2024 Income Tax Credit Review

Joint Legislative Income Tax
Credit Review Committee

December 4, 2024

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2024 Credit Reviews

- Annually reviews credits as determined in statute
- This year's review includes:
  1) Dependent Tax Credit
  2) Agricultural Pollution Control Equipment Credit
  3) Agricultural Water Conservation System Credit
  4) Qualified Facility Credit
  5) Credit for Renewable Energy Investment and Production for Self-Consumption by International Operations Centers
  6) Credit for Corporate Contributions to School Tuition Organizations for Displaced or Disabled Students
- All but the Dependent Tax Credit were last reviewed in 2019

Role of the Committee

- Determine original purpose of credit
- Establish standards for evaluating and measuring success or failure of credit
- After review process, recommend whether credit should be amended, repealed or retained

Standards for Evaluating Credit

- History, rationale and revenue impact of credit
- Benefits of credit in terms of measurable economic development, investments and jobs
- Complexity of credit in terms of application, administration and approval process

Confidential Taxpayer Information

- Statute authorizes DOR to disclose confidential "statistical information" to the Committee, JLBC Staff and Legislative Staff
- DOR considers credit information confidential if:
  - credits were claimed by 3 or fewer taxpayers, or
  - a single taxpayer used more than 90% of total credits
- Dependent Tax Credit and Agricultural Water Conservation System Credit are the only credits on the 2024 review schedule that do not include confidential information

Issues Affecting Evaluation

- Lack of performance measures
- Certain costs and benefits can be difficult to quantify

Dependent Tax Credit

December 4, 2024

Dependent Tax Credit
- Summary

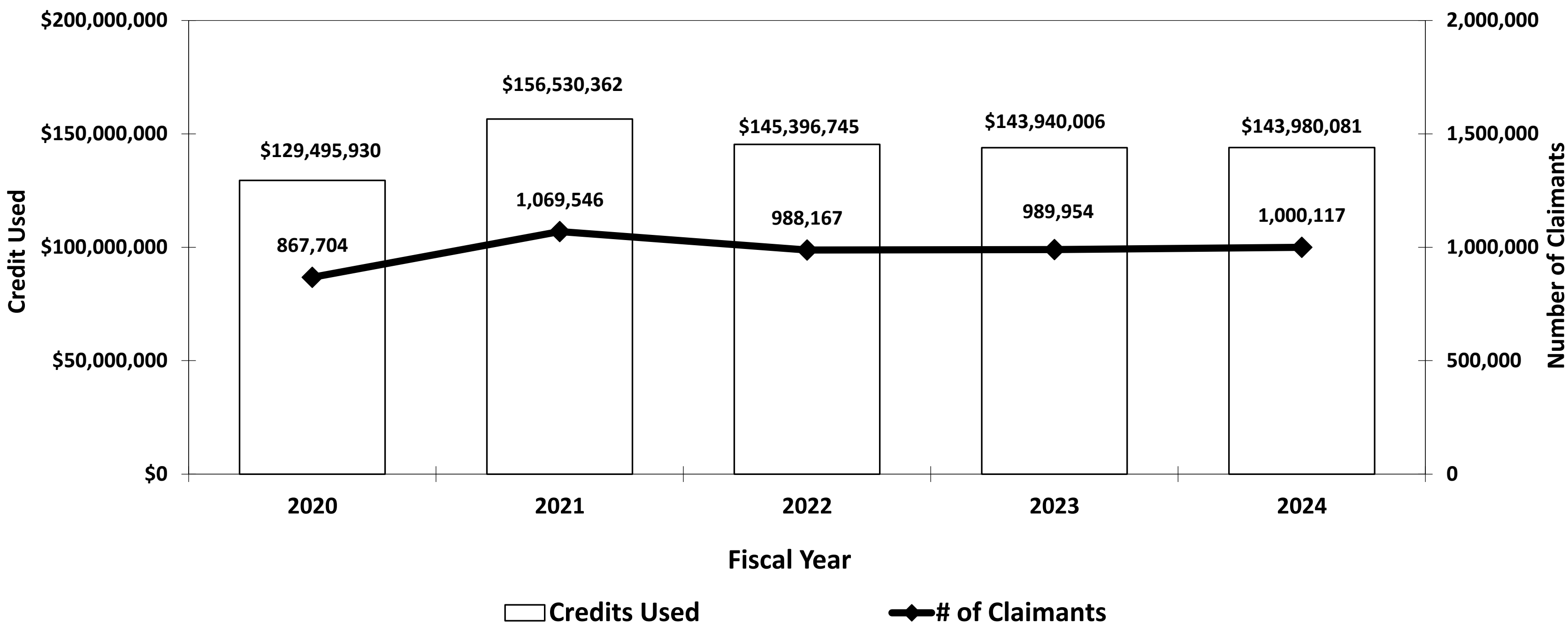
- Cost – $144 million in FY 2024, claimed by 1 million individual taxpayers
- Purpose – mitigate the costs incurred by taxpayers who care for dependents
- Complexity – simple to use. Worksheet for credit calculation is included in tax return instruction pamphlet. No separate administration and approval process is required.
- Performance Measures – none in statute

