conduct *an in-depth review of the cost and benefits* of selected tax incentives." (Emphasis added.) S.B. 1516 also specifies a set of twelve elements to be included in the IRC's treatment of each incentive reviewed, culminating in a public hearing. Particularly important is the seventh of the twelve elements which requires the review to include "A determination of the effectiveness in achieving the desired objective." Annual reports are prepared each year and submitted to the Governor and two principal legislative leaders

Principles of Sound Tax Incentives

Shortly after its formation in late 2004, the committee developed a set of "Principles of Sound Tax Incentives" to serve as guidelines in reviewing incentives. These were largely based on a review of the literature on economic development incentives and the identification of principles upon which there was wide agreement. They have been modified and supplemented only slightly since their original adoption. The following principles and commentaries are from the IRC's *2010 Annual Report*.

Principle 1. The costs of the incentive system should be less than the benefits.

Too often, we consider only the benefits, not the costs. Too often, we view the effect of incentives in a partial equilibrium sense, not general. For example, a highly successful incentive program might raise the cost of doing business for firms not receiving the incentive, necessitating a reduction in employment. States with balanced budget requirements must recognize that less revenue from one source creates greater burdens on existing firms and citizens. Similarly, when estimating the benefits and costs of an incentive program, the time value of money should be considered. That is, if the benefits of an incentive all occur many years in the future, the current benefit is significantly lessened and this impact must be accounted for in estimates of both costs and benefits.

Principle 2. An individual incentive program should fit well within the broad strategic framework of state economic objectives.

Individual incentive programs should play a key role within the portfolio of state policy initiatives promoting a favorable business environment. This environment emphasizes business attraction, business retention, new business start-up, high technology, efficient land use, geographic balance, and training to improve labor productivity and incomes. In addition, the state's objectives include a tax system characterized by equity and incentives for efficiency and growth. <u>An overarching consideration in the choice and design of economic development incentives is the need to compete effectively with other jurisdictions which also offer incentives.</u> Tax incentives for economic development are inherently selective and not available to all competitors within an industry (see Principle 4 below). To the extent possible, tax incentives should have minimum negative impacts on existing competitors unable to take advantage of the incentives' benefits.

Principle 3. The objectives of the program should be clearly identified.

Incentive programs have as their purposes (a) expansion of business activity that exports outside the regional economy, (b) substitution for imports to the regional economy, (c) increased productivity, (d) improved resource utilization, i.e., reduction of unemployment and underemployment. Just how a program is going to yield specific results should be clearly specified.

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Firms are not equal in their ability to contribute to the economic well-being of a region, as is evident by substantial variation in industry output, income, employment multipliers and emerging sectors wherein special competencies and competitive advantages rooted in regional research experience exist.

This is a basic fact of economic expansion that needs to be heeded. Targeting may also be necessary in order to compete with incentives offered by other jurisdictions.

The epitome of targeting is a "deal-closing" fund which is used by many jurisdictions to provide the marginal difference to a business making the location decision. "Deal-closing" funds are commonly used to create incentives to create or retain jobs by defraying costs for infrastructure, employee training or tax incentives.

Carefully administered targeting programs can reduce the overall cost to a state of its incentive programs. Targeting can avoid turning economic development incentives into generalized business "entitlements" which cost the state money but which do not change the behavior of business firms and thus do not promote economic development.

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Sunset provisions focus attention on the evaluation process and outcomes, and, thus, should be components of these programs. Industry is probably more mobile now than it has ever been, historically. Economic development initiatives should not fall into the trap of attempting to attract footloose industries and other copy-cat initiatives.

Principle 8. Incentive systems should be based on rules versus discretion.

Basing decisions on who gets incentives on a set of well-defined guidelines of eligibility is imperative to the ultimate potential for favorable evaluation.

Principle 9. Incentive systems using tax credits should seek to maximize the dollars flowing to the intended purpose.

Those incentive systems that utilize tax credits should consider the costs of those tax credits to the State and seek to structure credits in a manner that will maximize the dollars flowing to the intended purpose per dollar of state expenditures on the tax credit. A targeted firm with no tax liability will not benefit directly and immediately from a tax credit. Hence transferrable (i.e., saleable) tax credits are preferable to those that are nontransferable.

Selected Incentives Reviewed

Over the years, Oklahoma state government has created many measures involving revenues or expenditures and affecting economic development. While most of these measures may be classified as "tax expenditures," it is emphasized that the term "tax expenditure" has a much broader application. In its 101 page *Tax Expenditure Report 2009-2010*, the Oklahoma Tax Commission provides an extensive set of estimates of revenues forgone for various purposes including economic development. However, many of the measures treated as tax expenditures have other purposes, e.g. assistance to the poor or benefits to retired veterans.

The IRC staff at the Oklahoma Department of Commerce has developed a detailed listing of 104 of the economic development incentives and related measures including their statutory basis and the amount of expenditures or credits involved. The latest of these lists is available in the IRC's *2010 Annual Report.* Substantial details of the programs are described in the Oklahoma Department of Commerce's *2011 Oklahoma Incentives and Tax Guide* and earlier issues. This publication is easily accessible on the Department's web site.

During 2004-2010 the IRC has reviewed in detail several of the most significant of the incentives. Brief reviews and discussions have been held with respect to some of the lesser of the measures. Here is a selection of incentives examined by the IRC.

- Investment/New Jobs Income Tax Credit—This is a five-year tax credit for manufacturers investing in depreciable property and hiring new workers. Detailed analysis of impacts indicates effectiveness.
- Three programs of tax credits for firms supplying business capital—Rural Small Business Capital Formation, Small Business Capital Formation, and Venture Capital Tax Credit. In the 2008 fiscal year, the combined amount of credits for these three programs was $105 million. More analysis is needed.
- Oklahoma Quality Jobs Program—This consists of direct payments by the state to firms creating new jobs. Payments may be up to 5 percent of payroll. This is largely for manufacturers and is arguably the most popular of Oklahoma's economic development incentives. New revenues to state government probably are at least equal to the state's outlays for the program.
- The Oklahoma Opportunity Fund and the need for some type of "closing fund" for the state.
- Several little-used or not used incentives were recommended for abolition.
- Insurance Premium Tax Credits—These are from various sources, but general view is that they are helpful in retaining insurance company headquarters.
- Others reviewed include: Tax Increment Finance (TIF) districts; the five-year ad valorem tax exemption for new and expanded manufacturing facilities; the Oklahoma Development Finance Authority and the Oklahoma Industrial Finance Authority;

Incubator Site Tenant Tax Exemption; Tax Credit for Producer-Owned Agricultural Processing facilities; and Oklahoma Coal Production Credits.

Challenges in Policy Evaluation

The annual reports of the IRC 2005-2010 treat a wide range of state government economic development incentives. A good deal of information has been accumulated and reviewed during the committee's monthly meetings. Agencies have consistently cooperated in the provision of information. Much information on revenue impacts has been supplied by the Oklahoma Tax Commission. Staff of the Oklahoma Department of Commerce has regularly appeared before the IRC to provide details concerning the operation of incentives. Especially helpful has been ODOC staff in managing the regular operations of the IRC including recording minutes, distributing materials, fulfilling the requirements of agenda preparation and posting, and developing and maintaining a detailed listing of state incentives. Membership of the committee has been remarkably stable, with six of the nine original 2004 members continuing to serve in 2011.

From the outset, the IRC has had no budget to use to commission detailed reviews of the benefits and costs of individual incentives. Such research on the frequently used incentives could be helpful.[1] Nevertheless, the committee has gained insights into the environment in which incentives function and the challenges involved in evaluating their effectiveness.[2] Here are several general questions which arise in evaluating economic development incentives.

(1)Isn't the use of incentives by state and local governments throughout the nation (and the world) really a zero sum game in which the competing entities would be better off if there was no use of incentives at all? This question is always thought-provoking. However, there is no realistic possibility for the adoption of such a regime.

(2)Critics of incentives sometimes argue that they do not really change business behavior. Much more fundamental features such as labor market conditions and transportation costs are the determining factors in decisions to locate or expand a business. Wouldn't Oklahoma be better off not using incentives? This question is almost impossible to answer definitively. However, one response is that Oklahoma is a relatively small state that does not make the rules of the game, and, in the opinion of development specialists, would be at disastrous disadvantage in comparison with other jurisdictions without an effective mix of incentives. The IRC has been utilizing a remarkable state-by-state database on development incentives maintained by the national Council for Community and Economic Research (C2ER), an organization of chamber of commerce research specialists. Information is thus readily available concerning competing economic development incentives—and there are plenty.

The decision to locate a new facility in Oklahoma is a very important potential response to economic development incentives. Yet a large share of the incentive benefits are received by existing Oklahoma establishments that are expanding capital investment and employment after already making the decision to locate a facility in Oklahoma. It should be remembered that Oklahoma firms can relocate in a different state—as in the case of oil firms relocating to Houston.

(3)Isn't the implementation of incentives so opaque that it is virtually impossible to evaluate policy effectiveness? Isn't much more transparency needed? For the most part, the experience of the IRC is that information for evaluation is available and confidential firm-by-firm data is not necessary. For example, the Oklahoma Tax Commission provides extensive public information concerning the application of two of the state's major programs, i.e. the Quality Jobs Act, and the ad valorem tax exemption for new and expanded manufacturing facilities. More information about the use of tax credits in the formation of capital companies would be helpful.

(4)What about equity? Is it fair for the state to provide tax and other benefits to new firms when the same advantages are not provided to existing firms that are sharing markets with the firm receiving the benefit of the incentive? While this reflects a reasonable criticism, the IRC has not encountered this problem.

(5)Do we really know enough about future patterns of economic growth to be able to choose certain sectors for special incentives, e.g. bioscience, aviation, and nanotechnology? Although this "industrial policy" carries risk, some developments are a relatively sure bet on which to focus limited state government resources.

(6)Has the Oklahoma Legislature been sufficiently careful in designing incentive programs? An examination of the evolution of statutes in this field immediately indicates that a basic incentive measure is modified and expanded session after session. Laws get longer and longer. There may be good reasons for such changes, but there may also be cases in which there is political pressures to share the benefits of a program.

CONCLUSION

In a time of flagging state revenues, it is certainly understandable that the Oklahoma legislature is reconsidering economic development incentives. Other states are likely doing the same. Such programs should always be subjected to review and validation without reference to the current funding situation. Still, it is necessary to recognize that all states are caught in somewhat of a *prisoner's dilemma* trap. While all states would likely be better off not providing any incentives, thereby allowing economic development to follow its natural course, the fact that some states provide incentives forces others to respond.

Oklahoma is caught in that trap, but given that, it is appropriate that a principle-based response be offered and that existing programs are evaluated in the context of those principles and the benefit/cost information the program generates. As reported here, the Incentive Review Committee, to the best of its ability, hobbled by lack of a research budget, has engaged in formulation of principles and examination of several economic development incentive programs offered by the State of Oklahoma. There is a general lack of documentation of benefits in many programs. In the Quality Jobs program, where such documentation exists, the State appears to at least break even. In other sizable programs, such assessments are difficult to make. Our hope in this brief paper is to highlight some of the accomplishments and findings of the Incentive Review Committee and point the way towards a more rational and principle-based system capable of providing the information needed for objective appraisal of program benefits and costs.

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[1] The two authors have produced substantial analyses of two of the state's major programs, the Quality Jobs Act and the ad valorem tax exemption for new and expanded manufacturing facilities. See Robert C. Dauffenbach and Larkin Warner, Chapters 1 and 2 in Oklahoma 21st Century, *State Policy & Economic Development in Oklahoma: 2004*, pp. 1-27.

[2] For an extensive examination of these issues by a former specialist with the Oklahoma Department of Commerce, see Dan Gorin, "Economic Development Incentives: Research Approaches and Current Views," *Federal Reserve Bulletin*, October 2008, pp. A61-A73.

July 12, 2011

DAVE LOPEZ
OKLAHOMA SECRETARY OF COMMERCE & TOURISM

Governor of the State of Oklahoma
President Pro Tempore of the Senate
Speaker of the House of Representatives

Re: Update to the Oklahoma Quality Jobs Program Triennial Report dated March 2011

We are pleased to provide you with the enclosed update to the Oklahoma Quality Jobs Program Triennial Report dated March 2011. The report has now been updated as of June 2011 and includes additional cost/benefit data. We are grateful to the members of the Incentive Review Committee for taking the initiative to review our initial report and provide input for a more thorough fiscal analysis.

In addition to the information in the original report, the revised analysis contains information for FY 2008 to FY 2010 such as:

- Projected wages compared against actual wages of active participants
- Potential benefits compared against actual benefits paid, and
- Geographic sections for active, filing companies

Highlights include:

- $168,456,053 paid to active participants for new jobs
- $180,794,278 total benefit to the State;
- $12,338,225 positive net benefit to the State
- Active participants by industry sector

Sector/Industry	FY 2008	FY 2009	FY 2010
Energy	8	11	11
Manufacturing	80	86	66
Distribution & Transportation	12	11	10
Information & Professional Services	32	30	31
Corporate and Back Office	25	26	25
Total	157	164	143

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E-Mail: Dave_Lopez@okcommerce.gov

Please feel free to contact me with any additional questions.

Sincerely,

Dave Lopez
Secretary of Commerce & Tourism
Executive Director

Cc: Members of the Incentive Review Committee
Members of the Incentive Approval Committee

Encls.

Oklahoma Quality Jobs Program

Triennial Report
(As required by legislation)

March 2011
Revised June 2011

Submitted by:
Oklahoma Department of Commerce

Dave Lopez, Secretary
Jonna Kirschner, General Counsel
Richard Schwalbach, Program Manager
Jon Chiappe, Research & Economic Analysis

Oklahoma Quality Jobs Program

Triennial Report

Table of Contents

Oklahoma Quality Jobs Program
Triennial Report to the Legislative Body
Prepared January 2011

Introduction:

During the legislative session of 1993, the Oklahoma Quality Jobs Program (the "Program") was created and the first companies enrolled in the fall of 1993. Since that time, the Program has gained national attention as one of the best incentives for business attraction and expansion. Oklahoma has benefited from the Program in terms of jobs and investment in our economy, while many other states have attempted to duplicate its success.

