REVIEW OF STATE TAX CREDITS ADMINISTERED BY THE DEPARTMENT OF ECONOMIC DEVELOPMENT

From The Office Of State Auditor
Claire McCaskill

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The state of Missouri should develop a performance measurement system to allow for an effective evaluation of state tax credit programs

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PERFORMANCE AUDIT

Office Of The
State Auditor Of Missouri
Claire McCaskill

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YELLOW SHEET

Insufficient data and no set goals for state tax credit programs make a cost-benefit analysis nearly impossible, despite the demand for such a review.

Our audit set out to conduct an impact analysis of the 33 state tax credit programs so policymakers can evaluate each program's effectiveness. But we found a thorough review difficult due to the lack of data and clearly defined goals of each credit. This audit makes nine recommendations that need to be addressed before an adequate review is possible. (See page 11)

In addition, we gathered the necessary data to perform limited impact analyses on four small tax credits.

More data needed

No data is maintained on 16 of the 33 tax credit programs. The limited data maintained on the remaining 17 credits often does not include key information such as the number of jobs created per project, average wages, total investment, affected industry sectors, or even project street addresses. (See page 7)

Data is not reconciled

Major discrepancies exist on the tax credit data maintained by both the Economic Development and Revenue departments, an issue noted in previous reviews. These two departments showed a $19.4 million difference in what each considered as the total redeemed tax credits for fiscal year 1999. As a result, the simple task of reporting dollar amounts for approved, claimed and outstanding tax credits is not verifiable. (See page 9 and Appendix VIII, page 49)

Consensus necessary on program benchmarks

Although Missouri is already cited as an innovative leader in using tax credits, the state lacks clear goals to measure a program's effectiveness. Our report notes Ohio's performance-measurement system that could work in Missouri. The model guide manages, evaluates and monitors tax credit programs on an ongoing basis. (See page 5)

Inaccurate tax credit marketing

Our review showed several instances in which information on brochures marketing the tax credits did not match the state statute authorizing the program. For example, the summary for the Neighborhood Assistance Program states an annual cap different than the state statue. The summary for the Brownfield “Job/Investment” tax credit sets a maximum refund, but the statute mentions no such limit. (See page 10)

Small tax credit programs analyzed

Despite the lack of data and defined goals, our audit conducted an impact analysis of four small tax credits: film production, wine and grape growers, rebuilding communities and small business incubator. Because of the previously noted insufficient data, we surveyed these programs to gather the necessary information. (See survey and results on page 48) We explain the methodology used and the economic assumptions made. Each review includes the tax credit’s purpose, impact on state taxes, direct economic impact, total economic impact and data issues that hindered the analysis. (See page 15 and Appendix X, page 55)

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Missouri State Auditor

Honorable Governor Bob Holden
And
Joseph L. Driskill, Director of the Department of Economic Development
And
Members of the General Assembly

The State Auditor reviewed the 33 tax credit programs administered by the Department of Economic Development (DED). The objective of the review was to obtain information and data necessary to perform a cost-benefit analysis as mandated by Missouri Revised Statutes (RSMo) 2000. While we comment on internal control issues that are incidental to the objective of obtaining the necessary data to perform a cost-benefit analysis, our review was not intended to be an internal control audit and we therefore do not express an opinion on the internal controls for any of the state agencies referred to in this report.

We concluded that certain policy and data issues must be addressed before an adequate study can be done on the effectiveness of each tax credit program. A collaborative effort is needed between the responsible state agencies, the legislature and the administration to develop a performance measurement system that results in clear policy goals and improved data collection to assess progress towards accomplishing these goals. While Missouri is not that much different than most states in its inability to analyze the cost-benefit of its state tax credit programs, it should also be recognized that if Missouri is going to be a leader in using state tax credits to promote public policy it should be at the forefront in assuring Missouri taxpayers that using state revenue to promote a particular activity is cost-effective and supports a valid public purpose.

Claire McCaskill
State Auditor

December 22, 2000 (fieldwork completion date)

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RESULTS AND RECOMMENDATIONS

1. The State of Missouri Should Develop A Performance Measurement System to Allow for An Effective Evaluation of Tax Credit Programs

Clear policy goals or data systems do not exist to allow for an effective cost-benefit analysis of tax credit programs. Key data such as number of actual jobs created per project, average wages, total investment, industry sectors affected, street addresses for the projects and other relevant information are not captured in a centralized management information system and in some cases are not captured at all. Furthermore, the tax credit programs do not have clearly defined public policy goals to serve as benchmarks for measuring program performance. While Missouri is not unique in its inability to provide adequate data for an analysis of its economic development tax credit programs, Missouri has already been cited as an innovative leader[1] in the use of tax credit programs to promote public policy. Therefore, Missouri should be a leader in developing a performance measurement system to ensure the use of tax credits to promote community economic development is both cost-effective and achieving the intended policy goals.

Before an adequate cost-benefit analysis can be completed the following issues must be addressed:

- Lack of a centralized management information system to maintain and monitor key data on all economic development projects issued state tax credits.

- Failure of the Department of Economic Development and the Department of Revenue to periodically reconcile the approved, claimed and outstanding tax credit projects each agency maintains on its current tracking systems (this issue was noted in reviews conducted in 1992 and 1998.)

- Department of Economic Development policy to only maintain and monitor data on discretionary tax credit projects and not formula-based tax projects.

- Methodologies that should be employed to perform cost-benefit analyses of each state tax credit program have not been developed.

- Lack of clear policy goals established for each tax credit program so that performance may be measured against the policy benchmark.

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[1] According to an article titled "Using Tax Credits to Implement Public Policy: The Missouri Experiment" (Journal of Affordable Housing and Community Development Law, Summer 1999) written by Janette Lohman and Paul N. Tice.

Focus of audit

The State Auditor's Office reviewed data on the 33 tax credit programs administered by the Department of Economic Development (*see Appendix I, page30, for list of programs*). The purpose of the review was to obtain the data necessary to perform a cost-benefit analysis that would provide policymakers with sufficient information to evaluate the effectiveness of these state tax credit programs. This review is the first of an overall cost-benefit analysis of the economic development incentive programs administered by the Department of Economic Development, as mandated by Section 620.1300, RSMo. Supp. 1999.

The review focused on obtaining information to determine the

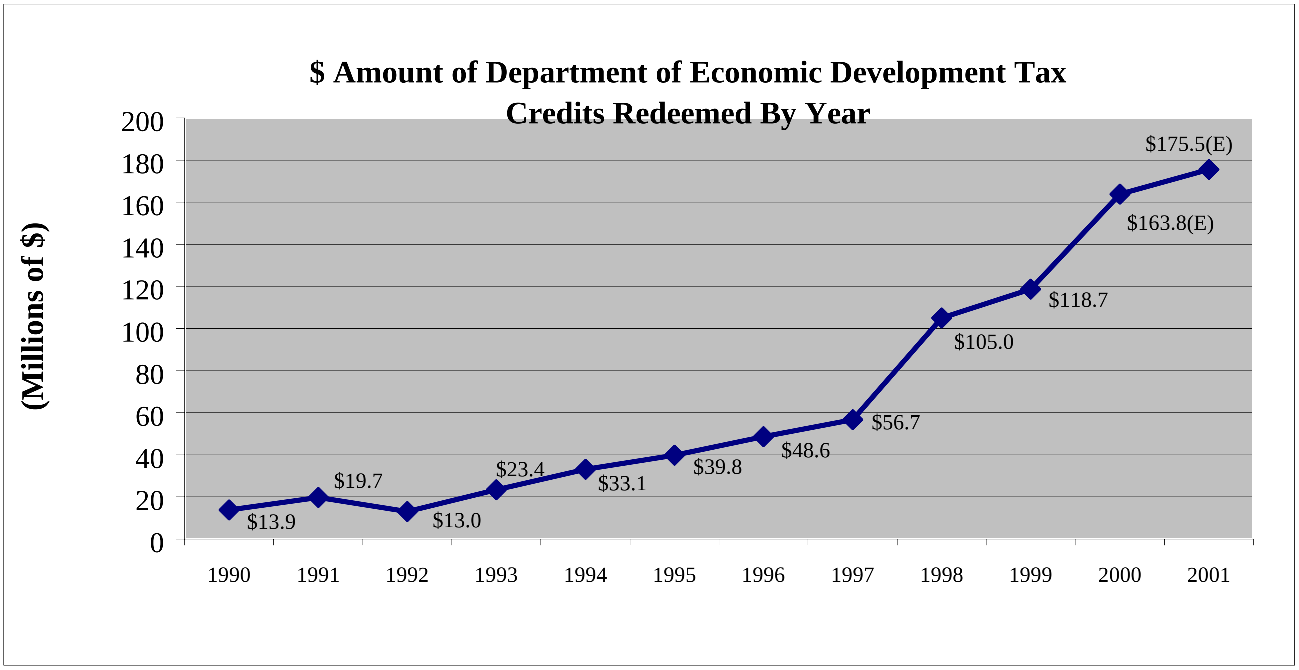
- cost for each program,
- direct state and indirect state benefits associated with each program,
- direct local and indirect local benefits associated with each program,
- safeguards to protect noneconomic influences in the award of programs administered by the Department of Economic Development, and
- likelihood of the economic activity taking place without the program.

Use of state tax credit programs is increasing in Missouri

Tax credit programs are instruments used by states to attract businesses and enterprises to the state. They grant businesses and enterprises relief from paying state taxes or portions of state taxes in order to entice the business to locate in the state. Tax credit programs vary in structure by industry and incentives. In some programs, the firm that is granted the credit may use the credit or sell it to another firm or individual. The competition for business is keen and businesses will play one state against another in order to get the best deal.

The need for an evaluation of state tax credits becomes evident as tax credits increasingly become a tool to promote public policy. Figure 1 illustrates the increasing use of tax credits indicated by the amount of tax credits redeemed by taxpayers each year.

Figure 1



Source: Tax Expenditure Report (years 1990 – 98);
DED Form 14 (year 1999– 01)
(E) = Estimate

Because of the increase in state economic development incentives, many state legislatures and taxpayers nationwide are demanding a cost-benefit analysis of the various community and economic development incentive programs the state provides. Until recently, most analysis of state economic development incentives performed in various states focused on the single large projects receiving multiple incentives and having large economic impacts on the state and local economies. Now it is widely understood that community and economic tax credit programs are tax expenditures and should be analyzed to determine if the program is a wise use of state resources. Recent audits in many states have been critical of the way tax credit programs have been handled by the state agency charged with administering the program. *(See Appendix VIII, page 49, for a summary of other state audits critical of the state agencies oversight of economic development tax credit programs*).

Department of Economic Development attempts to analyze cost benefit of tax credits

In a meeting with Department of Economic Development personnel, the general consensus by department staff was that a cost-benefit analysis of tax credits is difficult due to timing issues, data collection issues, and the inability to accurately link the economic activity to the tax credit. A former economist for the Department of Economic Development, who was the former Manager and Senior Economist for Office of Research and Policy Analysis, said that he has read a lot of the economic literature and attended numerous national conferences and has come to the conclusion that no one knows how to perform a useful cost-benefit analysis of tax credit programs. The economist also said it is difficult to determine what role a tax credit plays in the decision of a business to relocate or expand into Missouri. Department of Economic Development personnel stressed the importance of not looking at the tax credit incentives in a vacuum, but as only one component of an economic development incentive package.

According to Department of Economic Development personnel, over the last several years the agency has tried to develop a workable economic model to ensure a positive impact from the economic development tax incentive programs. They focused on determining what motivates a business to expand or relocate. From this analysis they determined that incentive packages should be used to address two situations: 1.) gap-financing, and 2.) competitiveness. Missouri has a competitive advantage over many states because of its lower overall taxes; and tax credits combined with other economic incentives, increase the competitiveness of Missouri.

After reviewing various tax credit programs studies, it is easy to conclude that any type of cost-benefit analysis, even one using the most sophisticated economic theory, falls short of truly measuring the tax credits' economic impact. *(See Appendix IV, page 40, for critique of economic analysis techniques).* One reason cost-benefit analysis of tax credit programs is often not considered credible is because economic assumptions must be made and reasonable people can easily debate these assumptions. This is why consensus is needed in how the tax credits should be measured. Clearly articulated policy goals are the first step in building a benchmark from which a cost-benefit analysis can be measured. However, an overwhelming problem cited by researchers attempting to analyze state tax credits is the lack of key data.

A Performance Measurement System is Needed

Before an effective cost-benefit analysis can be performed on Missouri state tax credit programs, a performance measurement system must be developed so that monitoring and evaluation efforts are productive. We noted a performance measurement system that was recommended by a State of Ohio study that could serve Missouri well.

Performance system recommended for Ohio could help Missouri

A study was commissioned by an Ohio State Senator and performed by Cleveland State University researchers and various subcontractors to perform an economic impact analysis of Ohio's economic development programs. In reference to cost-benefit analysis of economic development programs, the study stated that

> "*Given the state of knowledge and skill in this area, our study team concludes that performance measurement and improvement is not as easy as it may sound. While Ohio officials may insist that state economic development program monitoring and evaluation activities be increased in the immediate future, substantial progress in this area will take some time. Clarifying goals and broader expectations that guide these programs must be given equal attention, otherwise monitoring and evaluation efforts will produce little benefit*".

The Ohio study team proposed a comprehensive performance measurement system called the State Incentive Management System model. The model is a performance measurement system developed by the university team to guide, design, manage, evaluate and monitor economic development programs on an ongoing basis. The university team identified three components of this model in the study as follows:

1) The Planning Component: involves setting strategic goals and objectives; defining components of the model for the program; selecting performance measures to chart progress; setting budget levels; devising annual investment strategy with preferred investment targets for the program; and creating computer system requirements to support program planning, management, and evaluation.

2) The Management Component: involves training staff; administrative structure for the program; selecting the appropriate local and regional financial affiliates for the program; devising an appropriate portfolio management strategy for the program; devising appropriate legal agreements and negotiation strategies to use with companies; devising appropriate marketing and communications strategies to inform companies and others about the program, its requirements, and benefits.

3) The Monitoring and Evaluation Component: involves selecting computer modeling tools to facilitate the evaluation process; devising specific management performance measures under the five-layer performance measurement system; organizing an evaluation team spanning Ohio Department of Development, Office of Budget and Management, Taxation, and Legislative Budget Office; and training staff and local officials in using the new evaluation system.

The five-layer performance measurement system is a system that allows for an assessment of the individual and combined impact of Ohio's economic development programs by:

- Major industry sectors
- Urban and rural regions and communities
- Major population groups and labor market segments
- Major natural resources
- State and local government finances.

Policy goals are needed to establish benchmarks for analysis

In the Ohio Study cited above, the researchers call Ohio a "doer" state, not a "planner" state. Ohio has been aggressive and effective in helping businesses locate and grow in the state, but not very good at planning and strategizing, making it difficult to evaluate the effectiveness of the public assistance. The same could be said about Missouri's tax credit programs. The state has been an innovative leader in the use of various tax credit programs to promote public policy, however currently the Department of Economic Development has developed only limited performance-based expectations for how the state tax credit programs should perform.

A cost-benefit analysis is only as good as the underlying data used to perform the analysis. The Department of Economic Development maintains the information needed to administer the tax credit program; however, a change in policy is needed so that all of the data necessary to perform a cost-benefit analysis on each tax credit program is maintained and monitored by the department. There are major omissions in data needed for cost benefit analyses.

Data on formula-based tax credits should be gathered and maintained

Department excludes some tax credits from data collection

Data is not maintained or monitored for 16 of 33 tax credit programs. These 16 programs are formula-based tax credits, which are granted if the project meets the eligibility requirements set out in the authorizing statute. Department of Economic Development management stated that it is not the responsibility of the agency to monitor the economic impact that formula-based tax credits have on the state because they have no discretion over whether projects qualifying for the tax credit receive the tax credit. Sixteen of the 33 tax credit programs are formula based, and therefore the department does not maintain or monitor any data on these tax credit programs.

For large discretionary tax credit programs, the department obtains the necessary data from the company or individual applying for the tax credit program to complete the economic impact analysis worksheet. The department uses this data to perform a cost-benefit analysis to determine if the project resulted in a positive return on investment to the state. The department officials award or deny the tax credit based on this analysis.

The economic impact analysis is an effective way to gather data needed to perform an analysis of a particular tax credit project. The Department of Economic Development should consider using the economic impact analysis as a tool for gathering data on all tax credit projects regardless of whether the tax credit program is discretionary or formula-based. Without project level data, it is difficult to perform an effective cost-benefit analysis of a tax credit program which is usually comprised of several projects. *(See Appendix VII, page 47, for listing of type of tax credit program.)*

Data Maintained on Project Logs Should be Improved

Record keeping was not adequate

Department tax credit project logs did not contain enough information to conduct an analysis. Project logs only contained the amount of approved tax credits, but did not contain the amounts of claimed and outstanding tax credits. Department managers said they do not keep records of redeemed credits because the Department of Revenue is responsible for tracking redeemed tax credits. Reviews of the project logs showed that program managers use their discretion on the information retained, and there is no consistency among any of the project logs. The data included in the project logs was not adequate for an effective evaluation of the tax credit program.

Recommended Data Required For An Effective Analysis

Standard data elements should be collected

To perform an effective analysis of each of Missouri's tax credit programs it is necessary to look at the beneficiaries of the tax credit, i.e., those who do the required activity and benefit economically from the tax credit. Because several of the tax credit programs allow for the tax credit to be transferred or sold, the ultimate taxpayer who claims the tax credit may have no relationship to the original project receiving the incentive. To assess the overall impact of the tax credit project, at a minimum, the following data is needed, as applicable to each credit:

1. Description of project
2. Street address of project
3. Standard Industry Classification (SIC) Code for project
4. Approved amount
5. Claimed amount
6. Outstanding amount
7. Number of Jobs created, both direct and indirect
8. Payroll amount
9. Average Wage
10. Dollar amount of investment
11. Percentage discount on sale of tax credit
12. Name of party that redeems credit
13. Street address of party that redeems credit

The department should use the existing economic impact analysis worksheet to capture and maintain all relevant data necessary to perform a cost-benefit analysis of state tax credit programs. The data from this worksheet should be housed on a centralized management information system, where data could be extracted and reports generated, as needed.

The centralized management information system was not effectively used

State Agencies critical to effective analysis do not coordinate

The Financial Assistance System is the centralized management information system for all of the community and economic development programs administered by the department. The Department of Revenue and the Department of Insurance do not have access to this system, and the system is not designed for reconciling tax credits. Also, the system is not complete because individual project managers who were maintaining their own databases did not transfer all tax credits to the financial assistance system.

