

Fiscal Research Program

AN ANALYSIS OF PROPOSED NEW ECONOMIC DEVELOPMENT INITIATIVE

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An Analysis of a Proposed New Economic Development Incentive

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Executive Summary

This report contains an analysis of a new economic development incentive that has been proposed as an addition to the existing BEST program.

Proposed Incentive

The proposed incentive program is an investment incentive of up to 100 percent of the value of the qualified investment. The main features of the proposed incentive are:

- Firms in tiers 1, 2, and 3 would be allowed to take up to a 100 percent exemption of Georgia Corporate Income Tax, while firms in Tier 4 counties up to a 50 percent exemption.
- Firms would also be allowed to retain a percentage of the increase in employee personal income tax withholding. The percentage of the withholding that a firm could retain would vary by tier. Firms in Tier 1 would retain 100 percent of the income tax withheld, firms in Tier 2 would retain 80 percent, firms in Tier 3 would retain 60 percent, and firms in Tier 4 would retain 40 percent.
- The total value of these two benefits that a firm could take over the allowable period would be limited to the total value of the qualified investment.
- Eligibility for the proposed program would require both a minimum increase in jobs (equal to the current requirement for the job tax credit), and a minimum capital investment. The minimum investment would vary by tier: \$50,000 would be required in Tier 1; \$100,000 would be required in Tier 2; \$150,000 would be required in Tier 3; \$250,000 would be required in Tier 4.
- The process would require a formal application to be filed with the State of Georgia and the company would be required to receive initial approval prior to earning tax benefits (whether corporate & personal).
- Using the application as a guide, the state would establish the maximum amount of tax benefits available for each project. In other words, meeting the minimum eligibility requirements would not be sufficient to receive the incentives.

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- Firms would not be eligible for the existing Job Tax Credit or either of the two investment tax credits.

Compared to the existing Job Tax Credit and the two investment tax credit programs, the proposed program provides a much larger incentive. Under the new program the total incentive for a firm will be two to four times the total incentive under the existing programs.

Kentucky's Incentive Programs

Kentucky has three economic development incentive programs that, taken together, are similar to the proposed incentive program. The Kentucky Rural Economic Development Act (KREDA) program currently applies to 63 depressed counties, while the Kentucky Industrial Development Act (KIDA) program applies to the remaining 57 counties. Other than the level of the allowable credit, the two programs are similarly structured. Only firms in the manufacturing sector are eligible for these two programs. A third program, the Kentucky Job Development Act (KJDA) program, applies to non-manufacturing, non-retail businesses for which 75 percent of sales are from out-of-state purchasers.

These programs provide two types of incentives. First, firms can receive up to a 100 percent exemption of state income tax for investment in plant and equipment. The exemption is limited by the size and nature of the financing of the investment. Second, the firm may collect a "job development assessment fee" equal to a percentage of the gross wages of each new employee; the job assessment fee equals 3 percent for the KIDA program, 4 percent for the KREDA program, and up to 5 percent for the KJDA program.

For the KIDA program, firms must choose one or the other of the two incentives. For the other two programs, firms receive both incentives. The allowable benefits of the program are negotiated with the state, with actual benefits dependent on the actual investment and job creation.

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Table 1 presents the value of incentives actually taken by year for the three Kentucky programs. For 1998, the total value of the incentives taken was \$46.4 million for the three programs for both types of incentives.

Economic Effects of Kentucky's Incentive Programs

Since we were unable to identify any existing studies that analyze the economic effects of the Kentucky incentive programs, we conducted an analysis that focused on changes in per capita income, earnings, and employment. Information gleaned from comparisons of employment growth rates suggests conclusions similar to those from comparisons of per capita income and earnings.

In terms of overall employment growth, Kentucky appears to have performed at about the level of the Southeast as a whole, and appears to have under-performed relative to the nation as a whole, in the immediate five-year period following the initiation of the state's incentive programs in 1992. However, Kentucky significantly out-performed the Southeast and the nation in manufacturing employment growth during the same period, the sector in which the incentives were primarily targeted. Of course, these results are tempered by the fact that the state significantly out-performed the Southeast and the U.S. in manufacturing employment growth during the previous five-year period as well (1987 – 1992). Thus, there is little evidence that the growth in employment in Kentucky increased after 1992 relative to the growth that the nation and the Southeast was experiencing.

Cost of Proposed Incentive Program

If all eligible firms are allowed to take the available incentive, we estimate that the annual cost of the withholding component of the incentive ITWA for manufacturing firms is \$82.3 million. If non-manufacturing, non-retail firms are also eligible for the proposed incentive program, we estimate an additional cost of the proposed program of \$294.8 million.