Dependent Tax Credit

- Description of the Credit

- The amount of credit is equal to:
  - $100 for each dependent who is under 17 years of age
  - $25 for each dependent who is age 17 or older
- Credit is gradually phased out for income above $200,000 for single filers and for income above $400,000 for married couples
- Credit is nonrefundable
- Carry forward of unused credits not allowed

Dependent Tax Credit
- Amount of Credits Used & Number of Claimants by Fiscal Year



Dependent Tax Credit
- Benefits to the Arizona Economy

- Dependent tax credit has the effect of increasing the disposable income for approximately 1 million taxpayers in the state
- The average credit claim is $144 per household
- All else equal, the credit may have a positive impact on the Arizona economy insofar as it results in higher consumer spending

Dependent Tax Credit
- Potential Performance Measures

- There are no performance measures for this credit

- Committee has not previously reviewed this credit as it was created in 2019 and its first review was scheduled for 2024.

Agricultural Pollution Control Tax Credit

December 4, 2024

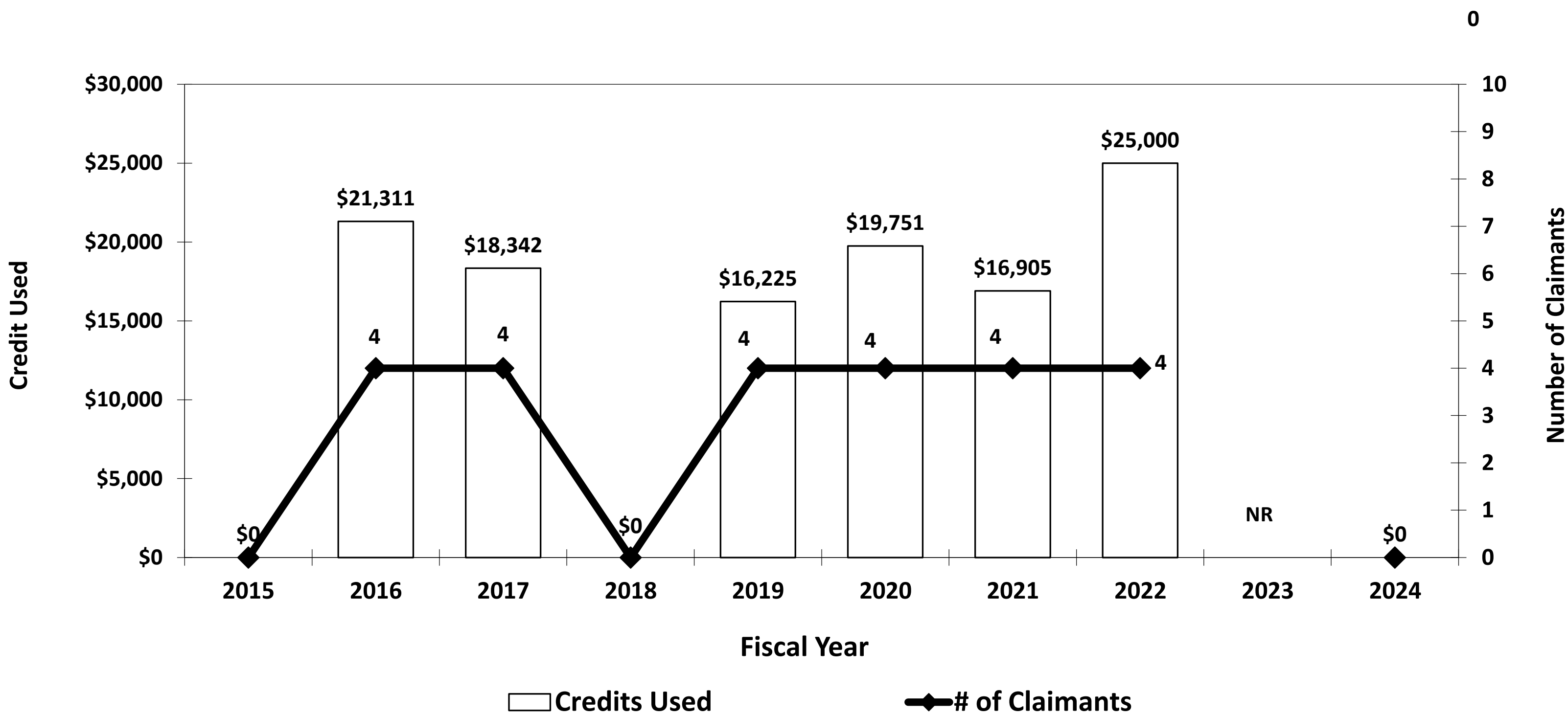
Agricultural Pollution Control Tax Credit
- Summary