In response to our inquiries, technology personnel advised that the financial assistance system is going to be replaced by a new system and that no agency will have access to this system. If not this system then some system will be needed to track and reconcile tax credits. And, better management of databases in the Departments of Economic Development and Revenue will be needed to effect reconciliation of tax credits.

Department of Economic Development & Revenue Data Could Not Be Reconciled

Even a task as simple as reporting the dollar amounts for approved, claimed and outstanding tax credits for a given year can become confusing and unverifiable due to timing issues and the lack of reconciliation of the data by the Departments of Economic Development, Insurance, and Revenue.

There were numerous discrepancies that raise substantial data integrity issues.

Data integrity and data system need to be improved

- Approved, claimed and outstanding tax credit amounts reported by both agencies could not be reconciled. Department of Economic Development staff admitted to calculation errors in several of the discrepancies noted, however, they did not provide documentation to determine if the amounts reconciled with Department of Revenue amounts. *(See Appendix VIII, page 49, for discrepancies by tax credit program).*

- A tax credit project was in the Department of Revenue system twice, resulting in an approved tax credit amount on the system for twice the amount actually certified by the Department of Economic Development. This was a case where both the original recipient of the tax credit (transferor) and the transferee were on the system with the same credit amount resulting in the double counting of the certified tax credit amount.

- The same Department of Revenue tracking code was being used for more than one tax credit causing the reported program totals to be overstated.

- The Department of Revenue does not have an automated system that allows for tracing transferred tax credits to the original approved tax credit. While revenue staff was able to provide data on claimed tax credits, it was impossible for this claimed amount to be traced to the original project performing the economic activity, thus limiting any project level analysis.

Economic Impact Statement Required By Law Was Not Maintained

The authorizing statute for the Film Production Tax Credit, Section 135.750, RSMo, states in part that:

> *"…the application shall include an economic impact statement, showing the economic impact from the activities of the film production project. Such economic impact statement shall indicate the impact on the region of the state in which the film production or production-related activities are located and on the state as a whole."*

Department of Economic Development ignored the law

A review of the only application for this tax credit and the file containing the application disclosed that an economic impact statement was not prepared. Department of Economic Development staff stated that an economic impact statement was not needed because the film production tax credit program was a discretionary program. This explanation does not coincide with the law that clearly states that an economic impact statement is required.

Department of Economic Development Tax Credit Summaries and Marketing Brochures Contain Errors

Tax credit marketing information did not match statute

A review of tax credit summaries, marketing brochures and Statements of Benefits and Costs[2](Form 14) disclosed several discrepancies between the information prepared by the Department of Economic Development and the authorizing statute. While recognizing that the department has the ability through its rule-making authority to limit some aspects of the tax credit program, there were several occasions where information prepared about the tax credit could not be reconciled under the statute or the department's rule-making authority.

- Small Business Investment Tax Credit (135.400 RSMo)

  The Tax Credit Summary states the program does not allow carry-back of the tax credit, however the statute allows a 3-year carry-back if the business is in a distressed area.

- Brownfield "Job/Investment" Tax Credit (447.708.1 RSMo)

  The Summary states the credit has a maximum refund of unused credits of $75,000. The statute does not allow for any refund of the tax credit.

- Youth Opportunity and Violence Prevention Program (620.1100 RSMo)

  The Summary states the credit is not sellable/transferable nor can it be carried forward. The Form 14 states the credit is sellable/transferable and can be carried forward. The statute, however only allows a 5-year carry forward and does not allow for the credit to be sold or transferred.

- Family Development Account (208.755 RSMo)

  The Summary states the project limit is $60,000 per organization per year or $120,000 for two years. The statute allows $50,000 per program not to exceed 50% of the contribution amount.

[2] The Statement of Benefits and Costs is prepared for each tax credit program and submitted to a budget analyst in the Office of Administration. The budget analyst makes sure there is one for each tax credit program. She then forwards them to the Director of Budget & Planning's office for review with the state's economist. They review the cost and benefits of each credit. The forms are then forwarded to the Senate Appropriations and House Budget committees.

- Transportation Development Tax Credit (135.545 RSMo)

  The Summary states the credit allows a 5-year carry forward. The statute allows a 10-year carry forward.

- Winery/Grape Growers Tax Credit (135.700 RSMo)

  The Summary states the credit cannot be carried forward while the Form 14 states that it can be carried forward. The authorizing statute does not allow a carry forward. The Summary also does not put a limit on the number of times the credit can be claimed while the statute limits the time period to 5 tax periods.

- Individual Training Account Tax Credits (620.1400 RSMo)

  The Summary allows a 3-year carry back. The statute does not allow a carry back (see 620.1440 paragraph (2).

- Mature Worker Child Care Tax Credit (620.1560 RSMo)

  The Summary states there is a project limit of 50% of training up to $1,500 per employee. The statute states in paragraph (5) the limit is 25% of the eligible salaries up to $10,000 per program participant each taxable year are eligible for the credit which shall not exceed 25% of the eligible salary amount.

There was no evidence that any party detrimentally relied on the incorrect information found on the Department of Economic Development documents. Since the incorrect information is being disseminated to the Office of Administration, the legislature and the public, it is essential that it be accurate.

The Department of Economic Development is in the best position to capture key data on tax credit programs

The department is clearly in the best position to collect data because they interface with applicants for the projects applying for the state tax credits. Department staff stated they did not have the resources to continually maintain and monitor data on each individual tax credit project for every tax credit program. Collaborating with other state agencies such as the Department of Labor and Industrial Relations to develop a system for capturing job creation and retention information and wage data may alleviate some of the resource concerns.

Recommendations

We recommend that the Director, Department of Economic Development

1-1. Develop a comprehensive performance measurement system similar to what the Ohio study recommended. This system should include clearly articulated policy goals and data collection procedures and systems necessary for an effective evaluation of the state tax credit programs and other economic development incentive programs in the state.

1-2. Collaborate with state agencies, the legislature and the administration on developing a set of performance-based benchmarks from which the effectiveness of the tax credit programs can be measured.

1-3. Use the existing economic impact statement worksheet to capture and maintain all relevant data necessary to perform a cost-benefit analysis of applicable state tax credit programs.

1-4. When designing the new management information system, take into consideration the state of Missouri's need for a performance measurement system to maintain and monitor data on each of the economic development incentive programs the department administers.

1-5. Maintain sufficient documentation so that reconciliation can be performed with the Department of Revenue and the Department of Insurance records.

1-6. Assign each tax credit program a separate DOR tracking code so that program activity can be traced and verified.

1-7. Coordinate with the Department of Revenue and develop an automated system using a key identifier that allows tax credits sold or transferred to be traced back to the project performing the economic activity encouraged by the tax credit.

1-8. Maintain all the documentation required by the authorizing statute for each tax credit program such as economic impact statements.

1-9. Ensure documents describing tax credits contain accurate information on each tax credit program and that such documents coincide with the law.

Department of Economic Development Comments

1-1. Because of time constraints, DED was unable to review the Ohio State Incentive Management System model. Therefore, the Department does not currently have an opinion on whether or not this system would be appropriate for tax credits programs administered by DED. The Department will review the Ohio system and also review other best practices used in other states in relation to performance measurement systems. Through the department's strategic planning process, DED does collect, track and develop targets regarding various performance data related to incentives that the Department administers. The Department has been utilizing this results measurement planning system since 1996. While these measures are not strictly related to tax credits, we do understand measurement, results and operations. We are interested in examining all programs, which might enable us to continue providing quality services for Missourians.

1-2. *The Department agrees that this type of collaboration would be helpful in establishing benchmarks and is willing to participate. It is vitally important that all agencies that administer tax credit programs participate in order to fully realize the benefits of the tax credit programs in total.*

1-3. *It should be noted that only four DED tax credit programs (Brownfield, BUILD, Historic, and Film) require by statute that a cost benefit test be performed. DED will attempt to gather this data on all tax credit programs. However, it must be noted that for some tax credits, statutes do not compel the tax credit recipients to disclose all thirteen types of data recommended for collection. In addition, as noted in the audit report, the collection of this data would not be applicable to each credit. Without a complete universe of data for each tax credit issued this data may not be reliable in conducting a cost benefit analysis.*

1-4. *The Department agrees to take this into consideration when designing the new information system.*

1-5. *The Department initiated meetings with officials from the Department of Revenue (DOR) to develop a system that will interface for the reconciliation of tax credits. Upon implementing a workable system with the Department of Revenue, we will encourage the Department of Insurance (DOI) to adopt the same system.*

1-6. *DED agrees that this should be done and we have already held discussions with the DOR to accomplish this task. DED and DOR are currently assessing the format that is needed that will work with both of the systems.*

1-7. *This clearly a shared responsibility and should include agreement by all agencies that administer transferable tax credits. It is DED's intent that on the programs we administer this information would be electronically submitted to the Department of Revenue in the new information system. We will actively encourage the other agencies involved, including DOR, to implement such an automated system.*

1-8. *DED concurs that the economic impact statement for the Film Production Tax Credit was not maintained in the files. Action has been taken to ensure staff of the Film Office are informed of the requirement to collect this information. In addition, DED has created an internal audit staff by reclassifying two positions to auditors. It is the intent that these positions will provide additional verification that appropriate tax credit documentation is maintained. However, these positions are not solely dedicated to reviewing tax credit information and it is their responsibility to review all of DED's operations. Without staff specifically dedicated to reviewing tax credit documentation reviews can only be done on a periodic basis.*

1-9. *DED agrees with the State Auditor's statement in the body of the report that "there was not evidence that any party detrimentally relied on the incorrect information found on the Department of Economic documents." The Department will review tax credit summaries,* *marketing brochures and other related documents for accuracy and make corrections as necessary (also see response 1-8).*

2. Impact Analysis of Four Small Tax Credit

Even absent a performance measurement system, we attempted to perform an analysis of four tax credits as required by Section 620.1300, RSMo. Supp. 1999. We used the Regional Economic Models, Inc., Policy Insight Model for the state of Missouri, to analyze the total economic impact of each credit. We had to make some assumptions to use the economic model because of the limited data available on these credits and because the use of economic theory is necessary to link the tax credit to the economic activity it produced. This methodology is discussed in the detailed discussion that follows for each tax credit. In general, the fiscal impact is negative in the first year as the credit reduces revenue more than the revenue generated from the increased economic activity. In the remaining nine years of the ten-year time period used for the projection, the revenue generated was greater than the redeemed credits. There would be a slight increase in employment during the period. The credits have a slightly negative impact on wage rates, which could be occurring because the firms are using the reduction in capital or production costs to make additional capital expenditures rather than employ highly trained workers. The credits have a positive impact on Gross State Product which is an economic output measure of overall compensation and profits.

In search of a methodology in which to perform an effective cost-benefit analysis we asked the Department of Economic Development officials to provide some small tax credit programs that we could look at in some depth. They provided files on four tax credit programs:

1. Film Production Tax Credit
2. Wine & Grape Growers Tax Credit
3. Rebuilding Communities Tax Credit
4. Small Business Incubator Tax Credit

A. Film Production Tax Credit Program

The film production tax credit is authorized by RSMo , Section 135.750 and became effective in 1999. The statute authorizes a tax credit for up to 50 percent of the amount of investment in production or production-related activities in a qualified film production project. The statute also requires both a $500,000 per project cap and $1,000,000 annual cap for the tax credit. By rule, the Department of Economic Development limits the tax credit to 25 percent of the amount of investment and has reduced the project cap to $250,000.

The film production tax credit is a discretionary program, meaning that the Department of Economic Development has discretion on whether or not a particular project should be awarded the tax credit. A taxpayer may carry forward unused tax credits for up to five tax periods, provided the credits are claimed within ten tax periods of the date the tax credits were certified for the qualifying project. The tax credits may be transferred or sold.

Because of the cap on the amount of the tax credits available, the department has established procedures requiring a film production company to prepare a pre-application which, if approved, will result in the department reserving a portion of that year's tax credits for the specific project.

Actual authorization of the tax credit does not occur until after the project is completed and the department has verified and approved the eligible expenses.

A key requirement for approval of the film production tax credit is that the film production company must not have selected Missouri as the site of its project prior to pre-applying for the tax credit. The department rules say the existence of a film production office in the region is evidence that Missouri has been already selected as a location for the project.

Purpose

The purpose of the film production tax credit is not explicitly stated in the authorizing statute. The statute requires a project to have at least $300,000 in Missouri expenditures to qualify for the tax credit. The department has interpreted the purpose of the tax credit to be an incentive program for attracting film production projects to Missouri. Based on eligibility requirements and the department officials' interpretation of the program, the public policy to be implemented by the tax credit is to provide an incentive for film production companies to choose Missouri for their project, while at the same time creating direct economic benefit to the state by requiring that a $300,000 minimum amount of expenditures be made in the state.

State Taxes Impacted

The authorizing statute for the film production tax credit allows for the credit to be used by the taxpayer to "offset the tax liabilities otherwise imposed by chapter 143, RSMo, excluding withholding tax imposed by sections 143.191 to 143.261, RSMo, or chapter 148, RSMo." Chapter 143 is the state individual and corporate income tax and Chapter 148 is the financial institution tax.

Information and Data Issues

The Department of Economic Development and the Department of Revenue records do not agree on the number of projects and the dollar amount of the film production tax credit approved and claimed. The Department of Revenue Tax Credit Tracking System showed two approved tax credits in the amount of $160,000 for 1999. The Department of Economic Development records showed that only one tax credit for $80,000 was approved in 1999. A review of the underlying data records and verification from the Department of Economic Development disclosed the Department of Revenue Tracking System showed the same $80,000 tax credit project twice. The reason for this error appears to be because the tax credit was transferred and both the transferor and the transferee were reflected on the system as having the tax credit.

A periodic reconciliation of tax credits approved, claimed and outstanding by the two agencies is recommended to ensure that records by both agencies are accurate. The Department of Revenue is dependent on the Department of Economic Development to provide certification that a taxpayer is eligible to claim the tax credit and the Department of Economic Development is dependent on the Department of Revenue to maintain its records so that only approved taxpayers claim the tax credit. Without a periodic reconciliation between the two agencies the risk of loss to the state treasury is increased. The problem of discrepancies between these two agencies' records were cited in a 1992 audit by our office and a 1998 program evaluation and expenditure review by the Committee on Legislative Research Oversight Division.

Direct Economic Impact

If measured strictly on the amount of lost revenues to the state the direct cost of the film production tax credit has been $4,540 (the amount claimed of the approved $80,000 tax credit as of June 30, 2000). The future cost to the state would be the $75,460 remaining under the $80,000 credit, assuming the remainder of the approved amount will be redeemed.

The film production tax credit did not produce any direct new jobs or investment. There is a requirement of a minimum expenditure of $300,000 dollars on Missouri based labor, products and services. The one project under the tax credit program met this requirement by spending a $394,470 on Missouri labor, products and services. The expenditures are categorized as follows:

Missouri Labor Wages/Salaries	$159,171
Missouri Contracted Services	$ 36,500
Missouri Equipment Rental/Purchase	$173,369
Printing	$22,879
Photography	$ 2,550

From a purely economic impact standpoint the expenditure amount, and the tax credit issued, would have negligible impact on both the Missouri economy and the state treasury because of the small dollar amounts involved. However, the small dollar amounts involved does not negate the need to evaluate whether or not the public policy of using a film production tax credit is beneficial to the state.

Total Economic Impact

We used the Regional Economic Models, Inc., Policy Insight Model for the state of Missouri to analyze the total economic impact of the film production tax credit on the Missouri economy. The model compares the baseline forecast of the Missouri economy with an alternative forecast that takes into account the film production tax credit. The outputs from the model used to evaluate the impact of the tax credit on the Missouri economy are as follows:

1. Growth in total employment
2. Growth in Gross State Product
3. Growth in personal income
4. Growth in real disposable income
5. Growth in industry output
6. Growth in wage rate
7. Fiscal impact

Two variables on the model were changed to create the alternative forecast: 1.) production costs for the motion picture industry and 2.) government spending. To analyze the economic impact of a particular public policy (i.e., a tax credit program) the analyst must determine what data inputs to use and which variables to adjust to reflect the direct inputs. The two variables we used (production costs and government spending) are two of thousands of variables in the model. An economist familiar with the model recommended using these two variables. The data inputs we used for the Film Production Tax Credit were the $80,000 benefit the project received and the $4,540 redeemed by the taxpayer. The “production costs” variable was decreased by $80,000 times the average 10 year growth rate for the motion picture industry over a 10 year period. Because only $4,540 of the $80,000 was redeemed by the taxpayer we used this amount in projecting how much “government spending” would be reduced during the 10-year period. The same growth rate was applied to the $4,540. Our goal was to use real numbers where possible and therefore we used the $4,540 redeemed instead of assuming the total $80,000 amount would eventually be redeemed, which may or may not eventually happen.

In 1999, the inception year for the film production tax credit, only one project used the credit. The methodology we used to show the total economic impact of the tax credit on the Missouri economy was dependent on this one project. The one Film Production project in 1999 may be somewhat unique because it was a nonprofit that could not use the credit, because it had no tax liability, and therefore transferred the tax credit to a for-profit business that could use the tax credit. The transfer was at 100% of the total value of the tax credit.

As a result of the transfer, the film project received the full $80,000 value of the tax credit in cash. To measure the total impact of the film production tax credit program we took the $80,000 in cash the film project received and increased this amount at the industry growth rate over a ten-year time period (1999-2008). We did the same for the $4,540 redeemed (it is possible that redeemed amounts may be much higher in future years, however to remain consistent throughout the analysis we used the 1999 redeemed amount and did not try to estimate future redemption amounts). The assumptions we have employed are that the usage of the tax credit will increase at the growth rate of the motion picture industry over a ten-year time period and the tax credit program will end after this arbitrary ten-year period.

Using the aforementioned inputs and assumptions, the total economic impact results are as follows *(See Appendix X, page 55, for a graphic of the results):*

- Total employment in Missouri would increase by approximately three to five jobs from the years 1999 to 2008. For the five years following the sunset year of the tax credit program, new jobs created declines steadily, but remain positive.

- Gross State Product would steadily increase by approximately $100,000 in 1999 to a peak increase of approximately $214,000 in years 2006 and 2007. After 2007 the increase in Gross State Product is at a declining rate until about 2012 when it appears to return to equilibrium.

- Growth in personal income is basically the same as Gross State Product gradually increasing starting in 1999 peaking at $214,000 in 2007 and increasing at a decreasing rate until 2011 when it returns to equilibrium.

- Growth in industry output also follows the same general trend of increasing from 1999 and peaking in 2007, but once the tax credit program ends, the growth rate decreases rapidly until it returns to equilibrium in about 2009.

- The structure of the film production tax credit does not lend itself to having much of an impact at all on wage rates in the state because the credit did not produce any new permanent jobs. The model predicts a small increase in wage rates in Missouri in the first year of the tax credit, no impact in the years 2000 through 2003, and a negative impact during the years 2004 through 2008.