The Program requires that the Oklahoma Department of Commerce ("Commerce") provide a report on the status of the Program every three years. The last report to the President Pro Tempore of the Senate, the Speaker of the House of Representatives and the Governor was on March 1, 2008. The March 1, 2011 Report was previously delivered. This report supplements the fiscal analysis required by the Statutes for the time period FY 2008 to FY 2010.

Oklahoma Quality Jobs Program Defined

The Program serves as an incentive to businesses to expand or locate within Oklahoma and create new taxable payroll within the state. Participants may qualify for a cash rebate of up to 5% over a ten-year period on new taxable payroll. To qualify, there are four basic thresholds that must be met by the participant:

Basic Industry - an applicant must be in a "basic industry" denoted by its industry code, known as a NAICS code. The legislation specifically lists by number those industries that can participate. The economic concept is that if these industries locate in Oklahoma, it will induce other industries to also locate or expand, creating additional jobs. At its inception, the principal industry code intended for the Program was manufacturing. Other industries now include computer related services (software, hosting, data processing), research and development, headquarter operations, distribution centers, financial and administrative centers and web search portals. There are other industry codes eligible for the Program which must also demonstrate an out-of-state sales level of 75% or more to qualify.

New Payroll - the participant must add a minimum of $2.5 million annual new taxable payroll for Oklahoma jobs. The jobs must be located within the state and the payroll must be subject to Oklahoma payroll withholding tax. A participant has up to three years to create this new payroll in order to continue in the Program for an additional seven years. A participant may receive benefits during the three-year "ramp up" period even if it has not created the required new payroll, provided it has met all other Program requirements.

Health Insurance Coverage – The participant must offer basic health insurance to all employees in "new jobs" that are eligible for Program benefits. This coverage must be offered within 180 days of employment and the employee must pay no more than 50% of the premium cost. Basic health insurance includes some coverage in the areas of doctor office visits, hospitalization, maternity, mental health, substance abuse and pharmacy benefits.

Minimum Wage Requirement - effective June 2003, participants must pay the employees in "new jobs" that are eligible for Program benefits a wage that is at least equal to the average county wage where the project is located subject to a statewide cap. While those wages vary from county to county, the statewide cap is indexed annually subject to various economic factors. It started at $25,000 in 2003 and has risen to the current level of $29,409. Participants often far exceed this wage requirement.

Upon application, staff at Commerce conduct due diligence work on each applicant to ensure it is a legal entity in good standing within the state. Commerce staff also determine the maximum amount of benefits the participant may receive (based on the economic impact of those jobs and wages) by doing a cost/benefit analysis. This ensures the state will pay out no more in benefits than the economic benefit that is created by the participant.

While an entity qualifies for participation in the Program is based on a projection of wages and jobs, it receives payment of benefits based solely on actual performance. A participant must file quarterly claims with the Oklahoma Tax Commission ("Commission"), verifying its payroll and job data, to receive any payment. The Commission then verifies this claim through payroll tax withholdings before issuing a warrant. Should a participant have any encumbrance due to a delinquency in any tax owed to the state, payment of benefits is withheld, pending resolution of the tax owed.

Since the advent of the Program, there have been changes and additions to the thresholds. For example, an entity that has been participating in the Program for at least a year, and expands with a new project with wages of at least 150% more than its current average wage, may qualify for a rebate of up to 6% of its new payroll (rather than 5%). Also, entities such as food processors and research and development companies may qualify with an average annual payroll threshold of $1.5 million instead of $2.5 million. Participants locating on former Military Installations may qualify with an average annual payroll threshold of $1.5 million, while entities locating on former Brownfield Sites (remediated) qualify at a zero payroll threshold.

Legislative Changes

Since the last Triennial Report in March 2008, there have been several legislative changes to the Program. Below is a summary, by year, of those changes:

<u>2008:</u>

- The participant must file its initial claim for benefits for the jobs that were created in the first full quarter following the Project Start Date (formerly could be any quarter up to 3 years later)
- Additional qualifying NAICS codes were added to the definition of "basic industry": 518130, Web Search Portals; 488190, Support Activities for Air Transport
- The NAICS code for Research & Development was amended by the Federal Government, now listed as 541711 and 541712.
- Language specifically excluded the use of the Program if the participant also participated in the Quality Investment Act

<u>2009:</u>

- Use of the Investment Tax Credit concurrently with the use of the Program became allowable, provided the qualifying investment exceeded $40 million dollars (effective January 1, 2010)
- Addition of Program elements that allow Federal Prime Contractors to bring work to Oklahoma and received incentive payments on the direct labor of both the Prime and any Oklahoma subcontractors
- The NAICS code for Wind Power Equipment Maintenance activities was added to the list of basic industries, listed as 811310 (effective November 1, 2000)

<u>2010:</u>

- Program elements related to the qualification of Federal Prime Contractors was enhanced to be more congruent with other Program language
- Additional qualifying NAICS codes were added as "basic industries": Alternative Energy Structure Construction (237130), Solar Reflective Coating Application (238160), Solar Heating Equipment Installation (238220), Support Activities for Rail Transportation (4882), and Support Activities for Water Transportation (4883)

Historical Performance Data – New QJ Enrollment FY 2008 - FY 2010

The following information is reported on a fiscal year basis. Information reported represents both projected data and actual data as reported by the participant based on jobs and wages.

Enrollment and performance since the last Triennial Report:

<u>FY 2008</u>:

Companies enrolled	35
Jobs projected	9,218
Wage range projected	\$30,863-\$117,230
Net Benefit range	4.41%-5.00%
Status	4 start up; 4 new; 27 expanding
Maximum benefits projected	\$190,263,851

<u>FY 2009:</u>

Companies enrolled	31
Jobs projected	4,859
Wage range projected	\$26,228-\$150,703
Net Benefit range	4.10%-5.00%
Status	3 start up; 3 new; 25 expanding
Maximum benefits projected	\$210,400,830

<u>FY 2010:</u>

Companies enrolled	23
Jobs projected	4,580
Wage range projected	\$30,046-\$141,707
Net Benefit range	3.56%-5.00%
Status	4 start up; 3 new; 16 expanding
Maximum benefits projected	\$111,329,040

Historical Performance Data, Cont'd
New QJ Enrollment FY 2008-FY 2010; Participating Industries

While the majority of the projects enrolled in the Program over the past three years are manufacturers, there are projects in a number of other areas as follows:

Industry type	2008	2009	2010
Manufacturing	25	15	8
Financial Transactions, Collections	1	2	-
Computer Services, Consulting	-	1	4
Distribution-Wholesale	1	1	1
Corporate-Administrative Office	-	2	-
Customer Care (Call) Center	1	-	2
Oil and Gas*	3	5	2
Research and Development	1	1	2
Engineering Services	1	2	1
Facilities Support	1	1	-
Windpower Maintenance	-	-	1
Information Technology	1	-	2
Professional Sports	-	1	-
Total projects	35	31	23

*While the NAICS code of Oil and Gas Extraction (2111) is an allowable code for participation in the Program, the only jobs eligible for benefits are limited to those jobs directly comprising the corporate headquarters of or directly relating to administrative, financial, engineering, surveying, geological or geophysical services performed by the establishment. Employment relating to drilling or field services is not considered a new direct job.

Historical Performance Data, Cont'd
Active, Filing Companies in the QJ Program: Employment

The previous sections related to new enrollees in the Program from FY 2008 to FY 2010. Information in this section and beyond contains information about active participants in the Program and includes information about any active participants whether it has filed its first claim, or its fortieth claim.

The issue of actual jobs created by the Program requires an understanding of how benefits are claimed. A job is considered to be "new" the first time it is reported in the Program and it remains "new" throughout the life of the project as long as it is over the stated baseline, or starting employment point, when the entity first applied. Therefore, when reporting these jobs and wages on a quarterly basis, it is not possible to just add these totals to determine "new" jobs created by the Program. That would result in a gross overstatement of new jobs. Rather, it is necessary to look at these quarterly reports as "snapshots in time" of new jobs created by the Program. An average by quarter helps to get an idea of the impact of the Program.

Also, it is important to note that not all companies report in a timely fashion. While most do, some fall behind and file their quarterly reports on a random basis. Therefore, there are fluctuations in the data as well. However, as reported below, there is consistency in the total number of jobs over the three-year period shown in this report.

Actual jobs claimed by quarter:

Quarter	FY 2008	FY 2009	FY 2010
1	28,530	26,078	19,229
2	29,767	25,973	17,264
3	26,148	24,552	15,815
4	26,787	22,231	15,431
Average	27,808	24,709	16,935
Active Companies	157	164	143

Historical Performance Data, Cont'd

Active, Filing Companies in the QJ Program: Payroll, Wage, and Incentives

The chart below relates total payroll, incentive payments, average net benefit rate in the Program, and wage data for each of the fiscal years. Total payroll and incentive payments have decreased in each of the fiscal years partly due to the lag of participant filings and partly as a result of the recessionary period.

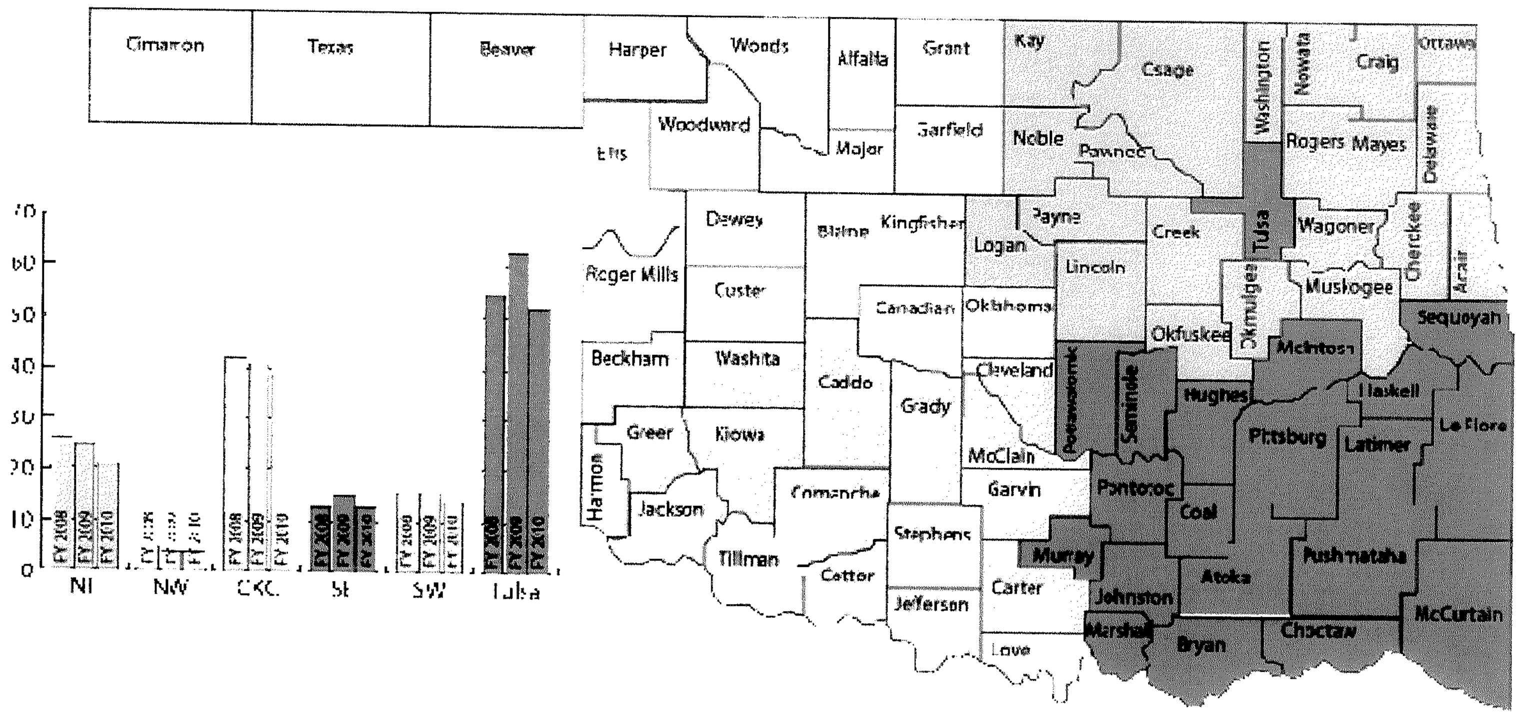
While there is fluctuation from year to year, the overall average wage of the new jobs created over the past three years has increased. Each time the average wage increases due to a Program participant in a given local economy, it helps to increase the overall wages of that economy, as the wage level becomes more competitive. As may be seen in the chart, not only have actual wages increased over time among the active participants, but they are also higher than the initial projected wages for each. The average wage represents the actual wages paid by active, filing participants in the respective fiscal years, and the projected wage indicates the wages that were initially projected by these participants on their application to the Program.

Quarter	FY 2008	FY 2009	FY 2010
3	$346,507,298	$298,623,134	$248,312,467
4	$338,188,490	$340,297,935	$247,456,593
1	$337,977,685	$292,993,083	$274,590,114
2	$282,528,064	$266,276,432	$238,039,093
Total payroll	$1,305,201,538	$1,239,099,783	$1,008,398,269
Total Incentive Paid	$60,216,107	$59,172,478	49,067,468
Net Benefit Rate			
New Jobs	27,808	25,495	19,170
Average Wage	$46,936	$48,601	$52,602
Active Companies	157	164	143
Projected Wage for Active Companies	$41,554	$45,072	$47,983

Historical Performance Data, Cont'd
Active, Filing Companies in the QJ Program: Active Companies by Geography

In FY 2008, there were 157 active participants in the Program, which increased to 164 active participants in FY 2009 and decreased to 143 active participants in FY 2010. The graph and map below indicates active participants by geography.

