Tax Incentive Reporting

Evaluation of Agency Compliance with Act 191 of the 2013 Regular Session

Financial Audit Services
Issued October 3, 2018

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LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA

October 3, 2018

The Honorable John A. Alario, Jr.,
President of the Senate
The Honorable Taylor F. Barras,
Speaker of the House of Representatives

Dear Senator Alario and Representative Barras:

This report provides our evaluation of agency compliance with Act 191 of the 2013 Regular Session. This Act requires, in part, that agencies annually report to the Legislature the return on investment for their tax incentives and whether these incentives met their intended purposes. Our objective was to determine if state agencies that administer tax incentives are complying with the reporting requirements outlined in Act 191 of the 2013 Regular Session.

I hope this report will benefit you in your legislative and operational decision-making processes.

Sincerely,

Daryl G. Purpera, CPA, CFE
Legislative Auditor

EMS:BQD:EFS:aa

ACT 191 EVALUATION

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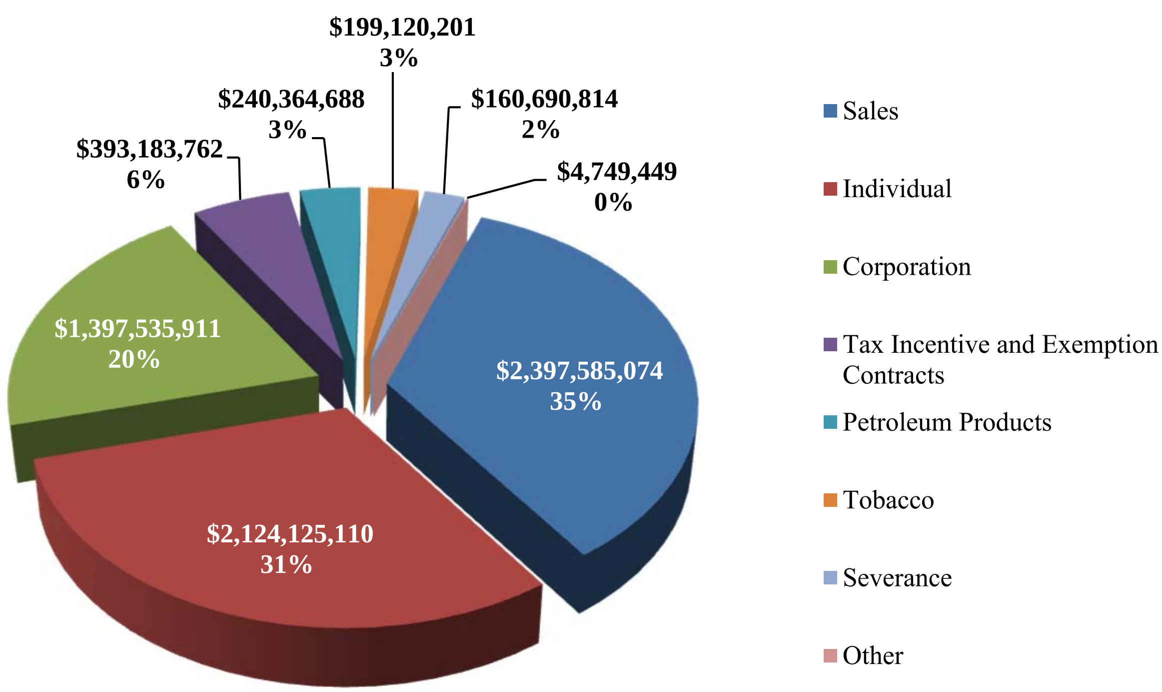
Introduction

The Tax Exemption Budget (TEB)[1] published on March 12, 2018, reported a $6.9 billion total tax revenue loss for fiscal year 2017. Represented within the report are exemptions, including those classified as credits, rebates, exclusions, and deductions, claimed by taxpayers to decrease their tax liability to the state; thereby, decreasing state tax collections.

Exhibit 1:
Fiscal Year 2017 Tax Exemption Budget
Total Tax Revenue Loss - $6,917,355,009

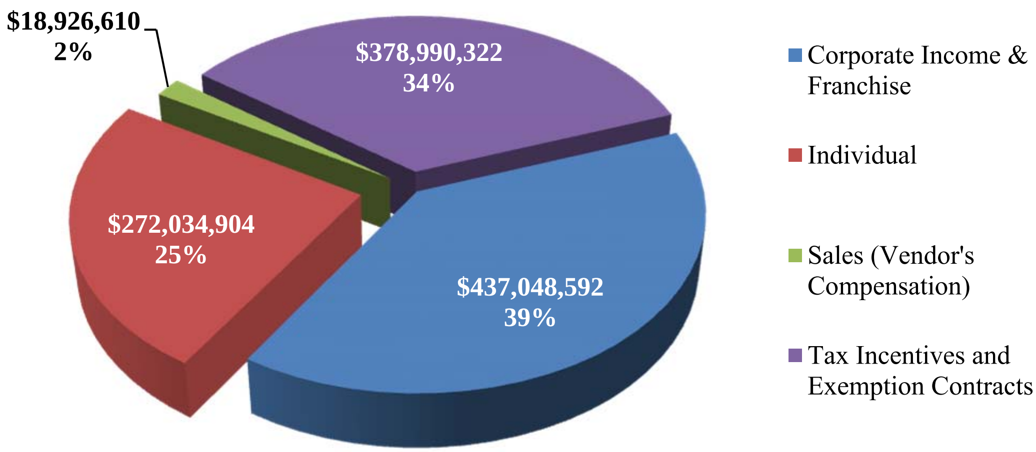


Source: Prepared by LLA using the 2017-2018 Tax Exemption Budget

[1] Louisiana Revised Statute 47:1517 requires the Louisiana Department of Revenue (LDR) to prepare an annual tax exemption budget documenting information on the effects of each exemption, deduction, exclusion, and credit allowed by the state's tax laws.

Tax incentives (tax credits and rebates) resulted in a reported $1.1 billion loss in tax revenues to the State of Louisiana for the fiscal year ended June 30, 2017.[2] Exhibit 2 presents a breakdown, by type, of those tax incentives reported in the 2017-2018 TEB.

