Tax Credit Review Commission
Economic Development Committee

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Tax Credits Assigned:

BUILD
Business Facility
Development Tax Credit
Enhanced Enterprise Zone
Film Tax Credit
MDFB Bond Guarantee
MDFB Infrastructure
Quality Jobs
Incubator Tax Credit
Rolling Stock Tax Credit

Preamble:

Success in economic development today and into the future requires that Missouri focus on three primary strategies: recruiting businesses to the state, incentivizing the expansion and retention of existing businesses, and fostering the growth of business startups. In today's economic development environment, Missouri must be equipped to compete with other states and countries to attract, retain and grow businesses with competitive business development incentives that are easy to understand, promote and utilize, and which complement Missouri's business-friendly environment by providing direct incentives to businesses that create jobs and make capital investments and by providing the financing necessary for public infrastructure that facilitates business growth.

State tax credits are an important part of Missouri's business development toolkit. Changes in today's economy and the evolution of operations have highlighted areas where Missouri's business development tax credits fall short in providing the most effective means to promote business development, job creation and capital investment. To make the most effective use of Missouri's business development tax credits and the taxpayer dollars they utilize, Missouri's tool kit should contain business development tax credits that:

- Incentivize economic activity that would otherwise not occur without the tax credit;

- Give priority to measurable job growth and capital investment;
- Complement and effectuate the strategic objectives developed through the Governor's Strategic Planning Initiative for Economic Growth by targeting high-growth industries to attract, retain and grow in the state; and
- Bear a proportionate relationship to the industry sectors that make up our existing and emerging economic base.

When working to recruit or retain a business prospect, the State will calculate and communicate the available business development tax credits to the prospect in the form of a proposal. In the current economic development climate, a business prospect is often simultaneously considering similar such proposals from competing states (or even countries).

The ability to provide a proposal, with confidence of the continued existence of the incentive or finance tool, provides a means that allows the natural business decision cycle to occur. This competitive landscape makes it critical for Missouri to be able to present a concrete, streamlined, and easy to understand proposal that can influence business decision-making on a real-time basis.

Tax credits, which are authorized by statute, complement the proposal process. Subjecting Missouri's business development tax credits to an annual appropriations process could severely hamstring Missouri's ability to provide the kind of concrete proposals necessary to attract and retain businesses that will create jobs and make significant capital investment in the state. The General Assembly should establish appropriate criteria in the award of both discretionary and entitlement business development tax credits. The committee hopes that the guiding principles set forth below will aid the General Assembly in that process.

Committee Methodology:

1. <u>Guiding Principles</u>

The Economic Development Committee approached its task by establishing a series of guiding principles related to the use of business development tax credits to promote economic development. The committee then applied these guiding principles to evaluate each of the existing tax credit programs assigned to the committee. The guiding principles adopted by the committee include the following:

- **Positive Return on Investment**
  - Discretionary business development tax credits offered directly to a business should be used only when the project will provide a positive return on investment, defined as a fiscal benefit to the state General Revenue fund net of the cost of the incentive and measured by a REMI or equivalent model. The amount of this return may vary between programs.
- **Return on Investment Within a Defined Time Period**
  - The fiscal benefits to the state General Revenue fund should occur within an established time period, not to exceed 10years, but in no event greater than the term of the benefit. However, discretionary business development tax credits used for public infrastructure should be allowed a longer period in which to gain a positive return on investment, not to exceed 20 years.
- **Focus on Primary Jobs**
  - Business development tax credits should focus predominantly on primary and base jobs.

- **Reward Higher-Paying Jobs With Benefits**
    - Business development tax credits should reward higher paying jobs (above county average wage) with due consideration for location, local employment (recent job loss), job numbers, and company permanency.
    - Business development incentives should reward companies who offer health insurance to their employees.
- **Consider Local Participation**
    - Business development tax credits should consider (and reward) cost sharing with local governments.
- **Flexibility**
    - Business development tax credits should be flexible to meet targeted, high growth industries and sectors, to incent a business activity or close a financing gap, and to apply to a variety of eligible activities, applicants and uses (able to address industry-specific cost pressures).
- **Simplicity**
    - Business development tax credits should be simple to understand, promote and execute and should be streamlined in their operation.
- **Up-Front Financing**
    - Business development tax credits should allow for the option of up-front financing in certain circumstances through the use of refundable tax credits, with defined clawbacks for non-performance.
- **Entitlement and Discretionary Components**
    - Possessing entitlement and discretionary components within the same credit, to provide both the certainty offered by an entitlement credit along with the project-specific flexibility offered by a discretionary credit.
- **Broad Applicability**
    - Business development tax credits should work in both urban and rural areas of the state and should be available for large and small businesses.

2. <u>Specific tax credit review and recommendations</u>

Applying the above principles, the committee reviewed each of the assigned tax credits and developed the following recommendations regarding the assigned credits. The first recommendation is program-specific and classifies each assigned credit into one of four categories A, B, C, or D. The categories are defined in the memorandum submitted to the Commission by Commissioner Van Matre and reproduced below:

The second recommendation provides a global framework for improving Missouri's toolkit by replacing the various economic development tax credit programs with one unified economic development tax credit program. The unified program would utilize the same pool of funding represented by the existing program caps, and therefore would not result in any additional cost the State, while at the same time would more effectively promote the guiding principles identified by the committee as being necessary to create jobs and promote capital investment in the state.

The third recommendation establishes a new Angel Tax Credit Program to address the financing gap that serves as an obstacle to growing new businesses in the State. The new program would utilize all of the existing cap on the Film Tax Credit ($4.5 million).