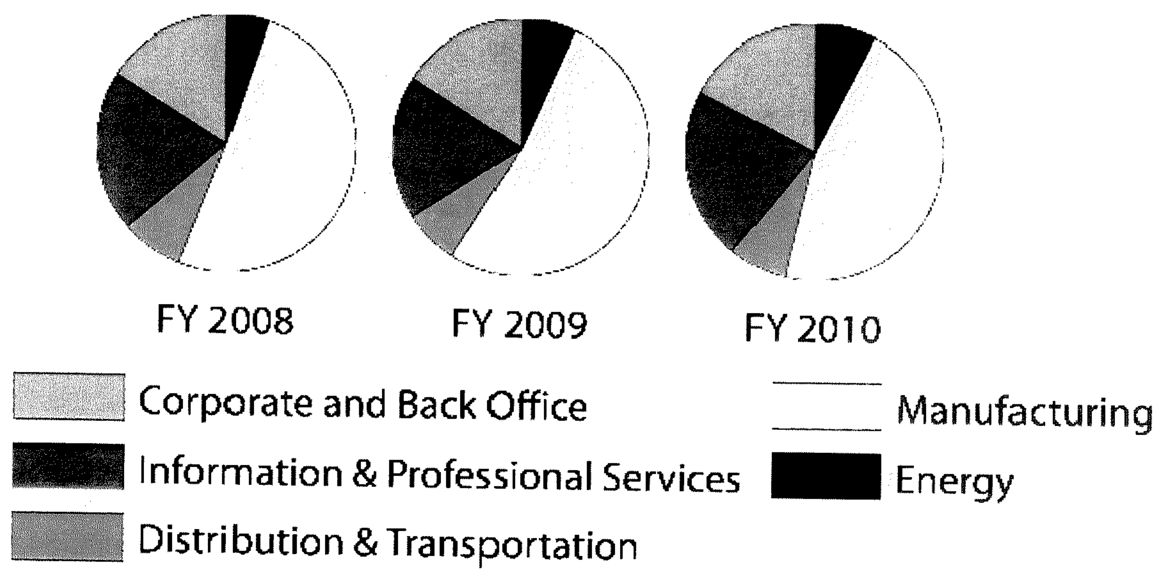
Regarding active participants for FY 2010, there is a time lag for filings in the Program, and it is possible that additional entities will be counted as active for FY 2010 in future time periods. While the most recent information indicates that 143 companies were active in FY 2010, that number could increase as companies can file multiple quarters at one time. In addition to the time lag of company filings, the lower number of active participants in FY 2010 may also be explained by the recent recession, which affected many businesses and is also evidenced by the lower number of new Program enrollees.



Historical Performance Data, Cont'd
Active, Filing Companies in the QJ Program: Active Companies by Industry

The accompanying table and pie charts relate the active participants in the Program by qualifying industry. As may be seen, manufacturing accounts for the largest number of active participants and also accounts for almost all of the decrease in active participants from FY 2009 to FY 2010. While the official dates of the most recent U.S. recession lasted from December 2007 through June 2009, active companies in the Program increased from FY 2008 to FY 2009. Lower Program enrollees and fewer active companies in the Program only occurred in FY 2010.

Sector/Industry	FY 2008	FY 2009	FY 2010
Energy	8	11	11
Manufacturing	80	86	66
Distribution & Transportation	12	11	10
Information & Professional Services	32	30	31
Corporate and Back Office	25	26	25
Total	157	164	143



Fiscal Analysis of the Costs and Benefits of the Program

For fiscal years 2008 to 2010, the Program has paid $168,456,053 to active participants for the jobs that these entities created. The total benefit to the state over this time period was $180,794,278. This means that while the Program is intended to be revenue neutral, the state of Oklahoma has retained a benefit of $12,338,225 over and above the costs of the Program. This is largely a result of companies paying higher wages than they project and the state retaining the tax benefits from those higher wages.

Furthermore, this calculation only includes those entities that were actively filing during the FY 2008 to FY 2010 time period. The state achieves additional benefits from successful participants in the Program. These successful participants have either participated in the Program for the maximum forty quarters or have fully claimed the maximum contracted incentive available to them. These entities have continued to employ Oklahomans and create revenue beyond the terms of the Program's contract.

Summary

Since the Oklahoma Quality Jobs Program (the "Program") first began, 582 companies have enrolled. These companies have created over 443,000 new jobs, with a payroll of over $14 billion in Oklahoma. The average wage of these jobs over the entire life of the Program is nearly $33,800. More recently, the average wage of active participants in the Program is greater than $52,600.

This Program has served as a major incentive for business attraction and expansion. Through Fiscal Year 2010, thirty two percent of the entities participating in the Program either were new to the state or were a start-up. Sixty-eight percent were entities already located in the state which expanded. Thirty-two percent of the new jobs created were located in rural areas (with a population of less than 50,000 people) and sixty-eight percent were in urban areas.

Many of the executives of companies participating in the Program have stated that it was a major reason the company decided to expand or locate in Oklahoma. Several have stated that the relative ease of application and claims filing is much more efficient than in other states where they have locations or considered before coming to Oklahoma.

With the advent of a "6% opportunity" two companies have brought in other segments of their businesses that pay significantly higher wages (at least 150% of that paid in their initial contract). While the company receives up to 6% as a benefit rate (instead of 5%) the state receives the economic benefit from these higher paying jobs.

With every participant in the Program, there is significant investment in capital expenditures that boosts the state's economy as well. Most projects have invested well over $1 million in capital investment related to expansion or location to Oklahoma. While some of this investment initially qualifies for the state's Ad Valorem tax exemption, it eventually reaches the property tax rolls generating income for the county where the project is located.

A participant does not receive any payment of benefits until it actually creates the new jobs and payroll, pays its withholding tax to the state and then files a claim. Legislatively, other tax credits and exemption opportunities normally available to the participant are eliminated for those using the Program.

The Oklahoma Department of Commerce is responsible for the initial application, collection of required supporting documents, due diligence for qualification and contracting with the participant. The Oklahoma Tax Commission then becomes responsible for processing the quarterly benefit claims. The partnership between the two agencies has functioned extremely well, and the participating divisions within the agencies work together on a daily basis to administer the Program, review claims, and recommend legislative changes to the Program. The Oklahoma Tax Commission, with the assistance of Program Management at the Oklahoma Department of Commerce, conducts quarterly claims training sessions for all entities recently enrolled in the Program. This initial training has increased the efficient flow of claims processing and payments as well as reducing waste and inefficiency overall.

Tax & Credits Comparison – Oklahoma & Surrounding States (Appendix F)

February 2012

Taxes

	Corporate Income Tax Rate	Franchise/ Capital Values Tax Rate	Personal Income Tax Rate	2008 Property Taxes per Capita (Rank)* National Per Capita = $1,346
Oklahoma	6.0%	$25, plus 1% of net revenue from OK business activity	0.5 to 5.0% under $8,700; 5.25% over $8,700	$580 (47th)
Arkansas	1% - 1st $3,000; 2%-6% up to $75K; 6.5% over $100K	0.3% of outstanding capital stock employed in state, No par stock, pay $300	1% - 1st $3,000; 2.5%-6% to $33.2K; 7% over $33.2K	$510 (49th)
Colorado	4.63%	None	4.63%	$1,242 (21st)
Kansas	4% + 3% surtax Over $50K	None	3.5% 1st $30K; 6.25% next $30K; 6.45% over $60K	$1,318 (19th)
Missouri	6.25%	1/37th of 1% of outstanding shares and surplus if they exceed $10 million	1.5% 1st $1K; 2%-6% up to $8K; 6% over $9K	$920 (37th)
New Mexico	4.8% - 1st $500K; 7.6% over $1M	$50 per tax year	1.7% 1st $5,500; 3.2%-4.7% up to $16K; 4.9% over	$566 (48th)
Texas	N/A	1% of taxable margin; 0.5% for retail or wholesale trade	N/A	$1,380 (17th)

*Sources: Thomson Reuters RIA All States Tax Guide www.riacheckpoint.com, and *CQ Press– State Rankings 2011 – A Statistical View of America*

Credits

	Historical Rehab ?	Oil & Gas?	Wind/ Renewable Energy?	Ad Valorem Exemption(s)?	Manufacturing?	Aerospace/ Engineer?	Coal Mining?	Moratorium?
Oklahoma	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Arkansas	Yes	None found	Yes	No, only industrial revenue bonds	Yes, for job creation	No, only grants & knowledge-based startup companies	Yes	No
Colorado	Yes, but with limitations	None found	None found	None found	Yes, sales tax exemption	Yes, aircraft new employees	No	No
Kansas	Yes	None found	Yes, bonds, Renewable facilities & Biomass	None found	Yes	None found	No	No
Missouri	Yes	None found	Only renewable and alternative fuels	None found	Yes	None found	Only on Charcoal	No
New Mexico	Only on certain cultural sites & buildings	None found	Yes, alternative, renewable and biomass	Yes	Yes	Yes, only aircraft manufacturers	No	No
Texas	Only grants for certain Main St. & revitalization programs	None found	Only Solar Franchise Tax exemption	No, but ED. Act allows school districts to keep property taxes	Only bonds and sales & use exemptions	Only Freeport property exemption on aircraft parts	No	No

Sources: C2ER Incentives Database, February 2012 www.c2er.org and government websites

ARKANSAS

- IRC Type Group: Arkansas Economic Development Commissioners
- Website: http://arkansasedc.com/arkansas-edc/commission-.aspx

- Responsibility: Provide guidance and direction for ongoing incentive efforts

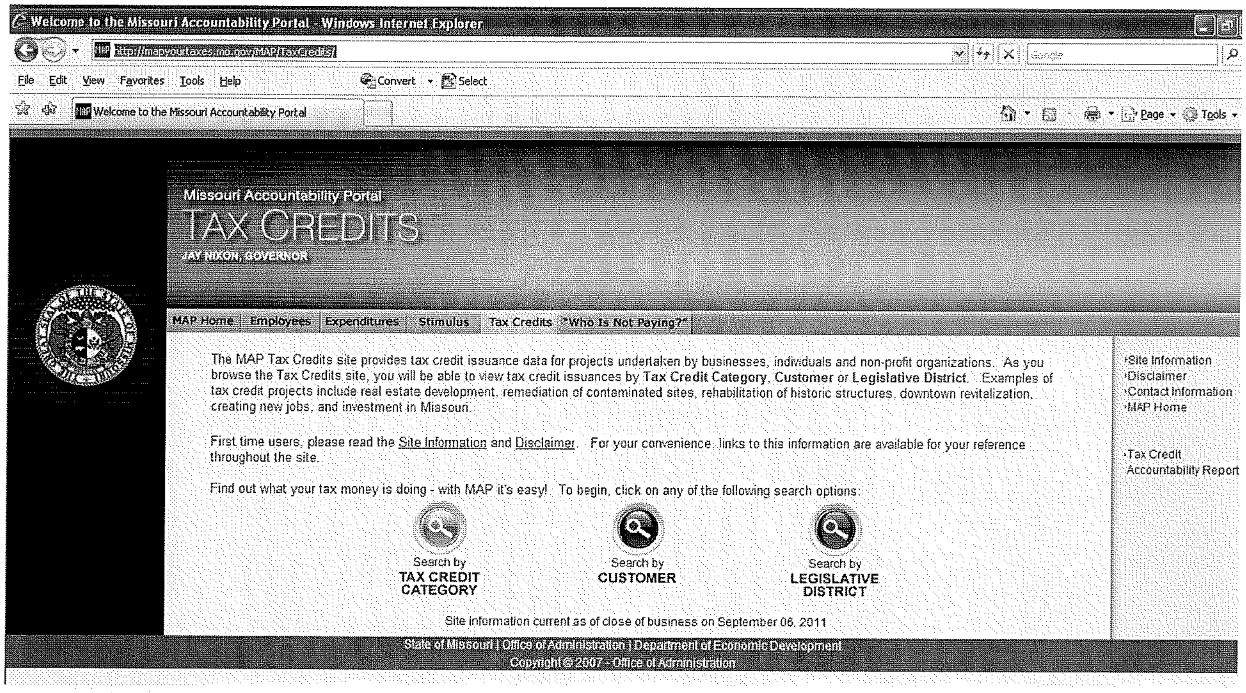
- Members: 16 members
- Restrictions: 3 members from each congressional district plus 4 at large
- Appointed/Elected: Appointed by Governor with advice and consent of state Senate
- Length of term: 4 years

- Structure:
  - Chairman
  - Vice Chairman
  - Executive Committee (5 members)
  - Technology Growth Committee (7 members)
  - Bond Guaranty/Small Business Loan Committee (8 members)

- Public reports: None found

MISSOURI

- IRC Type Group: none found
- Public reports: http://mapyourtaxes.mo.gov/MAP/TaxCredits/



Welcome to the Missouri Accountability Portal - Windows Internet Explorer

http://mapyourtaxes.mo.gov/MAP/TaxCredits/

Missouri Accountability Portal

TAX CREDITS

JAY NIXON, GOVERNOR

MAP Home | Employees | Expenditures | Stimulus | Tax Credits | "Who Is Not Paying?"

The MAP Tax Credits site provides tax credit issuance data for projects undertaken by businesses, individuals and non-profit organizations. As you browse the Tax Credits site, you will be able to view tax credit issuances by **Tax Credit Category**, **Customer** or **Legislative District**. Examples of tax credit projects include real estate development, remediation of contaminated sites, rehabilitation of historic structures, downtown revitalization, creating new jobs, and investment in Missouri.