Exhibit 2:
FY17 Composition of $1.1 Billion in Tax Incentives



Source: Prepared by LLA using the 2017-2018 Tax Exemption Budget

Act 191 of the 2013 Regular Session (Act 191) was enacted to provide the Legislature with accurate and complete information on how much tax incentives cost the state each year. This Act required state agencies administering tax incentives to report to the Legislature, by March 1st of each year, information regarding whether or not the incentive met its intended purpose; whether or not the state received a positive return on investment (ROI) through the incentive; and whether or not there were any unintended effects, benefits, or harm caused by each incentive, including any conflicts with other state laws or regulations. Act 191 also required the House Committee on Ways and Means and the Senate Committee on Revenue and Fiscal Affairs to conduct hearings on the reports every odd-numbered year to "analyze and consider tax incentives that have caused revenue loss to the state in any one of the three previous fiscal years." The committees may report to the Legislature findings or recommendations determined through these hearings.

Act 87 of the 2018 Regular Session (Act 87) amended the reporting requirements of the Act 191 effective May 10, 2018. Agencies must now report to the Legislature, the House Committee on Appropriations, and the Senate Committee on Finance by April 1 of every even-numbered year to correspond with the fiscal sessions of the legislature. In addition, agencies administering tax incentives with job creation requirements are now required to include the number of employees hired with a Louisiana driver's license. This requirement was added to enable the Legislature to evaluate how well the incentives intended to bring jobs to Louisiana are meeting their purpose. Also, beginning in 2020, the Louisiana Department of Revenue (LDR) will be required to

[2] 2017-2018 Tax Exemption Budget prepared by LDR (unaudited).

perform a separate, comprehensive return on investment analysis for all tax incentives with a revenue loss of $1 million or more in the previous fiscal year. This change shifts the burden of reporting ROI exclusively to LDR.

This is our third report evaluating agency compliance with Act 191 of the 2013 Regular Session. Our last report, issued September 14, 2016, found that 46 (58%) of the 79 reports due to the Legislature for 2016 were either not submitted or did not comply with all of the reporting requirements. Using the 2017-2018 TEB, we identified 78 tax incentives administered by five agencies that are subject to the reporting requirements of Act 191. The reduction in the number of incentives reported in the TEB in 2017 is due to the repeal of the Vehicle Alternative Fuel Usage Credit.

Exhibit 3:
Agencies Administering Tax Incentives

Agency	Number of Incentives
Department of Revenue (LDR)	47
Louisiana Economic Development (LED)	20
Department of Education (DOE)	6
Department of Culture, Recreation, and Tourism (CRT)	3
Department of Environmental Quality (DEQ)	2
Total	**78**

Source: Prepared by LLA using the 2017-2018 Tax Exemption Budget prepared by LDR

We reviewed the tax incentive reports submitted to the Legislature for fiscal year 2017 to address the following objective:

Evaluate state agency compliance with the tax incentive reporting requirements outlined in Act 191 of the 2013 Regular Session.

We found 25 (32%) of the 78 tax incentive reports that agencies were required to submit to the Legislature by March 1, 2018, did not comply with all of the reporting requirements. Specifically, the reports for 25 incentives claimed by taxpayers in fiscal year 2017, which resulted in a revenue loss of approximately $127 million, did not include whether or not the state received a positive return on investment through the incentive. As a result, the legislative committees charged with making decisions to revise or eliminate costly incentive programs continue to lack critical information necessary to make key decisions.

Appendix A contains agencies' responses; Appendix B provides our scope and methodology; and Appendix C provides a complete list of tax incentives administered by each agency, including their associated revenue losses as reported in the 2017-2018 TEB for fiscal years 2015, 2016, and 2017.

Objective: Evaluate state agency compliance with the tax incentive reporting requirements outlined in Act 191 of the 2013 Regular Session.

We found that three of the five administering agencies (LDR, LED, and DEQ) failed to comply with certain requirements of Act 191 of the 2013 Regular Session. Specifically, the reports for 25 incentives claimed by taxpayers in fiscal year 2017, which resulted in a revenue loss of approximately $127 million, did not include whether or not the state received a positive return on investment through the incentive. As a result, the legislative committees charged with making decisions to revise or eliminate costly incentive programs continue to lack critical information necessary to make key decisions.

The results of our work, including a summary of the information contained in the fiscal year 2017 reports relating to the timely submission, return on investment, purpose/benefits, and unintended effects of the tax incentives, are described in more detail below.

Of the 78 tax incentive reports agencies were required to submit to the Legislature, eight (10%) reports were not submitted, and 25 (32%) reports were considered noncompliant as they did not include return on investment data.

Of the 78 reports, 70 (90%) were submitted by April 2, 2018, which we considered timely. Exhibit 4 lists the eight incentive reports that were not submitted during fiscal year 2017. We did not consider these reports noncompliant since the incentive had minimal or no activity during the fiscal year.

Exhibit 4: Reports Not Submitted Fiscal Year 2017
LED – Atchafalaya Trace Heritage Area Development Zone Tax Exemption
LED – Corporate Headquarters Relocation Program
LED – Corporate Tax Apportionment Program
LED – Louisiana Community Economic Development
LED – Mentor-Protégé Tax Credit
LED – Technology Commercialization Credit and Jobs Program
LED – University Research and Development Parks
LED – Urban Revitalization Tax Incentive Program
Source: Prepared by LLA using the 2017-2018 TEB and reports submitted to the House Committee on Ways and Means and the Senate Committee on Revenue and Fiscal Affairs.

Of the 70 tax incentive reports agencies submitted to the Legislature, 25 (36%) did not include whether or not the state received a positive return on investment through the incentive; however, all other requirements were met. Exhibit 5 shows a breakdown of each agency's overall compliance with Act 191 requirements.