- The model predicts the fiscal impact on the state will be positive during the ten-year time period. However, this analysis is somewhat skewed by how the credit was used by the one project. Because the nonprofit film production company immediately received the full benefit of the tax credit by transferring the tax credit, and the transferee redeemed only a fraction of the credit, the cost to the state was minimal compared to the benefit the film production company received. However, because the film production tax credit has a carry forward feature, there is the probability the transferee will fully redeem the credit resulting in much greater cost to the state than is reflected in this analysis.

Survey Response

A key issue in determining the cost-benefit of the film production tax credit program is whether the activity would have occurred without the tax credit. If the film production project would have been done in the state without the tax credit incentive, the state has spent $80,000 (or more if indirect costs are included) for economic activity it could have had at no cost to the state treasury. The Department of Economic Development explicitly states in its brochure that to qualify for the tax credit the film production company cannot have already selected the state for the project. The question that must be answered is whether the entity would have gone to another state to do the project.

To know with absolute certainty whether or not the economic activity would have occurred without the tax credit we would have to know the subjective thoughts of the manager(s) of the business performing the activity. This is not possible. The best we could do was send a questionnaire to the business benefiting from the tax credit and ask what affect the tax credit had on their decision-making.

The response from the one project that had utilized the film production tax credit in 1999 indicated the tax credit was a factor in the decision-making process. The respondent indicated that without the tax credit they could show that their costs would have been lower in other states. *(See Appendix IX, page 51, for full survey results).*

Noneconomic Influence

A response from a recipient of the film production tax credit said “the state film [production] tax credit helps the fledgling arts community in our state and helps illuminate our state's resources through a positive portrayal in film & television". Film production is seen not only as an economic activity but also as a cultural activity. The film production tax credit promotes culture in the state. Also, the Department of Economic Development states the film production tax credit will increase tourism in the state. While tourism clearly has an economic impact on the state, quantifying this impact is difficult and therefore many analysts treat tourism as a noneconomic factor.

An argument could be made that state tax credit programs should be designed to assist as many of its citizens as possible and the economic development incentives should be particularly geared towards improving areas in need. While these two issues have economic aspects to them, the economic impact to the state may not necessarily be affected by the dispersion or the location of the beneficiary of the tax credit. Therefore, we treat these issues as noneconomic influences in the award of the tax credit.

The lone project for this credit was located in St. Louis. It may take a few years for more companies to take advantage of the film production tax credit. Film productions are usually planned months, maybe even a year, in advance. Once out-of-state productions learn of this credit, then they may begin to plan to film here. For the immediate future, local small-budget productions and commercials may be the only projects to apply for this credit. *(See Appendix III, page 34, for a distribution of projects by geography and census-tract income level).*

B. Wine & Grape Production Tax Credit Program

The wine and grape production tax credit program is authorized by Missouri Revised Statutes, Section 135.700 and became effective in 1999**.** Eligible wine and grape producers are entitled to a tax credit in an amount equal to 25% of the purchase price of all-new equipment and materials used directly in the growing of grapes or the production of wine in Missouri. The wine and grape production tax credit is a formula-based tax credit. Wine and grape producers must complete an application and provide invoices to the Department of Economic Development specifying the total amount of new equipment and materials purchased during the calendar year. A project manager reviews the application and the accompanying invoices to ensure the tax credit amount is based on only qualified expenditures.

The tax credit program has no annual or cumulative caps. The tax credit cannot be carried forward or backward, must be used during the year received and can only be applied for and received by a taxpayer for five tax periods. The credit is not sellable or transferable. No pre-application is required. The tax credit is distributed when eligible expenditures are made.

Purpose

The purpose of the winery and grape growers tax credit is not explicitly stated in the authorizing statute. The statute provides a tax credit of 25% of new equipment and materials purchased by wine producers and grape growers. The Department of Economic Development has interpreted the purpose as facilitating the growth of wineries and grape growers in Missouri.

State Taxes Impacted

The authorizing statute for the wine and grape production tax credit allows for the credit to be used by the taxpayer to offset the tax liabilities otherwise imposed by chapter 143, RSMo, excluding withholding tax imposed by sections 143.191 to 143.261, RSMo. Chapter 143 is the state individual and corporate income tax.

Information and Data Issues

Files maintained by the Department of Economic Development contained copies of tax credit certificates, applications and accompanying invoices for expenditures by each project approved in 1999. However, the files did not contain employment or wage data. Employment, wage and other economic data should be maintained within a management information system that would allow for a cost-benefit analysis of the tax credit program.

Direct Economic Impact

In 1999, the first year of the program, 27 applicants applied for projects a total of 31 times. Tax credits approved during this period totaled $824,158 based on eligible expenditures of $3,296,629. According to Department of Revenue records for tax year 1999, $290,759 in wine and grape production tax credits were claimed. While we cannot verify these numbers due to our inability to reconcile records, if Department of Economic Development and Department of Revenue data are consistent, only 47 percent of the total tax credits approved were redeemed and 53 percent of the tax credits are lost because they were not used in the year they were approved.

Total Economic Impact

We used the model to analyze the total economic impact of the wine and grape production tax credit on the Missouri economy. The model compares the baseline forecast of the Missouri economy with an alternative forecast that takes into account the wine and grape production tax credit.

Two variables on the model were changed to create the alternative forecast: 1.) capital costs for the eating and drinking industry and 2.) government spending.

To measure the total impact of the wine and grape production tax credit program, we took the $290,759 redeemed in 1999 and projected the usage over a 10 year time period by taking the 1999 actual amount approved and multiplying this amount by the growth rate of the industry over the 10 year period (we acknowledge that usage of the tax credit may be much higher in future years, however to remain consistent throughout the analysis we used the 1999 redeemed amount). The two variables were then reduced by the dollar amount projected for each year over the ten-year period.

Using the aforementioned inputs and assumptions, the total economic impact results are as follows *(See Appendix X, page 57, for a graphic of the results):*

- As a result of the tax credit, the model forecasts an increase of approximately four jobs for the years 1999 through 2003, an increase of five jobs for the years 2004 and 2005 and an increase of four jobs for the years 2006 through 2008. Since the tax credit program had a time horizon of ten years (1999-08), after year 2008 the tax credit program is no longer in effect and employment declines by approximately one worker in 2009, and gradually declines back to an equilibrium.

- Growth in Gross State Product is positive from 1999 to its peak of just over $300,000 in 2007. Once the tax credit program expires in 2008 the growth in Gross State Product rapidly declines.

- Growth trends for personal income, real disposable income and industry output all have similar trends to that of Gross State Product.

- The structure of the wine and grape production tax credit does not lend itself to having a positive impact on wage rates in the state of Missouri. Because the tax credit is geared towards reducing the cost of purchasing new equipment this increases the attractiveness of outlays for new equipment versus outlays for labor.

- The fiscal impact of the wine and grape production tax credit is negative in the first year, as the credit redeemed reduces revenue more than the revenue generated from the increase in economic activity. However, beginning in the year 2000, the economic activity promoted by the wine and grape production tax credit begins to generate more state revenue than the cost of the redeemed credit and there is positive impact to state revenues. This positive impact continues until 2008 when the tax credit ends and state revenues rapidly moves towards equilibrium.

Survey Response

Twenty out of 23 surveys mailed to the project applicants were returned. When asked if the tax credit had an effect on their decision-making, 4 applicants said no while 16 said yes. If the four that answered "no" meant they would have done the economic activity without the tax credit, the tax credit was wasted as a tax incentive. Approved tax credits for the four projects totaled $13,971.

All but one respondent said that the tax credit is an effective way to promote economic and community development in their community. Fifteen applicants claimed the tax credit was a form of gap-financing, one said they could show that without the tax credit their costs would have been lower in another state, and four did not respond to the question. *(See Appendix IX, page 53, for full survey results).*

Noneconomic Influence

A 1994 analysis found Missouri to be the third largest producer of wine in the United States. Prior to prohibition, Missouri was the second largest producer. While wine and grape production clearly have an economic impact on the state of Missouri, becoming a leader in this industry will increase tourism to Missouri wineries.

An argument could be made that state tax credit programs should be designed to benefit as many of its citizens as possible and the economic development incentives should be particularly geared towards improving areas in need. While these two issues have economic aspects to them, the economic impact to the state may not necessarily be affected by the dispersion or the location of the beneficiary of the tax credit. Therefore, we treat these issues as noneconomic influences in the award of the tax credit.

This tax credit has benefited projects statewide. The projects are located across the central portion of the state and in the southwest. For many of the credits, it seems they are concentrated near the large cities. It does appear that rural areas of the state are also benefiting from this tax credit, as evidenced by projects located in Barry, Gasconade, Webster, and Wright counties. (*see Appendix III, page 35, for a distribution of projects by geography and census-tract income level*).

C. Rebuilding Communities Tax Credit Program

The rebuilding communities tax credit is authorized by RSMo, Section 135.535 and became effective in 1999**.** The program is divided into two categories: 1.) new or relocating businesses and 2.) existing businesses. New or relocating businesses are eligible for either a tax credit equal to 40 percent of the value of specialized equipment purchased during the first four years of eligibility, or for a tax credit equal to 40 percent of the income tax owed during the first three years of eligibility. Employees for businesses eligible for one of the 40 percent tax credits are eligible for a 1.5 percent withholding tax credit based on the gross salary of the employee during the first three years of eligibility. Existing businesses are eligible for a credit of 25 percent of the increase in their spending on equipment based on the average amount of spending for the previous two years. The annual cap on the program for new or relocating businesses is $10 million, with a project cap of $75,000 a year for four years for the tax credit based on specialized equipment purchases, or $125,000 a year for three years for the tax credit based on the business's income tax**.** There is no limit on the 1.5 percent employee credit. The annual cap for existing businesses is $750,000 and the limit per project for existing businesses is $75,000 a year.

For both new and relocating businesses and existing businesses, the credit is sellable and transferable and can be carried forward for five years and carried back for three years.

Purpose

The purpose of the rebuilding communities tax credit for new or relocating businesses is not explicitly stated in the authorizing statute. The statute allows a tax credit of 40 percent of either specialized equipment for four years or income tax liability for three years. Also, the employees of the company would receive a tax credit of 1.5 percent of their salary for three years. The Department of Economic Development has interpreted the purpose to be to economically stimulate business activity in the state's "Rebuilding Areas".

State Tax

The rebuilding communities equipment tax credit may be applied against the following state taxes:

I. Individual and corporate income taxes (excluding withholding taxes) imposed by Chapter 143, RSMo
II. Corporate franchise taxes, imposed by Chapter 147, RSMo
III. Financial institution tax imposed by Chapter 148, RSMo

Information and Data Issues

The annual cap for this credit is $10 million. Early estimates by Department of Economic Development had Fiscal Year (FY) 2000 redeemed credits at $4 million. A revised estimate for 2000 has redeemed credits at $973,750. The FY 2001 estimate for redeemed credits was revised downward from $5 million to $2.9 million. Department of Economic Development estimates of the usage of the tax credit appears to have been somewhat optimistic and have steadily been revised downward.

The files we reviewed did not always have jobs, wages or other economic data available for the projects utilizing the rebuilding communities tax credit. Employment, wage and other economic data should be maintained within a management information system that would allow for a cost-benefit analysis of the tax credit program.

Direct Economic Impact

Since it's inception in 1999, the program has resulted in 16 projects. Ten projects are existing businesses that expanded in a distressed area, five projects are new businesses starting out in a distressed area and one project is a business that relocated its business from a non-distressed area to a distressed area. Among Missouri's counties, St. Louis City has the most projects with ten, accounting for 61 percent of the total projects. The number of projects by business sector is as follows:

- Manufacturing - six projects
- Professional, scientific, and technical services - five projects
- Information - four projects, and
- Health care and social assistance - one project

In 1999, a total dollar amount of $402,245 in rebuilding communities tax credits were approved. The 25 percent specialized equipment credit totaled $293,510. The 40 percent specialized equipment credit equaled $105,188 and the 1.5 percent employment credit equaled $3,547. According to records provided by the Department of Revenue Division of Taxation and Collection, rebuilding communities tax credits redeemed for tax year 1999 totaled $ 214,376.

Total Economic Impact

We used the model to analyze the total economic impact of the rebuilding communities tax credit program on the Missouri economy. The model compares the baseline forecast of the Missouri economy with an alternative forecast that takes into account the rebuilding communities tax credit.

Two variables on the model were changed to create the alternative forecast: 1.) production costs for the rebuilding communities tax credit qualified industries and 2.) government spending. We lowered the production costs and the government spending variables by the same dollar amount. In this case, we took the approved amount of tax credits ($398,698) and apportioned it by the industry receiving the tax credit (this was determined by using the SIC code for each business that received the tax credit). We then forecasted this approved amount over a 10 year time period using the 10 year average growth rate for each specific industry impacted by the rebuilding communities tax credit. We then decreased the production costs (for each industry) and government spending variables by the approved amount projected for each of the 10 years (1999-08).

To measure the total impact of the rebuilding communities tax credit program we took the $398,698 approved in 1999 and projected the usage over a 10 year time period by taking the 1999 actual amount approved and multiplying this amount by the growth rate of the industry over the 10 year period. While it is preferred to use the redeemed amount of the credit instead of the approved amount, since the redeemed amount is an actual cost to the state, neither the Department of Economic Development nor the Department of Revenue were able to provide redeemed amounts at the project level. The approved amount was apportioned by the industry of the project using the credit. The growth rate used was dependent on the growth rate for the particular industry. The two variables were then reduced by the dollar amount projected for each year over the ten-year period**.** Both the production costs variable and the government spending variable were decreased by the amount of the approved credit (excluding the employee withholding tax credit) as forecasted for each of the 10 years**.** The dollar amount of the decrease was the same for both variables.

Using the aforementioned inputs and assumptions, the total economic impact results are as follows *(See Appendix X, page 59, for graphs of the results):*

- The model predicts a decrease in employment of four jobs in the first year of the rebuilding communities tax credit program. In 2002, employment growth begins to turn positive and peaks in 2009 with an increase of seven jobs.

- Like the trend in employment growth, Gross State Product and personal income both have negative growth in the first year of the rebuilding communities tax credit program, but turn positive a year or two later and remain positive throughout the ten year time horizon for the rebuilding communities tax credit program and the remaining six years of the measurement period.

- Real disposable income and industry output both demonstrate positive growth from the inception year of the rebuilding communities tax credit program. The increase in real disposable income peaks in 2005 at approximately $259,000. The increase in industry output peaks in 2007 at approximately $946,000.

- The rebuilding communities tax credit has a negative impact on the wage rates. This possibly could be occurring because the firms are using their reduction in capital or production costs to make additional capital expenditures rather than employ highly trained workers.

- The fiscal impact of the rebuilding communities tax credit is negative in the beginning as the credit redeemed reduces revenue more than the revenue generated from the increase in economic activity. Positive fiscal impact does not begin until year 2003 when the economic activity promoted by the rebuilding communities tax credit begins to generate more state revenue than the cost of the redeemed credit. This positive impact continues until 2008 when the tax credit ends and state revenue gradually moves towards equilibrium.

Survey Response

Eight out of 16 surveys mailed to the applicants for projects were returned. When asked if the tax credit had an effect on their decision-making, one applicant said no while seven said yes. If the one that answered “no” meant the economic activity would have occurred without the tax credit, then the tax credit was a wasted tax incentive.

All eight respondents said that the tax credit is an effective way to promote economic and community development in their community. Six projects claimed the tax credit was a form of gap-financing, two said they could show that without the tax credit their costs would have been lower in another state. *(See Appendix IX, page 53, for full survey results).*

Noneconomic Influence

While new and expanding business clearly has economic impact on a distressed community, the establishment of new and thriving businesses in a once vacant building breaks down psychological barriers that exist in many of these neighborhoods and if the business is successful will help towards possibly bringing more businesses to the area. (S*ee Appendix III, page36, for a distribution of projects by geography and census-tract income level*).

D. Small Business Incubator Tax Credit Program

The small business incubator tax credit is authorized by, Section 620.495 RSMo and became effective in 1990. The small business incubator tax credit is a discretionary program with both project and annual caps of $500,000 each. The tax credit can be carried forward 5 years and it may be sold or assigned.

Purpose

The purpose of the small business incubator tax credit is to assist in the growth of small businesses during their start-up periods. The statute allows a tax credit of fifty percent of any amount contributed by a taxpayer to the incubator fund or to the sponsor of an eligible small business incubator. The Department of Economic Development has interpreted the purpose of the tax credit as a means to generate private funds to create a "protective business environment", where a number of small businesses can grow and develop during their start-up period.

State Tax

The small business incubator tax credit may be applied against the following state taxes:

I. Individual and corporate income taxes (excluding withholding taxes) imposed by Chapter 143, RSMo
II. Corporate franchise taxes, imposed by Chapter 147, RSMo
III. Financial institution tax imposed by Chapter 148, RSMo

Direct Economic Impact

According to the Department of Economic Development project log, tax credits approved in 1999 totaled $115,125 based on contributions of $230,250. Tax credits claimed in 1999 totaled $84,103. Based on this data the direct impacts on the Missouri economy state treasury are minimal because of the small dollar amounts involved, however the small dollar amount does not negate the need to evaluate whether or not the public policy of using a small business incubator tax credit is beneficial to the state.

Total Economic Impact

We used the model to analyze the total economic impact of the Small Business Incubator Tax Credit Program (SBITC) on the Missouri economy. The model compares the baseline forecast of the Missouri economy with an alternative forecast that takes into account the SBITC.

Two variables on the model were changed to create the alternative forecast: 1.) production costs for growth industries in Missouri and 2.) government spending.

Since we were unable to obtain information on the small businesses benefiting from the SBITC, several assumptions were necessary to create input data for the model. The SBITC is intended to give assistance to small businesses during their start-up phase. We assumed the SBITC primarily benefits growth industries, as most start-up businesses would tend to be in an industry with growth potential. Growth potential was assumed if the industry experienced job growth during the 1998-99 period. Using this methodology there were a total of thirty-three industries identified as growth industries in Missouri. We then calculated the share of employment growth of each industry in relation to the total employment growth in Missouri. To measure the total impact of the SBITC program we took the $84,103 in tax credits redeemed in 1999, apportioned it by the share of employment growth for each industry, and projected the usage over a 10-year time period by taking the 1999 amount redeemed per industry and multiplying this amount by the growth rate of the industry over the 10-year period. The growth rate used was dependent on the growth rate for the particular industry.

The two variables were then reduced by the dollar amount projected for each year over the ten-year period. Both the production costs variable and the government spending variable were decreased by the amount of the redeemed credit as forecasted for each of the 10 years. The dollar amount of the decrease was the same for both variables.