First time users, please read the Site Information and Disclaimer. For your convenience, links to this information are available for your reference throughout the site.

Find out what your tax money is doing - with MAP it's easy! To begin, click on any of the following search options:

Search by **TAX CREDIT CATEGORY** | Search by **CUSTOMER** | Search by **LEGISLATIVE DISTRICT**

Site information current as of close of business on September 06, 2011

Site Information
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MAP Home

Tax Credit Accountability Report

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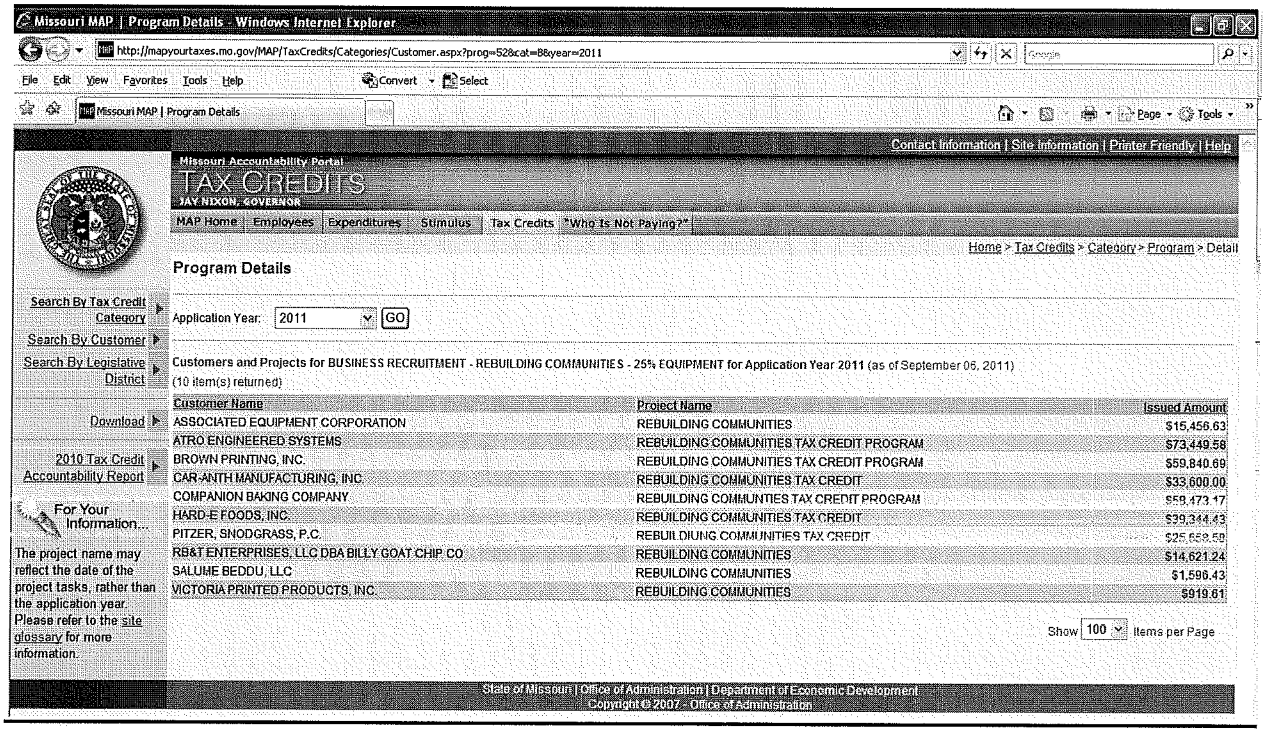

Missouri MAP | Program Details - Windows Internet Explorer

http://mapyourtaxes.mo.gov/MAP/TaxCredits/Categories/Customer.aspx?prog=52&cat=8&year=2011

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Missouri Accountability Portal

TAX CREDITS

JAY NIXON, GOVERNOR

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Home > Tax Credits > Category > Program > Detail

Search By Tax Credit Category
Search By Customer
Search By Legislative District
Download
2010 Tax Credit Accountability Report

For Your Information...

The project name may reflect the date of the project tasks, rather than the application year. Please refer to the site glossary for more information.

Program Details

Application Year: 2011 GO

Customers and Projects for BUSINESS RECRUITMENT - REBUILDING COMMUNITIES - 25% EQUIPMENT for Application Year 2011 (as of September 06, 2011)
(10 item(s) returned)

Customer Name	Project Name	Issued Amount
ASSOCIATED EQUIPMENT CORPORATION	REBUILDING COMMUNITIES	$15,456.63
ATRO ENGINEERED SYSTEMS	REBUILDING COMMUNITIES TAX CREDIT PROGRAM	$73,449.58
BROWN PRINTING, INC.	REBUILDING COMMUNITIES TAX CREDIT PROGRAM	$59,840.69
CAR-ANTH MANUFACTURING, INC.	REBUILDING COMMUNITIES TAX CREDIT	$33,600.00
COMPANION BAKING COMPANY	REBUILDING COMMUNTIES TAX CREDIT PROGRAM	$59,473.17
HARD-E FOODS, INC.	REBUILDING COMMUNITIES TAX CREDIT	$39,344.43
PITZER, SNODGRASS, P.C.	REBUILDIUNG COMMUNITIES TAX CREDIT	$25,658.58
RB&T ENTERPRISES, LLC DBA BILLY GOAT CHIP CO	REBUILDING COMMUNITIES	$14,621.24
SALUME BEDDU, LLC	REBUILDING COMMUNITIES	$1,596.43
VICTORIA PRINTED PRODUCTS, INC.	REBUILDING COMMUNITIES	$919.61

Show 100 Items per Page

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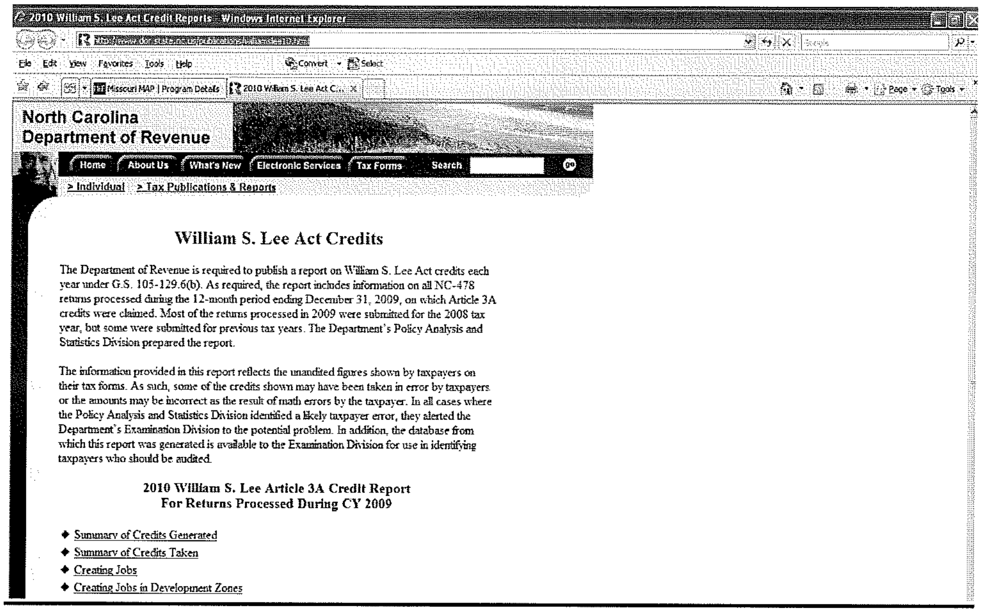
NORTH CAROLINA

- IRC Type Group: none found
- Public reports: http://www.dor.state.nc.us/publications/williamslee10.html



2010 William S. Lee Act Credit Reports - Windows Internet Explorer

North Carolina
Department of Revenue

Home | About Us | What's New | Electronic Services | Tax Forms | Search

> Individual > Tax Publications & Reports

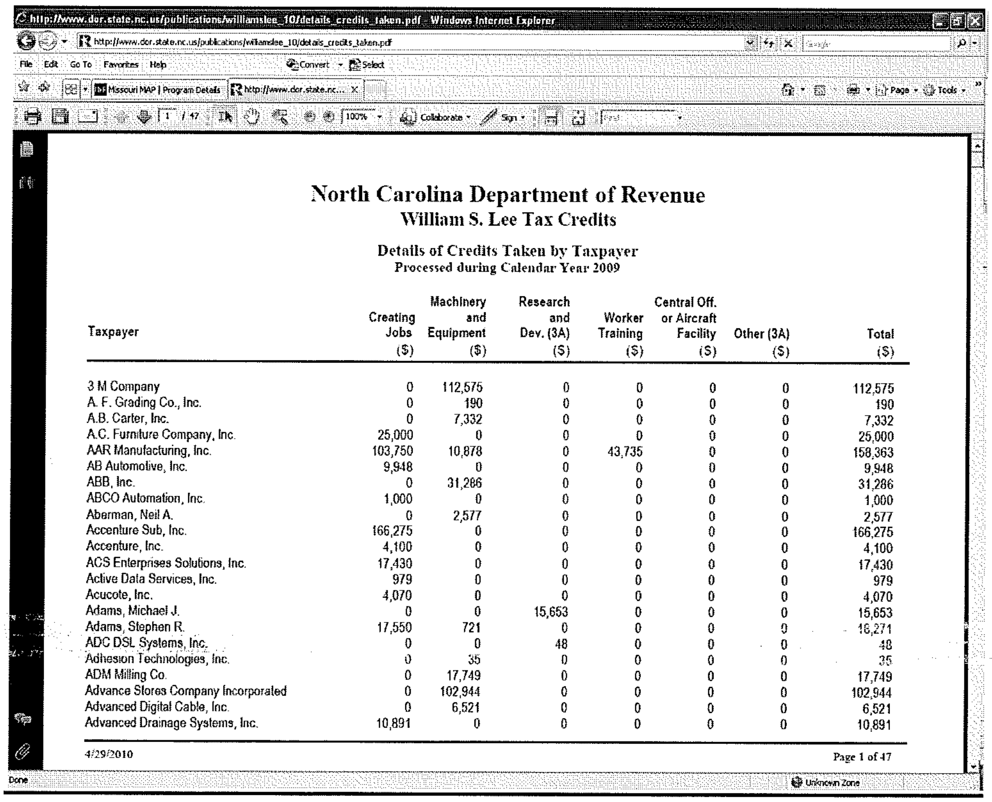
William S. Lee Act Credits

The Department of Revenue is required to publish a report on William S. Lee Act credits each year under G.S. 105-129.6(b). As required, the report includes information on all NC-478 returns processed during the 12-month period ending December 31, 2009, on which Article 3A credits were claimed. Most of the returns processed in 2009 were submitted for the 2008 tax year, but some were submitted for previous tax years. The Department's Policy Analysis and Statistics Division prepared the report.

The information provided in this report reflects the unaudited figures shown by taxpayers on their tax forms. As such, some of the credits shown may have been taken in error by taxpayers or the amounts may be incorrect as the result of math errors by the taxpayer. In all cases where the Policy Analysis and Statistics Division identified a likely taxpayer error, they alerted the Department's Examination Division to the potential problem. In addition, the database from which this report was generated is available to the Examination Division for use in identifying taxpayers who should be audited.

2010 William S. Lee Article 3A Credit Report
For Returns Processed During CY 2009

- Summary of Credits Generated
- Summary of Credits Taken
- Creating Jobs
- Creating Jobs in Development Zones



http://www.dor.state.nc.us/publications/williamslee_10/details_credits_taken.pdf - Windows Internet Explorer

North Carolina Department of Revenue
William S. Lee Tax Credits

Details of Credits Taken by Taxpayer
Processed during Calendar Year 2009

Taxpayer	Creating Jobs ($)	Machinery and Equipment ($)	Research and Dev. (3A) ($)	Worker Training ($)	Central Off. or Aircraft Facility ($)	Other (3A) ($)	Total ($)
3 M Company	0	112,575	0	0	0	0	112,575
A. F. Grading Co., Inc.	0	190	0	0	0	0	190
A.B. Carter, Inc.	0	7,332	0	0	0	0	7,332
A.C. Furniture Company, Inc.	25,000	0	0	0	0	0	25,000
AAR Manufacturing, Inc.	103,750	10,878	0	43,735	0	0	158,363
AB Automotive, Inc.	9,948	0	0	0	0	0	9,948
ABB, Inc.	0	31,286	0	0	0	0	31,286
ABCO Automation, Inc.	1,000	0	0	0	0	0	1,000
Aberman, Neil A.	0	2,577	0	0	0	0	2,577
Accenture Sub, Inc.	166,275	0	0	0	0	0	166,275
Accenture, Inc.	4,100	0	0	0	0	0	4,100
ACS Enterprises Solutions, Inc.	17,430	0	0	0	0	0	17,430
Active Data Services, Inc.	979	0	0	0	0	0	979
Acucote, Inc.	4,070	0	0	0	0	0	4,070
Adams, Michael J.	0	0	15,653	0	0	0	15,653
Adams, Stephen R.	17,550	721	0	0	0	0	18,271
ADC DSL Systems, Inc.	0	0	48	0	0	0	48
Adhesion Technologies, Inc.	0	35	0	0	0	0	35
ADM Milling Co.	0	17,749	0	0	0	0	17,749
Advance Stores Company Incorporated	0	102,944	0	0	0	0	102,944
Advanced Digital Cable, Inc.	0	6,521	0	0	0	0	6,521
Advanced Drainage Systems, Inc.	10,891	0	0	0	0	0	10,891

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TEXAS

- IRC Type Group: Select Committee on Economic Development
- Enabling Bill: http://tx.opengovernment.org/system/bill_documents/001/240/451/original/HB02785S.htm?1310511439
- Responsibility: Develop objective criteria to evaluate incentive
- Members: 12 members
- Appointed/Elected: 4 appointed by Governor
  - 2 must be owners or employees business operating in state
  - 1 must be member of governing body for a city or county

  2 appointed by Lt. Governor
  2 State Senators appointed by Lt. Governor
  2 appointed by Speaker of House
  2 Members of House appointed by Speaker
- Length of term: not addressed
- Public reports: None available as of yet
- Special Notes: Newly created – first report due 1/1/2013
  Committee to be abolished 9/1/13

WASHINGTON

- IRC Type Group: Citizen Commission for Performance Measurement of Tax Preferences
- Website: http://www.citizentaxpref.wa.gov/default.htm

- Responsibility: Develop schedule to review all tax preferences at least once every ten years

- Members: 7 member commission
- Appointed/Elected: 2 each appointed by house and senate, 1 by governor, 2 ex-officio
- Length of term: 4 years (may be appointed for more than one term)

- Public Reports: http://www.citizentaxpref.wa.gov/reports.htm

The Commission may exempt any preference it determines to be a "critical part of the structure of the tax system," and may recommend an expedited review process for any tax preference that has an estimated biennial fiscal impact of $10 million or less.