In addition to the ITWA, firms can use their corporate tax liability to take the proposed investment incentive. We estimate that the annual corporate tax liability

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that manufacturing firms could take between \$7.3 million to \$9.2 million per year in tax credits. For non-manufacturing, non-retail firms, we estimate that the revenue loss would be \$22.0 million to \$27.9 million.

Combining the two components, i.e., the ITWA and the investment tax credit, the estimated total annual revenue loss to the State, assuming that the State allows all eligible firms to take as much incentive as feasible, is between \$89.6 million and \$91.5 million for manufacturing firms, and between \$316.8 million and \$322.7 million for non-manufacturing, non-retail firms.

The proposal calls for the State to determine which firms get the incentive and the amount. It is not possible to predict how restrictive the State would be in allowing firms to take the incentives. However, Kentucky's program is discretionary, and so we can estimate the revenue cost to Georgia if Georgia was as restrictive as Kentucky has been. The KREDA program is closest to the proposed program, but there are some differences with the proposed program. Adjusting for these differences, we obtain an estimate of the annual revenue loss to the State of \$84.2 million for manufacturing firms. The actual revenue loss to the State will depend upon how restrictive the State is in granting incentives to eligible firms and whether non-manufacturing, non-retail firms are eligible.

Fiscal Impact

To estimate the likely fiscal impact on the State, we consider two scenarios regarding who gets new jobs and the two scenarios regarding the industry in which the new job is located yield four alternatives sets of assumptions. Table 2 shows for each assumption the net fiscal benefit (additional revenue less additional expenditures) to the State per year per job created by the incentive, gross of the value of the incentive. As can be seen, under the assumption that all jobs go to new residents and using the weighted average of the fiscal effect across all eligible industries the net fiscal benefit to the State, gross of the incentive, is \$794 per year. If we use the weighted average of the fiscal effect across just manufacturing industries, the net fiscal effect, gross of the incentive, falls to \$359. The net fiscal effect, gross

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TABLE 2. FISCAL BENEFIT TO THE STATE FROM ONE NEW JOB

| Assumption | Net Fiscal Benefit to State Government Per Year Per Job |
|---|--|
| Job growth equal to actual, new jobs go to non-resident | \$794 |
| Job growth equal to actual in manufacturing, new jobs go to non-resident | \$359 |
| Job growth equal to actual, half of new jobs go to non-resident | \$6,045 |
| Job growth equal to actual in manufacturing, half new jobs go to non-resident | \$5,936 |

of the incentive, increases substantially under the assumption that half of the jobs go to current residents.

The fiscal benefit net of the incentive depends upon how well the State does in restricting incentives to firms that would not otherwise have located in Georgia. If the State does a perfect job, then each job can be credited to the incentive. In that case the net fiscal benefit described in Table 2 can be associated with each job that receives an incentive. But if the State does an extremely bad job of picking firm to which it provides an incentive, i.e., incentives go to firms that would have located in Georgia without the incentive, then little of the benefits described in Table 2 can be credited to the incentives.

A previous report provided estimates of the number of job tax credits that resulted in new jobs.* That estimate was that 30 percent of the credits were for new jobs. Thus, if the State were to grant an incentive to every firm that applied, we would expect that it would be a “success” 30 percent of the time, where success means giving an incentive to a firm that would not have otherwise located in Georgia. It is an open question as to whether the State could be more successful than that, and it is possible that it could do worse.

We estimate that the investment per worker will be about \$70,000 per worker. But the typical firm will not be able to take full advantage of the incentive because of

* Dagney Faulk, et al., *An Analysis of Georgia’s Economic Development Tax Credit Incentives*, Report No. 42, January 2000. Atlanta: Fiscal Research Program, Andrew Young School of Policy Studies, Georgia State University.

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limited corporate income tax liability and income tax withholding. We assume that 25 percent of the maximum possible incentive will be taken by the firm. Thus, the typical incentive would be about \$1750 per worker. This is higher than the first two entries in Table 2, meaning the State would suffer a fiscal loss. However, if 50 percent of the new jobs are taken by current Georgia residents, and if one out of three firms that the State gave incentive to would not have located in Georgia in the absence of the incentive, then the incentive would yield a positive fiscal benefit, net of the incentive, to the State.