Exhibit 5: Agency Compliance					
		Act 191 Requirements			
Agency	**Total Tax Incentive Reports Submitted**	**Timely Submission**	**Purpose/ Beneficiaries**	**Return on Investment***	**Unintended Effects+**
LDR	47	47	47	27	47
LED	12	12	12	8	12
CRT	3	3	3	3	3
DEQ	2	2	2	1	2
DOE	6	6	6	6	6
Total	**70**	**70**	**70**	**45**	**70**

*ROI data was reported for 22 incentives (8 LDR, 5 LED, 2 CRT, 1 DEQ, and 6 DOE) - the other 23 (19 LDR, 3 LED, and 1 CRT) reports listed as compliant were for incentives with no 2017 activity.
+Reports are considered compliant even if the agency reported "none identified" or had no activity. Fifty-four reports – 39 LDR, 12 LED, 1 CRT, 1 DOE, and 1 DEQ – included a "none identified" response for this requirement or had no activity.

Of the 70 reports submitted, 23 had no activity in fiscal year 2017; therefore, no ROI could be calculated, and 25 did not include ROI data. The 22 incentive reports that were submitted with ROI data represent 89% of the total revenue loss during fiscal year 2017.

Exhibit 6 provides a summary of the calculated return and the basis of that calculation for every $1 provided in incentives in fiscal year 2017 for the 22 incentives that reported ROI. In Exhibit 6, the blue shaded incentives represent ROI rates below a dollar for dollar return, or a negative return on investment for the state and those with no reported ROI.

Exhibit 6: Reported Return on Investment by Basis			
Agency	**Tax Incentive**	**FY17 Revenue Loss**	**FY17 ROI**
Based on Certified Spending			
DEQ	Purchase of Qualified Recycling Equipment	$255,209	$5.00
Based on Federal Grants			
DOE	School Readiness Child Care Directors and Staff	$8,895,807	$0.73▲
DOE	School Readiness Child Care Provider	$4,985,128	$0.73▲
DOE	School Readiness Child Care	$2,356,523	$0.73▲
DOE	School Readiness Fees and Grants to Resource and Referral Agencies	$884,256	$0.73▲
DOE	School Readiness Business Supported Child Care	$474,465	$0.73▲
Based on Direct Investment			
CRT	Rehabilitation of Historic Structures	$91,902,642	$5.37
CRT	Rehabilitation of an Owner Occupied Residential or Mixed-use Property	$354,368	$13.49
Based on Estimated Revenue Generated[α] as a Result of the Incentive Program			
LED	Louisiana Quality Jobs Program	$99,342,295	$1.96
LED	Enterprise Zones	$41,081,153	$1.18
Based on New State Tax Revenue			
LED	Motion Picture Investor Tax Credit	$205,833,457	$0.22*
LDR	Solar Energy System	$16,832,096	$0.07
LED	Musical and Theatrical Production Tax Credit[3]	$6,100,794	$0.13/$0.18*
LED	Sound Recording Investor Tax Credit	$81,550	$0.00*
Issuing of Student Scholarships			
DOE	Tuition Donation Rebate Program	$3,139,789	$1.15
Regional Economic Models, Inc. (REMI) Simulations – No Calculated Return			
LDR	Inventory Tax/Ad Valorem Tax	$312,699,545	N/A
LDR	Ad Valorem Tax on Offshore Vessels	$54,676,999	N/A
LDR	Ad Valorem Tax Paid by Certain Telephone Companies	$13,927,894	N/A
LDR	LA Citizens Property Insurance Corporation Assessment	$11,702,340	N/A
No Calculated Return			
LDR	Earned Income Tax Credit	$47,462,414	N/A
LDR	Insurance Company Premium Tax	$40,274,162	N/A
LDR	Certain Child Care Expenses	$16,623,173	N/A
	Total	**$979,886,059**	

[α]Revenue generated as a result of the incentive program can include direct payroll spending, purchases of goods from Louisiana businesses and services, new capital investment in Louisiana business facilities, and indirect activity generated as a result of the direct spending
*Based on FY16 analysis
▲Auditor calculated using information provided in the Act 191 reports submitted by DOE.
Source: Prepared by LLA using reports submitted to the House Committee on Ways and Means and the Senate Committee on Revenue and Fiscal Affairs and the 2017-2018 Tax Exemption Budget prepared by LDR.

[3] Using data provided by LED, we calculated a return per dollar of tax credit for live performance production ($0.13) and live performance infrastructure ($0.18).

Only five incentives with no calculated/reported ROI would reasonably be expected to have a related ROI. According to LDR, not all tax credits are intended to provide a return of revenue to the state but may still have some other type of immeasurable return, such as to ensure Louisiana is competitive from a business friendly perspective or to offer appropriate assistance to Louisiana citizens. For these credits, a return on investment analysis would not be appropriate. LDR stated that, when analyzing the credits, legislative intent and purpose should be considered in determining whether or not the credit is successful.

As seen in Exhibit 6, for some of these programs (7 in total), LDR submitted data related to the effects of the credit on the state but was not able to calculate an ROI (See Exhibit 6, "Regional Economic Models, Inc. (REMI) Simulations – No Calculated Return" and "No Calculated Return"). Per LDR, these programs were not created to generate a return for the state. See Exhibit 7 for the stated purpose of these seven incentives, along with the 25 incentives with no reported ROI data by the administering agencies. The blue shaded incentives are those that would reasonably be expected to have a related ROI. The bolded incentives represent those with reported ROI, but no calculated return.

Although we recognize that many incentives are not created with the intent to return revenue to the state, each report should state if there is no positive return and why. Other relevant information should be provided to evaluate the success of the incentive at meeting its intended purpose.