The Commission meets quarterly in effort to consider citizen input and establish a schedule for review of tax preferences. They may hold additional meetings as necessary. The schedule is delivered to the Joint Legislative Audit and Review Committee (JLARC). The Commission takes into account any newly enacted or terminated tax preferences and revises the schedule as needed each year.

Tax preference reviews are conducted by the Joint Legislative Audit and Review Committee (JLARC) according to the schedule established by the Commission. For each tax preference, JLARC will evaluate whether the public policy objective is being met and provide recommendations to continue, modify, schedule for future review, or terminate the preference. JLARC may also recommend accountability standards for future reviews of tax preferences. JLARC must report its findings and recommendations for scheduled tax preferences to the Commission by August 30th of each year. The Commission will review and comment on the JLARC report. The final JLARC reports will be submitted to House and Senate fiscal committees for a joint hearing.

- Additional: Washington State Department of Revenue
- Website: http://dor.wa.gov/Content/FindTaxesAndRates/TaxIncentives/Def_Credits.aspx#SBC

- Responsibility: Provide Annual report of tax credit recipients

- Public Reports: Based on Annual Tax Incentive Survey; report available at https://fortress.wa.gov/dor/efile/content/doingbusiness/myaccount/TaxIncentivePublicDisclosure/

From: http://dor.wa.gov/docs/reports/2010/DescriptiveStatistics2010.pdf

http://dor.wa.gov/docs/reports/2010/DescriptiveStatistics2010.pdf - Windows Internet Explorer

Table 1.3

SUMMARY OF DESCRIPTIVE STATISTICS BY PROGRAM

Participation in Tax Incentive Programs by Calendar Year
Latest Five Years

Program	Number of Participants				
	2005	2006	2007	2008	2009
B&O RATE REDUCTIONS:					
Manuf. timber/wood	n.a.	323	357	299	260

http://dor.wa.gov/docs/reports/2010/DescriptiveStatistics2010.pdf - Windows Internet Explorer

Table 1.4

SUMMARY OF DESCRIPTIVE STATISTICS BY PROGRAM

Tax Savings Associated with Tax Incentive Programs by Calendar Year
Latest Five Years

Program	Tax Savings ($ in millions)				
	2005	2006	2007	2008	2009
B&O RATE REDUCTIONS:					
Manuf. timber/wood	n.a.	$ 1.8	$ 7.9	$ 14.1	$ 10.8

http://dor.wa.gov/docs/reports/2010/DescriptiveStatistics2010.pdf - Windows Internet Explorer

Table 1.5

SUMMARY OF DESCRIPTIVE STATISTICS BY PROGRAM

Total Jobs for Tax Incentive Program Participants by Calendar Year
Latest Five Years

Program	Number of Total Jobs in Washington Reported by Participants				
	2005	2006	2007	2008	2009
B&O RATE REDUCTIONS:					
Manuf. timber/wood	n.a.	20,986	23,499	20,335	18,315

From:
https://fortress.wa.gov/dor/efile/content/doingbusiness/myaccount/TaxIncentivePublicDisclosure/

Tax Incentive Public Disclosure Reports - Windows Internet Explorer

https://fortress.wa.gov/dor/efile/content/doingbusiness/myaccount/TaxIncentivePublicDisclosure/ State of Washington [US]

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Tax Incentive Public Disclosure Reports

Department of Revenue Washington State "Working together to fund Washington's future"

Tax incentive public disclosure reports Tax Incentive Home

Public Disclosure Reports

Public disclosure reports provide tax incentive information reported by businesses, as required by law.

Annual Surveys

- 2010
- 2009
- 2008
- 2007
- 2006
- 2005
- 2004

Annual Reports

- 2010
- 2009
- 2008
- 2007
- 2006
- 2005
- 2004

Survey Public Disclosure Data - Windows Internet Explorer

https://fortress.wa.gov/dor/efile/Content/DoingBusiness/MyAccount/TaxIncentivePublicDisclosure/SurveyPublicDisclosure.aspx?TaxYear=2010 State of Washington [US]

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Survey Public Disclosure Data

Department of Revenue Washington State "Working together to fund Washington's future"

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Back

Survey Public Disclosure Data for 2010

TRN	Business Name	Non-Disclosure Requested	High Technology Business & Occupation Tax Credit	Rural County Sales & Use Tax Deferral	High Technology Sales & Use Tax Deferral	Fruit and Vegetable Processors B&O Tax Exemption	Aerospace Non-Manufacturing	Aerospace FAR Parts 145 Repair Station	Dairy Products B&O Exemption	Seafoo Produc B&O Exemp
036-002-642	BATTELLE MEMORIAL INSTITUTE	false	2,000,000.00		70,568.00					
041-000-061	BLUE STAR GROWERS INC	false								
042-000-052	TROUT BLUE CHELAN MAGI INC	false								
046-005-182	VAN DOREN SALES INC	false		16,972.00						
065-011-931	COLUMBIA VISTA CORPORATION	false								
113-004-668	PASCO MACHINE CO INC	false		23,874.00						
141-004-575	OCEAN SPRAY CRANBERRIES INC	false		1,038,480.00		74,550.89				
144-002-363	HOQUIAM PLYWOOD CO INC	false								
145-000-043	CITY OF MONTESANO	false								
145-001-198	VAUGHAN CO INC	false		20,617.00						
173-002-203	SMITH BROTHERS FARMS INC	false							223,595.03	
178-000-544	NATIONAL FROZEN FOODS CORPORATION	false				178,056.36				
178-005-035	DARIGOLD INC	false		641,229.00					945,995.00	

TRN: 048-000-001, Site: World Publishing - Windows Internet Explorer

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Department of Revenue Washington State

"Working together to fund Washington's future"

Tax Incentive public disclosure reports

Tax Incentive Home

Back to report list

048-000-001:WORLD PUBLISHING COMPANY

Site:World Publishing, Tax Year:2010

Business Information

Name of Business as Registered: WORLD PUBLISHING COMPANY

UBI Number used with Department of Employment Security
(if this number differs from Revenue's Tax Registration Number)
048000001

Total number of employees statewide (as reported to Employment Security) on December 31, 2010
119

Employment Security Reference Number(s)

004467000

☐ Check this box if you are a tooling manufacturer.

☐ Check this box if you have no sites in Washington

☐ Check this box if you have no business sites and no employees in Washington State.

How many manufacturing sites do you have in Washington that were supported by tax incentives during this calendar year?

1

Selected Incentives:
Newspaper Industry Incentive

Site Details

Site Name:
World Publishing

Contact Name:

Address line 1
14 N. Mission

Address line 2

City Zip State

Internet 100%

Appendix G

December 30, 2011

Governor Mary Fallin
212 State Capitol
Oklahoma City, OK 73105

President Pro Tempore Brian Bingman
422 State Capitol
Oklahoma City, OK 73105

Speaker Kris Steele
401 State Capitol
Oklahoma City, OK 73105

Dear Governor Fallin, President Pro Tempore Bingman and Speaker Steele:

As Co-chair of the Task Force on Comprehensive Tax Reform, I am pleased to provide to you with the report required pursuant to Senate Joint Resolution 61 (2010 Legislative Session) to study comprehensive reform for Oklahoma's tax system. The Task Force focused on three primary goals:

1. Resolution of the issues surrounding taxation of intangible properties;
2. Changes to our tax code which would lower income tax rates and broaden the base of taxpayers to stimulate our economy and grow our tax revenue base for government priorities; and
3. Development of a framework for Oklahoma to become a "no-income tax" state.

Thanks to the hard work, dedication and intensive collaboration of the members of the Task Force, the following report provides recommendations to address each of the goals listed above. In addition to four public hearings, a large number of Task Force members put in numerous hours of thought and effort during several work sessions to discuss the advantages and disadvantages of the ideas and concepts that were presented to us by guest experts at our hearings. Our work proceeded in a very inclusive manner to make sure that adequate consideration was given to all participants in this process.

As you and members of the Legislature consider these proposals, we hope that the taxpayers of Oklahoma will be your main priority. The non–partisan Tax Foundation has rated Oklahoma's overall tax structure number 30 out of the 50 states when assessing our job creation environment. We can and must do better to shift our tax code away from special interest groups who benefit from obsolete and ineffective tax preferences and toward hardworking Oklahomans who deserve to keep more of their hard earned income. If done correctly, tax reform will lower tax rates and broaden the base of taxpayers. This in turn will raise the standard of living for all Oklahomans and also generate an increase in government revenues for top priorities such as education and roads and bridges.

We believe that if the following recommendations are put into action, tremendous economic benefit will result for the state of Oklahoma for years and years to come. We hope and respectfully ask that you and the Legislature give special time and attention to this report and our recommendations.

Task Force members in support of this Final Report and Recommendations:

Senator Mike Mazzei, Task Force Co-Chair
Representative David Dank, Task Force Co-Chair

Senator Rick Brinkley
Secretary of State Glenn Coffee
Director of State Finance Preston Doerflinger
Bryan Gonterman
Tax Commission Chairman Thomas Kemp
Kirby Lehman
Marty Lewis
Charles Mills
County Assessor Wade Patterson
Dan Ramsey
Dana Weber
Representative Harold Wright

TASK FORCE ON COMPREHENSIVE TAX REFORM (SJR 61)

List of Members

Name	Appointing Authority	SJR 61 Qualifications
Senator Mike Mazzei, ***Co-Chair***	Senate	Chair of Senate Finance Committee
Representative David Dank, ***Co-Chair***	House	Chair of House Revenue and Taxation Subcommittee of the Appropriations and Budget Committee
Senator Rick Brinkley	Senate	Vice-Chair of Senate Finance Committee
Secretary Glenn Coffee	Senate	Member of Senate (at time of original appointment)
Kirby Lehman	Senate	Superintendent or Board Member of Elementary or Independent School District
Russell Phillips	Senate	Representing the Energy Industry
Dan Ramsey	Senate	Representing the Insurance Industry
Mark Headley	House	Representing Statewide Organization of Business
Albert "Kell" Kelly	House	Representing Banking Industry
Marty Lewis	House	Superintendent or Board Member of Elementary or Independent School District
Representative Harold Wright	House	Vice-Chair of House Revenue and Taxation Subcommittee of the Appropriations and Budget Committee (original appointment)
Richard Dowell	Governor	Representing Small Business
Bryan Gonterman	Governor	Representing Technology Industry
Don Millican	Governor	Member at Large
Charles Mills	Governor	Representing Small Business
Wade Patterson	Governor	County Assessor
Nicholas Tricinella	Governor	Representing the Energy Industry
Dana Weber	Governor	Representing a Statewide Organization of Business
Preston Doerflinger	Statutory	Office of State Finance
Thomas Kemp	Statutory	Oklahoma Tax Commission

TASK FORCE ON COMPREHENSIVE TAX REFORM

INTRODUCTION

The Task Force on Comprehensive Tax Reform was created in Senate Joint Resolution 61 during the 2010 legislative session. The Task Force was given a broad mandate to, "recommend amendments to the Business Activity Tax Code, to review the different types of tax imposed on businesses and individuals in this state and to develop recommendations and proposed legislation to provide increased simplification and fairness in the tax structure of the state." The legislation provided for 21 members, appointed by the Governor, Senate and House. The group includes members of the State Legislature, other state and local officials, and members of the business and education communities. This final report is required to be submitted the Governor, President Pro Tempore and Speaker on or before January 1, 2012.

BACKGROUND

The Task Force held four public meetings for the purpose of hearing testimony and gathering information related to the Task Force's mission.

The first meeting was held on September 15, 2011. The purpose of this meeting was to receive input from a variety of speakers representing local and national perspectives. The Task Force heard from the following:

- Mandy Rafool, Fiscal Affairs Program, National Conference of State Legislatures;
- Michael Carnuccio, President, Oklahoma Council of Public Affairs; and
- David Blatt, Director, Oklahoma Policy Institute.

Ms. Rafool provided the Task Force with an overview of: state tax sources, the tax structures of Oklahoma's surrounding states and the state of North Dakota and recent comprehensive tax reform efforts in other states. The information provided by Ms. Rafool showed the extent to which each state relies upon various tax types to fund state and local government and the breakdown of state and local business tax collections. She highlighted tax reform efforts in Ohio, Texas and Michigan.

The presentations by Mr. Carnuccio and Mr. Blatt were structured in response to specific questions posed by the Task Force. The response of each of the speakers is summarized below.

1. Should the Oklahoma Constitution be amended to exempt all intangible personal property from the ad valorem tax?

Mr. Carnuccio: Yes, due to the disadvantages and problems inherent in taxing intangible personal property.