- Cost – $0 in FY 2024 for the individual credit, as no claims were filed. The corporate credit was repealed in 2020.
- Purpose – to mitigate costs incurred by farmers and ranchers to comply with environmental regulations
- Complexity – simple to use and administer
- Performance Measures – none in statute

Agricultural Pollution Control Tax Credit
- Description of the Credit

- The credit is for expenses incurred to acquire agricultural pollution control equipment
- Example of equipment that may qualify for the credit is dust filters in cattle feed yards
- The credit is equal to 25% of the cost of equipment up to a maximum of $25,000
- Credit is nonrefundable
- Carry forward is 5 years

Agricultural Pollution Control Tax Credit
- Amount of Credits Used & Number of Claimants by Fiscal Year



NR = Data not releasable due to Arizona confidentiality laws

Agricultural Pollution Control Tax Credit
- Benefits to the Arizona Economy

- Credit may have a small positive impact on the environment insofar as it induces taxpayers to reduce pollution that would not occur in the absence of the credit

- However, the impact on the state's economy is likely negligible due to the limited use of the credit

Agricultural Pollution Control Tax Credit
- Potential Performance Measures

- Type of equipment purchased and its related environmental impact
- Number of other states where a taxpayer receives a comparable credit
- Last reviewed in 2019
- Committee recommended that the tax credit be eliminated

Agricultural Water Conservation Tax Credit

December 4, 2024

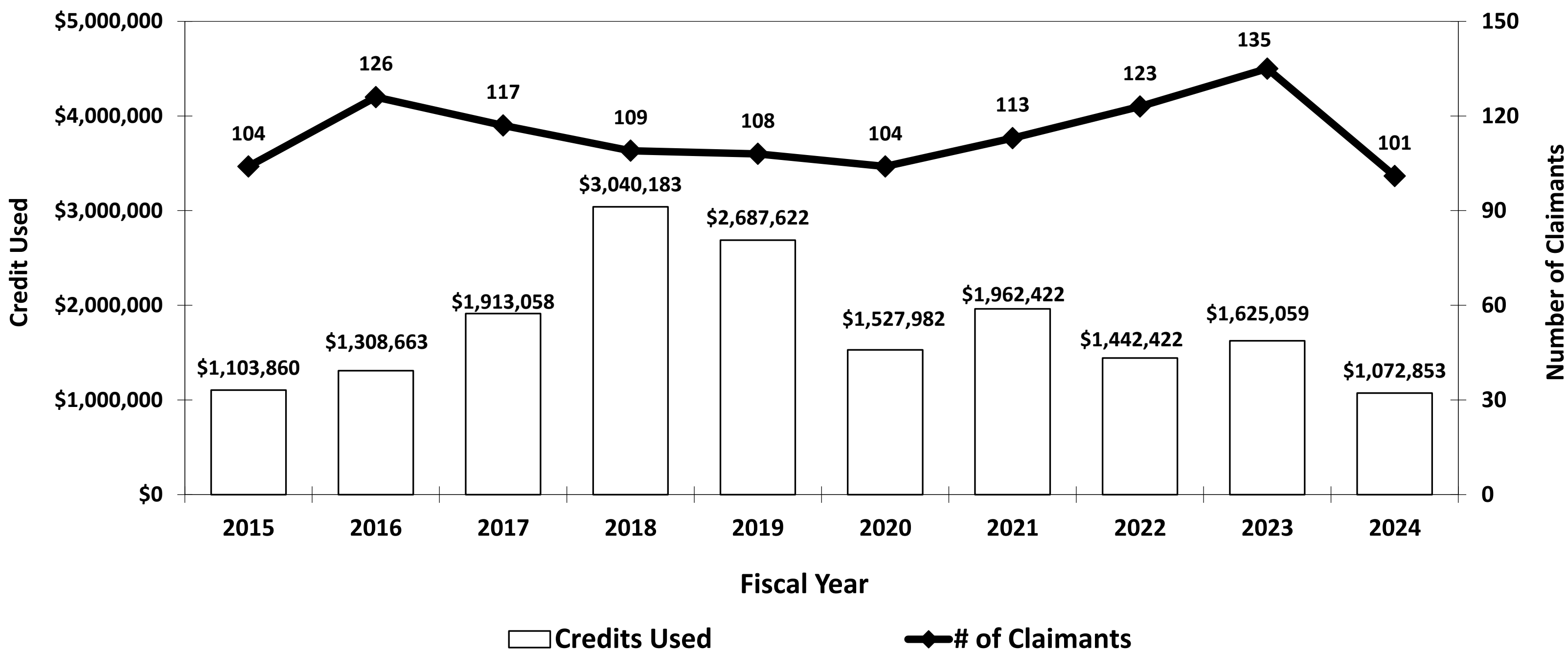
Agricultural Water Conservation Tax Credit
- Summary