Exhibit 7 - Intended Purpose of Incentives with No Calculated/Reported ROI			
Incentive	**Purpose**	**FY 2017 Revenue Loss**	**Investment?**
Inventory Tax/Ad Valorem Tax	**To reimburse taxpayers for property taxes paid on inventory to local governments**	**$312,699,545**	**No**
Net Income Taxes Paid to Other States	To allow an offset for taxes paid to other states when an individual taxpayer has tax liabilities in more than one state	$56,377,492	No
Ad Valorem Tax on Offshore Vessels	**To reimburse industry for local taxes paid**	**$54,676,999**	**No**
Earned Income Tax Credit	**To incentivize employment**	**$47,462,414**	**No**
Insurance Company Premium Tax	**To provide an offset for the premium taxes paid by insurance companies**	**$40,274,162**	**No**
Vendor's Compensation	To compensate dealers in accounting for and remitting the sales tax levied	$18,926,610	No
Certain Childcare Expenses	**To encourage employment for persons with dependent children**	**$16,623,173**	**No**
Ad Valorem Tax paid by Certain Telephone Companies	**To ensure that tax expenses at the telephone company level are not passed along to consumers through a rate increase**	**$13,927,894**	**No**
LA Citizens Property Insurance Corporation Assessment	**To reimburse residential and commercial policyholders for fees passed along to them for disaster losses by affected insurance companies**	**$11,702,340**	**No**
Digital Interactive Media and Software Tax Credit	Production of new revenue for the state	$9,885,415	Yes
Education	To assist taxpayers with education expenses	$9,358,176	No
Ad Valorem Tax on Natural Gas	To ensure that tax expenses at the business level are not passed along to consumers through a rate increase	$6,138,905	No
Research and Development Tax Credit	Production of new revenue for the state	$5,386,914	Yes
Procurement Processing Company Rebate Program	Production of new revenue for the state	$4,211,331	Yes
Conversion of Vehicles to Alternative Fuel	To provide an incentive to persons or coporations to invest in qualified clean burning motor vehicle fuel property	$3,940,449	No
Retention and Modernization Credit	Production of new revenue for the state	$3,643,558	Yes
Certain Disabilities	To offer state assistance by reducing the tax burden of those persons with certain disabilities	$1,963,019	No
Angel Investor Tax Credit Program	Production of new revenue for the state	$1,535,732	Yes
New Markets Tax Credit	To encourage and attract private sector qualified equity investment in a qualified community development entity in the state	$1,459,027	No

Exhibit 7 - Intended Purpose of Incentives with No Calculated/Reported ROI (Cont.)			
Incentive	**Purpose**	**FY 2017 Revenue Loss**	**Investment?**
Contribution of Tangible Personal Property of Sophisticated and Technological Nature to Educational Institutions	To provide an incentive to corporations, persons, estates, and trusts to contribute or donate, or sell below cost tangible movable property to public educational institutions for purposes of research, research training, or direct education of students in the state	$1,204,784	No
Milk Producers	To assist the milk industry within the state by providing a credit when the price of milk falls below a certain amount	$886,942	No
Special Allowable Credits	To allow a portion of the federal credits to be applied against the state tax liability	$745,426	No
New Jobs	To encourage the employment of individuals that qualify as economically disadvantaged or is a resident of a neighborhood with an unemployment rate of 10 percent or more	$546,393	No
Small-town Doctors/Dentist	To encourage eligible medical professionals to locate in small, underserved towns	$455,108	No
Amounts Paid by Certain Military Service Members for Obtaining Louisiana Hunting & Fishing Licenses	To allow certain military service members to receive the licenses free by providing them a credit for the amount paid without reducing self-generated revenues of the Department of Wildlife and Fisheries	$112,184	No
Educational Expenses Incurred for Degree Related to Law Enforcement	To encourage further education for certain employees in law enforcement	$18,112	No
Brownfields Investor Tax Credit	To encourage voluntary remediation of brownfields sites	$17,652	No
Purchase of Bulletproof Vest	To alleviate the cost associated with performing law enforcement duties	$16,933	No
Living Organ Donation Credit	To alleviate the travel cost or costs of work absence associated with donating organs	$11,341	No
Donations to Public Elementary or Secondary Schools	To encourage donation of immovable property to a public school immediately adjacent or contiguous to the property	$11,016	No
Employment-related Expense for Maintaining Household for Certain Disabled Dependents	To provide some relief to taxpayers who incur such extraordinary expenses	$10,387	No
Apprenticeship	REPEALED	$194,387	REPEALED
Bolded incentives represent those with reported ROI data but no calculated return **Source:** Prepared by LLA using information provided by LDR.			

For the 22 reports that did present ROI information, we found that various methodologies were used to calculate the state's ROI across five reporting agencies. A description of these methodologies is as follows:

- Based on Certified Spending - calculated using certified spending in the state divided by the fiscal year revenue loss. Certified spending in the state is the total of qualified expenditures, usually verified by a CPA, certified by the administering agency of each tax incentive. Each credit has specific requirements defined within the applicable statutes, as listed in Appendix C. The administering agency preparing the calculation of return on investment using the certified spending basis should be able to support the total expenditures used with detailed certified expenditure reports.

- Based on Federal Grants - The ROI from incentives administered by DOE was calculated by dividing the amount of tax credits used as state match for federal funds by the fiscal year revenue loss.

- Based on Direct Investment - The ROI from incentives administered by CRT was calculated using direct investment in income-producing buildings, which is defined as the eligible costs and expenses incurred during the rehabilitation of certain historic structures. For example, eligible costs and expenses for the Rehabilitation of Historic Structures tax credit are defined in Section 47c(2)(A) of the Internal Revenue Code of 1986. Taxpayers must submit an application to CRT and the credit is earned as a percentage of the eligible costs and expenses.

- Based on Estimated Revenue Generated as a Result of the Incentive Program - calculated using state revenue generated as a result of the tax incentive program divided by the fiscal year revenue loss. State revenue generated can include direct payroll spending, purchases of goods from Louisiana businesses and services, new capital investment in Louisiana business facilities, and indirect activity generated as a result of the direct spending.

- Based on New State Tax Revenue - calculated using actual new state tax revenue divided by the fiscal year revenue loss associated with certified credits.

- Based on Issuing of Student Scholarships - The ROI from the incentive administered by DOE was calculated using the amount of student scholarships issued as a result of the rebate.

- Regional Economic Models, Inc. (REMI) Simulations - No Calculated Return - Several reports include additional information in the return on investment section from simulations performed in REMI Tax-PI+. This model "captures the direct, indirect, and induced fiscal and economic effects of taxation and other policy changes over multiple years." Simulations are performed by creating custom scenarios of tax changes and comparing to a direct, baseline model of the state budget. REMI uses forecasts to trace out the effects of policy changes over time and takes into account more complicated aspects of economic impact, such as inflation, cost-effects, etc. The simulations were used to estimate the effects of eliminating the credits and using the money to either fund a sales tax decrease or reduce state spending and to estimate the effects of certain industries leaving the state as a result of eliminating the credits.