Using the aforementioned inputs and assumptions, the total economic impact results are as follows *(See Appendix X, page 61, for graphs of the results):*

- The model predicts no change in employment related to the SBITC program in 1999, the first year of the measurement period. For the years subsequent to 1999, the model projects growth in employment of between one to three jobs, with the exception of year 2012 where there is no change in employment.

- Like the trend in employment growth, the SBITC program does not impact Gross State Product until the second year of the measurement period. For the subsequent years the impact on Gross State Product is positive with a peak positive change of $122,100 in 2003. The level of positive change tends to fluctuate in each year. This may be due to the tax credit having different effects on the significantly different industries assumed to benefit from the SBITC.

- There is a positive increase in personal income in 1999. The model projects no change in personal income in 2000 and then a positive change in all subsequent years. The model projects a peak increase of $106,800 in year 2011. As with Gross State Product, the level of positive change to personal income tends to fluctuate from year to year. This may be due to the tax credit having different effects on the significantly different industries assumed to benefit from the SBITC.

- The SBITC is projected to have an immediate effect on real disposable income with an increase of $83,920 in 1999. The peak increase in real disposable income is $122,100 which is projected to occur in 2004. Similar to other projections, the increase in real disposable income fluctuates from year to year.

- The model projects that industry output will increase from $91,550 in 1999 to a peak increase of $244,100 in years 2005-07 and then steadily increase at a declining rate through 2014.

- The model projects the SBITC will have a very minimal negative impact on wage rates during the measurement period.

- The fiscal impact of the SBITC is negative in the 1999 as the credits redeemed reduce revenue more than the revenue generated from the increase in economic activity. There is a positive impact on state revenues in year 2000, but in year 2001the model projects a negative impact on state revenues. For the years 2002-08 the model projects positive effects on state revenue. After 2008, the model projects a negative impact on state revenues, presumably this occurs because 2008 is the year the tax credit ends and the model inherently projects a return to an equilibrium.

Survey Response

Two small incubators responded, but for tax credits other than the small business incubator. Therefore, there were no valid responses recorded for this tax credit program.

Noneconomic Influences

The state should use its resources to benefit as many of its citizens as possible and the economic development incentives should be particularly geared towards improving areas in need. While these two issues have economic aspects to them, the economic impact to the state may not necessarily be affected by the dispersion or the location of the beneficiary of the tax credit. Therefore, we treat these issues as noneconomic influences in the award of the tax credit.

The benefits of this tax credit were spread evenly across the state. The two incubators located in the St. Louis metropolitan area that benefited from the program were located in St. Charles County and the City of St. Louis. One incubator was located in the Kansas City area. The three remaining incubators were located in the rural areas of Columbia, Rolla and Macon, Missouri. (*See Appendix III, page 37, for a distribution of projects by geography and census-tract income level*).

APPENDIX I

OBJECTIVE, SCOPE AND METHODOLOGY

Objective

To gather and review information and data needed to perform a cost-benefit analysis that would provide policymakers with sufficient information to evaluate the effectiveness of all Missouri tax credit programs administered by the Department of Economic Development.

Scope and Methodology

Information and data was reviewed for all 33 tax credit programs administered by the Department of Economic Development. A more in-depth analysis was performed on four tax credits: film production, wine and grape production, rebuilding communities, and small business incubator.

The 33 tax credit programs administered by the Department of Economic Development and the authorizing state statute for each program are as follows:

TAX CREDIT PROGRAM	*AUTHORIZING RSMO*
Affordable Housing	*§ 32.111*
Brownfield Investment	*§ 447.700*
Brownfield Remediation	*§ 447.700*
BUILD Missouri Bonds	*§ 100.700*
Business Facility	*§ 135.100*
(Capital) Small Business Investment	*§ 135.400*
Certified Capital Companies (CapCo)	*§ 135.500*
Community Bank	*§ 135.400*
Community College New Jobs	*§ 178.894*
Development	*§ 32.105*
Dry Fire Hydrant	*§ 320.093*
Enterprise Zone	*§ 135.200*
Family Development Account	*§ 208.755*
Film Production	*§ 135.750*
Guarantee Fee	*§ 135.766*
Historic Preservation	*§ 253.545*
Individual Training Account (Skills Development)	*§ 620.1400*
Mature Worker Child Care	*§ 620.156*
MDFB Development and Reserve	*§ 100.250*

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Missouri Development Finance Board Export Finance	***§ 100.250***
Missouri Development Finance Board Guarantee	***§ 100.286***
Missouri Development Finance Board Infrastructure	***§ 100.250***
Missouri Low Income Housing	***§ 135.350***
Neighborhood Assistance	***§ 32.100***
Neighborhood Preservation	***§ 135.535***
New Enterprise Creation	***§ 620.635***
Rebuilding Communities	***§ 135.535***
Research Expense	***§ 620.1039***
Seed Capital	***§ 348.300***
Small Business Incubator	***§ 620.495***
Transportation Development	***§ 135.545***
Winery and Grape Growers	***§ 135.700***
Youth Opportunity	***§ 620.1100***

Our review involved two interrelated parts. First, we examined the economic literature to determine how a cost-benefit analysis might be performed on state tax credit programs. We also reviewed information and data that was available on each state tax credit program administered by the Department of Economic Development. As the review progressed we realized the analysis was dependent on the information and data available, so we attempted to obtain information that would allow us to perform the cost-benefit analysis we thought appropriate. At the conclusion of our review we determined that key data needed for an effective cost-benefit analysis was not available and we were unable to satisfactorily verify some of the key data that was available, in effect decreasing the usefulness of that data.

While there is some literature on economic development tax incentives in general, and on big tax incentive packages for large companies in particular, there is very little written on the effectiveness of state tax credit programs. There is also some literature on the cost-benefit of state tax incentives from a national perspective. Since we are only concerned with Missouri we limited our scope to the economic impact of the state tax credits on the state of Missouri and did not consider the effects from a national perspective.

In the economic literature we found three ways to perform a cost-benefit analysis on tax credits:

1. A cost benefit analysis may require a determination of the "efficiency" of the tax credit. A tax credit is efficient if it encourages activity that would not have occurred “but for” the tax credit. A tax credit is inefficient if the activity would have occurred without the tax credit.

2. A cost benefit analysis may require determining if the state's economic benefit resulting from the private sector's contribution or investment is greater than the tax revenue decrease that results from the private sector's utilization of the tax credit.

APPENDIX I

3. Finally, a cost benefit analysis may be performed to determine if a tax credit is more efficient than an equivalent direct spending program because such a subsidy uses the pre-existing tax system to communicate state policy at a relatively low marginal cost. In some cases direct government outlays will be preferable to comparable tax expenditures; in other cases, a tax subsidy through the state revenue code will be the preferred means of implementing state policy.

The cost benefit analysis mandated by Section 620.1300, RSMo is based on the first two types of cost benefit analysis, therefore no attempt was made to review whether or not the tax credit was more or less efficient than a direct subsidy.

To measure the economic impact of the tax credit on the Missouri economy we purchased a secondary user license to allow us to use the Regional Economic Models, Inc., Policy Insight Model for the state of Missouri already owned by the Missouri Development Finance Board.

Additionally, pursuant to Section 620.1300, RSMo, we reviewed the noneconomic influences of the tax credit programs if possible.

APPENDIX II

BACKGROUND

The review of state of Missouri tax credit programs was performed under the mandate of Section 620.1300, RSMo.

Section 620.1300 prescribes that a cost-benefit analysis shall be prepared to evaluate the effectiveness of all programs operated by the department of economic development for which the department approves tax credits, loans, loan guarantees, or grants. Each analysis shall be conducted by the state auditor, and shall include, but not be limited to, the costs for each program, the direct state and indirect state benefits and the direct local and indirect local benefits associated with each program, the safeguards to protect noneconomic influences in the award of programs administered by the department, and the likelihood of the economic activity taking place without the program. The result of each analysis shall be published and distributed, by January 1, 2001, and every two years thereafter, to the governor, the speaker of the house of representatives, the president pro tem of the senate, the chairman of the house budget committee, the chairman of the senate appropriations committee and the joint committee on economic development policy and planning.

APPENDIX III

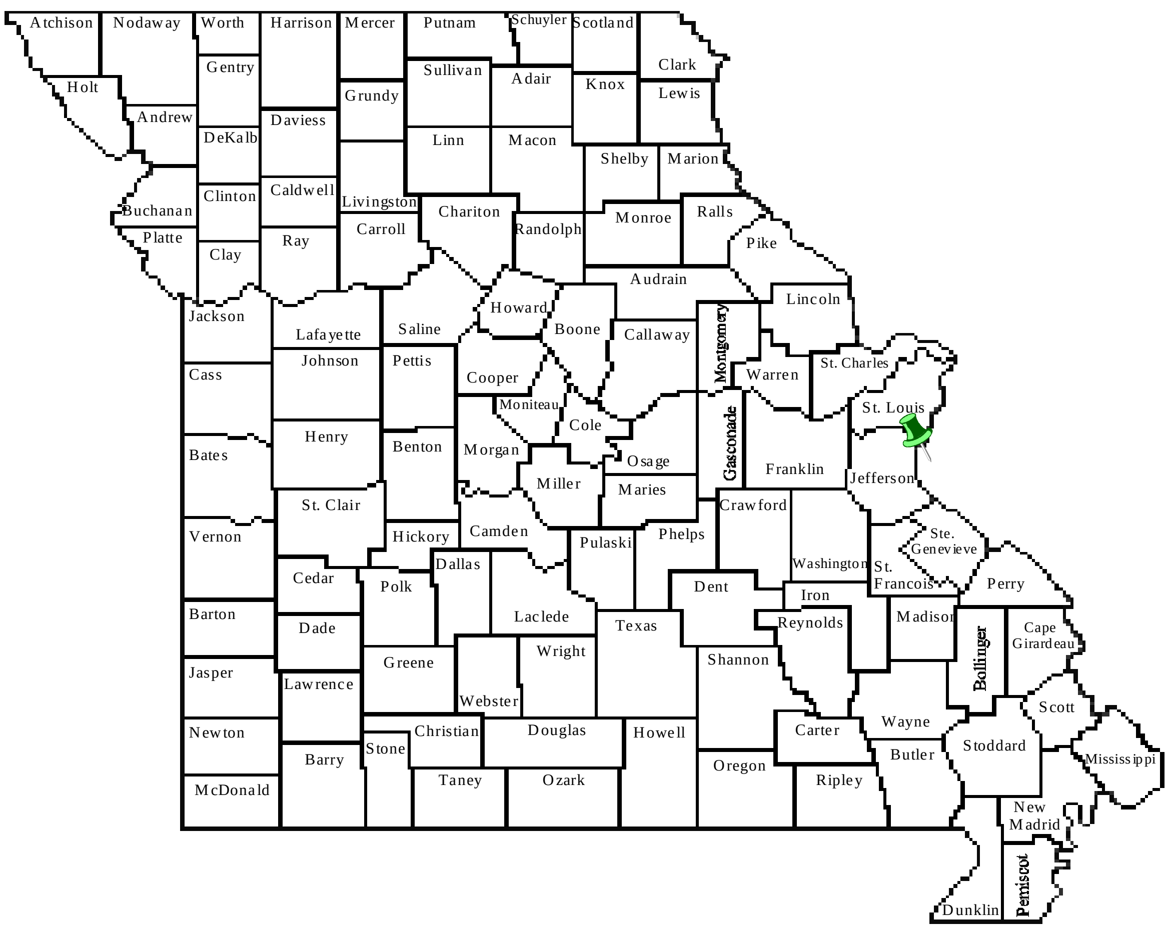
Distribution Of Tax Credit Projects By Geography And Census-Tract Income

Maps of tax credit projects by geography

The maps in this Appendix show the geographic location of where tax credits were taken.

Film Production Tax Credit

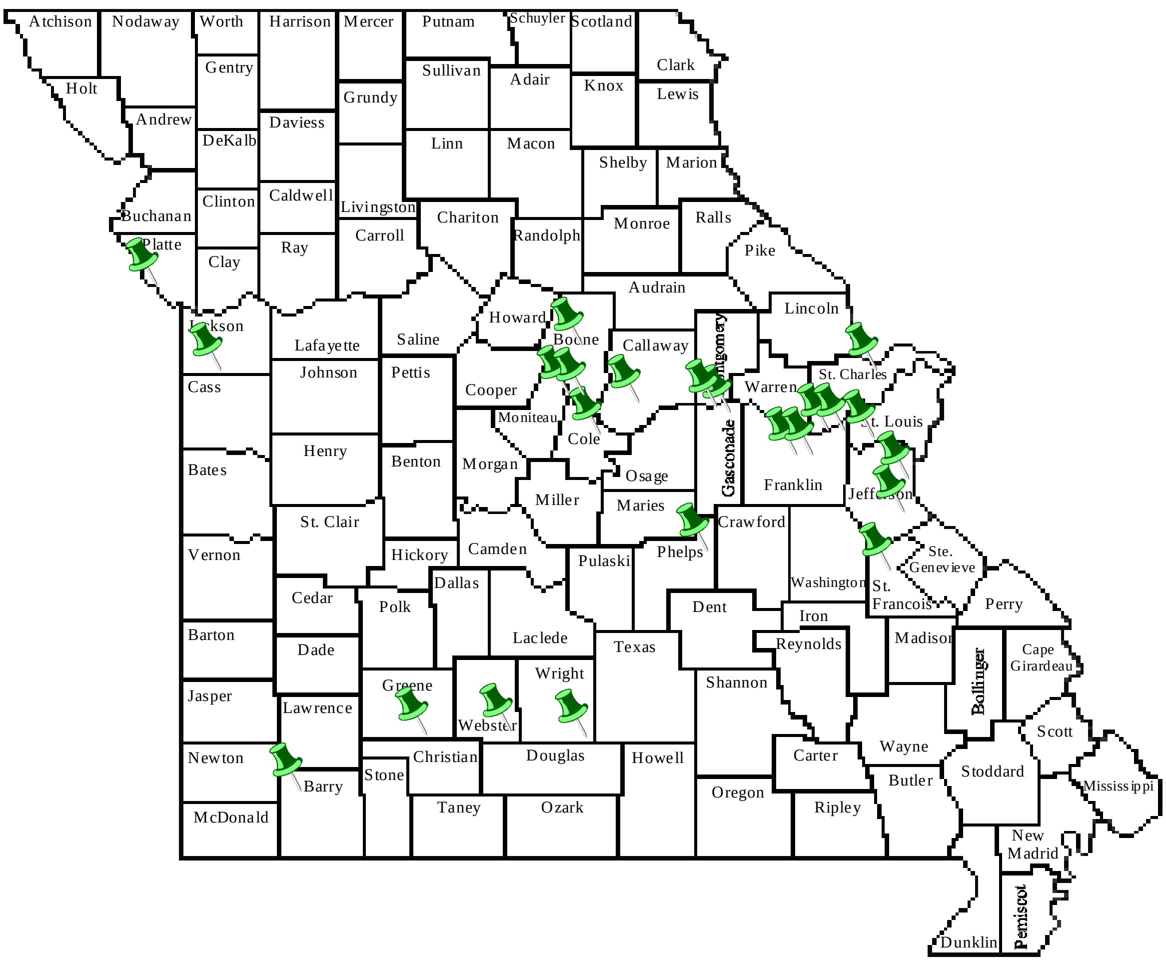
The lone project for this credit was located in St. Louis. It may take a few years for more companies to take advantage of the film production tax credit. Film productions are usually planned months, maybe even a year, in advance. Once out-of-state productions learn of this credit, then they may begin to plan to film here. For the immediate future, local small-budget productions and commercials may be the only projects to apply for this credit.



APPENDIX III

Winery and Grape Growers Tax Credit

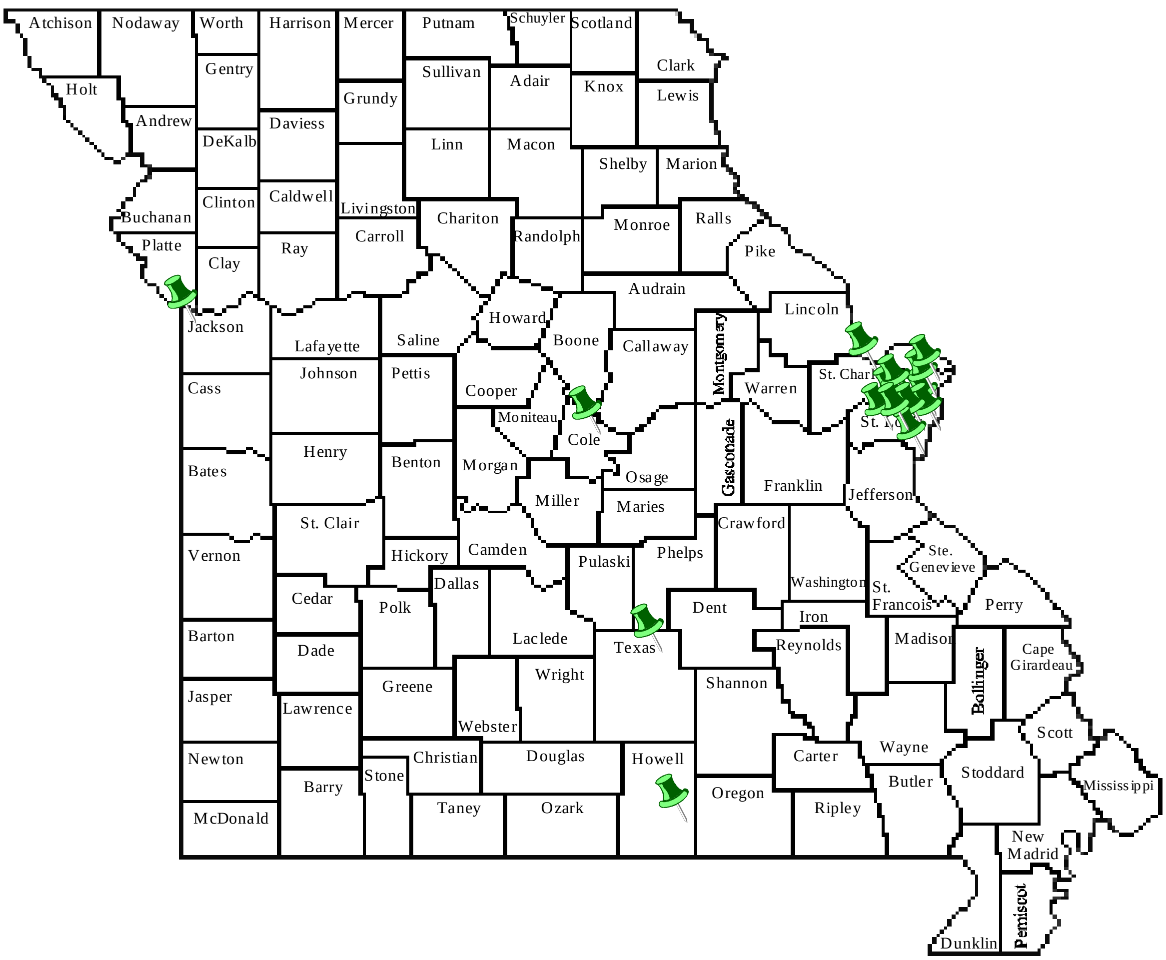
This tax credit has benefited projects statewide. The projects are located across the central portion of the state and in the southwest. For many of the credits, it seems they are concentrated near the large cities. It does appear that rural areas of the state are also benefiting from this tax credit.