- Cost – $1.1 million in FY 2024, claimed by 101 individual taxpayers. Corporate credit was repealed in 2000.
- Purpose – mitigate cost incurred by farmers and ranchers to comply with water conservation requirements under the 1980 Groundwater Management Code
- Complexity – simple to use and administer
- Performance Measures – none in statute

Agricultural Water Conservation Tax Credit
- Description of the Credit

- The credit is equal to 75% of expenses for the purchase and installation of an agricultural water conservation system. Credit is not capped.
- Examples of water conservation systems: sprinklers, pipes, water pumps, and computer aided irrigation and water management systems
- Taxpayer must have a conservation plan on file with the USDA to qualify for credit
- Credit is nonrefundable
- Carry forward is 5 years

Agricultural Water Conservation Tax Credit
- Amount of Credits Used & Number of Claimants by Fiscal Year



Agricultural Water Conservation Tax Credit
- Benefits to the Arizona Economy

- Credit may have a positive impact on the environment with reduced water usage that would not occur absent of the credit

- Credit may enhance Arizona's competitiveness relative to other states by reducing cost of production

- No data is available to quantify potential impact on the state's economy

Agricultural Water Conservation Tax Credit
- Potential Performance Measures

- A requirement to report on the reduction in water usage due to the installation of a qualified water conservation system
- Number of other states where a taxpayer receives a comparable credit
- Last reviewed in 2019
- Committee recommended that the performance measures be enacted into law, but there were no subsequent statutory changes.

Qualified Facility Tax Credit

December 4, 2024

Qualified Facility Credit
- Summary

- Cost – $51.5 million in FY 2024, claimed by 48 corporate taxpayers. Individual credit claims data in FY 2024 have not been released due to confidentiality.

- Purpose – expanding or locating a qualified facility in Arizona; create employment

- Complexity – moderate due to procedural requirements

- Performance Measures – none in statute

Qualified Facility Credit
- Description of the Credit

- A “qualified facility” is a building that dedicates 80% or more of its space for manufacturing, research and development, or headquarters
  - Minimum capital investment of $250,000 to locate or expand a qualified facility in Arizona
- Qualified facilities must create “qualified jobs”. Requirements include:
  - At least 51% of workers must be paid at least 125% of state median wage (100% in rural locations)
  - In FY 2025, the state median wage is $44,495 (125% is $55,744)
  - Company must offer to pay at least 65% of health insurance premiums for full-time workers
  - New hire must not have worked for the company within the last 12 months

Qualified Facility Credit
- Calculation of the Credit

- The credit is the lesser of:
  - 10% of the qualified facility capital investment
  - $20,000 per qualified job created at the facility if investment is under $2 billion
  - $30,000 per qualified job created at the facility if investment is over $2 billion
  - $30 million per taxpayer
- The credit is refundable
  - Can exceed taxpayer's liability
- The credit must be taken over 5 equal installments
- The credit is capped at $125 million per calendar year

Qualified Facility Credit
- Approval for credit

- Credit must be approved by the Arizona Commerce Authority (ACA)
- Projects are pre-approved on a first-come, first-served basis
- When a project is completed, ACA performs a review to verify the facility meets the requirements of the credit
- If the project is deemed eligible, the project receives post-approval and can receive the tax credit.