- No Calculated Return - The ROI portion of the reports include information on the state's investment; however, no return on investment is calculated and the additional information provided is not sufficient to calculate a return.

There are no specifications in the statutes regarding the method of calculation to be used in determining the ROI related to each incentive. With no guidelines or restrictions, the accuracy of the ROI calculation and the appropriateness of the methodology used cannot readily be determined. Many of the reports appear to focus on the overall impact to the state's economy rather than the direct revenue received by the state as a result of the credit. For example, total certified spending reported as part of a program inflates the ROI related to the program. Though many incentives are created with economic development in mind, the activity generated by the program such as new sales is not equivalent to the actual state revenue generated by the program.

A good example of the variation that can be produced by using different methods of calculating ROI is the Motion Picture Investor tax credit. In *The Economic Impact of Louisiana's Entertainment Tax Credit Programs for Film, Live Performance, and Sound Recording* report, the return on investment is not calculated. Instead, the report explains various ways of evaluating the benefit to the state, such as sales per dollar of tax credit, reported as $4.56. The report also discloses that according to the Legislative Fiscal Office, for every new dollar in household income, the state only receives 7 cents in new revenue. LED management represented that the return on investment should be calculated by using taxes received by the state as compared to the certified tax credits. This calculation results in a $0.22 ROI, or 22 cents in tax revenue for every dollar of credits certified.

Unintended effects were identified for 16 tax incentives.

The tax incentives established by Louisiana Revised Statutes are designed and intended to support development in certain industries or limit the tax burden on specific individuals or endeavors. Certain side effects of a tax credit may not be foreseen when established by the Legislature and may result in a negative impact to the state. It is also important for any conflicts with laws and regulations to be reported to the Legislature.

Most of the reports stated that no inadvertent effects or legal conflicts had been identified; however, 16 reports included unintended side effects. Some included unintended benefits such as the ability to use incentives to help meet maintenance of effort requirements for certain federal programs; increased access to recycling services; reduced financial strain on elderly, disabled, students, and parents of dependent children; and parents choosing higher quality care for their children.

Unintended negative effects were reported in eight of the fiscal year 2017 reports, as summarized in Exhibit 8. Reporting negative side effects allows the Legislature to evaluate the tax incentives and applicable statutes to eliminate or reduce the unintended negative impact on the state, which could include additional revenue loss due to unintended beneficiaries.

Exhibit 8 - Unintended Negative Effects of Certain Tax Incentives

Tax Credit	Unintended Negative Effects
Ad Valorem Tax Credit for Offshore Vessels	LDR reported that since the state allows the refundable credit, there is no incentive for taxpayers to criticize a property assessment which could cause the assessment amounts to become inflated.
Inventory Tax/Ad Valorem Tax	LDR reported that since the state allows the refundable credit, there is no incentive for taxpayers to criticize a property assessment which could cause the assessment amounts to become inflated.
Earned Income Tax Credit	LDR reported that the IRS estimates that approximately $12 million per year (21%-26%) of refund claims are paid in error due to fraud and the complexity of tax rules.
LA Citizens Property Insurance Corporation Assessment	LDR reported that it is assumed that Higher Education and Healthcare bore the burden of the reduced state revenues/spending reduction as a result of the tax credit.
Net Income Taxes Paid to Other States	LDR reported that prior to Act 109 of 2015, the credit subsidized residents who earned income in a state with high income taxes. Act 109 limits the credit to the amount of tax that would have been imposed if the income earned in the other state had been earned in Louisiana. After July 1, 2018, the state is scheduled to return to the subsidy.
Solar Energy System	LDR reported that since more than 80% of the corporate tax credits have been given to corporations with no taxable income, taxpayers have been subsidizing corporations, and there has been income redistribution toward the wealthy.
Rehabilitation of an Owner Occupied Residential or Mixed-use Property	CRT reported that the program is extremely labor intensive for the relatively small tax incentives staff.
Rehabilitation of Historic Structures	CRT reported that the overwhelming response to the program has led to an inability of allocated staff to keep up with the program demand.

Source: Tax incentive reports submitted by LDR and CRT for fiscal year 2017.

Recommendation: LDR should establish a method of data collection and tracking in order to maintain the financial data and statistics required for economists to evaluate the ROI of the incentive programs in the state. Reports of ROI should specifically identify new revenue to the state produced by the program and should include a clear definition of the calculation of the ROI. Those incentive programs not created with the purpose of creating new revenue for the state should be identified and any qualitative effects of the program should be presented separately from the ROI.

Summary of LDR Response: LDR concurs with LLA's recommendation and recognizes the importance of reporting accurate and complete information to the Legislature. The agency outlined its plan to further develop and improve incentive reporting in future years.

Summary of LED Response: LED agrees that not all credits are designed to have a short-term positive revenue to the state and further explains the uniqueness of Economic Development tax credits.

APPENDIX A – MANAGEMENTS' RESPONSES

State of Louisiana
Department of Revenue

JOHN BEL EDWARDS
Governor

KIMBERLY LEWIS ROBINSON
Secretary

September 21, 2018

Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
P.O. Box 94397
Baton Rouge, LA 70804

RE: Management Response to "Tax Incentive Reporting – Evaluation of Agency Compliance with Act 191 of the 2013 Regular Session"

Dear Mr. Purpera:

Act 191 of the 2013 Regular Session mandated that each state agency responsible for administering a tax credit or tax rebate submit an annual report to the Legislature regarding each tax incentive administered by the agency. Act 191 was enacted to provide the Legislature with accurate and complete information on the cost of the tax incentives to the state.

Thank you for the opportunity to provide our response to your report and recommendation. In your report, you recommend that:

> LDR should establish a method of data collection and tracking in order to maintain the financial data and statistics required for economists to evaluate the ROI of the incentive programs in the state. Reports of ROI should specifically identify new revenue to the state produced by the program and should include a clear definition of the calculation of the ROI. Those incentive programs not created with the purpose of creating new revenue for the state should be identified and any qualitative effects of the program should be presented separately from the ROI.