Mr. Blatt: No, due to the substantial revenue loss which could result from property which is currently subject to ad valorem taxes (intangible personal property of centrally-assessed entities). The optimal solution is to limit the tax levy to such property (the status quo ante).

2. Should Oklahoma tax business activity with a BAT, a corporate income tax, and a franchise tax as done under the present system or should one of those taxes be levied in place of the others?

Mr. Carnuccio: The BAT and franchise taxes penalize activity and production. If business activity must be taxed at all, the corporate income tax is the least problematic.

Mr. Blatt: The corporate income tax is an important component of an adequate and fair system, but should be strengthened by adopting combined reporting. In addition, Oklahoma should retain some form of broad-based, low rate assessment calculated on investment or gross receipts.

3. Should Oklahoma enact stricter enforcement of taxes for online sales?

Mr. Carnuccio: Oklahoma should continue to justly collect taxes for online sales but not in a way that undermines the spirit of the *Quill* decision.

Mr. Blatt: Mr. Blatt explained the challenges of taxing online sales and the estimated revenue loss which results. He noted that some states have enacted provisions to clarify the interpretation of "nexus".

4. *Should Oklahoma seek to reduce its income tax rate from its current level at5.25%? If so, what do you believe is the ideal income tax threshold?*

Mr. Carnuccio: Yes, individual income taxes should be eliminated completely over a period of seven to ten years.

Mr. Blatt: No, income tax is vital for an adequate and balanced system. The amount of all tax collections represented by income tax has fallen since 2005.

5. How do you accomplish an income tax reduction and maintain revenue neutrality?

Mr. Carnuccio: By eliminating all income tax credits and deductions and using resulting revenue gains to phase out the income tax.

Mr. Blatt: In 2001, this proposition was considered and then-Governor Keating initially proposed a 5.9% gross receipts tax as a substitute for income tax and sales tax on groceries.

6. Should Oklahoma eliminate the income tax to be more competitive in a 21st century economy?

Mr. Carnuccio: Yes, in the nine states without income taxes this has resulted in higher GDP growth, job growth and total state tax receipts.

Mr. Blatt: No, income tax is vital for our system and slashing the tax is not the right path for economic growth. Research has shown that investment decisions are driven more by a well-trained, productive workforce and strong infrastructure than by state and local tax rates.

7. If you could design your ideal tax system for Oklahoma, how would it be structured and why?

Mr. Carnuccio: The system would have no personal income tax, other main tax types (sales, corporate income and premium taxes) would be broad-based and at the lowest possible rate. Local taxes would include sales and property taxes only.

Mr. Blatt: Five ideas for tax reform include: (1) limit tax incentives; (2) limit itemized income tax deductions; (3) strengthen sales tax; (4) allow higher taxes on commercial property; and (5) provide broad-based income tax cuts.

The second meeting was held on October 20, 2011. The purpose of this meeting was to receive input from representatives of the state and local business community. The Task Force heard from the following:

- Chris Benge, Sr. Vice President, Government Affairs, Tulsa Metro Chamber of Commerce;
- Scott Meacham, Board Member, Oklahoma State Chamber of Commerce; and
- Wes Stuckey, President, Ardmore Chamber of Commerce

Each of the speakers addressed the issues raised in the questions posed by the Task Force. The response of each of the speakers is summarized below.

1. Should the Oklahoma Constitution be amended to exempt all intangible personal property from the ad valorem tax?

Mr. Benge: If the failure to do so would result in taxing previously-untaxed intangible personal property, it would need to be done to keep from creating a huge new tax burden.

Mr. Meacham: New taxation of intangibles could pose a serious threat to businesses large and small. However, the State Chamber also believes government supported services which are currently receiving ad valorem revenue from the taxation of intangibles are important.

Mr. Stuckey: The importance of property tax in business development depends on the type of business. When property tax is an important issue to a relocating business, Oklahoma compares very favorably to Texas.

2. Should Oklahoma tax business activity with a BAT, a corporate income tax, and a franchise tax as done under the present system or should one of those taxes be levied in place of the others?

Mr. Benge: The most important thing is to simplify and streamline the tax code in a way that encourages business growth.

Mr. Meacham: The most advantageous move would be to roll all of the taxes into as few as possible. The type of tax can be misleading. For example, Texas has a franchise tax which is based on income, but no "income tax".

Mr. Stuckey: There is no silver bullet answer to the best way to tax business activity because it depends on the way each business is structured. Our income tax is a stable source of revenue needed to fund state services. Credits and exemptions could be eliminated to reduce the top rate.

3. Should Oklahoma enact stricter enforcement of taxes for online sales?

Mr. Benge: The Tulsa Chamber supports stricter enforcement of sales and use tax as a way to help brick and mortar businesses compete with online sales from out of state. They appreciate last year's legislative efforts to address this issue.

Mr. Meacham: All taxes that are due by law should be collected so Oklahoma businesses are not put at a disadvantage. Determinations about online sales are difficult due to interpretation of the *Quill* decision and to actions like those taken by Amazon.

Mr. Stuckey: Broadening the tax base to include more services has potential for our state. We have an enforcement problem in some areas where a cash economy exists and sales are underreported.

4. Should Oklahoma seek to reduce its income tax rate from its current level at5.25%? If so, what do you believe is the ideal income tax threshold?

Mr. Benge: The Tulsa Chamber would support anything that encourages the creation and development of more capital in the state but believes this must be balanced with the need to maintain government programs and services which are also vital to economic growth.

Mr. Meacham: If enough tax preferences are eliminated, the state could reduce its top rate to as much as 3%.

Mr. Stuckey: Oklahoma is very competitive when it comes to overall tax burden. Reducing tax preferences might allow for a lower rate but this is only one of a host of factors which businesses use to determine where to locate or expand. The relative importance of the top income tax rate depends on the type of business and the value they place on that over many other factors. A business locating a branch plant may care less about income tax levels than one locating a corporate headquarters.

5. How do you accomplish an income tax reduction and maintain revenue neutrality?

Mr. Benge: Although they would support a revenue neutral income tax rate reduction they urge caution that it is not accomplished by shifting tax burden to business.

Mr. Meacham: Revenue neutrality will only be successful if it is not a reallocation onto the backs of business. A shift to greater reliance on sales tax could be problematic to certain businesses in particular. Tax expenditures which are "give-aways" should be scrutinized and dynamic revenue forecasting should be used.

Mr. Stuckey: There is no silver bullet solution. We must be able to fund state services.

6. Should Oklahoma eliminate the income tax to be more competitive in a 21st century economy?

Mr. Benge: Income tax is only one of the factors important to business growth and development. Elimination of the tax would have to be balanced in such a way that other important factors do not suffer.
Mr. Meacham: The state will lose business and jobs if it eliminates too much of the revenue source which supports government services like education.

Mr. Stuckey: Getting rid of the income tax might not have the expected impact on economic development because there are many other very important issues for economic growth and development.

7. If you could design your ideal tax system for Oklahoma, how would it be structured and why?

Mr. Benge: The system would be designed to attract and retain capital and maintain our pro-growth atmosphere and our low-tax status.

Mr. Meacham: An ideal system would appropriately balance the three primary sources of revenue – income, sales and property tax – and would be much simpler than our present system.

Mr. Stuckey: Because economic development depends highly on the type of business being recruited and its particular needs, an ideal system is difficult to determine. The most important thing is to have a state that is known for excellence.

The third meeting was held on November 17, 2011. Presenters included four economists who provided the Task Force members with perspectives on tax reform. The Task Force heard from the following:

- Dr. Larkin Warner, Economist and Regents Professor Emeritus, Oklahoma State University;
- Dr. Alexander Holmes, Regents Professor of Economics and Department Chair, University of Oklahoma;
- Dr. Mickey Hepner, Dean, College of Business Administration, University of Central Oklahoma; and
- Dr. Noel Campbell, Associate Professor of Economics, University of Central Arkansas

Dr. Warner and Dr. Holmes were asked to comment on a tax reform study they and others authored in 2001 at the request of the Governor and legislative leaders. Their final report was entitled, "Revenue-Neutral Tax Reform for Oklahoma: Issues and Options". Dr. Warner urged the group to be aware of three particular challenges in developing tax policy:

1. Identify your goals and how you plan to achieve them. He noted the difficulty in making tax policy under the constraints of Article X, Section 33, which limits the ability of the Legislature to enact tax increases (commonly referred to as "State Question 640").
2. Make policy using the overall tax structure, not just one aspect or tax type.
3. Look at revenue from the federal government as part of the budget picture. This is likely to change and will have an impact on state revenue and budget decisions.

Dr. Warner also briefly discussed the principles of a good tax system, as described in the 2001 report. Dr. Holmes reflected on some of the constraints to creating the ideal state tax system. Those included: the constitutional limit on tax increases, particular qualities of certain tax types (e.g. volatility of gross production tax), tax competition between various levels of government and equity issues. Holmes suggested that when policymakers look at all of the state's primary state tax sources, it does not make sense to eliminate income tax unless government stops providing or provides less government services and eliminates tax incentives.

Dr. Mikey Hepner and Dr. Campbell were asked to respond to the seven questions posed by the Task Force members. Their responses are summarized below.

1. Should the Oklahoma Constitution be amended to exempt all intangible personal property from the ad valorem tax?

Dr. Hepner: Yes, because the outcome of the Court ruling creates a competitive disadvantage for public service companies, which is contrary to optimal tax policy. In addition, such a tax could cause a migration of firms which have valuable intellectual property.

Dr. Campbell: Yes, accurate valuation is difficult because there is not enough market data for proper comparisons.

2. Should Oklahoma tax business activity with a BAT, a corporate income tax, and a franchise tax as done under the present system or should one of those taxes be levied in place of the others?

Dr. Hepner: The ideal approach is to rely on a reformed corporate income tax and eliminate the franchise tax. In Oklahoma, corporate income tax is determined using the "three-factor formula", where equal weight is given to payroll, property and sales. Hepner believes the formula should be modified and a "single sales factor" should be used.

Dr. Campbell: Oklahoma should maintain the corporate income tax and eliminate the franchise and BAT tax.

3. Should Oklahoma enact stricter enforcement of taxes for online sales?

Dr. Hepner: If possible, yes because brick and mortar businesses in the state are at a disadvantage. However, this could lead some retailers to reduce their investments and business relationships in the state.

Dr. Campbell: It depends upon the marginal benefit and cost associated with stricter enforcement. In Colorado, some e-retailers left the state as a result of increased enforcement efforts.

4. *Should Oklahoma seek to reduce its income tax rate from its current level at5.25%? If so, what do you believe is the ideal income tax threshold?*

Dr. Hepner: No, the impact would be relatively small and Oklahoma's personal income taxes are currently below the national average. A better strategy would be to reduce sales taxes, which are above the national average.

Dr. Campbell: Campbell was unwilling to take a position on this question citing his lack of background knowledge on Oklahoma finances and general opinion about the use of personal income tax as a revenue producer.

5. How do you accomplish an income tax reduction and maintain revenue neutrality?

Dr. Hepner: This would require significant revenue increases in other tax types. There several alternatives, each with advantages and disadvantages. One is to expand the sales tax base by including services and raise the tax rate. The other would be to increase property taxes, possibly by levying a state property tax.

Dr. Campbell: There are several paths to revenue-neutrality. One is to enact offsetting changes in the tax code, either by increasing the rate on another tax base or by levying a new tax. Another possibly is to rely upon the increased economic activity and productivity which may result from the income tax reduction. These assume that government spending will decrease to the optimal level – spending and taxes cannot be separated.

6. Should Oklahoma eliminate the income tax to be more competitive in a 21st century economy?

Dr. Hepner: No, the sales tax rate is a more pressing problem and our economy is already competitive. Also, elimination of the income tax could shift more tax burden towards middle-and lower-income families.

Dr. Campbell: Oklahoma should seriously consider eliminating the income tax but not without carefully managing future expenditures. Eliminating income tax could unleash latent innovation, entrepreneurship and venture creation.

7. If you could design your ideal tax system for Oklahoma, how would it be structured and why?

Dr. Hepner: The optimal tax structure would include: a reformed corporate income tax, elimination of the franchise tax and many current tax preferences, reduction of state sales tax and increased reliance on deductible taxes such as income and property tax.

Dr. Campbell: The ideal system would be robust, transparent and difficult to alter and most importantly, would have the lowest possible transition costs. It would also provide government with sufficient revenue to perform its functions.

The fourth and final meeting of the Task Force was held on December 1, 2011… Presenters included three individuals who provided the Task Force members with the small business and practitioner perspective on tax reform. The Task Force heard from the following:

- Ron Barber, Barber & Bartz
- Bill Lohrey, Lohrey & Associates; and
- Jerrod Shouse, National Federation of Independent Business

1. Should the Oklahoma Constitution be amended to exempt all intangible personal property from the ad valorem tax?

Mr. Barber: Yes, because prior interpretations of the law have relied upon things such as goodwill being exempt and it would be unfair to change the interpretation now. Also valuation is tricky and would create uncertainty. Finally it might penalize the most innovative companies.

Mr. Lohrey: Yes, but this change should probably be phased in through a logical, slow method. For accounting purposes, it is important to know the rules at the beginning of each year.

Mr. Shouse: Yes, small businesses are particularly vulnerable to this tax.

2. Should Oklahoma tax business activity with a BAT, a corporate income tax, and a franchise tax as done under the present system or should one of those taxes be levied in place of the others?

Mr. Barber: Income tax should be the primary source and a properly implemented BAT tax could be a supplemental source. Taxes like the BAT and franchise tax are not the most sound and serve more as a backstop or floor to assure that businesses connected with the state pay something. There is a greater need to simplify the taxes than there is to lower them.

Mr. Lohrey: Income tax should be the primary focus. Simplicity and continuity are important for small business. Mr. Lohrey agrees with Mr. Barber and emphasizes that taxes like the BAT and franchise tax are more like "registration fees".