APPENDIX III

Rebuilding Communities

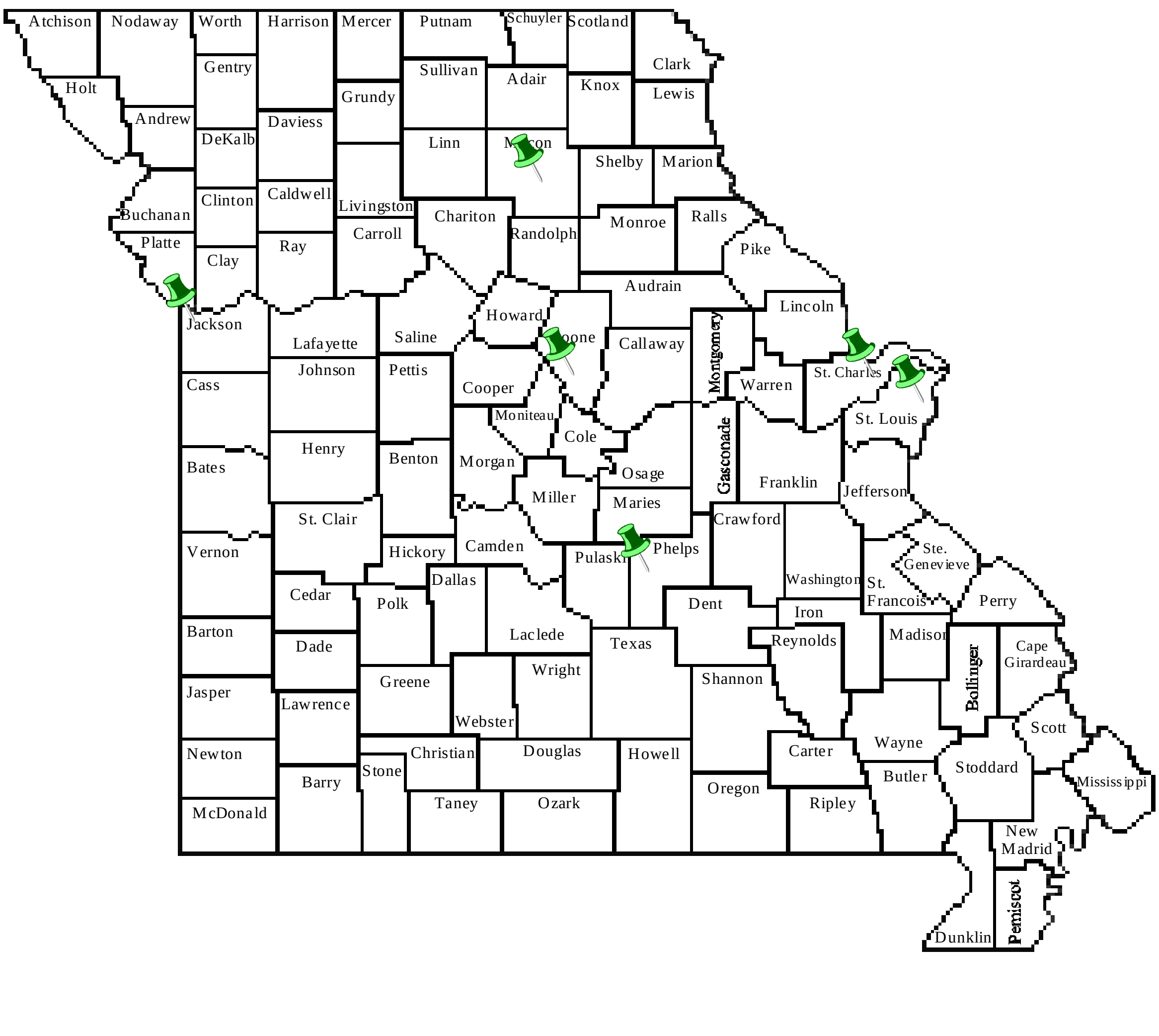
Twelve out of sixteen of the projects were located in the St. Louis metropolitan area and ten of the twelve were in the City of St. Louis. There were two small manufacturing firms located in the rural areas of West Plains and Licking which also used the credit. The remaining two projects were in Jefferson City and Kansas City.



APPENDIX III

Small Business Incubator

The benefits of this tax credit were spread evenly across the state. The two incubators located in the St. Louis metropolitan area, which benefited from the program were located in St. Charles County and the City of St. Louis. One incubator was located in the Kansas City area. The three remaining incubators were located in the rural areas of Columbia, Rolla and Macon, Missouri.



APPENDIX III

Distribution Of Tax Credit Projects By Census-Tract Income Level

Census-tract income is measured as follows:

Low	Median Family Income % is < 50%
Moderate	Median Family Income % is > = 50% and < 80%
Middle	Median Family Income % is > = 80% and < 120%
Upper	Median Family Income % is > = 120%

Winery and Grape Growers:

There are a total of 23 projects that used the wine and grape production tax credit. Nine percent of the projects were in moderate income census-tracts. Sixty-one percent of the projects were within middle income census-tracts and 22 percent were in upper income census-tracts. However, there were two projects making up 9 percent of the winery and grape growers tax credit projects, whose census-tract could not be determined.

Small Business Incubator:

Six projects used the small business incubator tax credit. Thirty-three percent of the projects were in low income census-tracts. Fifty percent of the projects were in middle income census-tracts and 17 percent were within upper income census-tracts.

Film Production:

Only one project used the film production tax credit and it was located in a low income census-tracts.

Rebuilding Communities (Expanding):

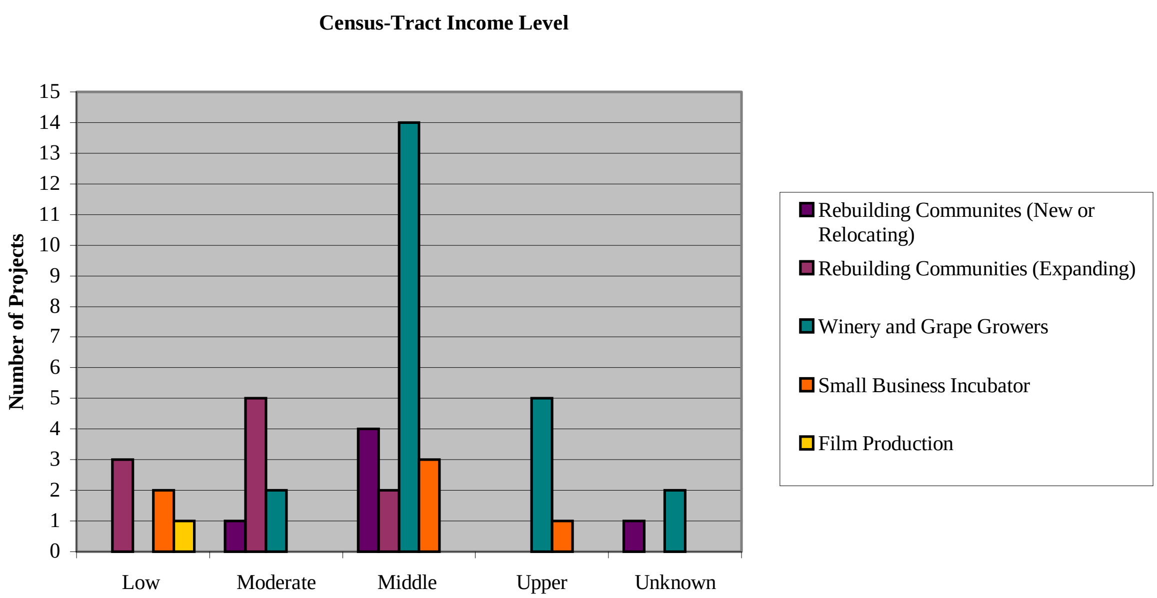
Ten projects used the Rebuilding Communities (Expanding) tax credit. Thirty percent of the projects were in low income census-tracts. Fifty percent were in moderate income census-tracts, and 20 percent of the projects were located in middle income census-tracts.

Rebuilding Communities (New or Relocating):

Six projects utilized the Rebuilding Communities (New or Relocating) tax credits. Of the six projects, 17 percent of the projects were in moderate income census-tracts. The majority of the projects, 67 percent, were considered within middle income census-tracts. There was one project whose census-tract income level could not be determined because we could not determine the street address.

APPENDIX III

The following chart illustrates the dispersion of the four tax credit programs by census-tract income level (note: to allow for a view of new business to the community versus existing business, the rebuilding communities tax credit Program is shown by both its "new or relocating" and "expanding" components) :



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APPENDIX IV

TECHNIQUES USED FOR A COST-BENEFIT ANALYSIS OF TAX CREDIT PROGRAMS

In our review we found the following critique of four techniques for conducting an evaluation of economic development incentive programs:

Source: The Federal Reserve Bank of Boston issued "Tax and Spending Incentives and Enterprise Zones," a paper by Peter S. Fisher and Alan H. Peters, focusing on the various incentives being offered to businesses in economic development zones.

I. The Econometric Method

"The econometric literature is very large indeed, but nearly all published models concern taxes. Moreover, of the tax models, very few have included data on local abatements or the various tax credits commonly in use at either the state or local levels. With a few notable exceptions, most models merely use effective tax rates (ETRs) as the exogenous tax variable within the location equation. Effective tax rates are calculated by dividing gross receipts (say, corporate income and franchise tax receipts) by some base (employment or population). Econometric models have been developed for various spatial scales and for a number of different state and local taxes. "Aggregate" or "macro" models have used state and local growth measures such as "levels of" or "changes in" employment, Gross State Product, per capita personal income, new plant openings, birth rates of small firms, and so on. "Micro" models, often using conditional linear analysis techniques, focus on the decision to locate a new plant. The models also range widely in their technical sophistication -- from simple regressions with poorly specified locality growth variables, no treatment of time lags in the growth variable, or fixed-effects controls or endogeneity in the explanatory variables, to considerably more complex models which address most, if not all, of these issues. Almost all develop equations that use local labor costs, transportation costs, energy costs, infrastructure provision, tax costs and so on -- in other words, the traditional location factors -- to explain local growth."

II. The Survey Technique

"In a number of studies, researchers have surveyed executives to determine what role taxes and development incentives play in the firm's relocation and expansion decisions. The surveys often distinguish between "must have" location factors and merely "desirable" factors. Since the evidence shows that large manufacturing firms tend to make their final location choice based on a sequential evaluation of factors at successively narrower spatial scales, deciding first on a broad geographic region, then a state, a metropolitan area (or county), a city, and finally, a plant site, some surveys have attempted to distinguish the impact of incentives (and other locational factors) at various spatial scales.

APPENDIX IV

The advantages and disadvantages of the survey technique are well known. At their best, surveys provide direct information about the actual siting decisions made by executives. Moreover, the more complex statistical assumptions that beset econometric analyses can be avoided. Unfortunately, survey researchers often have difficulty finding the cohort of individuals within a corporation who were responsible for a particular location decision. Moreover, executives may have a direct interest in saying that incentives are important even if they were not (admitting that an incentive had little effect on one's location decision might cause later political problems), although, given the findings of the literature, this problem may have been exaggerated. Finally, while surveys may rank the importance of various locational factors, they do not provide a precise measure of the impact of each locational factor on local growth.

The results from the survey-based tax literature are unclear, with some research indicating that incentives are indeed important to location decisions and other studies indicating the opposite. Part of the confusion may have to do with research methodology. But it is also possible that some development incentives are important while others are not, and the confusion in the literature merely reflects this fact. Work by researchers, who attempted a comprehensive survey assessment of the various classes of incentives, appears to support this conclusion. Their research covered everything from tax incentives, capital assistance, property development, and zoning flexibility to labor force development assistance. The study focused on Wichita-Sedgewick County, Kansas. They find that property tax abatements and regulatory flexibility are widely considered important by firms. Direct low-interest loans were the only capital-related incentive to enjoy broad-based support from most business types. More esoteric capital assistance, such as venture capital and incubator funds, was not valued highly by business."

III. <u>The Case Study Technique</u>

"Some researchers have used variations on the case study method to evaluate the impact of specific economic development programs. The advantage of this method is that the work has covered a variety of different incentive instruments, from enterprise zones, research parks, and property tax abatements to export promotion schemes. Unfortunately, this approach also has major problems. In the first place, incentive programs are often very small relative to the local economy in which they operate. Thus, even where subsidies are effective, measuring their impact on a local economy is rendered difficult by economic white noise -- the other local factors that influence growth. Moreover, impact evaluations need to establish some sort of comparative control economy in order to measure the effect of incentives precisely. But choosing a control -- in the best of all worlds, the control economy would be identical to the economy receiving the incentive, except that the control would not receive the incentive -- is itself fraught with practical methodological and political difficulties.

APPENDIX IV

Not surprisingly, given the range of programs covered, the published research using the single program approach is as contradictory -- in terms of both detailed method and results – as the survey-based literature. Moreover, much of the research concerns issues of fiscal impact or cost-benefit ratios of programs. Apart from the topic of enterprise zones, little work has considered the impact of incentives on location and investment decisions. However, even work focusing on broadly similar types of programs shows discrepant results. For instance, in a recent, widely quoted volume on enterprise zones, one paper found clear evidence of impact success (M. Rubin 1991), while two other papers found little or none (Elling and Sheldon 1991; Grasso and Crosse 1991)."

IV. The Hypothetical Firm Technique

"Given the difficulty of drawing any firm conclusions based on the existing literature, a few researchers have opted for an entirely different approach to the problem of taxes, incentives, and growth. This solution involves looking at the impact local taxes and incentives have on a firm's actual income. In order to accomplish this, researchers build models that replicate the operating ratios, balance sheets, and income and tax statements of real, or at least "potentially" real, firms. This allows researchers to calculate exactly what impact a state's or city's taxes have on a firm's income. Almost all the work in this tradition has looked at comparative tax burdens and has ignored incentives. In a few cases, the results of hypothetical firm studies have been included in econometric analyses of the relationship between taxes and growth (or, at least, taxes and investment). Industry-specific measures of the burden of taxes deriving from the hypothetical firm model replace effective tax rates (ETRs) as one of the independent variables in the econometric equation."

In addition to using the model to analyze the economic impact of the tax credit program, we also decided the survey technique would probably be more reliable in gauging the "effectiveness" of a tax credit program in advancing the desired public policy than an analysis based solely on the econometric method. The case study technique was ruled out because we wanted to look at the entire tax credit program and not solely at individual projects and the hypothetical firm technique was not used due to the amount of data, time and training involved to perform this type of analysis.

APPENDIX V

STRENGTHS AND WEAKNESSES OF THE REGIONAL ECONOMIC MODELS, INC., POLICY INSIGHT MODEL FOR THE STATE OF MISSOURI

The model was obtained as an econometric model to measure the economic impact of the tax credit programs on the state of Missouri economy. Eventually the analysis may be done at the local regional level, as well.

The model is a useful tool but is only a rough approximation of possible scenarios. Other factors must be included in any analysis and undue weight should not be given to the model results. The model does use theoretical soundness and established economic theory.

Some strengths and weaknesses of the model are outlined below:

Strengths:

- Integrated population and demographic forecasts, which helps to keep projected population growth and economic growth internally consistent;

- Top-down approach should ensure that the projections for states and sub-state areas are not inconsistent with overall regional and national growth patterns;

- Theoretical soundness, with logical and consistent relationships with established economic theory;

- The level of economic detail, which facilitates the understanding of future emissions; and

- Flexibility in specifying exogenous variables.

Weaknesses:

- The top-down approach means that forecasts are likely to be most accurate at the national level and successively poorer at the regional and sub-regional level;

- Projections are based on past historical relationships and will not necessarily reflect events or trends which might be foreseen by local experts;

- The large number of variables and the complex linkages among them mean that the accuracy and reliability of the interrelationships cannot be determined readily;

APPENDIX V

- Some issues of special importance in this project are of concern, specifically, the fact that tourism activity must be specified as an exogenous variable, and that the model does not account for fuel switching by electric utilities.

- While the model overcomes many of the shortfalls typically associated with input-output modeling, it still limits the scope of potential economic relationships. Moreover, the econometric processes by which many relationships are identified necessarily contain some amount of unexplained-variation. Ultimately this model, like any model, provides rough approximations.

Sources: The Projected Economic Impacts of West Virginia's Agenda for Fair Taxation, by Mark L. Burton, Ph.D. at the Center for Business and Economic Research Lewis College of Business, Marshall University, Huntington, West Virginia November, 1998 Prepared for The Governor's Commission on Fair Taxation. (Website: www.wvscpa.org/TaxReform/Nov.1998.htm)

Economic and Demographic Projects, prepared by the Grand Canyon Visibility Transport Commission (website: www.nmia.com/gvtc/ecdem.html)

Econometric Issues:

- Most studies done in the 1980's indicated that tax incentives have no effect on where a business decides to locate or whether it expanded or not. (i.e., tax incentives did not increase jobs or new investment). Sophisticated and, not so sophisticated, econometric modeling in the 1990's began to allow researchers to show that tax incentives did have an effect.

- Econometric models draw attention away from opportunity costs (i.e., when tax law modifications change relative prices, resources are diverted from the use to which they should have been put absent the change). Models tend to disregard or assume away facts that cannot be measured or quantified in any way and about which only imprecise or general knowledge is available.

- When Congress enacts an incentive, econometric models are used to provide estimates of the overall revenue effect of the incentive. This estimate will provide an indication of the extent to which the incentive is expected to attract resources to the targeted activity given the underlying assumptions used in the model. This estimate, which will look like a concrete amount, is in reality an estimate of objective costs. However, it will not be possible to know exactly from where the resources will be drawn. Therefore the opportunity costs are unknown, but are crucial to the overall revenue impact of the tax legislation and its effect on the economy.

APPENDIX V

- As increasing reliance has been placed on "econometric models", the frequency of tax legislation has also increased.

- In the Congressional Budget Act of 1974, Congress imposed a requirement that all new tax legislation had to include an estimate of revenue gains and losses projected over five years.