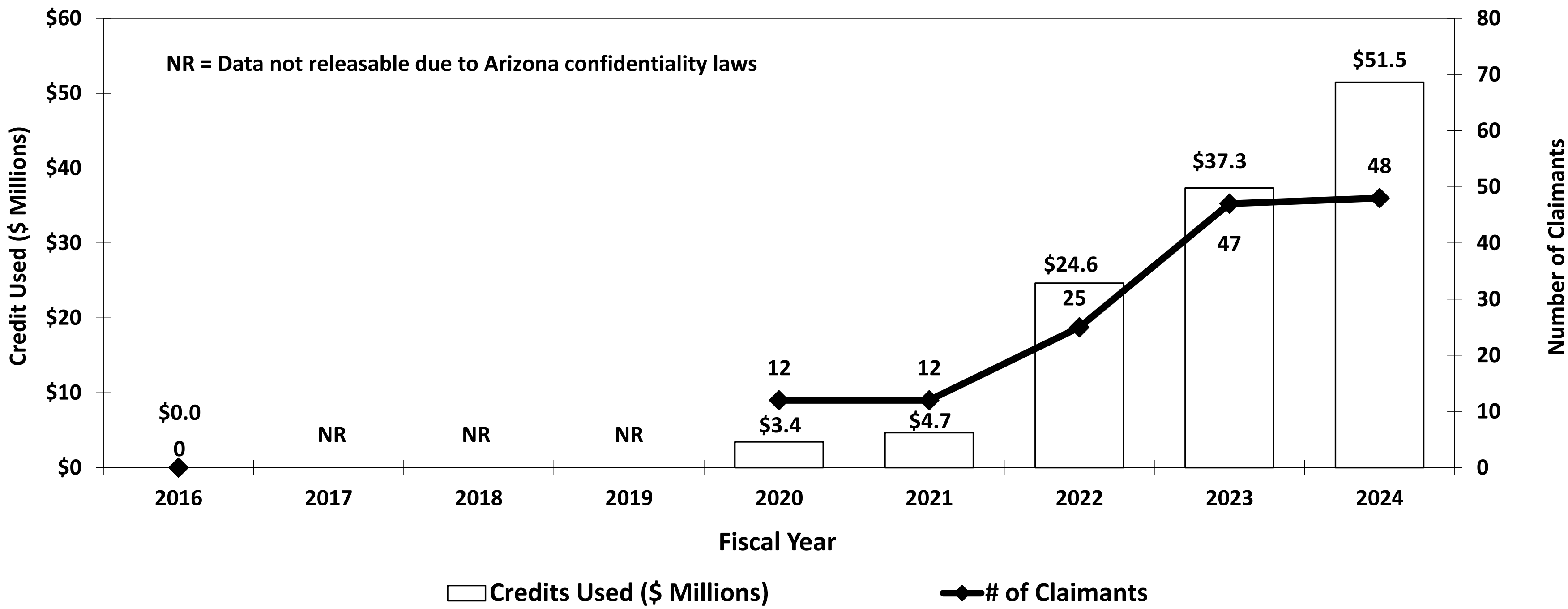
Qualified Facility Credit

- Legislative Changes Since the Last Review

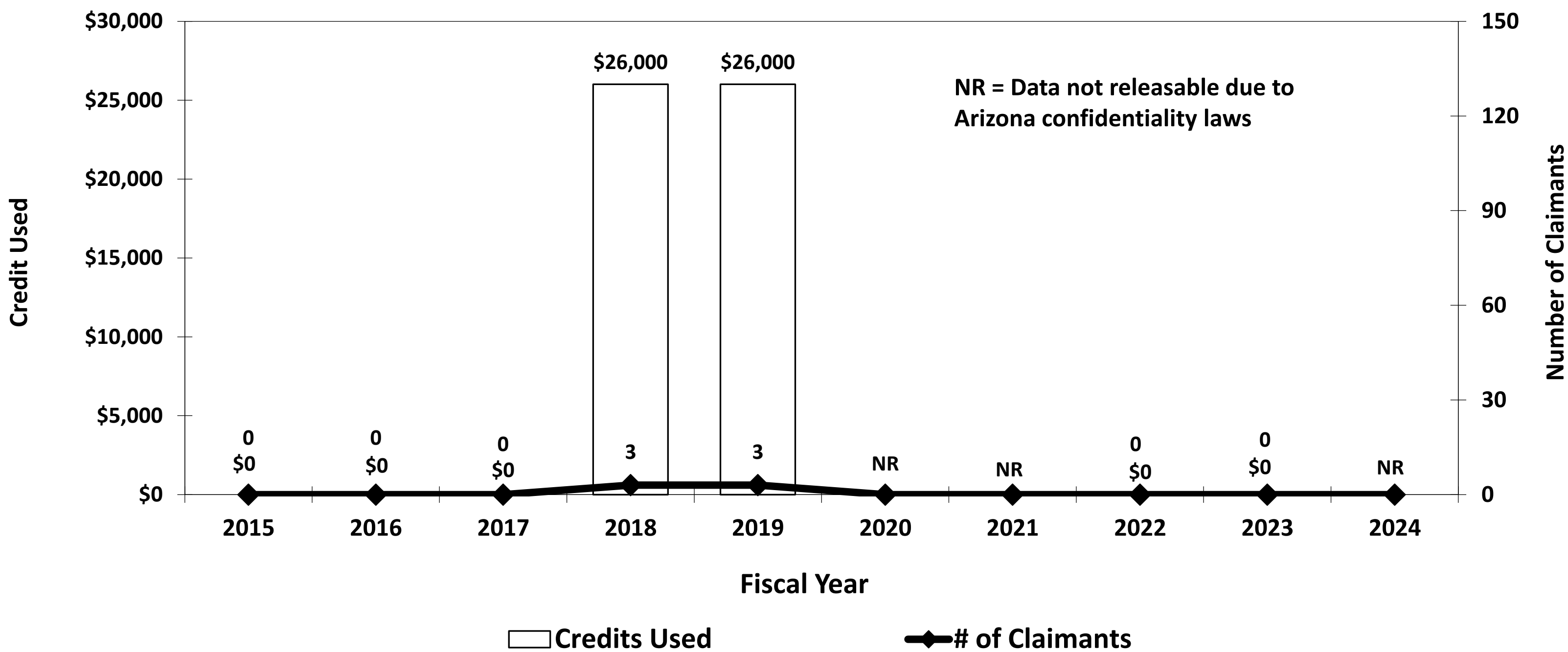
- Laws 2020, Chapter 7
  - Extended the repeal date from December 31, 2022 to December 31, 2030