Mr. Shouse: NFIB members are varied and the answer to this question might differ depending upon how they are structured. Anything that makes compliance simpler is better for small businesses.

3. Should Oklahoma enact stricter enforcement of taxes for online sales?

Mr. Barber: Yes, although this is a complex problem we must address it since such sales are only going to increase in the future. The best way to implement this is through cooperation with other states.

Mr. Lohrey: Yes, but this area is confusing so that is difficult to do.

Mr. Shouse: Yes, this is a fairness issue which affects brick and mortar businesses in Oklahoma.

4. *Should Oklahoma seek to reduce its income tax rate from its current level at5.25%? If so, what do you believe is the ideal income tax threshold?*

Mr. Barber: Yes, but if that results in a reduced level of services or shifting of the tax burden it will not entice anyone looking to move to or expand in our state. His client recently made a decision to expand an Oklahoma plant for a variety of reasons and tax structure was low on the list of reasons, especially when compared to quality of services available. A rate in the 4% to 5% range would probably be ideal if it is coupled with measures to maintain services.

Mr. Lohrey: It is not clear that the state is losing business because of the top rate so reducing it is not critical. If it is reduced, some rate between 4% and 5%, along with elimination of some credits, could be revenue-neutral.

Mr. Shouse: Yes, a reduction or elimination of income taxes would allow small businesses to invest more back into their operations. However, if the result is a shift to heavier reliance on sales tax, this would hurt small businesses.

5. How do you accomplish an income tax reduction and maintain revenue neutrality?

Mr. Barber: Revenue-neutrality could be accomplished by cutting expenses, eliminating certain tax credits, supplementing revenue decreases with changes in other tax types and reviewing the experience of other states to see if they have been successful in that way.

Mr. Lohrey: In Texas, the lack of income tax has resulted in a reliance on property taxes. That is no considered optimal. Continuing to look critically at tax credits and incentives is important as well as looking at the experience of other states.

Mr. Shouse: Although it is not clear how revenue-neutrality could be accomplished OCPA's plan is promising and Dank's Task Force is on the right track.

6. Should Oklahoma eliminate the income tax to be more competitive in a 21st century economy?

Mr. Barber: We should focus on other ways to improve our competitive position. If we determine that eliminating the income tax is necessary to be competitive, we must know the impact first and determine how states without income tax finance government services.

Mr. Lohrey: See answer to question #4.

Mr. Shouse: Although states without an income tax seem to be prospering, small business relies on state-provided services like education and transportation. This would be an important consideration.

7. If you could design your ideal tax system for Oklahoma, how would it be structured and why?

Mr. Barber: The income tax system could be modified by fixing the tax brackets, eliminating most, if not all, targeted credits, implementing some limits on deductions, possibly reducing rates if it will stimulate growth and adopting combined reporting for business. The Ad Valorem system could be improved by making a distinction in tax rates between residential and commercial properties and eliminating any tax on intangibles. For sales tax, groceries should be exempt and sales tax for online purchases should be fully collected. Oklahoma needs to retain its gross production tax. Finally, if a BAT tax is levied, it should be low and broad-based and the impact on groups like farmers and sole practitioners should be reviewed.

Mr. Lohrey: He agrees generally with Mr. Barber.

Mr. Shouse: Simplicity is greatly important because small businesses generally have less time and resources to devote to compliance.

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RECOMMENDATIONS AND CONCLUSIONS

Recommendation 1: The Task Force recommends that a constitutional amendment be put before the voters of Oklahoma to expand the scope of the existing constitutional ad valorem exemption for specified intangible property to cover any and all intangible property. The Task Force further recommends that the Legislature determine the most appropriate methodology for valuation of centrally assessed property.

Recommendation 2: The Task Force recommends that taxation of business activity in Oklahoma be simplified by allowing the business activity tax to expire on December 31, 2012 and by eliminating the levy of franchise tax completely. We anticipate that the $47 million in revenue collected for the franchise tax before the advent of the business activity tax will be offset by gains achieved under Recommendation 3.

Recommendation 3: The Task Force recommends that to minimize tax avoidance, corporations be required to use the accounting practice known as "combined reporting". The Task Force acknowledges, however, that the methodology for combined reporting varies from state to state therefore careful consideration should be given to the type of combined reporting requirements that best fit Oklahoma. It should be noted that combined reporting is required in 24 states, including the state of Texas.

Recommendation 4: The Task Force recommends that the corporate income tax rate be reduced from 6% to 5%. The revenue loss for this change is estimated to equal approximately $60 million. To offset the cost of the corporate rate reduction, we propose eliminating those tax credit items claimed by corporations which are targeted to narrow business interests. This includes provisions identified by the Task Force on Tax Credits and Economic Incentives, such as credits for: venture capital investments, coal production, rehabilitation of historic buildings, and energy efficient residential construction.

Recommendation 5: The Task Force recommends that the individual income tax rate be reduced in a revenue neutral manner. In agreement with individuals making presentations before the Task Force, we recommend that any change in the income tax rate must be coupled with the following:

- Thorough review of existing tax preferences with an expectation of reduction or elimination of most or all preferences;
- Recognition that in order to make Oklahoma attractive for business activity, the existing revenue stream flowing to core government services must be preserved and new revenue which may result must be used to fund priorities such as education and transportation; and
- Simplification of the tax structure.

Income tax rate: Reduce top marginal rate from 5.25% to 4.75%, in quarter-point increments over a two-year period.

Offset: [1] Eliminate the "value" of existing income tax preference items in Appendix A, over a two-year period by half each year (estimated revenue impact is + $352 million); and [2] Eliminate the advantage of the deduction for state and local taxes by requiring Oklahoma taxpayers who itemize deductions to "add back" such amounts on the state return (estimated revenue impact is + $67 million). Note: This deduction is already imbedded in the federal itemized deductions transferred to the Oklahoma income tax form.

Estimated net savings: $70.6 million (Based on revenue impact analysis by Oklahoma Tax Commission)

Recommendation 6: The Task Force believes that the adoption of Recommendation 5 will have a positive impact on overall revenue growth for the state of Oklahoma as income tax rates decline and the taxpayer base increases. Therefore, the Task Force recommends that the Legislature reinstate the income tax "trigger" provision in order to further reduce the top marginal rate by an additional quarter point, subject to growth in revenue. The reinstated provision would utilize 2011 fiscal year revenue amounts as a baseline for any future determinations rather than prior year amounts.

Recommendation 7: The Task Force recommends that if federal legislation such as the Main Street Fairness Act is enacted to address the issue of collection of the existing tax due on online sales, the estimated $180 million in additional sales tax revenue be used to reduce the top marginal income tax rate by a quarter point. The Task Force further recommends that the Legislature urge Oklahoma's congressional delegation to act to remove the competitive disadvantage that uncollected tax creates for Oklahoma's brick and mortar businesses.

Recommendation 8: Based on the assumption that Recommendations 1 through 7 become part of Oklahoma's tax structure, the Task Force recommends that the Governor and Legislature consider the long term goal of making Oklahoma a "no income tax" state. In order to reach that goal and create a significant economic competitive advantage for Oklahoma in a 21st Century service-driven economy, the following should be considered:

- Operating costs must be reduced where appropriate by making government more efficient;
- Core government services, such as education and transportation, which make Oklahoma attractive to business, must continue to be funded to the appropriate level;
- All tax preference items and incentive programs must be eliminated or reduced significantly;
- Sequentially lower income tax rates over a 7 to 10 year period must generate an increase in sales tax collections; and
- An intensive review must be made of Oklahoma's sales tax base as it compares to other states, particularly those which are "no income tax" states.

APPENDIX A

PROPOSED TAX PREFERENCE ITEMS TO ELIMINATE

Type	Citation	Estimated revenue impact
Investment in Equipment Used for Recycling, Reuse, or Source Reduction of Hazardous Waste	27A O.S. § 2-11-303	$3,300
Child Care	68 O.S. § 2357	$28,991,000
Gas Used in Manufacturing	68 O.S. § 2357	$79,000
Oklahoma Investment/New Jobs	68 O.S. § 2357.4	$28,497,000
Energy Conservation Assistance Fund	68 O.S. § 2357.6	$21,000
Venture Capital	68 O.S. § 2357.7	$12,294,000
Oklahoma Coal Production	68 O.S. § 2357.11	$4,276,000
Agricultural Processing Facilities	68 O.S. § 2357.25	$2,517,000
Child Care Services- Employers	68 O.S. § 2357.26	$33,000
Child Care Service Providers	68 O.S. § 2357.27	$198,000
Coast to Coast Airline Service	68 O.S. § 2357.28	$2,000
Ad Valorem Tax (Tornado)	68 O.S. § 2357.29	$26,000
Small Business Guaranty Fee	68 O.S. § 2357.30	$227,000
Credit for Electricity Generated by Zero-Emission Facilities (Wind power generation)	68 O.S. § 2357.32A	$1,239,000
Credit Manufacturers of Advanced Small Wind Turbines	68 O.S. § 2357.32B	$775,000
Hepatitis Immunization	68 O.S. § 2357.33	$19,000
Tax Credit for Qualified Rehabilitation Expenditures (Historic Buildings)	68 O.S. § 2357.41	$671,000
Oklahoma Earned Income Tax Credit	68 O.S. § 2357.43	$31,887,000
Donations to Biomedical Research Foundations or Cancer Research Institutes	68 O.S. § 2357.45	$364,000
Energy Efficient Residential Construction	68 O.S. § 2357.46	$3,776,000
Modification expenses paid for an injured employee	68 O.S. § 2357.47	$33,500
Qualified Recycling Facility	68 O.S. § 2357.59	$32,000
Investment in Qualified Small Business Capital Companies	68 O.S. § 2357.62	
Investment In Small Business Ventures	68 O.S. § 2357.63	$11,060,000
Investment in Rural Venture Capital Companies	68 O.S. § 2357.73	
Investment in Rural Small Business Ventures	68 O.S. § 2357.74	$37,406,000
Local Development and Enterprise Zone Investment Incentive Credit	68 O.S. § 2357.81	$150
Poultry Litter Tax Credit	68 O.S. § 2357.100	$173,000
Film and Music Profit Reinvestment Credit	68 O.S. § 2357.101	$34,000
Dry Fire Hydrant Credit	68 O.S. § 2357.102	$45,000
Railroad Modernization Credit	68 O.S. § 2357.104	$1,130,000
Specially Trained Canine Credit	68 O.S. § 2357.203	$129,000
Personal Exemption	68 O.S. § 2358	$132,699,190
Blind Individuals	68 O.S. § 2358	$130,722

Type	Citation	Estimated revenue impact
Individuals Sixty-five (65) or older	68 O.S. §2358	$474,303
Taxpayers with Physical Disabilities	68 O.S. §2358	$42,682
Dividend/Interest Income Exclusion	68 O.S. §2358	$1,691,285
Nonrecurring Adoption Expenses	68 O.S. §2358	$155,264
Oklahoma College Savings Program	68 O.S. §2358	$2,412,122
Political Contributions	68 O.S. §2358.3	$138,755
Volunteer Firefighter Credit	68 O.S. §2358.7	$418,000
Loans by Financial Institutions under Rural Economic Development Loan Act	68 O.S. §2370	$35,000
Stafford Loan Origination Fee	68 O.S. §2370.3	$349,000
Low Income Property Tax Relief	68 O.S. §2908	$226,000
Film Enhancement Rebate	68 O.S. §3624	$5,000,000
Sales Tax Relief	68 O.S. §5011	$43,212,000
Research and Development Incentives Act	68 O.S. §54006	$14,000
TOTAL		**$352,936,273**

notes:

1. This list includes only those income tax preferences for which a revenue impact was reported by the Tax Commission for the most recent data period in the TAX EXPENDITURE REPORT. It does not include those with a zero amount or those where data was not available.

2. The timing of any "savings" realized would be delayed due to the difference in the calendar and fiscal year.

3. Some of the amounts have been updated by the OTC and differ from the most recent Tax Expenditure Report.

4. Because some tax credits are eligible to be carried over for anywhere from 3 to 20 years, credits already earned could continue to be claimed for a period of time after the credit itself is eliminated.

5. Certain preferences have been subject to sunset recently or are scheduled to sunset within the next few years. This means the revenue impact shown here may be inaccurate in future years.

FINAL REPORT

HB 1285 TASK FORCE ON TAX CREDITS AND ECONOMIC INCENTIVES

Rep. David Dank, Co-Chair
Sen. Mike Mazzei, Co-Chair

December 31, 2011

Executive Summary

HB 1285 created the Task Force on State Tax Credits and Economic Incentives. The Task Force is comprised of ten (10) members as follows:

Chair of the House Revenue and Taxation Subcommittee on Appropriations and Budget
Rep. David Dank

Chair of the Senate Finance Committee
Sen. Mike Mazzei

Chair of the House Appropriations and Budget Committee
Rep. Earl Sears

Chair of the Senate Appropriations Committee
Sen. David Myers

House Minority Leader
Rep. Scott Inman

Senate Minority Leader
Sen. Andrew Rice

State Auditor and Inspector
Gary Jones

State Treasurer
Ken Miller

Director of the Office of State Finance
Preston Doerflinger

Secretary of State
Glenn Coffee

The Task Force met ten times during the months of July, August, September, October, November and December, 2011.

With the exception of the first meeting and the last meeting, all proceedings before the Task Force were conducted in the Chamber of the Oklahoma House of Representatives and were streamed live via the Internet in both video and audio formats. Each of those proceedings has also been archived on the Oklahoma House of Representatives website. The link to reach the proceedings is: www.okhouse.gov

From the House Home Page, select the "Video" tab, then from the drop down menu select "House Video" and then look for the proceedings of the Task Force which are available for continued reference in the "Archived Videos" section of that webpage.