Source: Smoke and Mirrors: Tax Legislation, Uncertainty and Entrepreneurship, Linda A. Schwartzstein, Professor of Law, George Mason University. Published in Cornell Journal of Law and Public Policy, Fall, 1996.

APPENDIX VI

LIST OF HOW TAX CREDITS ARE TO BE AWARDED

Below is a listing of how state law requires DED to approve each tax credit:

	TAX CREDIT PROGRAM	*TYPE*
1	Youth Opportunity and Violence	Competitive
2	Neighborhood Assistance Program	Competitive selection by DED
3	Affordable Housing Assistance	Competitive selection by MDFB[3]
4	BUILD Missouri Bonds	Discretion based on other state competition
5	Brownfield Remediation	DED discretion
6	Community Bank	DED discretion
7	Community College New Jobs Training Bonds	DED discretion
8	Development Tax Credit	DED discretion
9	Film Production Tax Credit	DED discretion
10	Small Business Incubator	DED discretion
11	MDFB Bond Guarantee Credit	MDFB discretion
12	MDFB Development & Reserve	MDFB discretion
13	MDFB Export	MDFB discretion
14	MDFB Infrastructure	MDFB discretion
15	Certified Capital Companies	CapCo's discretion
16	New Enterprise Creation	Fund Manager discretion
17	Seed Capital Tax Credit	Innovation Centers discretion
18	Brownfield Jobs/Investment	Formula;DED discretion
19	Missouri Low Income Housing	Formula
20	Business Facility Tax Credit	Formula
21	Enterprise Zone Tax Credit	Formula
22	Guarantee Fee	Formula
23	Historic Preservation	Formula
24	Winery/Grape Growers Tax Credit	Formula
25	Capital (Small Business Investment)	Formula;first come
26	Dry Fire Hydrant	Formula;first come
27	Individual Training Account Tax Credit	Formula;first come
28	Mature Worker Child Care Tax Credit	Formula;first come
29	Rebuilding Community	Formula;first come
30	Research Expense	Formula;first come
31	Transportation Development	Formula;first come
32	Family Development Account	First come
33	Neighborhood Preservation	First come

[3] Missouri Development Finance Board

APPENDIX VII

SUMMARY OF STATE AUDIT FINDINGS ON ECONOMIC DEVELOPMENT PROGRAMS

Five states, including Missouri, have looked at the tax credit programs within their respective states. In each of the states, lack of key data to evaluate the program is cited as an issue.

Source: Minding the Candy Store:
State Audits of Economic Development
by Good Jobs First
A project of the Institute on Taxation and Economic Policy.
www.goodjobsfirst.org

State/Agency	**Auditing Agency**	**Date (Type)**
Colorado		
Economic Development Commission and Department of Local Affairs	State Auditor	2/98

Enterprise Zone Program
Findings: difficult to determine whether economic improvements are related to the program; significant data-related problems and ambiguous goals limit the auditor's ability to make thorough comparisons or draw conclusions about effectiveness; and investment tax credit does not have strong impact on job creation. Recommendations: better program oversight for stronger participant accountability, particularly monitoring program eligibility and criteria; increase efforts to ensure that incentives are better tied to economic conditions and are better coordinated with the state's overall strategy.

Connecticut		
Department of Economic and Community Development Committee	Legislative Program Review and Investigations	12/97

Enterprise Zones
Finding: inadequate performance monitoring. Recommendations: renew commitment to accountability and collaboration; and develop and maintain a database including job retention and creation numbers, other tax credits, grants, and loans received by participating businesses, and current status of businesses.

APPENDIX VII

Kansas

Kansas, Inc.	Kansas, Inc.	1/00

Sales Tax Exemption and Economic Development Income Tax Credits Report
Assesses impact of incentives based on a survey of businesses that used them. Evaluation is made more difficult by the questionnaire system currently in place to get information from users of the credits. Only 14 percent of businesses using the credits have filled out the survey.

Missouri

Department of Economic Development	Committee on Legislative Research, Oversight Division	12/98

Department of Economic Development: Evaluation of Tax Credit Programs
Findings: tax credit programs lack fiscal accountability; weak financial control and accounting procedures; many discrepancies in information reported in tax expenditure reports, Department of Revenue records, and Department of Economic Development records; weak monitoring of job creation and utilization of investments; inadequate retention of financial and compliance records for projects; insufficient audits; inadequate system for tracking amounts of credits approved, claimed, and outstanding; and noncompliance with statutory cost-benefit analysis. Recommendation: separate duties of authorization and monitoring within the Department.

Vermont

Vermont Economic Progress Council	State Auditor	6/00

State Auditor's Review of the Vermont Economic Progress Council's Implementation of Act 71 of 1998
Findings: questionable use of the cost-benefit model and the frequent practice of granting maximum credits; questionable use of the "but for" provision for approving credits; there is little to no verification of data; tax credits were committed before the program existed; tax credits were given to companies that threatened job loss instead of to job creation projects; no formal policies and procedures regarding applicant evaluation and disposition; and inconsistent program administration.

APPENDIX VIII
TABLE OF DISCREPANCIES BETWEEN AGENCY RECORDS

The chart below shows the discrepancies between Department of Revenue (DOR) and Department of Economic Development (DED) claimed tax credits for state fiscal year-end June 30, 1999:

Tax Credit	*Code*	*DOR Amount Claimed*	*DED Amount Claimed*	*Difference*
Affordable Housing	AHC	1,866,929	1,866,929	0
Brownfield Jobs/Investments	BJI		12,336	-12,336[1]
Brownfield Remediation	RTC		50,654	-50,654[2]
BUILD Missouri Bonds	BUC	0	583,000	-583,000[3]
Business Facility	BFC	6,560,648	6,560,648	0
Capital (Small Business Investment)	ISB	1,325,372	1,325,372	0
Certified Capital Company (CapCo)	CPC	0	5,000,000	-5,000,000[4]
Community Bank	CBC	63,857	63,857	0
Community College New Jobs Training	JTC	9,190,424	9,190,424	0
Development	DVC	75,875		75,875[5]
Dry Fire Hydrant	DFH			0
Enterprise Zone	EZC	15,039,155	19,944,431	-4,905,276[6]
Family Development Account	FDA			0
Film Production	FPC		0	0
Guarantee Fee	SBG			0
Historic Preservation	HPC	2,559,713	2,559,713	0
Individual Job Training Account	ITC			0
Low Income Housing	LHC	3,609,593	3,609,593	0
MDFB Development and Reserve	DRC	0		0
MDFB Export	EFC	0		0
MDFB Infrastructure Development	IDC	8,532,781	17,482,172	-8,949,391[7]
MDFB Bond Guarantee				
Neighborhood Assistance	NAC	7,958,526	7,958,526	0
New Enterprise Creation	NEC			0
Rebuilding Communities	RCC		0	0
Research	REC	10,891,633	10,891,612	21
Seed Capital	SCC	90,954	90,954	0
Small Business Incubator	SBI	30,920	30,920	0
Winery/Grape Growers	WGC			0
Youth Opportunity	YOC	888,628	888,628	0
Mature Worker Child Care				0
Transportation Development				0
Neighborhood Preservation				0
Totals		68,685,010	88,109,769.00	-19,424,757

APPENDIX VIII

DED responses to the discrepancies were as follows:

[1.] DED stated the DOR record was correct and the DED record was incorrect. DED further stated that procedures have been developed to reduce the likelihood of a similar error occurring in the future.

[2.] DED stated the DOR record as of 08/27/99 reflected the same amount DED included in the budget book. The DOR record we received on this tax credit program was as of 06/30/99 and therefore it did not include this DOR revision.

[3.] DED stated the DOR record was correct and the DED record was incorrect. DED further stated that procedures have been developed to reduce the likelihood of a similar error occurring in the future.

[4.] DED stated that a formula error resulted in DED reporting the incorrect amount of the credit redeemed. DED further stated that procedures have been developed to reduce the likelihood of a similar error occurring in the future

[5.] DED stated that DOR reports combine the Development Tax Credit into the Neighborhood Assistance Tax Credit. DED stated it will indicate this fact on the budget forms in the future.

[6.] DED stated that it includes income modifications and/or refunds for the Enterprise Zone Tax Credit and the DOR Tracking System only reflects the amount redeemed. DED stated the Office of Budget and Planning prefer that income modification and/or refunds be included on the budget form.

[7.] DED stated its budget form incorrectly reported credits authorized instead of credits redeemed and the DOR record is correct. DED further stated that procedures have been developed to reduce the likelihood of a similar error in the future.

APPENDIX IX

SURVEY RESULTS

As part of the audit, a survey was sent to recipients of tax credits. A schedule of response rates and responses to the questions follows:

Response Rates for Questionnaires:

1. In total, the response rate for the questionnaires was 72% (29 out of 40 responded)

2. The response rate per tax credit program was as follows:

Film Production Tax Credit -	100% (1 out of 1 responded)
Wine & Grape Growers Tax Credit -	87% (20 out of 23 responded)
Rebuilding Communities Tax Credit -	50% (8 out of 16 responded)
Small Business Incubator -	0% (0 out of 6 responded; 2 of the incubators responded, however the response was for a tax credit other than the Small Business Incubator tax credit)

The following survey questions were posed to recipients of the Film Production Tax Credit, the Wine and Grape Production Tax Credit, the Rebuilding communities tax credit, and the Small Business Incubator Tax Credit:

1. Please state the name, address, and phone number of your firm or organization

   Result: all respondents gave their name and address of the project.

2. Has your business or community group ever used (and/or benefited from) a state tax credit program? Please circle: Yes or No If yes , please name the program(s):

   Result: all 29 participants responded "**yes**" with, 2 respondents claiming more than 1 credit.

3. If the answer to question #2 is yes, did the tax credit have an effect on your decision-making (i.e., was the tax credit an incentive to relocate, expand or start your business or activity)? Please circle: Yes or No

   Result: 24 responded yes and 5e participants responded no.

4. If the answer to question #2 is yes, please list below how much new investment dollars and/or new jobs you would say resulted from the use of the state tax credit:

   a. New investment: $______________________________

   b. New jobs #______________________________

   Result: the total dollar amount invested in Missouri was $14,938,434 with total jobs created of 96 full time positions and 2 part-time positions.

5. Other than the tax credit, please list the factors which influence your decision-making and rank them in the order of importance:

   Result: 10 responses were received for Earnings/Profits and Return on Investment; 5 responses were for Market Demand; 4 responses for Location and 3 for Capital Resources Available; 3 responses for Cash Flow; 2 for Tax Incentives; 2 for Economic Climate. Other responses include: Job Security, Low Costs, Labor Resources Available, Telecommunications Infrastructure, Industry Niche, Maintain Business Relationships, Maintain Viability of Company, Fruit Research, Retirement Planning, Supplier Demand, State and Federal Cooperation, Financial Stability, Adherence to Mission, and Quality of Production, Simplicity of the programs for support, Need to diversify, Ability to self-manage (home based business).

6. Do you consider the state tax credit program(s) as an effective way to promote economic and community development in your community? Please circle: Yes or No

   Result: 28 responded “yes” and 1 participant responded “no”.

7. If a tax credit has been utilized by your firm or organization, please circle below the best answer that applies:
   a. The tax credit was a form of gap financing that allowed our firm or organization to do the activity.
   b. Our firm or organization was offered tax incentives from other states.
   c. Without the tax credit we can show that our costs would have been lower in other states.

   Result: 21 responded to “a”, 0 responded to “b”, 4 responded to “c”, 3 responded “n/a”; and 1 responded "incentive to purchase".

8. Please provide any additional comments on how the state tax credit program(s) have, or have not, benefited your business and/or community

APPENDIX IX

Result: Film Production Tax Credit-

"The state film commission tax credit helps the fledgling arts community in our state and helps illuminate our state's resources through a positive portrayal in film & television."

Wine and Grape Production Tax Credit –

1. "Would not have had adequate capital to get the business up and operating in 5-6 yrs. This will provide 35 acres of vineyard devoted to wine making which will increase MO tax revenue and eventually provide 2 full-time and 2-4 part-time jobs."
2. "Last year we applied 'personally' for the tax credit for expenses to plant and grow grapes. It was a great incentive to continue a very expensive industry. It helped us afford the personal investment required to start our corporation… and we plan to re-apply under our corporation this year for the grape & wine tax credit."
3. "It provides incentive to pursue a long term commitment with no return for several years."
4. "The production of grapes for wine involves a huge up-front expenditure with limited returns starting 3 years after planting. Without the tax credits, the small grower probably would not even attempt to start the business."
5. "I think tax credits & incentives can increase grape production and tourism for a small dollar amount spent in support of Missouri's grape & wine industry."
6. "Application process was prompt and responsive."
7. "Individuals who are making large capital outlays with start up expenses cannot fully take advantage of the tax credit because they are paying very low or no state taxes because of losses incurred in their start up years. Grape growers layout large amounts of cash for root stock and arbor equipment with no expectation of any appreciable income for at least 4 to 5 years."
8. "Definite benefit, and has allowed us to expand business faster than we would have without it."
9. "The state tax credit program did give my small business a small financial help. I do believe this type if economic program will always help those Missouri businesses that are worthy of help."
10. "The tax credit we use fosters the grape and wine industry and the overall economy of the state of Missouri."
11. "Helped provide additional funds needed for a new business. Created four times the amount of credit in purchases of new equipment from local merchants."
12. "The tax credit has allowed me to put my land into production more quickly and will allow me to absorb extensive initial costs of installing a vineyard."

APPENDIX IX

Rebuilding communities tax credit

1. "We received positive press for being part of the tax credit program… articles, speaking engagements, etc."
2. "We have worked with several companies and investors launching several new companies. The tax credit programs are a great asset and value in attracting investors and new technology companies to Missouri."
3. "In 1999 the 25% tax credit program "pushed" us into a position to think more aggressively about buying equipment that would increase our productivity. This piece of equipment also made it possible to hire one person. Already this year we have increased our computer system along with our manufacturing equipment. We are now looking to hire one person and then one more before the year is over. These are purchases that we eventually would have made and new employees we would have hired. But I do not believe that we would have moved as quickly without the incentives."
4. "Typically we find that tax credits are too much trouble for the results you get. However, the Rebuilding Communities program worked well and really was the first and only help Missouri has ever given us, it took a long time since this business was founded in 1850. Also, this program allowed us to update our factory from 1960's type production, to computer advanced machinery. I thank Pat Bannister of the Economic Development Department in St. Louis and the state of Missouri for this help."
5. "The tax credit enabled us to financially justify the purchase of additional manufacturing capacity which in turn enabled us to meet our customer's needs, improve our profitability and cash position, and hire additional workers."

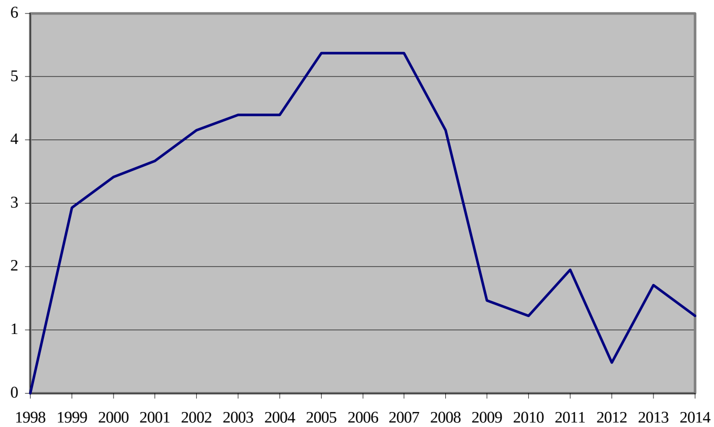
"The tax credits provided an added incentive and economic [sic] to starting up a new business in what is considered a depressed area. The program could be simplified and expanded to cover more start-up costs, but it is helpful as it currently exists. Thanks."

APPENDIX X

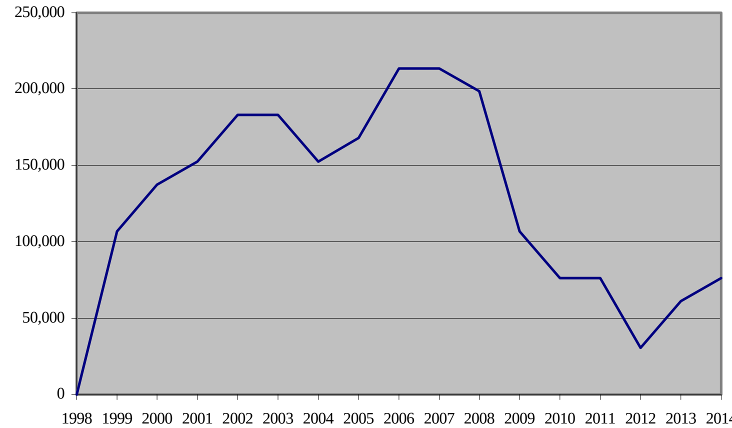
Graphs Of Total Economic Impact Analysis

FILM PRODUCTION TAX CREDIT

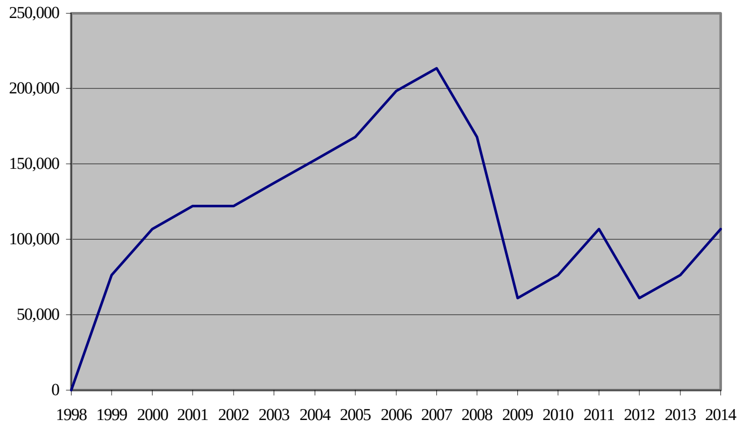
Film Production Tax Credit
Employment Growth (# of jobs)



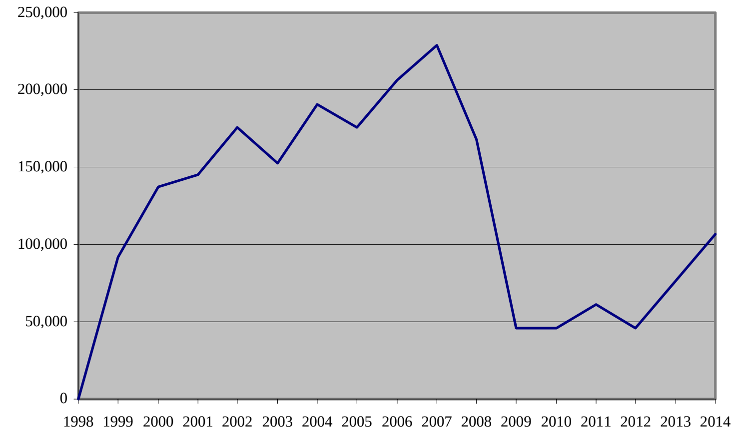
Film Production Tax Credit
Gross State Product Growth ($)



