

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 Each of those proceedings has also been archived on the Oklahoma House of Representatives website.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 $6\% \times 10,000 = \$600.00$. 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.