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Introduction

The Georgia Department of Industry, Trade and Tourism requested an analysis of a new economic development incentive that has been proposed as an addition to the existing BEST program. This report contains an analysis of that proposed incentive. Section 1 describes the proposed incentive program. Section 2 describes the Kentucky incentive programs on which the proposed program is based. Section 3 contains an analysis Kentucky's experience with its incentive programs. Section 4 provides an analysis of the proposed incentive program for Georgia. Finally, Section 5 provides an update of the incentives offered by other southeastern states.

An Analysis of a Proposed New Economic Development Incentive

I. The Description of the Proposed Incentive Program

The proposed incentive program is an investment incentive of up to 100 percent of the value of the qualified investment. The two main features of the proposed incentive concern how the firm would take advantage of the incentive:

- Firms in Tiers 1, 2, and 3 would be allowed to take up to a 100 percent exemption of Georgia Corporate Income Tax, while firms in Tier 4 counties up to a 50 percent exemption.
- Firms would also be allowed to retain a percentage of the increase in employee personal income tax withholding. The percentage of the withholding that a firm could retain would vary by tier. Firms in Tier 1 would retain 100 percent of the income tax withheld, firms in Tier 2 would retain 80 percent, firms in Tier 3 would retain 60 percent, and firms in Tier 4 would retain 40 percent.

The total value of these two benefits that a firm could take over the allowable period would be limited to the total value of the qualified investment. We assume that if a firm took the proposed incentive, the firm would not be eligible for the existing Job Tax Credit or either of the two investment tax credits.

Table 1 summarizes the main features of the current BEST job tax credit program. For the current Investment Tax Credit, firms must investment a minimum of \$50,000 and in turn receive a corporate income tax credit of 5 percent of the investment for Tier 1 firms, 3 percent for Tier 2 firms, and 1 percent for Tier 3 and Tier 4 firms. The credit can be taken over 10 years. For the Optional Investment Tax Credit, the minimum investments are higher, \$5 million in Tier 1, \$10 million in Tier 2, and \$20 million in Tiers 3 and 4. The corporate income tax credit is also higher: 10 percent for Tier 1 firms, 8 percent for Tier 2 firms, and 6 percent for Tier 3 and Tier 4 firms. The credit can be taken over 10 years. The credit cannot exceed 90 percent of the increase in tax liability over the base year.

Table 2 shows how the proposed incentive differs from the BEST tax credit programs. Values are highlighted in bold where there are changes or additions.

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TABLE 1. CURRENT BEST JOB TAX CREDIT PROGRAM

| | Tier 1 | Tier 2 | Tier 3 | Tier 4 |
|---|---|---|---|---|
| Number of Counties ^a | 71 | 35 | 35 | 18 |
| Tax credit per new full-time job per year for five years (as long as maintained) | \$3,500 | \$2,500 | \$1,250 | \$750 |
| Job creation requirements | 5 | 10 | 15 | 25 |
| New job average wage requirements | Above the average wage of the county that has the lowest average wage of any county in the state. | Above the average wage of the county that has the lowest average wage of any county in the state. | Above the average wage of the county that has the lowest average wage of any county in the state. | Above the average wage of the county that has the lowest average wage of any county in the state. |
| Health insurance to be made available if available to current employees | Yes | Yes | Yes | Yes |
| Limits on use of job tax credit against income tax liability (<i>i.e. Corporate Income Tax</i>) | 100% | 100% | 50% | 50% |
| Use of income tax withholding ^b | Yes | No | No | No |
| Percentage of payroll withholding that can be retained by company (<i>i.e. Personal Income Tax</i>) | 100% | 0% | 0% | 0% |
| Joint Development Authority bonus | \$500 | \$500 | \$500 | \$500 |
| Port Authority bonus | \$1,250 | \$1,250 | \$1,250 | \$1,250 |

Notes:

^a Counties are ranked each year, prior to December 31, using the following criteria: A) highest unemployment rate for the most recent 36 month period; B) lowest per capita income for the most recent 36 month period; and C) highest percentage of residents whose incomes are below the poverty level. Tier 1 counties are those most economically distressed.

^b This provision, available in Tier 1 counties, allows companies that are unable to use all their credits against income tax liability to also use their credits against payroll taxes withheld from their employees.