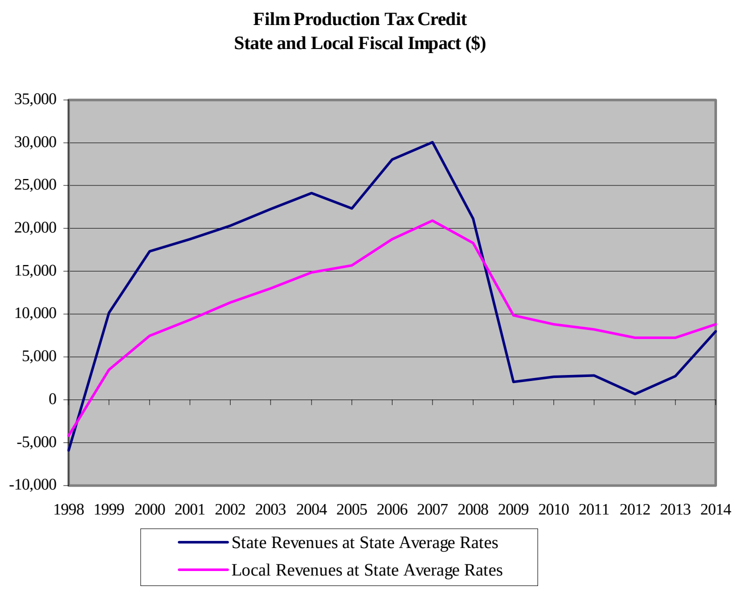
Film Production Tax Credit
Personal Income Growth ($)



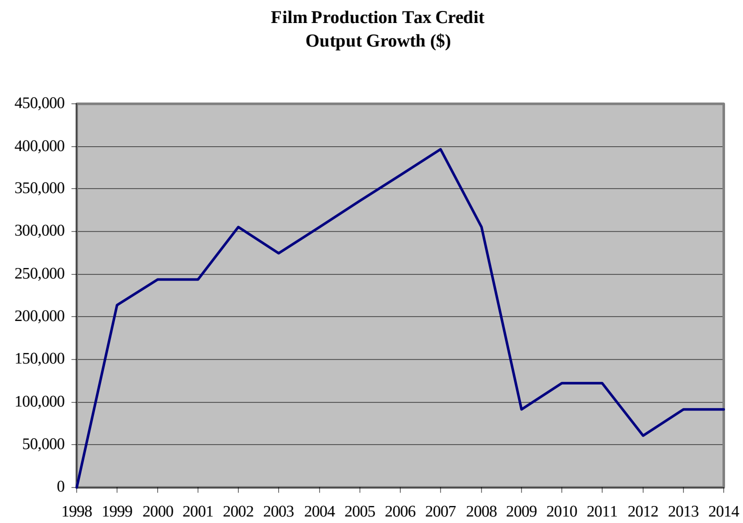
Film Production Tax Credit
Real Disposable Income Growth ($)



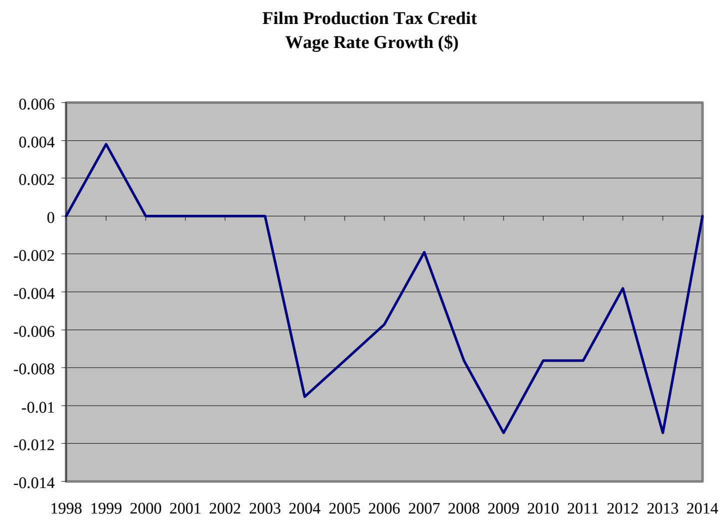
APPENDIX X



Film Production Tax Credit
State and Local Fiscal Impact ($)
35,000
30,000
25,000
20,000
15,000
10,000
5,000
0
-5,000
-10,000
1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014
State Revenues at State Average Rates
Local Revenues at State Average Rates



Film Production Tax Credit
Output Growth ($)
450,000
400,000
350,000
300,000
250,000
200,000
150,000
100,000
50,000
0
1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014

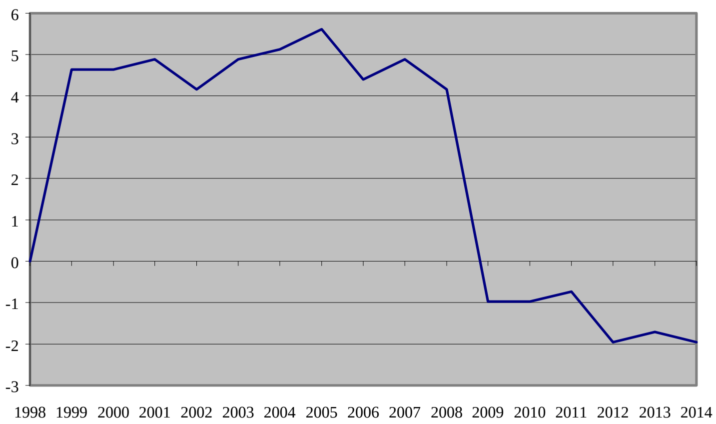


Film Production Tax Credit
Wage Rate Growth ($)
0.006
0.004
0.002
0
-0.002
-0.004
-0.006
-0.008
-0.01
-0.012
-0.014
1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014

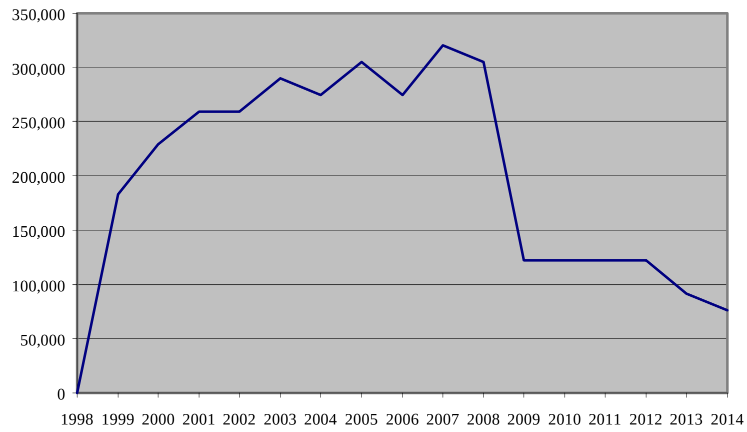
APPENDIX X

WINE AND GRAPE PRODUCTION TAX CREDIT PROGRAM

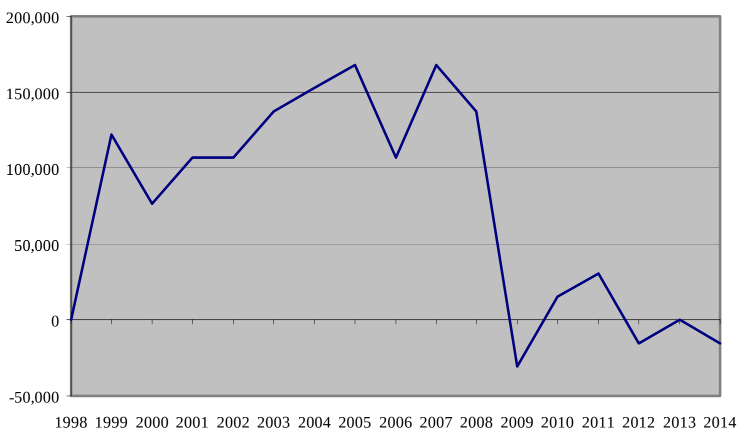
Wine & Grape Production Tax Credit
Employment Growth (# of Jobs)



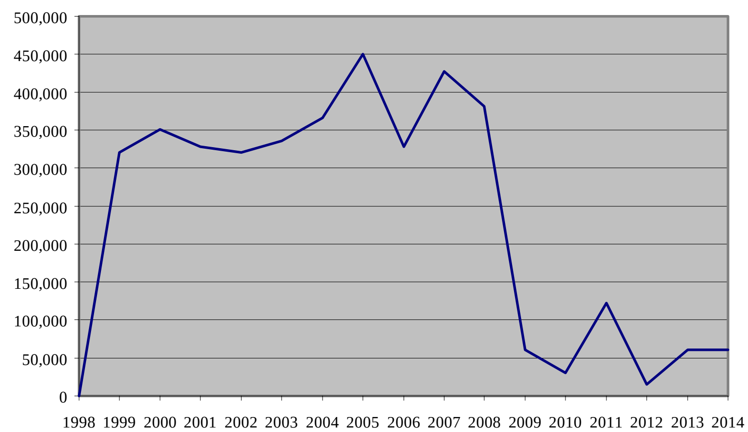
Wine & Grape Production Tax Credit
Gross State Product Growth ($)



Wine & Grape Production Tax Credit
Personal Income Growth ($)

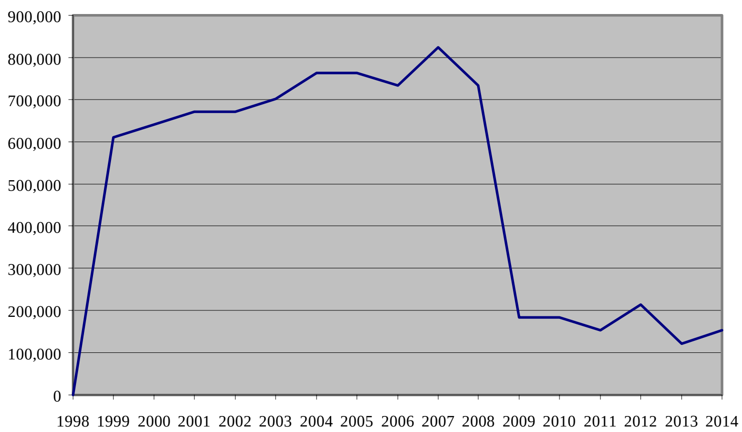


Wine & Grape Production Tax Credit
Real Disposable Personal Income Growth ($)

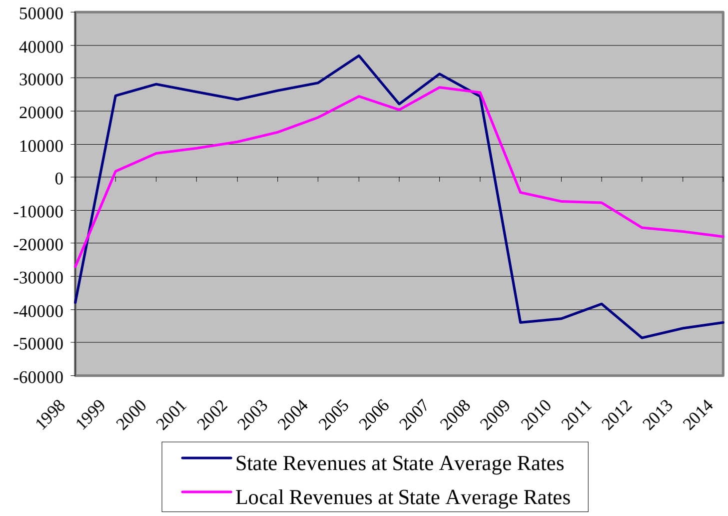


APPENDIX X

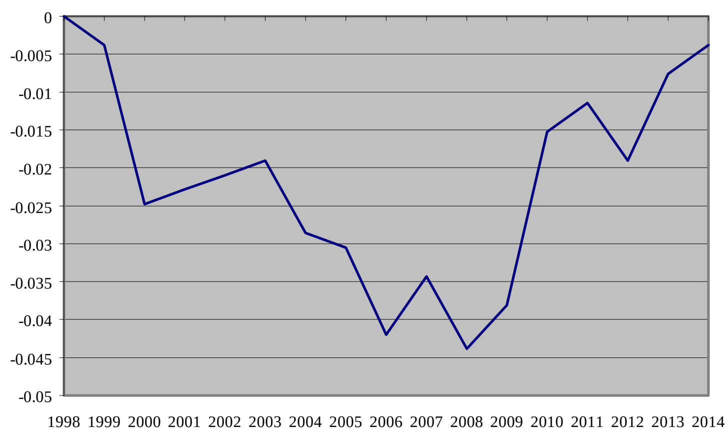
Wine & Grape Production Tax Credit
Output Growth ($)



Wine & Grape Production Tax Credit
State and Local Fiscal Impact

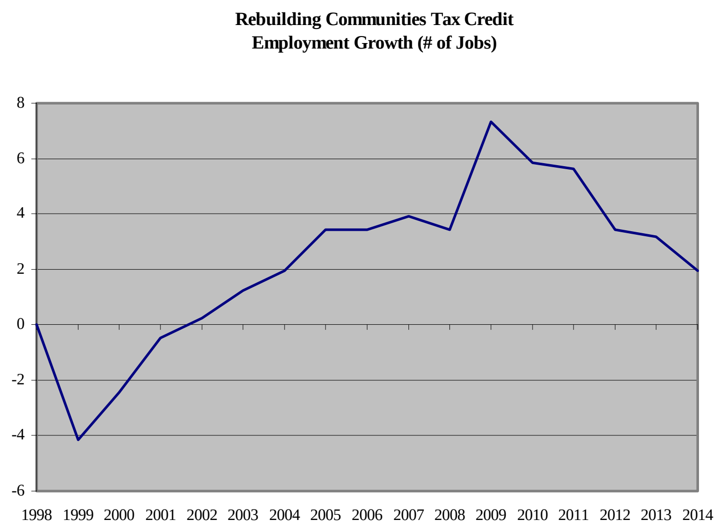


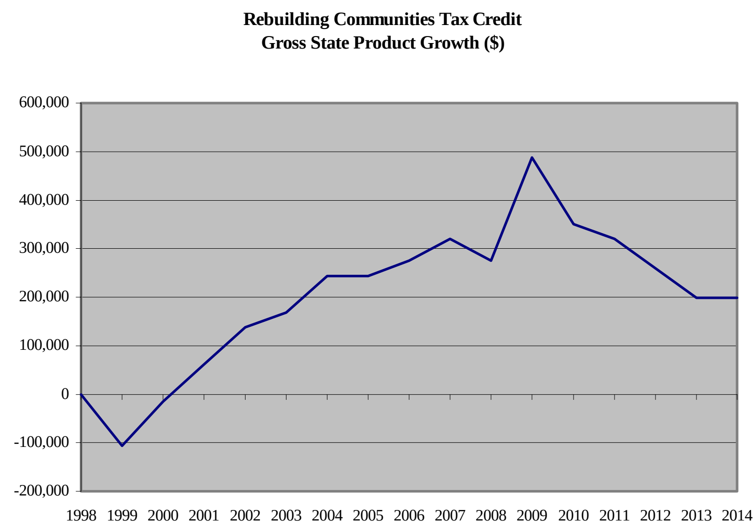
Wine & Grape Production Tax Credit
Wage Rate Growth ($)