We recognize the importance of providing accurate and complete information to the Legislature. As we mentioned in our August 10, 2016, Management Response letter following a similar legislative audit, we hired an economist to assist with data compilation and ROI analyses for the tax incentives administered by the Department. As mentioned in your report, we have incorporated the use of REMI simulations into our ROI calculations which has proven successful. Further, you note that the statutes do not provide specifications regarding the method of calculation to be used in determining the ROI related to each incentive. In prior and the current Act 191 Reports, the Department has used various ROI calculation methodology depending on the type of incentive, available internal data and resources, and third party and other agencies' data.

In consideration of the new statutory requirements of Act 87 of the 2018 Regular Session, we intend to further develop and dedicate resources to a team of economists within the Department. We plan to collect and track all necessary data and devise a methodology appropriately suited for each incentive for which an ROI calculation is required. The economists, working in conjunction with our analysts, will develop consistent procedures and defined calculations for use in ROI analysis for those incentives that are legislatively intended to provide a return of revenue to Louisiana.

As explained in your report, many tax incentives are not intended to provide a return of revenue to Louisiana. For example, LA R.S. 47:297.9 authorizes a refundable individual income tax credit for amounts paid by an active or reserve military servicemember (as well as the servicemember's spouse and dependents) for obtaining a Louisiana noncommercial hunting or fishing license. As a benefit to servicemembers and their families, the credit does not return a certain dollar amount for each dollar of credit granted. Instead, the credit is designed to reimburse servicemembers and their families for the purchase of Louisiana noncommercial hunting or fishing licenses without reducing the self-generated revenues of the Department of Wildlife and Fisheries. You have recommended that we identify these types of incentives and their qualitative effects to present separately from ROI. We will incorporate, to the extent practical, this recommendation in preparation of the upcoming Act 191 Report.

If you need any additional information or clarification, please do not hesitate to reach out to my staff or me.

Sincerely,

Kimberly Lewis Robinson
Secretary

LOUISIANA
ECONOMIC
DEVELOPMENT

John Bel Edwards
Governor

Don Pierson
Secretary

September 14, 2018

Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
Post Office Box 94397
Baton Rouge, LA 70804-9397

Re: Tax Incentive Reporting-Agency 2018 Compliance with Act 191 of the 2013 Regular Session - LED

Dear Mr. Purpera:

We are in receipt of the LLA report on compliance of Act 191 of the 2013 session and appreciate the opportunity to respond.

This letter serves as the official response as to why LED did not include a calculation for return on investment (ROI) in the report for the Digital Interactive Media and Software Tax Credit (DMTC), the Angel Investor Tax Credit, the Research and Development Tax Credit and the Retention and Modernization Credit.

As LDR has already indicated in the LLA report, not all tax credits are designed to have a short-term positive revenue to the state. However, these unique economic development credits were created to spur some type of activity in the state, such as industry creation, entrepreneurship, or to ensure Louisiana remains completive from a business friendliness standpoint. The Act 191 report submitted by LED highlights the public policy purpose of the Digital Interactive Media and Software Development Tax Credit, which as delineated in statute was created to encourage the development of a strong capital base for the production of digital interactive media products and platforms in order to achieve a more independent, self-supporting industry. There are immediate and long-term objectives outlined in the statute itself. The immediate objectives are to attract investment for the production of digital interactive media platforms in Louisiana; develop an infrastructure which encourages private investment; and develop a tax infrastructure utilizing tax credits which encourage investments in multiple state-certified productions. The long-term objectives of the credit are to encourage increased employment opportunities within the digital media sector, to increase Louisiana's competitiveness as it pertains to developing a robust ecosystem for the development of digital interactive media products and platforms in the state; and to encourage new education curricula and partnerships with Louisiana educational institutions in order to provide a trained labor force in all aspects of digital interactive media and software development.

The purpose of the Digital Interactive Media and Software Tax Credit (DMTC) program was to take a nascent industry in the State and quickly build an industry cluster. The software and digital media industries create high-paying jobs, with many indirect impacts, including the formation of jobs to support the industry. This program has resulted in several major project wins across the State, including GE Digital, IBM, General Dynamics (formerly CSRA), EA Sports, CGI, and most recently, DXC. Before the latest iteration of the tax credit, Louisiana had essentially no presence in the software development sector but is now consistently in consideration when software and digital media companies are considering an expansion or relocation project. The outcome is a positive result due to the focused investment by the State.

Another example is the Angel Investor Tax Credit program, which enhances the State's entrepreneurial business environment by encouraging high net worth third parties to invest in early stage Louisiana-based entrepreneurial businesses for the purpose of expanding the State's economy by increasing the number of wealth-creating businesses and also the number of jobs available, which could help retain the younger workforce educated in Louisiana that has often moved out of state in the past. The tax credit for this program is not based upon the addition of new jobs or capital expenditures; rather, it is indirectly linked to job growth through its inherent design to attract private investment into entrepreneurial businesses. Since the purpose of this program is not directly tied to net new jobs or the company's capital investment, there is not sufficient data available to determine the amount of net state tax revenue generated as a result of the program.

In addition, the Research & Development Tax Credit program encourages businesses with operating facilities in Louisiana to establish or continue research and development activities within the State. The purpose of the research and development tax credit is to encourage new and continuing research and development activities within Louisiana. The availability of the credit encourages development, growth, and expansion of the private sector within the State. Louisiana's salary average for all sectors is approximately $56,642 per year. In contrast, research and development employees have significantly higher wages on average. For example, employees affiliated with FY17 applicants earned approximately $79,177 per year. The tax credit for this program is not based upon the addition of new jobs or capital expenditures; rather, it is indirectly linked to job growth through its inherent design to incentivize increased private sector spending on research and development in Louisiana. Immeasurable benefits include: the creation of an environment conducive to innovation across industry sectors within Louisiana, increased partnership and utilization of research assets at Louisiana public and private universities, and enhanced state support for Louisiana small businesses, which are a significant portion of the population of the companies participating in this program.