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TABLE 2. PROPOSED INCENTIVE PROGRAM
(Bold text reflects changes from the existing programs)

| | Tier 1 | Tier 2 | Tier 3 | Tier 4 |
|---|---|---|---|---|
| Number of Counties ^a | 71 | 35 | 35 | 18 |
| Tax credit per new full-time job per year for five years (as long as maintained) | \$0 | \$0 | \$0 | \$0 |
| Job creation requirements | 5 | 10 | 15 | 25 |
| New job average wage requirements | Above the average wage of the county that has the lowest average wage of any county in the state. | Above the average wage of the county that has the lowest average wage of any county in the state. | Above the average wage of the county that has the lowest average wage of any county in the state. | Above the average wage of the county that has the lowest average wage of any county in the state. |
| Health insurance to be made available if available to current employees | Yes | Yes | Yes | Yes |
| Required Minimum Capital Investment | \$50,000 | \$100,000 | \$150,000 | \$250,000 |
| Percentage of income tax liability eligible for credit for investment tax credit (i.e. Corporate Income Tax) | 100% | 100% | 100% | 50% |
| Can income tax withholding be used^b | Yes | Yes | Yes | Yes |
| Percentage of increase in Payroll Withholding to be Retained by Company (i.e. Personal Income Tax) | 100% | 80% | 60% | 40% |
| Joint Development Authority bonus | \$0 | \$0 | \$0 | \$0 |
| Port Authority bonus | \$0 | \$0 | \$0 | \$0 |

Notes:

^a Counties are ranked each year, prior to December 31, using the following criteria: A) highest unemployment rate for the most recent 36 month period; B) lowest per capita income for the most recent 36 month period; and C) highest percentage of residents whose incomes are below the poverty level. Tier 1 counties are most economically distressed.

^b This provision, available in all counties, will allow companies that are unable to use all of their job tax credits against their corporate income tax liability to also use their credits against payroll taxes withheld from their employees.

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Other features of the proposed incentive relative to the current provisions in BEST are:

- Eligibility for the proposed program would require both a minimum increase in jobs (equal to the current requirement for the job tax credit), and a minimum capital investment. The minimum investment would vary by tier: \$50,000 would be required in Tier 1; \$100,000 would be required in Tier 2; \$150,000 would be required in Tier 3; \$250,000 would be required in Tier 4.
- The incentive can be taken over a 10-year period, which is the same as the current Investment Tax Credit. The current Job Tax Credit can be taken for each of five years and has a 5-year carry-forward provision.
- For purposes of our analysis and to be consistent with the Kentucky program, eligible projects would include new and expanding manufacturing facilities and non-manufacturing, non-retail firms that are new or expanding. The latter is more inclusive than the eligible industries as defined in current BEST legislation.
- At least 75 percent of the sales of non-manufacturing, non-retail firms must be to out-of-state purchasers.
- The current bonuses associated with Joint Development Authorities and Port Authorities, would not be applicable.
- The process would require a formal application to be filed with the State of Georgia and the company would be required to receive initial approval prior to earning tax benefits (whether corporate & personal).
- The application would require a \$500 application fee, which would be used to offset a portion of the administrative costs of the incentive program.
- Further, the company would be required to pay to the State of Georgia an administrative fee of 0.25 percent of the maximum amount of eligible benefits, up to a maximum fee of \$25,000. This fee would also be used to offset the administrative costs of the incentive process.
- The application would require a letter of support from the local development authority.
- Using the application as a guide, the state would establish the maximum amount of tax benefits available for each project. In other words, meeting the minimum eligibility requirements would not be sufficient to receive the incentives.

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II. The Kentucky Incentive Programs

Kentucky has three economic development incentive programs that, taken together, are similar to the proposed incentive program. The Kentucky Rural Economic Development Act (KREDA) program currently applies to 63 depressed counties, while the Kentucky Industrial Development Act (KIDA) program applies to the remaining 57 counties. Other than the level of the allowable credit, the two programs are similarly structured. Only firms in the manufacturing sector are eligible for these two programs. A third program, the Kentucky Job Development Act (KJDA) program, applies to non-manufacturing, non-retail businesses for which 75 percent of sales are from out-of-state purchasers.

These programs provide two types of incentives. First, firms can receive up to a 100 percent exemption of state income tax for investment in plant and equipment. The exemption is limited by the size and nature of the financing of the investment. Second, the firm may collect a “job development assessment fee” equal to a percentage of the gross wages of each new employee; the job assessment fee equals 3 percent for the KIDA program, 4 percent for the KREDA program, and up to 5 percent for the KJDA program.

For the KIDA program, firms must choose one or the other of the two incentives. For the other two programs, firms receive both incentives. The allowable benefits of the program are negotiated with the state, with actual benefits dependent on the actual investment and job creation. The three programs are described below; more details are presented in the Appendix. (The descriptions are based on information from the State of Kentucky web site.)