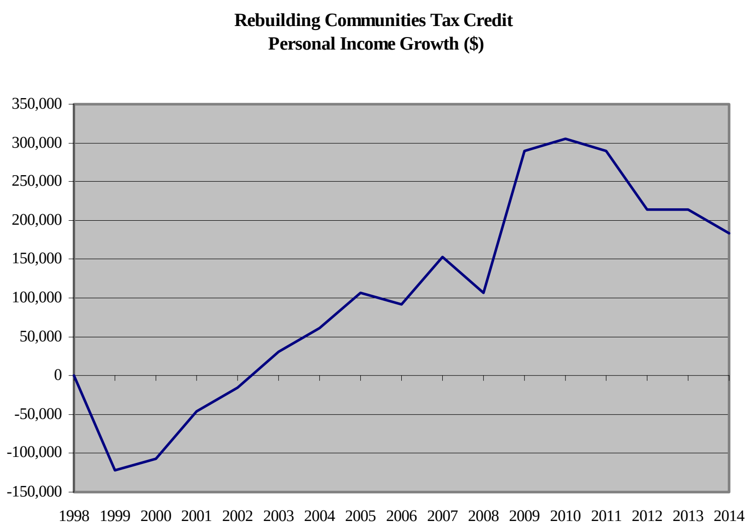


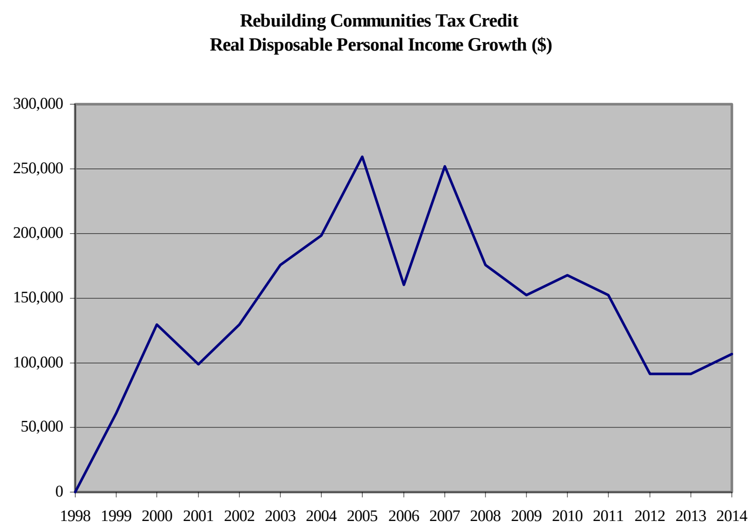
APPENDIX X

REBUILDING COMMUNITIES TAX CREDIT PROGRAM



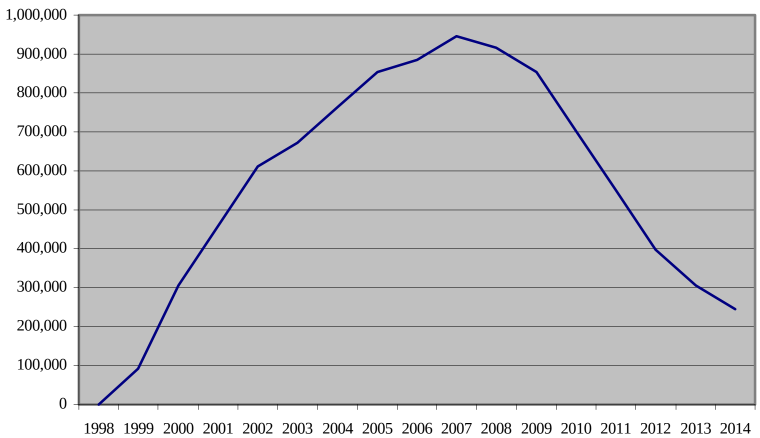




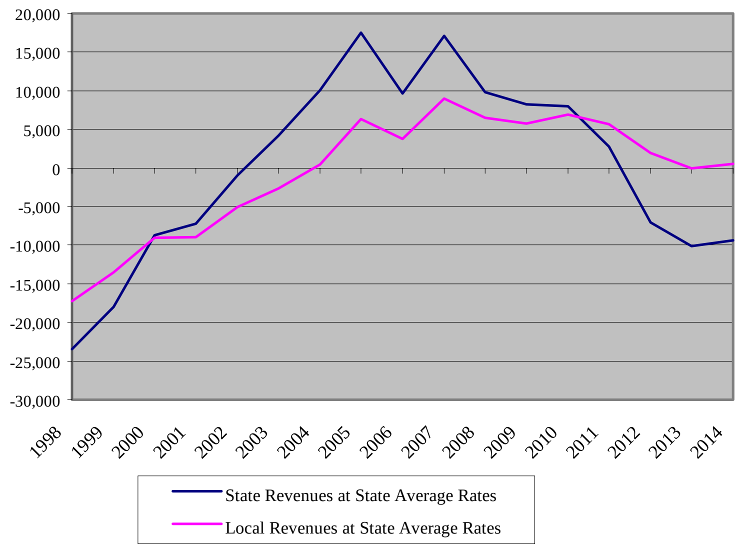


APPENDIX X

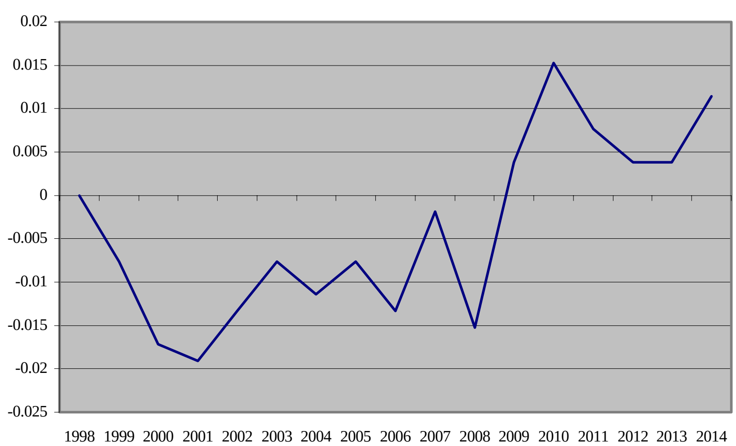
Rebuilding Communites Tax Credit
Output Growth ($)



Rebuilding Communities Tax Credit
State and Local Fiscal Impact ($)

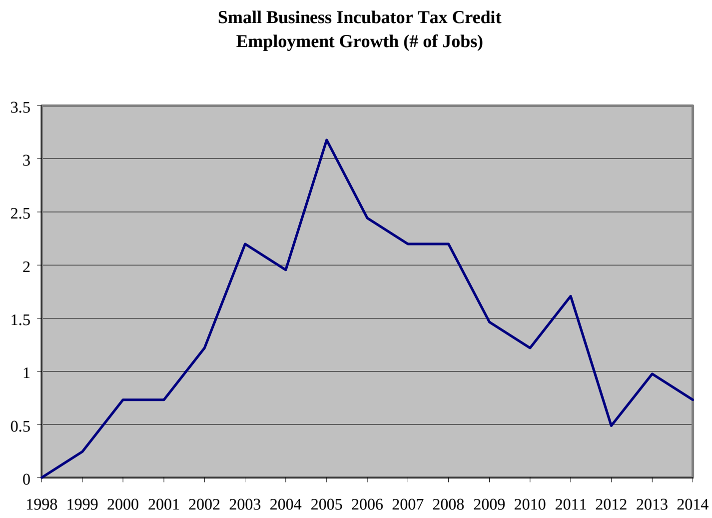


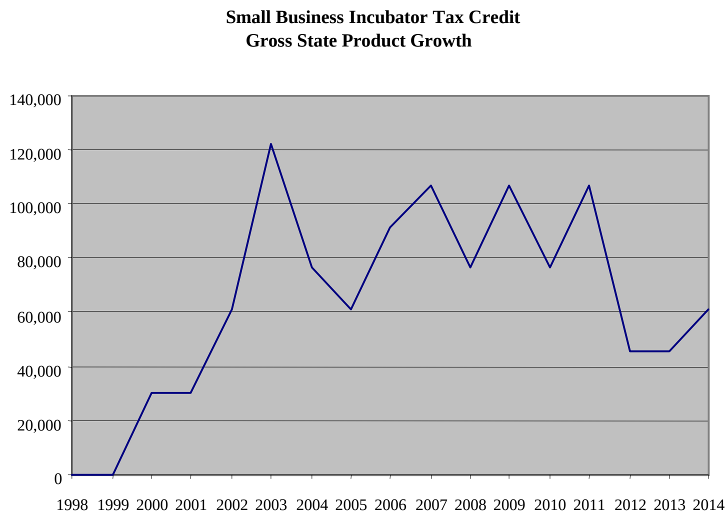
Rebuilding Communities Tax Credit
Wage Rate Growth ($)

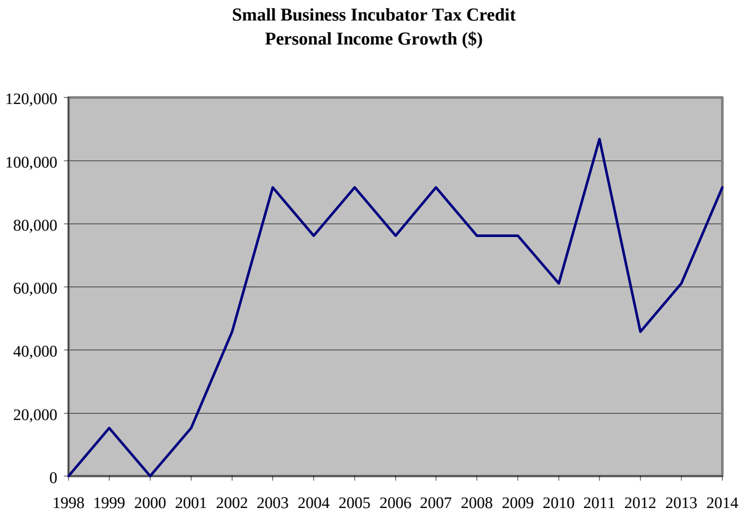


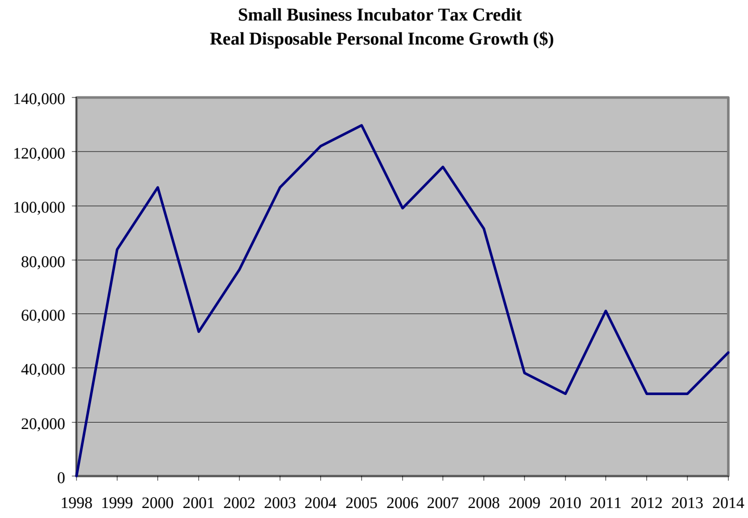
APPENDIX X

SMALL BUSINESS INCUBATOR TAX CREDIT PROGRAM

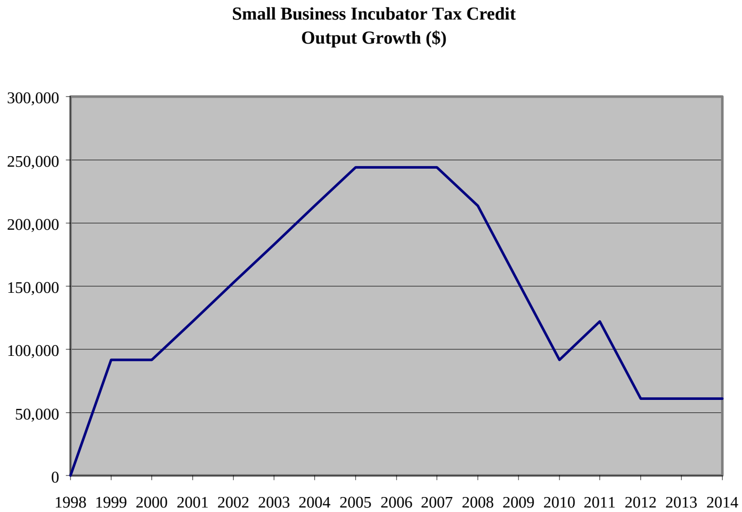


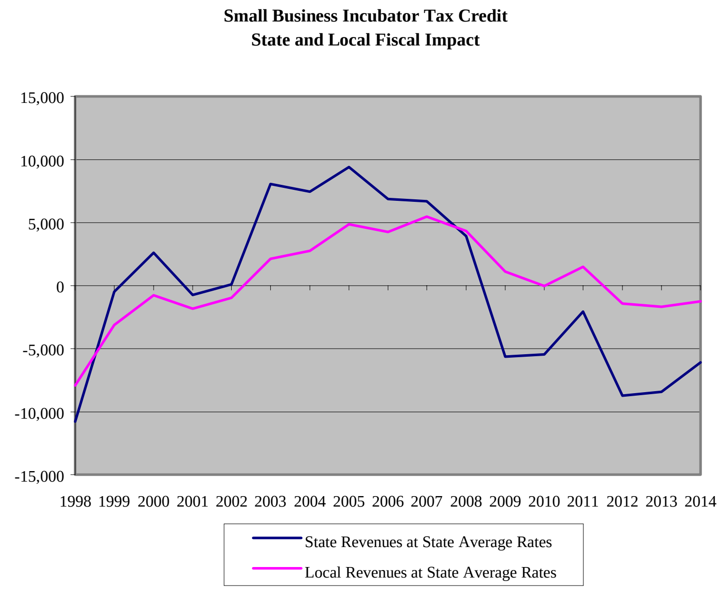


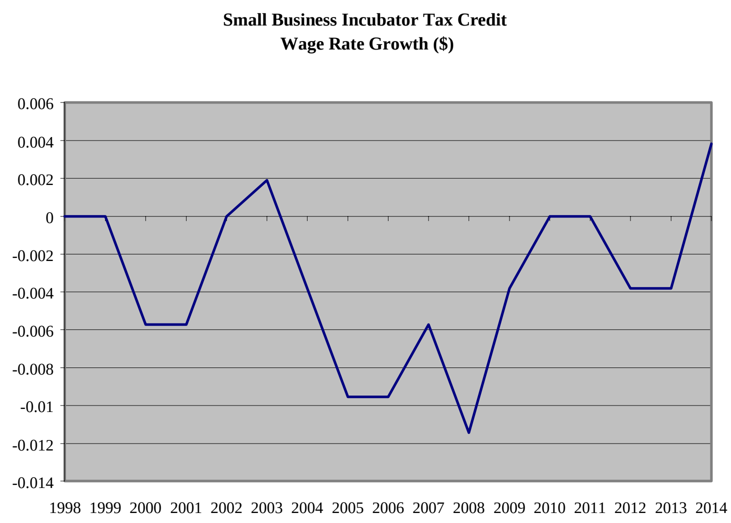




APPENDIX X


Small Business Incubator Tax Credit
Output Growth ($)
300,000
250,000
200,000
150,000
100,000
50,000
0
1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014


Small Business Incubator Tax Credit
State and Local Fiscal Impact
15,000
10,000
5,000
0
-5,000
-10,000
-15,000
1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014
State Revenues at State Average Rates
Local Revenues at State Average Rates


Small Business Incubator Tax Credit
Wage Rate Growth ($)
0.006
0.004
0.002
0
-0.002
-0.004
-0.006
-0.008
-0.01
-0.012
-0.014
1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014

MISSOURI
DEPARTMENT OF ECONOMIC DEVELOPMENT

Bob Holden
Governor

Joseph L. Driskill
Director

February 15, 2001

Honorable Claire McCaskill
Auditor of the State of Missouri
Harry S Truman State Office Building
Room 880
Jefferson City, MO 65101

Dear Ms. McCaskill:

This letter is in response to the Office of State Auditor's review of state tax credits administered by the Department of Economic Development. Attached is the Department of Economic Development's response to your recommendations cited in that report.

The Department has long recognized the importance that such an independent review be conducted. Even though it was not our statutory responsibility under RSMo 620.1300, our department requested funds for FY 1999 for this purpose, but the request was not approved. Lacking statutory authority and adequate funding, DED was unable to implement a detailed review. However, we utilized existing funds and partnered with the Missouri Development Finance Board (MDFB) to undertake an economic study of the tax credit programs we administer. In addition, we purchased and implemented an econometric modeling system in order to help us estimate the impact of various credit expenditures.

Now that your Office has been given authority and funding, the Department appreciates the opportunity to participate in your review, as mandated by law.

If you have any questions concerning this information, please feel free to contact Arlan Holmes of my office at 526-7863.

Very truly yours,

Joseph L. Driskill

C: David Mitchem
Arlan Holmes

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(573) 751-4962 Fax (573) 751-7258

<u>AUDITOR RECOMMENDATION</u>

1-1. Develop a comprehensive performance measurement system similar to what the Ohio study recommended. This system should include clearly articulated policy goals and data collection procedures and systems necessary for an effective evaluation of the state tax credit programs and other economic development incentive programs in the state.

<u>AGENCY RESPONSE</u>

Because of time constraints, DED was unable to review the Ohio State Incentive Management System model. Therefore, the Department does not currently have an opinion on whether or not this system would be appropriate for tax credits programs administered by DED. The Department will review the Ohio system and also review other best practices used in other states in relation to performance measurement systems. Through the department's strategic planning process, DED does collect, track and develop targets regarding various performance data related to incentives that the Department administers. The Department has been utilizing this results measurement planning system since 1996. While these measures are not strictly related to tax credits, we do understand measurement, results and operations. We are interested in examining all programs which might enable us to continue providing quality services for Missourians.

<u>AUDITOR RECOMMENDATION</u>

Collaborate with state agencies, the legislature and the administration on developing a set of performance-based benchmarks from which the effectiveness of the tax credit programs can be measured.

<u>AGENCY RESPONSE</u>

The Department agrees that this type of collaboration would be helpful in establishing benchmarks and is willing to participate. It is vitally important that all agencies that administer tax credit programs participate in order fully to realize the benefits of the tax credit programs in total.

<u>AUDITOR RECOMMENDATION</u>

Use the existing impact statement worksheet to capture and maintain all relevant data necessary to perform a cost-benefit analysis of applicable state tax credit programs.

<u>AGENCY RESPONSE</u>

It should be noted that only four DED tax credit programs (Brownfield, BUILD, Historic, and Film) require by statute that a cost-benefit test be performed. DED will attempt to gather this data on all tax credit programs. However, it must be noted that for some tax credits, statutes do not compel the tax credit recipients to disclose all thirteen types of data recommended for collection. In addition, as noted in the audit report, the collection of this data would not be applicable to each credit. Without a complete universe of data for each tax credit issued this data may not be reliable in conducting a cost benefit analysis.

AUDITOR RECOMMENDATION

1-4. When designing the new management information system, take into consideration the state of Missouri's need for a performance measurement system to maintain and monitor data on each of the economic development incentive programs the department administers.

AGENCY RESPONSE

The Department agrees to take this into consideration when designing the new information system.

AUDITOR RECOMMENDATION

Maintain sufficient documentation so that reconciliation can be performed with the Department of Revenue and the Department of Insurance records.

AGENCY RESPONSE

The Department initiated meetings with officials from the Department of Revenue (DOR) to develop a system that will interface for the reconciliation of tax credits. Upon implementing a workable system with the Department of Revenue, we will encourage the Department of Insurance (DOI) to adopt the same system.

AUDITOR RECOMMENDATION

Assign each tax credit program a separate DOR tracking code so that program activity can be traced and verified.

AGENCY RESPONSE

DED agrees that this should be done and we have already held discussions with the DOR to accomplish this task. DED and DOR are currently assessing the format that is needed that will work with both of the systems.

AUDITOR RECOMMENDATION

Coordinate with the Department of Revenue and develop an automated system using a key identifier that allows tax credits sold or transferred to be traced back to the project performing the economic activity encouraged by the tax credit.

AGENCY RESPONSE

This is clearly a shared responsibility and should include agreement by all agencies that administer transferable tax credits. It is DED's intent that on the programs we administer this information would be electronically submitted to the Department of Revenue in the new information system. We will actively encourage the other agencies involved, including DOR, to implement such an automated system.

AUDITOR RECOMMENDATION

1-8. Maintain all the documentation required by the authorizing statute for each tax credit program such as economic impact statements.

AGENCY RESPONSE

DED concurs that the economic impact statement for the Film Production Tax Credit was not maintained in the files. Action has been taken to ensure staff of the Film Office are informed of the requirement to collect this information. In addition, DED has created an internal audit staff by reclassifying two positions to auditors. It is the intent that these positions will provide additional verification that appropriate tax credit documentation is maintained. However, these positions are not solely dedicated to reviewing tax credit information and it is their responsibility to review all of DED's operations. Without staff specifically dedicated to reviewing tax credit documentation reviews can only be done on a periodic basis.

AUDITOR RECOMMENDATION

1-9. Ensure documents describing tax credits contain accurate information on each tax credit program and that such documents coincide with the law.

AGENCY RESPONSE

DED agrees with the State Auditor's statement in the body of the report that "there was no evidence that any party detrimentally relied on the incorrect information found on the Department of Economic documents." The Department will review tax credit summaries, marketing brochures and other related documents for accuracy and make corrections as necessary (also see response 1-8).