As the final example, the Retention and Modernization Tax Credit program is designed to provide an inducement for businesses to remain in the State and to modernize their existing operations in Louisiana. This inducement to reinvest in existing operations fits with the State's and LED's priority to retain and grow existing industry. The credit is rarely used and limited to situations where the threat of job losses is imminent. Thus, it would be improper to tabulate the direct and indirect value of the retained jobs as "ROI."

According to Act 87 of the 2018 Regular Session, LDR will perform an independent, comprehensive ROI analysis for all tax incentives with revenue loss of $1 million or more in the previous fiscal year. To fully support LDR's compliance with Act 87, LED will provide all available incentive data, including direct payroll spending, purchases of goods and services, and indirect activity generated as a result of the direct spending on payroll and goods/services. As there are multiple methods to calculate ROI, and revenue to the State can come in many forms, this more complete data set will help LDR determine the full impact of the economic development incentives, and therefore be able to create a realistic return on investment for the State.

Thank you again for the opportunity to respond to the Act 191 2018 compliance report.

Sincerely,

Anne G. Villa

Anne G. Villa
Undersecretary

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APPENDIX B: SCOPE AND METHODOLOGY

We conducted procedures to provide information to the Legislature on the response and impact of Act 191 of the 2013 Regular Session (Act 191). Our objective was to determine if state agencies that administer tax incentives are complying with the reporting requirements outlined in the Act.

To accomplish our objective, we performed the following steps:

- Reviewed requirements of Act 191
- Obtained the fiscal year 2017 tax incentive reports from the House Ways and Means Committee and the Senate Committee on Revenue and Fiscal Affairs
- Obtained and reviewed the fiscal year 2017-2018 Tax Exemption Budget to determine the incentives requiring Act 191 reporting and the responsible agencies
- Compiled the data reported by the tax incentive administering agencies
- Analyzed the tax incentive reports submitted for fiscal year 2017
- Discussed Act 191 reporting requirements with personnel from the state agencies administering the tax incentives

APPENDIX C: ACT 191 TAX INCENTIVES

Tax Incentive	Legal Citation	FY 17 Revenue Loss	FY 16 Revenue Loss	FY 15 Revenue Loss
Louisiana Department of Revenue				
1. Inventory Tax/Ad Valorem Tax	R.S. 47:6006	$312,699,545	$225,684,121	$570,391,962
2. Net Income Taxes Paid to Other States	R.S. 47:33	56,377,492	50,827,918	103,808,582
3. Ad Valorem Tax on Offshore Vessels	R.S. 47:6006.1	54,676,999	35,109,278	76,267,675
4. Earned Income Tax Credit	R.S. 47:297.8	47,462,414	48,894,977	47,314,323
5. Insurance Company Premium Tax	R.S. 47:227	40,274,162	33,146,177	39,578,635
6. Vendor's Compensation	R.S. 47:306(A)(3)(a)	18,926,610	24,166,368	25,882,917
7. Solar Energy System	R.S. 47:6030	16,832,096	17,390,901	72,420,240
8. Certain Child Care Expenses	R.S. 47:297.4	16,623,173	17,935,243	17,704,968
9. Ad Valorem Tax Paid by Certain Telephone Companies	R.S. 47:6014	13,927,894	6,299,521	28,723,996
10. LA Citizens Property Insurance Corporation Assessment	R.S. 47:6025	11,702,340	28,514,696	44,436,115
11. Education	R.S. 47:297(D)	9,358,176	9,751,540	16,476,887
12. Ad Valorem Tax on Natural Gas	R.S. 47:6006	6,138,905	2,135,428	7,922,333
13. Procurement Processing Company Rebate Program	R.S. 47:6351	4,211,331	204,154	-
14. Conversion of Vehicles to Alternative Fuel	R.S. 47:6035	3,940,449	1,242,251	7,057,922
15. Certain Disabilities	R.S. 47:297(A)	1,963,019	2,214,169	2,838,812
16. New Markets Tax Credit	R.S. 47:6016	1,459,027	1,989,769	2,124,450
17. Contribution of Tangible Personal Property of Sophisticated and Technological Nature to Educational Institutions	R.S. 47:37, R.S. 47:287.755	1,204,784	894,438	1,411,309
18. Milk Producers	R.S. 47:6032	886,942	850,680	1,123,750
19. Special Allowable Credits	R.S. 47:297(B)	745,426	793,619	1,172,645
20. New Jobs	R.S. 47:34, R.S. 47:287.749	546,393	330,059	643,804
21. Small-town Doctors/Dentist	R.S. 47:297(H)	455,108	511,297	850,296
22. Apprenticeship (Repealed)	R.S. 47:6033	194,387	519,966	844,331
23. Amounts Paid by Certain Military Service Members for Obtaining Louisiana Hunting & Fishing Licenses	R.S. 47:297.9	112,184	96,425	144,115
24. Educational Expenses Incurred for Degree Related to Law Enforcement	R.S. 47:297(J)	18,112	32,645	76,834
25. Purchase of Bulletproof Vest	R.S. 47:297(L)	16,933	15,241	14,686
26. Living Organ Donation Credit	R.S. 47:297(N)	11,341	18,873	18,730
27. Donations to Public Elementary or Secondary Schools	R.S. 47:6013	11,016	-	-