A. Kentucky Industrial Development Act (KIDA)

Projects approved under KIDA may receive a state income tax exemption (or credit), for up to 10 years, equal to up to 100 percent of annual debt service costs (principal and interest) for financing the project. The debt must be used to finance land, buildings, site development, building fixtures, or equipment used in the project. Financing may be provided by any source, typically banks, industrial revenue bonds,

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or inter-company loans. Alternatively, the company may collect a job assessment fee equal to 3 percent of the gross wages of each employee whose job is created by the approved project and who is subject to Kentucky income taxes. (The employee receives credits for the job assessment fee against his or her state income taxes.) Unused KIDA credits may be carried forward for the term of the agreement. Total KIDA benefits (tax credit and job development assessment fee) cannot exceed the original principal amount of debt used to finance the project.

To be eligible, the project must be a new or expanding manufacturing project located in a non-KREDA county. The project must have a minimum investment of \$100,000 and must create at least 15 new full-time jobs. Eligible equipment costs are limited to \$10,000 per new, full-time job created.

B. Kentucky Rural Economic Development Act (KREDA)

Companies with projects approved under KREDA may potentially receive state income tax credits and job assessment fees for up to 100 percent of annual debt service costs, for up to 15 years, associated with the purchase of land, buildings, site development, building fixtures and equipment used in the project. Financing may be provided by any source, typically banks, industrial revenue bonds, or inter-company loans. The company may also collect a job assessment fee of 4.0 percent of the gross wages of each employee whose job is created by the approved project and who is subject to Kentucky income taxes. (The employee receives credits for the fee against his or her state income taxes.) Unused KREDA credits may be carried forward for the term of the agreement.

To be eligible, the project must be a new or expanding manufacturing project located in a KREDA-designated county. The project must have a minimum investment of \$100,000 and create at least 15 new full-time jobs. Eligible equipment costs are limited to \$10,000 per new full-time job created. Total KREDA benefits (tax credit and job development assessment fee) cannot exceed the original principal amount of debt used to finance the project.

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C. Kentucky Job Development Act (KJDA)

KJDA apply to non-manufacturing, non-retail businesses. KJDA projects may receive, for up to ten years, a 100 percent credit against the state income tax arising from a project, and may collect a job assessment fee of up to 5.0 percent of the gross wages of each employee whose job is created by the project and who is subject to Kentucky income taxes. The total incentive amount cannot exceed 50 percent of project start-up costs (i.e., costs associated with furnishing and equipping the facility) plus 50 percent of annual facility rental cost or rental value. The maximum approved start-up costs (i.e., the costs associated with furnishing and equipping the facility) are \$10,000 per new full-time job. The local community must approve the project prior to the firm submitting an application for KJDA. Unused credits may be carried forward for the term of the agreement. If the company uses the wage assessment, the employee receives credit for the fee against his or her state income taxes and local occupational taxes.

Eligible companies are service or technology related companies and new or expanding non-manufacturing, non-retail firms. Firms must generate more than 75 percent of their revenue from purchasers located outside Kentucky. Firms must create at least 25 new, full-time jobs for Kentucky residents.

D. An Example

To illustrate how these programs work, consider the following example. Specifically, consider a firm that plans to invest in a new project for which land and buildings account for \$1.050 million and equipment equals \$450,000. Assume the annual rental value of the building is \$120,000. Further, suppose the company will employ 15 people at an annual wage of \$30,000 each. Assume that the firm finances the \$1.2 million over 10 years at 7 percent, which results in an annual debt payment of about \$167,000. Assume that the firm's net income subject to Kentucky taxation is \$2 million. \$2 million in net income would produce a corporate income tax liability of approximately \$160,000 per year for 10 years (the marginal tax rate in Kentucky is 8.25 percent on net income over \$250,000).

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For the KIDA program eligible investment equals \$1.2 million, which is comprised of the \$1.050 million investment in land and building and \$150,000 in equipment (the maximum of \$10,000 per employee times 15 employees). Consider first the income tax credit option. Since the debt service of \$167,000 exceeds the income tax liability, the firm can claim a credit of only \$160,000 per year. The \$7,000 annual unused credit can be carried forward through the term of the KIDA agreement.

Consider next the job development assessment fee option. With 15 new employees, each paid an annual wage of \$30,000, the total increase in salary is \$450,000. The firm can receive a job assessment fee of 3 percent of that total in each year, or \$13,500. For the KIDA program the firm must choose one of the two options. In this example, the firm would clearly take the tax credit option.