Attorney General Opinion No. 2010-16

In December, 2010, the Attorney General issued Opinion No. 2010-16 which addressed a number of questions related to the constitutionality of tax credits generally. The Oklahoma Constitution prohibits the State of Oklahoma from making a gift to a private business. The Oklahoma Constitution also requires that public revenue be used for a public purpose. AG Opinion No. 2010-16 established a three part test for determining whether a tax credit is constitutional under Oklahoma law.

First, the tax credit must serve a public purpose. Second, the tax credit must provide adequate consideration to the citizens of the State of Oklahoma for the foregone tax revenue that the state would otherwise receive except for the credit amount. Third, the tax credit must have adequate safeguards and controls.

A copy of the Opinion is attached as **Exhibit "1"**

The Task Force heard testimony from a number of presenters during its deliberations and in many cases the presenters addressed the application of the three part test from the Attorney General Opinion with respect to the tax credit or incentive which was the subject of their testimony.

Scope of the Inquiry Made by the Task Force

Some of the presentations made to the Task Force related to features of Oklahoma law which are not tax credits in the strict sense.

For purposes of this Final Report, a tax credit is something that must be claimed on a tax return (such as an income tax return or an insurance premium tax return). A tax credit reduces a tax liability after the applicable tax rate has been multiplied by the applicable tax base.

In the case of a corporation, its taxable income is multiplied by 6% (Oklahoma's corporate income tax rate) to arrive at its pre-credit liability. Tax credits are then subtracted from this "gross" tax amount to arrive at a net tax liability.

Exemptions or deductions have a different effect on a tax return than tax credits. Exemptions or deductions reduce the base amount upon which the tax rate is imposed. For a corporation that has taxable income of $100,000.00, an exemption or deduction of $10,000.00 results in a taxable income of $90,000.00. The tax rate of 6% is multiplied by this reduced amount of $90,000.00. The tax liability for a corporation in this example would have been $5400.00 without a deduction. The tax benefit for this deduction is 6% x 10,000= $600.00. The corporation has a final tax liability of $4800.00.

There are certain features of the Oklahoma Tax Codes that reduce the liability owed by a business enterprise, but the full amount of tax is paid at the time the tax return is first due. The business enterprise is then allowed to make a claim for a "rebate" of taxes based upon the features of the particular tax type. Gross production taxes and the exemptions from gross production tax related to certain types of drilling activity are administered in this manner, but this system is not generally considered to be a tax credit in the strict sense.

Oklahoma has enacted a number of economic incentives that allow a business enterprise to receive a payment from the Oklahoma Tax Commission based upon the creation of new direct jobs or the retention of existing jobs. These incentives, such as the Oklahoma Quality Jobs Program Act, the Saving Quality Jobs Act, the Small Employer Quality Jobs Act and the recently enacted 21st Century Quality Jobs Act all share a common feature: the direct payment of the incentive amount to the business enterprise. This type of incentive is not a tax credit in the strict sense because the business does not wait for a tax period (such as an income tax year) to close for purposes of filing a return, computing a tax liability and then reducing the liability amount with a credit.

But the concept of economic development incentives was part of the inquiry which the Task Force was directed by HB 1285 to undertake along with tax credits in the "strict" sense.

Testimony and Presentations

The Task Force heard testimony from numerous persons representing tax administrators, economic development specialists, industry representatives, legislators and concerned citizens.

The goal of the Task Force was to develop a system for evaluating state tax credits and economic incentives.

There are over 60 tax credits which have become part of the Oklahoma Tax Code and there are numerous incentives which, although not a direct credit against a tax liability, either reduce the tax burden on a business entity or which allow the business to add value to its balance sheet.

The Task Force did not attempt to hear testimony with respect to each and every tax credit or incentive, but focused its attention on credits and incentives that have been identified as having either desirable features or undesirable features. The Task Force learned about features of tax credits that might be considered "best practices" and features that might be considered either questionable or not desirable.

Criteria for Evaluation of Tax Credits and Other Economic Incentives

Ultimately, the Task Force voted upon a set of criteria by which either existing or future tax credits or economic incentives may be evaluated by the Legislature, tax administrators and others involved in the decision making process for allowing business enterprises to either reduce a tax liability or to qualify for a state offered incentive which has the effect of adding value to the business enterprise in some way.

The Task Force adopted, by unanimous votes, the following criteria for evaluation of tax credits or other economic incentives.

Transferability:

The Task Force recommends that for existing tax credits and for any tax credits enacted in the future, transferability of the credit for value be eliminated.

Post Tax Credit Usage Audits by the State Auditor and Inspector

The Task Force recommends that the State Auditor and Inspector be given the power and duty to conduct audits of the financial records of a business enterprise that uses a state level tax credit to ensure compliance with the statutory requirements that allowed the credit to be used.

Projects Eligible for Tax Credits Should Receive Prior Approval

The Task Force recommends that before any future tax credits are authorized, the project which serves as the basis for the tax credits be thoroughly evaluated by a state level entity, the membership of which is to be determined in legislation, in order verify that the project or economic transaction matches all required criteria applicable to the credit or other incentive.

Tax Credit Legislation Should Not Be Enacted Without a Detailed Fiscal Impact Statement

The Task Force recommends that future tax credit legislation should not be enacted unless there is a detailed fiscal impact statement prepared before any vote upon the measure during final passage in the legislative process.

Job Creation or Retention

The Task Force recommends that all future tax credit legislation contain a requirement either for the creation of new jobs in the State of Oklahoma or for the retention of existing jobs in the State of Oklahoma.

Tax Credit Legislation as a Last Resort

The Task Force recommends that in order for the Legislature to assist with the promotion of business start up or development, methods to accomplish the promotion of business activity other than tax credits be considered first and that tax credits should be considered the incentive of "last resort".

Fiscal or Other Limitations on Dollar Amounts

The Task Force recommends that future tax credits contain some type of limitation on the total revenue exposure to the State of Oklahoma whether on an aggregate fiscal year basis or a dollar limit imposed on the tax credit claimant or both such limitations.

Sunset Provisions

The Task Force recommends that future tax credits, if any, contain a definite "sunset date" beyond which the credit cannot be claimed unless extended by legislative enactment.

Consideration of Tax Credit Legislation During Final Days of a Legislative Session

The Task Force recommends that future tax credits, if any, not be considered during the final days of a legislative session and that the restriction be similar to the restriction in the Oklahoma Constitution for consideration of a revenue raising measure (Article V, Section 33).

Transparency Regarding Tax Credits or Other Incentives

The Task Force recommends that tax credits and other incentives be made transparent so that interested persons and policy makers can evaluate the effect of the credit or incentive both for purposes of state tax and fiscal policy and whether the credit or incentive benefits the taxpayers in the manner originally intended.

CONCLUSIONS

The Task Force adopted criteria which reflect the major conclusions reached as a result of the study.

Job creation or retention is an essential requirement for the use of tax credits.

Transferable tax credits have the undesirable feature of allowing persons or business entities having no economic connection to targeted business or economic activity to reduce their personal or business tax liabilities. This constitutes an inefficient use of state revenue partly because transferable credits are frequently sold at a discount—diminishing the impact of the credit for the business enterprise that was supposed to be able to benefit from the credit program in the first instance.

A tax system that allows persons or business entities to claim a tax credit after the economic activity has already taken place puts the State of Oklahoma into a position of auditing tax returns long after the activity for which the tax credit was granted has taken place---increasing the risk that the State of Oklahoma and its citizens did not benefit in a material way for the tax revenue that was foregone because of the credit allowed when the tax return was filed.

Appendix I

To the extent the State of Oklahoma elects to use tax credits to create incentives to support particular industries and create jobs, it is important that the credits seek to maximize the dollars flowing to the intended purpose. In order to do so, tax credits should be made transferable or, in the alternative, legislation should be enacted that results in "non-transferable" tax credits being truly non-transferable.

After one year of study, review and conducting interviews, the committee voted to add Principle # 9 in *Appendix A* of this report citing the explanation and example below:

Principle No. 1 of our *Principles of Sound Tax Incentives* requires an estimation of the costs of a tax incentive. While some tax credits will expire unused and some will be used in later years, thereby lowering their net present value cost, when considering the trade-offs between "non-transferable" tax credits and transferable tax credits, we suggest it is appropriate to assume that each costs the State of Oklahoma $1.00 in lost revenue for each $1.00 in tax credit. This is particularly the case in programs that generate significant amounts of tax credits because a network of promoters, brokers, lawyers and accountants has developed around the State's tax credit programs that make it likely that credits are used quickly.

In the case of transferable tax credits, it is the brokers who are preeminent. They bring the sellers (generally industries that generate the credits but have no use for them because of the lack of taxable income) and the buyers together. For this the brokers receive a fee (generally in the range of 6%) paid from the proceeds from the sale. The role of lawyers and accountants in the transferable tax credit business is relatively minor. Normally it is limited to ascertaining that the credit is valid (essentially due diligence) and estimating its net present value to the prospective purchaser. In this context, any lawyers' or accountants' fees are paid by the purchaser of the credits. Third-party promoters are virtually non-existent in the transferable tax credit arena.

This is in stark contrast to the "non-transferable" tax credit industry. Quotations are appropriate when referring to non-transferable tax credits because, despite the name, they are indeed transferable, albeit through a system that is both inefficient and costly to the State of Oklahoma.

We will first describe the manner in which "non-transferable" tax credits are allocated and thus transferred and the roles of the various participants in that process. Second, we will describe the adverse tax consequences to the State of Oklahoma when compared to transferable tax credits.

The most common method of allocating or transferring a "non-transferable" tax credit is through the use of a partnership that allocates the tax credit to a particular class of partners whose only economic reason for becoming partners joining in the partnership is to receive the allocation of tax credits. Because there is material cost involved in organizing the partnership, the allocation of "non-transferable" tax credits generally takes place in programs where it is possible to generate large amounts of tax credits through capital investments. Structuring and administering these partnerships results in significant "up front" costs paid to lawyers and accountants and ongoing fees paid to the promoters of the programs. But these costs – the promoter, the brokers, the lawyers and the accountants – pale in comparison to the cost associated with the federal income tax treatment of "non-transferable" tax credits.

When an investor purchases an interest in a partnership for the purpose of enabling the partnership to allocate to the investor a "non-transferable" tax credit, the investor is, in substance, purchasing the tax credit. However, for federal income tax purposes, the investor is not treated as having purchased a tax credit and therefore has no tax basis in the credit. While the investor can use the allocated credit to reduce the investor's state tax liability, the investor is also not entitled to deduct, for federal income tax purposes, any amount associated with the payment of that state tax liability. In contrast, had the investor paid its state tax liability in cash, the amount of the cash payment would have been deductible by the investor for federal income tax purposes.

As a result of this federal income tax treatment, a prospective investor desiring to receive an allocation of non-transferable tax credits would rarely, if ever, pay more than $0.65 for each $1.00 in state tax credits received. And, as noted in the following table, most often the value associated with these non-transferable credits is approximately 50¢ on the dollar.

In the case of a transferable tax credit, the purchaser of the credit is treated for federal income tax purposes as having purchased an asset (the tax credit) in which the purchaser has tax basis. When the credit is surrendered to the state for payment of tax, the purchaser is entitled to a deduction for federal income tax purposes for the payment of the tax, just as if the purchaser had paid its state tax liability in cash. The principal difference is that, to the extent there is a spread (the difference between the amount paid by the purchaser for the tax credit and the purchaser's state tax liability); the purchaser will have a taxable gain on the spread. While this reduces the value of the transferable tax credit to the purchaser, the reduction in value is relatively small.***** Further, the state participates in the taxes associated with the taxable gain on the spread. The final principal difference is that the seller of a transferable tax credit realizes a taxable gain from the sale of the credit equal to the proceeds received from the sale. Most often, the seller of the tax credit will not have state income tax liability. If it did, it would use the credit itself rather than sell it. However, the sale is a taxable gain and it may create tax revenue in the year of the sale or, by reducing the amount of a net operating loss, create taxable income in the future.

*****By way of example, if $100 in transferable tax credits are sold for $85, the extra value to the purchaser from the federal income tax treatment is $28.00 over $100 in "non-transferable" credits. The formula for this calculation is 40% (x) ($85-$15) where 40% is the assumed marginal tax rate (federal and state), $85 is the purchase price of the transferable tax credits, and $15 is the gain on the spread.

The following table is intended to reflect/illustrate the difference in cost to the State of Oklahoma of a transferable credit and a non-transferable credit. Cost to the State of Oklahoma is treated as the difference between the amount of investment which the tax credit generates as compared to the loss of tax revenue. As noted above, it is assumed that all tax credits are applied against tax in the year generated. The table is based upon the following assumptions:

1. Amount of tax credits – $5,000,000.
2. Effective "sale" price of tax credits (these are approximate prevailing market prices):
   - Transferable tax credits – $0.85
   - Non-transferable tax credits – $0.50
3. Seller of transferable tax credit generates no immediate tax revenue as a result of the sale.
4. Promoter/management fees and expenses – three years, 3% per annum.
5. Broker fees – 6% of the amount raised.
6. Lawyer fees – $50,000.
7. Accountant fees – three years, $25,000 per year.

	Transferable	Non-Transferable
Proceeds from sale of tax credits	$4,250,000	$2,500,000
Plus proceeds from		
– gain from sale	-0-	-0-
– gain from spread (5% of $750,000)	37,500	-0-
Less – Broker fees	(255,000)	(150,000)
– Promoter/Mgmt. fees and expenses	-0-	(225,000)
– Lawyer fees	-0-	(50,000)
– Accountant fees	-0-	(75,000)
Net available for investment	$4,032,500	$2,000,000
Cost to Oklahoma	$5,000,000	$5,000,000
Net available for investment	(4,032,500)	(2,000,000)
Net cost to Oklahoma	$ 967,500	$3,000,000