Tax Incentive	Legal Citation	FY 17 Revenue Loss	FY 16 Revenue Loss	FY 15 Revenue Loss
Louisiana Department of Revenue (Cont.)				
28. Employment-related Expense for Maintaining Household for Certain Disabled Dependents	R.S. 47:297.2	$10,387	$104,764	$361,146
29. Donations to Assist Qualified Playgrounds	R.S. 47:6008	Negligible	14,997	38,663
30. Donations of Material, Equipment, or Instructors Made to Certain Training Providers	R.S. 47:6012	Negligible	Negligible	48,048
31. Accessible and Barrier-Free Constructed Home	R.S. 47:297(P)	Negligible	Negligible	45,866
32. Louisiana Basic-Skills Training	R.S. 47:6009	Negligible	Negligible	22,992
33. Gasoline and Special Fuels Taxes for Commercial Fisherman	R.S. 47:297 (C)	Negligible	Negligible	10,043
34. Sugarcane Transport	R.S. 47:6029	-	-	208,001
35. Costs to Reprogram Cash Registers	Acts 1990, No. 386, Section 4	-	21,558	14,766
36. Employment of Certain First-time Nonviolent Offenders	R.S. 47:287.752, R.S. 47:297(O)	-	Negligible	Negligible
37. Hiring Eligible Re-entrants	R.S. 47:287.748	-	Negligible	Negligible
38. Bone Marrow Donor Expense	R.S. 287.758, R.S. 47:297(I)	-	-	Negligible
39. Debt Issuance Costs	R.S. 47:6017	-	-	Negligible
40. Employment of Certain First-time Drug Offenders	R.S. 47:297(K)	-	-	Negligible
41. Employment of the Previously Unemployed	R.S. 47:6004	-	-	Negligible
42. Family Responsibility	R.S. 47:297(F), R.S. 46:449	-	-	Negligible
43. Cash Donations to the Dedicated Research Investment Fund	R.S. 51:2203	-	-	-
44. Certain Refunds Issued by Utilities	R.S. 47:265, R.S. 47:287.664	-	-	-
45. Long-Term Care Insurance Premiums	R.S. 47:297(M)	-	-	-
46. Neighborhood Assistance	R.S. 47:35, R.S. 287.753	-	-	-
47. Purchases from Prison Industry Enhancement Contractors	R.S. 47:6018	-	-	-
48. Vehicle Alternative Fuel Usage (Repealed)	R.S. 47:287.757, R.S. 47:38	-	-	-
LDR Total Revenue Loss		**$620,786,645**	**$509,711,073**	**$1,069,999,842**
Louisiana Economic Development				
1. Motion Picture Investor Tax Credit	R.S. 47:6007 et seq.	$205,833,457	$211,235,516	$200,507,106
2. Louisiana Quality Jobs Program	R.S. 51:2451 et seq.	99,342,295	149,223,716	72,864,143
3. Enterprise Zones	R.S. 51:1781 et seq.	41,081,153	45,048,115	44,890,879
4. Digital Interactive Media and Software Tax Credit	R.S. 47:6022	9,885,415	10,946,339	12,090,705
5. Musical and Theatrical Productions Tax Credit	R.S. 47:6034	6,100,794	5,320,869	13,408,741
6. Research and Development Tax Credit	R.S. 47:6015	5,386,914	4,700,295	47,570,280

Tax Incentive	Legal Citation	FY 17 Revenue Loss	FY 16 Revenue Loss	FY 15 Revenue Loss
Louisiana Economic Development (Cont.)				
7. Retention and Modernization Credit	R.S. 51:2399.1-6	$3,643,558	$1,660,848	$761,822
8. Angel Investor Tax Credit Program	R.S. 47:6020 et seq.	1,535,732	536,475	1,015,903
9. Sound Recording Investor Tax Credit	R.S. 47:6023	81,550	330,206	271,357
10. Technology Commercialization Credit and Jobs Program	R.S. 51:2351 et seq.	57,076	78,780	162,997
11. Mentor-Protégé Tax Credit	R.S. 47:6027	Negligible	Negligible	20,899
12. Competitive Projects Payroll Incentive Program	R.S. 51:3121	-	-	53,625
13. Louisiana Community Economic Development	R.S. 47:6031	-	-	12,854
14. Atchafalaya Trace Heritage Area Development Zone Tax Exemption	R.S. 25:1226 et seq.	-	-	Negligible
15. University Research and Development Parks	R.S. 17:3389	-	-	Negligible
16. Corporate Headquarters Relocation Program	R.S. 51:3111-3115	-	-	-
17. Corporate Tax Apportionment Program	R.S. 47:4331	-	-	-
18. Ports of Louisiana - Import Export Cargo Credit	R.S. 47:6036	-	-	-
19. Ports of Louisiana - Investor Tax Credit	R.S. 47:6036	-	-	-
20. Urban Revitalization Tax Incentive Program	R.S. 51:1801	-	-	-
LED Total Revenue Loss		**$372,947,944**	**$429,081,159**	**$393,631,311**
Department of Culture, Recreation, and Tourism				
1. Rehabilitation of Historic Structures	R.S. 47:6019	$91,902,642	$58,906,706	$67,353,163
2. Rehabilitation of an Owner Occupied Residential or Mixed-use Property	R.S. 47:297.6	354,368	298,743	373,547
3. Cane River Heritage Tax Credit	R.S. 47:6026	-	-	-
DCRT Total Revenue Loss		**$92,257,010**	**$59,205,449**	**$67,726,710**
Department of Environmental Quality				
1. Purchase of Qualified New Recycling Manufacturing or Process Equipment and/or Service Contracts	R.S. 47:6005	$255,209	$183,003	$459,718
2. Brownfields Investor Tax Credit	R.S. 47:6021	17,652	34,670	450,106
DEQ Total Revenue Loss		**$272,861**	**$217,673**	**$909,824**
Department of Education				
1. School Readiness Child Care Directors and Staff	R.S. 47:6106	$8,895,807	$8,580,787	$8,158,998
2. School Readiness Child Care Provider	R.S. 47:6105	4,985,128	4,251,625	4,644,816
3.Donations to School Tuition Organization	R.S. 47:6301	3,139,789	313,321	60,975
4. School Readiness Child Care	R.S. 47:6104	2,356,523	3,098,313	3,238,177
5. School Readiness Fees and Grants to Resource and Referral Agencies	R.S. 47:6107 (A) (2)	884,256	726,520	947,215
6. School Readiness Business Supported Child Care	R.S. 47:6107 (A) (1)	474,465	318,859	557,278
DOE Total Revenue Loss		**$20,735,968**	**$17,289,425**	**$17,607,459**
Total Revenue Loss		**$1,107,000,428**	**$1,015,504,779**	**$1,549,875,146**

Source: 2017-2018 Tax Exemption Budget