If the firm had located in a KREDA-designated county, the firm could utilize both the tax credit and the job assessment fee up to the maximum eligible amount, *i.e.*, \$167,000 per year. Thus, the firm would receive a tax credit of \$160,000 per year (*i.e.*, 100 percent of the corporate income tax liability). While the potential value of the job assessment fee is \$18,000 per year (*i.e.*, 4 percent of the increase in wages of \$450,000), the firm can claim only \$7,000 since the total claim (income tax credit and job assessment fee) cannot exceed \$167,000.

If the firm had applied under the KJDA program, the maximum annual incentive would be \$135,000, *i.e.*, 50 percent of the \$120,000 annual rental plus 50 percent of the allowable \$75,000 start up costs. The annual incentive the firm would take is thus \$135,000.

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III. The Kentucky Experience

A. Credit Applications, Receipts, and Costs

Through Bryan Quinsey we obtained Kentucky incentive program application data that were obtained through a freedom of information request. These data provide the potential incentives available for every project and the expected number of new jobs for the period 1992 – 1999 for the three incentive programs (only partial records were available for 1999). These are the amounts contained in the application, not necessarily the actual incentive taken or jobs created. For the KREDA program, there have been 407 applications (with some firms having multiple applications). To date, the total potential incentives amount to \$3.048 billion and the number of new jobs expected equals 50,654. This implies an incentive of \$60,173 per new job. For the KIDA program, there have been 306 applications. To date the total potential incentives amount to \$1.603 billion and the number of new jobs expected equals 34,856. This implies an incentive of \$45,989 per new job. For the KJDA program, there have been 504 applications. To date the total potential incentives amount to \$1.321 billion and the number of new jobs expected equals 43,923. This implies an incentive of \$30,075 per new job.

The grand total for all three programs is 1,218 applications, with total potential incentives equal to \$5.972 billion and potential jobs equal to 129,433. This implies an average incentive of \$46,139 per new job. According to an individual familiar with the program, these amounts are the incentives the firms could receive, but the firms actually earn considerably less than this. First, the actual project may be smaller than originally proposed; second, the state may have limited the total value of the incentive that a firm can take, and; third, firms may have decided to locate elsewhere or decided not to expand.

Through our contacts in Kentucky we were able to obtain the value of incentives actually taken by year (Table 3). The information for 1999 is incomplete. For 1998, the total value of the incentives taken was \$46.4 million for the three programs for both types of incentives.

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TABLE 3. KENTUCKY DEVELOPMENT INCENTIVES TAKEN

| Year | Job Assessment Fee | | | Tax Credit | | | Total Incentive | | | TOTAL |
|------|--------------------|-------------|--------------|--------------|-------------|-------------|-----------------|-------------|--------------|--------------|
| | KIDA | KJDA | KREDA | KIDA | KJDA | KREDA | KIDA | KJDA | KREDA | |
| 1990 | \$0 | \$0 | \$47,428 | \$0 | \$0 | \$0 | \$0 | \$0 | \$47,428 | \$47,428 |
| 1991 | \$0 | \$0 | \$330,104 | \$0 | \$0 | \$228,483 | \$0 | \$0 | \$558,587 | \$558,587 |
| 1992 | \$0 | \$0 | \$785,637 | \$0 | \$0 | \$566,736 | \$0 | \$0 | \$1,352,373 | \$1,352,373 |
| 1993 | \$0 | \$146,505 | \$1,730,761 | \$114,163 | \$365,722 | \$1,463,821 | \$114,163 | \$5122,27 | \$3,194,582 | \$3,820,972 |
| 1994 | \$0 | \$892,098 | \$3,447,707 | \$1,382,793 | \$256,701 | \$3,975,351 | \$1,382,793 | \$1,148,799 | \$7,423,058 | \$9,954,650 |
| 1995 | \$0 | \$1,101,740 | \$5,651,972 | \$2,636,400 | \$923,683 | \$975,556 | \$2,636,400 | \$2,025,423 | \$6,627,528 | \$11,289,351 |
| 1996 | \$0 | \$2,461,540 | \$7,546,041 | \$8,069,089 | \$2,743,448 | \$5,039,707 | \$8,069,089 | \$5,204,988 | \$12,585,748 | \$25,859,825 |
| 1997 | \$52,250 | \$4,472,123 | \$11,757,560 | \$12,593,155 | \$2,992,247 | \$8,328,550 | \$12,645,405 | \$7,464,370 | \$20,086,110 | \$40,195,885 |
| 1998 | \$204,163 | \$6,895,082 | \$17,151,750 | \$11,925,734 | \$2,333,904 | \$7,827,851 | \$12,129,897 | \$9,228,986 | \$24,979,601 | \$46,338,484 |
| 1999 | \$218,691 | \$7,240,104 | \$18,144,821 | \$185,842 | \$265,987 | \$1,498,834 | \$404,533 | \$7,506,091 | \$19,643,655 | \$27,554,279 |