- Laws 2021, Chapter 80
  - Increased the credit from $20,000 to $30,000 per net new job if total qualifying investment is $2 billion or greater
  - Increased the aggregate cap of the credit that can be pre-approved by ACA from $70 million to $125 million per calendar year
  - Expanded the statutory definition of “qualified manufacturing” to include products sold to other qualifying facilities regardless of whether these facilities have been pre-approved by the ACA

Qualified Facility Credit (Corporate)
- Amount of Credits Used & Number of Claimants by Fiscal Year



Qualified Facility Credit (Individual)
- Amount of Credits Used & Number of Claimants by Fiscal Year



Qualified Facility Credit
- Benefits to the Arizona Economy

- In CY 2023, 15 projects by 13 companies were post-approved by ACA, for a total of $123.8 million in credits

- Actual level of investments and job creation by these companies not reported

- We do not know how many of these 15 projects would have been undertaken absent the credit

Qualified Facility Credit
- Potential Performance Measures

- Number of new employees hired
- Total capital expenditures invested because of the credit
- Last reviewed in 2019
- Committee recommended these performance measures be enacted into law, but there were no subsequent statutory changes.

Credit for Renewable Energy Investment and Production for Self-Consumption by International Operation Centers

December 4, 2024

Renewable Energy for Self-Consumption Tax Credit
- Summary

- Cost – $0 for corporate credit in FY 2024, as no claims were made. Individual credit was repealed in 2019.
- Purpose – to reduce the carbon footprint by investing in and producing renewable energy for self-consumption
- Complexity – application, administration and approval process of credit appears relatively simple
- Performance Measures – none in statute

Renewable Energy for Self-Consumption Tax Credit
- Description of the Credit

- The credit is for investment in new renewable energy facilities that produce energy for self-consumption by an International Operations Center (IOC)

- To qualify as an IOC for the purpose of claiming the credit, the taxpayer must meet the following requirements:
  - Invest ≥ $100 million in renewable energy facilities by December 31, 2018
  - Invest ≥ $1.25 billion in new capital assets within 10 years of IOC certification (minimum annual capital investment is $100 million)
  - Use ≥ 51% of the energy produced for self-consumption by the 5th year the IOC is in operation

Renewable Energy for Self-Consumption Tax Credit
- Description of the Credit (continued)

- Credit amount is $5 million per year for 5 years for each renewable energy facility, for a total of $25 million
- However, regardless of the number of renewable energy facilities, no single taxpayer can receive more than $5 million per year, and $25 million in total over 5 years
- The maximum amount of credit approved for all taxpayers is $10 million per year
- No new credits can be claimed after December 31, 2025
- Only 1 company qualified for the credit before the statutory deadline of December 31, 2018
- Besides the renewable tax credit, there is also a sales tax exemption on electricity and natural gas purchased by an IOC

Renewable Energy for Self-Consumption Tax Credit
- Amount of Credits Used & Number of Claimants by Fiscal Year

- Only 1 company met the requirements to qualify for the credit by the statutory due date of 12/31/2018
- Due to Arizona confidentiality laws, DOR has not reported this company's actual credit use
- However, from available data, we can infer that this company claimed the credit for 5 years from FY 2019 through FY 2023
- DOR reported that there was no credit use in FY 2024

Renewable Energy for Self-Consumption Tax Credit
- Benefits to the Arizona Economy

- According to ACA's Annual Reports, ACA has certified 2 companies as IOCs (Apple and Microsoft)
- However, only Apple qualified for the tax credit by the due date of December 31, 2018. (Both Apple and Microsoft receive sales tax exemption on electricity and natural gas.)
- According to a 2015 news release, Apple promised to invest $2 billion over 10 years in a "command center," which would result in 150 full-time jobs and temporary 500 construction jobs
- JLBC Staff does not have the required data to determine to what extent these objectives have been met

Renewable Energy for Self-Consumption Tax Credit

- Potential Performance Measures

- A requirement to report on:
  - Number of net new jobs created by the IOC
  - Percentage of electricity generated that is used for self-consumption by the IOC
- Committee reviewed this credit in 2019, and recommended that the credit be retained

Private School Tuition Organization (STO) Displaced/Disabled Pupil Scholarship Credit

December 4, 2024

Private STO Displaced/Disabled Credit
- Summary

- Cost – $7.9 million in credits claimed in FY 2024
  - Exceeds $6.0 million cap due to timing issue
- Purpose – assist parents with the cost of private school tuition for displaced or disabled pupils
- Complexity – simple to use for donors. Administration, reporting, and oversight are time-consuming for STOs and DOR because of the number of students and STOs and data quality issues
- Performance Measures – none in statute