Recommendation #1

In order to support classifications of the assigned credits into one of the categories identified in Commissioner Van Matre's memorandum, the committee compared the attributes of the existing programs to the guiding principles developed by the committee. The existing programs were then ranked from most to least consistent with the guiding principles.

Program	Rank	Category	Recommendations
BUILD	High	B	Consider lowering the minimum thresholds for participation to enable a greater number of businesses to take advantage of the program.
MDFB Bond Guarantee	High	B	Consider lowering the cap to more accurately reflect the usage.
Quality Jobs	High	B	Amend to include a discretionary component that would allow for the direction of funding to targeted industries or allow for the option of up front financing in certain cases. Amend to lower the current job thresholds to 10 jobs for a period of not more than 3 years in order to promote economic recovery and increase job growth. Amend to include a tax credit benefit to allow for certain levels of capital investment that occurs in the state.
Enhanced Enterprise Zone	High	B	Amend to include a discretionary option for up-front financing in certain cases. Consider amending to provide a more flexible definition of distressed communities that would include extreme situations of blight and economic obsolescence.
MDFB Infrastructure	Medium	B	Consider administrative changes to make the program operate more efficiently.
Incubator Tax Credit	Medium	C	The certified incubators that use this tax credit could be more effectively funded through a grant program based on an annual appropriation process. The current $500,000 cap, when divided up among all of the certified incubators around the state, fails to provide sufficient efficiencies of scale to operate a contribution tax credit program. In place of the credit, funding for a grant program could be appropriated to the Missouri Technology Corporation for award and distribution in a manner similar to the existing process for funding Innovation Centers and other similar state and federally-funded programs. Any proposed grant program should also include a required match in order to maintain the private match currently enabled by the tax credit.
Development Tax Credit	Medium	B	The tax credit uses a cumbersome process requiring a non-profit to actually hold title to equipment purchased by a business and then lease it back to the business. The General Assembly should create a more efficient design that retains the discretionary credit for helping to offset equipment purchases and upgrades and is specifically targeted at the retention of Missouri businesses. Additional changes could include allowing

			additional benefits for higher paying jobs with health benefits, requiring proof of either a long-term lease or minimum amount of private capital investment, and rewarding companies with a significant likelihood for additional expansion. Simplifying the process eliminates unnecessary transaction costs.
Business Facility	Medium	B	The current credit is too narrow in its focus and too limited in its eligibility requirements to be broadly utilized to attract and retain jobs and capital investment. The eligibility requirements should be expanded to include additional targeted industries and should allow greater flexibility to calibrate the amount of benefits based on the jobs created, capital investment, and overall return to the state. The credit could also be modified to allow for an incentive based on capital investment alone.
Film Tax Credit	Low	D	This tax credit serves too narrow of an industry and fails to provide a positive return on investment to the state. There is currently no long-term opportunity for the location of production facilities for films in Missouri.
Rolling Stock	Low	D	This tax credit serves too narrow of an industry and fails to require a positive return on investment to the state.

Recommendations #2

The committee has also developed a global recommendation for improving Missouri's toolkit by replacing the various economic development tax credit programs with one flexible, unified program. As discussed above, this unified program could utilize the same pool of funding represented by the existing program caps (and potentially other programs currently under review by other committees), while at the same time better effectuating the guiding principles identified by the committee as being necessary to create jobs and promote capital investment in the state.

Specifically, the committee recommends that a unified economic development credit be considered that follows the guiding principles to replace the existing BUILD, Enhanced Enterprise Zone, and Missouri Quality Jobs Programs. The guiding principles are:

- Positive Return on Investment
- Return on Investment Within a Defined Time Period
- Focus on Primary Jobs
- Reward Higher-Paying Jobs With Benefits
- Consider Local Participation
- Flexibility
- Simplicity
- Up-Front Financing
- Entitlement and Discretionary Components
- Broad Applicability

The features of this unified credit would include:

- refundable tax credit (allows entity to gain a cash refund from State DOR regardless of tax liability) with an annual cap on issuance
- provide the benefit based on both jobs and capital investment
- provides a positive economic return over a fixed period of time

- company eligibility similar to the current Missouri Quality Jobs, but flexible enough to be utilized by large and small businesses and in rural and urban areas
- focus on companies with a majority of their business in interstate commerce like in the current EEZ and BUILD programs
- a financial but-for" requirement similar to that in the current BUILD program, whereby the project would not occur without state assistance to fill a financing gap
- entitlement base benefit similar to Quality Jobs, with an additional discretionary additional benefit based upon amount of positive return to the state, amount of local participation, competition with other states, or proven gap financing
- additional discretionary benefit for targeted industries (e.g. Information Technology and Data Centers)
- option for up front financing with claw back provisions (with annual not-to-exceed limit)
- limits on "stacking"

Recommendation #3

The third recommendation establishes a new Angel Tax Credit Program to address the financing gap that serves as an obstacle to growing new businesses in the State. The Department of Economic Development will be allowed to authorize tax credits tax credits per year to encourage equity investment in technology-based early stage Missouri companies, commonly referred to as angel investments. Investors who contribute a benchmark amount in equity investment to a qualified Missouri business may be issued a tax credit equal to an established percent of the investment or a higher percent of the investment if the qualified business is located in a rural area or distressed community. An investor can receive a credit of up to an established maximum for an investment in a single qualified business and up to an established maximum for investments in more than one qualified business per year. Tax credits for equity investment in technology-based early stage Missouri companies may be carried forward for up to three years or transferred. To create this new program it is recommended that the existing cap on the Film Tax Credit ($4.5 million) be utilized.