Source: Office of the State Budget Director, Commonwealth of Kentucky

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B. Economic Impact of the Kentucky Incentive Program

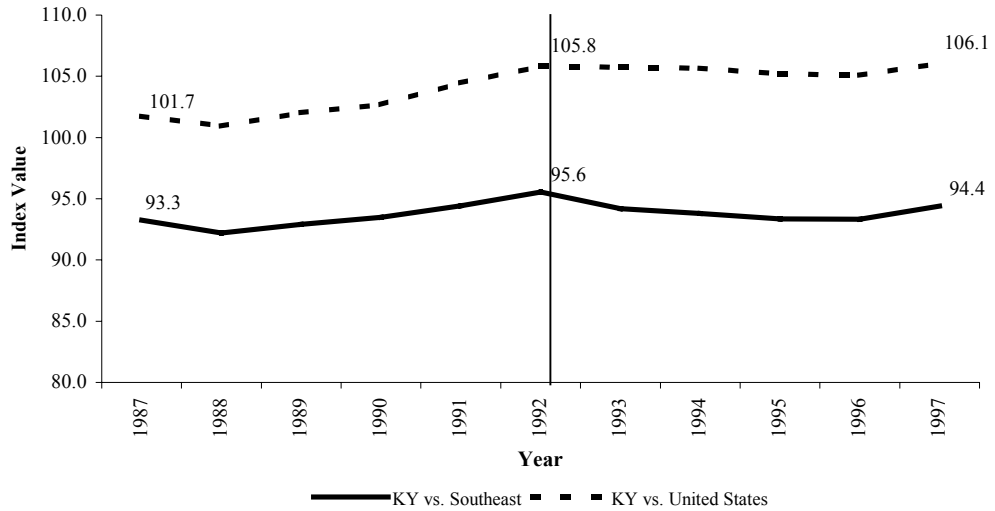
We were unable to identify any existing studies that analyze the economic effects of the Kentucky incentive programs. We conducted an analysis that focused on changes in per capita income, earnings, and employment.

Per Capita Income and Earnings

In terms of per capita income and other measures of economic well-being, Kentucky and the rest of the Southeast have lagged behind the nation as a whole since reconstruction, which makes comparisons of levels of performance over time tenuous. Thus, for comparison purposes, we set the ratio of Kentucky per capita income to U.S. per capita income at 100.0 in our base year (1969) and recalculate the index for succeeding years relative to that base year. For example, a value of 105 in 1979 would indicate that the ratio of per capita income in Kentucky relative to per capita income in the rest of the United States increased by 5 percent over the 10-year period. A similar index is used to compare Kentucky economic performance relative to that of the Southeast as a whole. The use of indices also is useful in that natural controls for the macroeconomic environment (*e.g.*, recessions) are included in the analysis. Figure 1 shows the value of this per capita income index in the ten-year period surrounding the adoption of KIDA, KIRA, and KJDA programs in 1992. Figure 2 shows patterns in a related index, namely total private earnings of workers in the private sector.

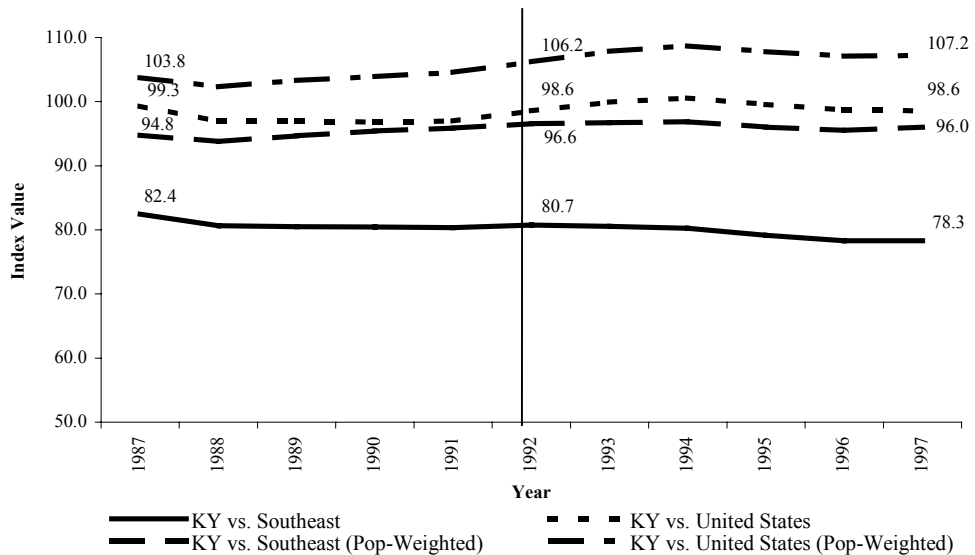
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FIGURE 1. PER CAPITA INCOME INDEX, KENTUCKY VS. THE SOUTHEAST AND UNITED STATES, 1987-1997 (1969=100)