Private STO Displaced/Disabled Credit
- Description of Credit

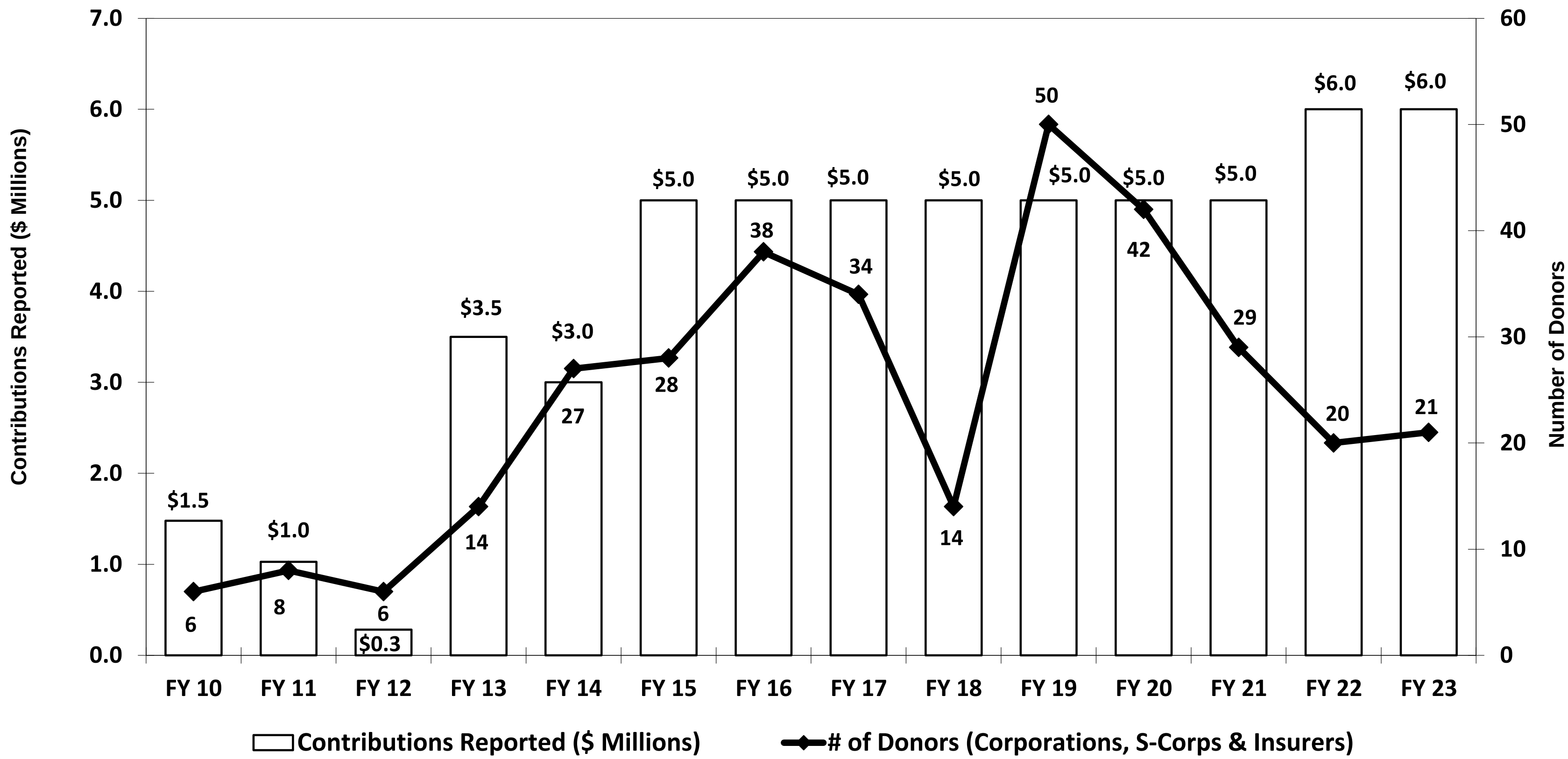
- Corporate, individual (S-corporation) and insurance premium income tax credit for contributions to a school tuition organization (STO):
  - Charitable organization exempt from federal taxes
  - Awards 90% of tax credit revenue for scholarships and grants
- Maximum credit allowed is $6.0 million statewide:
  - No separate maximum for corporations, individuals (S-corporations), or insurers
  - DOR must preapprove credits
  - Cap reached for the first time in FY 2015 and annually thereafter
  - Cost can exceed cap on a fiscal year basis because credits are claimed on a tax year basis
- 11 STOs received contributions in FY 2023

Private STO Displaced/Disabled Credit
- Related STO Credits

Three other STO tax credits exist (none under review this year):

- Corporate and insurer “low-income pupil scholarship” credit
  - Scholarships for low-income pupils
- Individual “original” STO credit
  - Scholarships for private school students (not restricted to low income or displaced/disabled)
- Individual “switcher” STO credit
  - Scholarships mainly for pupils who switch to private schools
  - Donor must first take maximum “original” STO credit

Private STO Displaced/Disabled Credit
- In FY 2023, Average Contribution Was $285,700



Private STO Displaced/Disabled Credit
- Impact on State Revenues

- $6.0 million in donations would result in $(6.0) million state revenue loss if all donations resulted in credits
- Amount and timing of credits is uncertain because one tax year can cover 4 fiscal years
- Additionally, credits may be carried forward for 5 years
- Credit amount claimed during FY 2024 was $7,892,300
  - $2,149,800 for corporations
  - $299,100 for individuals (S-corporations)
  - $5,443,400 for insurers

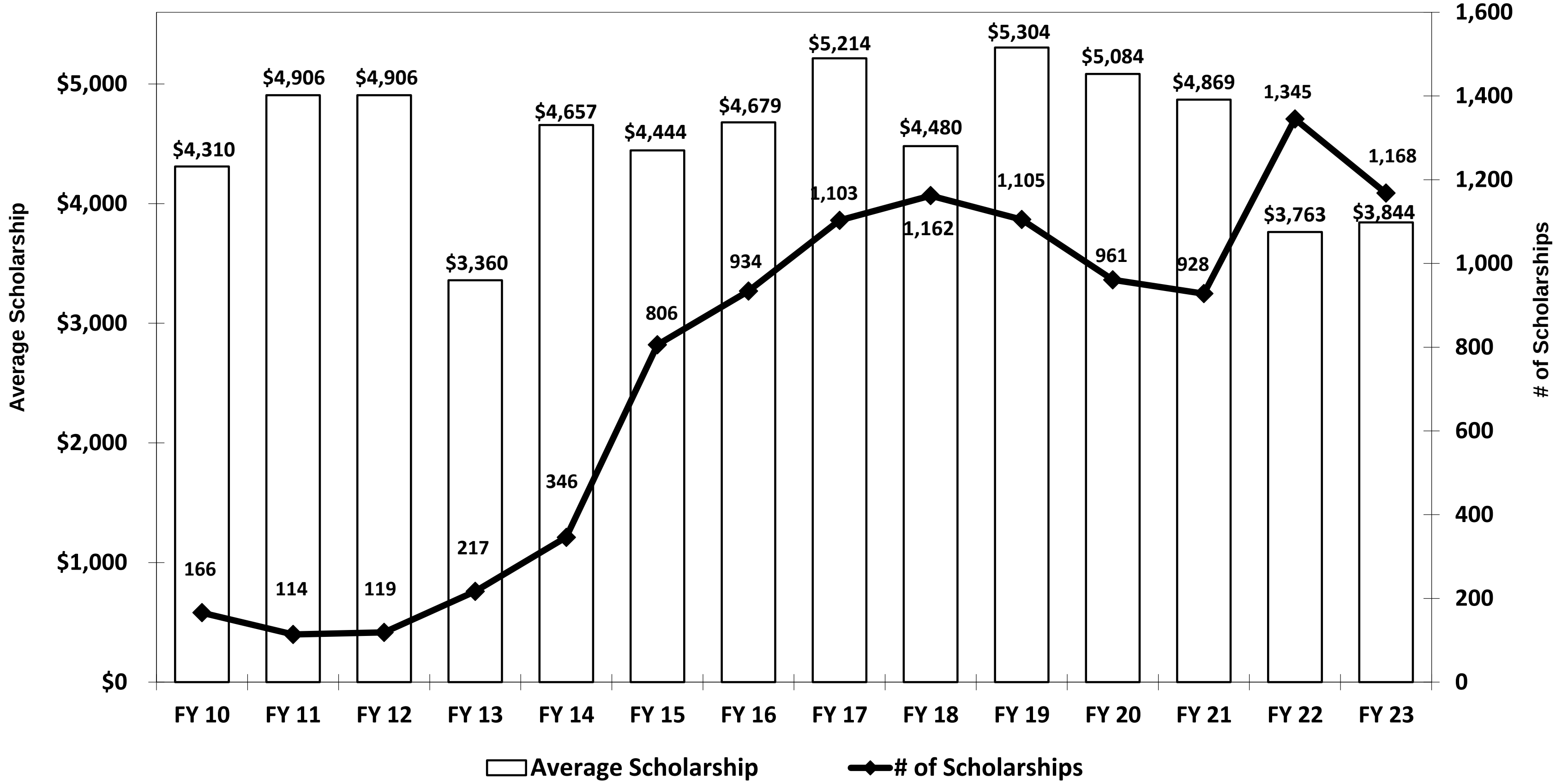
Private STO Displaced/Disabled Credit
- Impact on State K-12 Costs

- Credit may result in foregone General Fund spending to the extent that STO-funded scholarships result in reduced public school enrollment.

- We are unable, however, to determine whether or how many additional students would have attended public schools instead of private schools without a STO scholarship.

Private STO Displaced/Disabled Credit

- In FY 2023, 1,168 scholarship awarded (average = $3,844)



Private STO Displaced/Disabled Credit
- Potential Performance Measures

- Percent of STO revenues retained for administrative costs

- Percent of private school tuition paid for with award funding