Source: Regional Economic Information System, U.S. Bureau of Economic Analysis

FIGURE 2. PRIVATE EARNINGS, KENTUCKY VS. THE SOUTHEAST AND UNITED STATES, 1987-1997



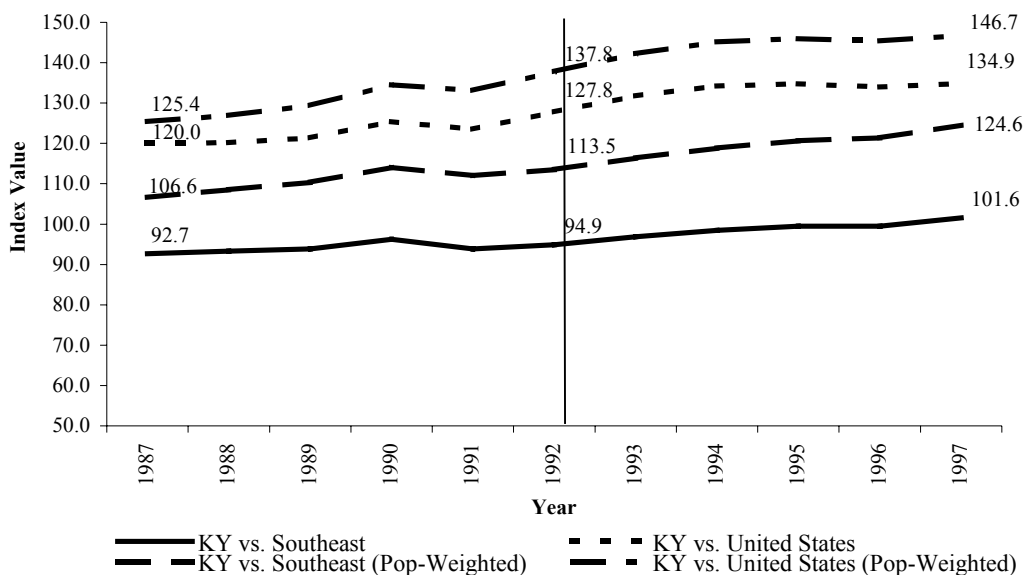
Source: Regional Economic Information System, U.S. Bureau of Economic Analysis

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Although the State of Kentucky has seen some improvement in its overall economic performance since the inception of its development plans in 1992, as measured by per capita income and private earnings, it actually gained considerably more ground on the two comparison groups in the previous five-year period, 1987 – 1992, prior to the adoption of the incentive programs. When accounting for associated changes in population, Kentucky actually lost ground on the Southeast and United States between 1992 and 1997. Together, data on per capita income and private earnings suggest that the Kentucky incentive programs did not have a noticeable economic impact on the state overall, at least relative to other states in the Southeast and to the nation.

Where Kentucky does seem to have gained substantial ground relative to the Southeast and nation as a whole is in manufacturing, as measured by manufacturing earnings (Figure 3). The index measuring Kentucky manufacturing earnings relative to the Southeast increased from 94.9 in 1992 to 101.6 in 1997, a change of approximately 7.1 percent. Likewise, the index comparing Kentucky manufacturing

FIGURE 3. MANUFACTURING EARNINGS, KENTUCKY VS. THE SOUTHEAST AND UNITED STATES, 1987-1997



Source: Regional Economic Information System, U.S. Bureau of Economic Analysis

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earnings to that of the United States increased from 127.8 in 1992 to 134.9 in 1997, a gain of 5.6 percent. Comparable figures for the 1987 – 1992 period reflect index gains of 2.4 percent and 6.5 percent, respectively.

Employment

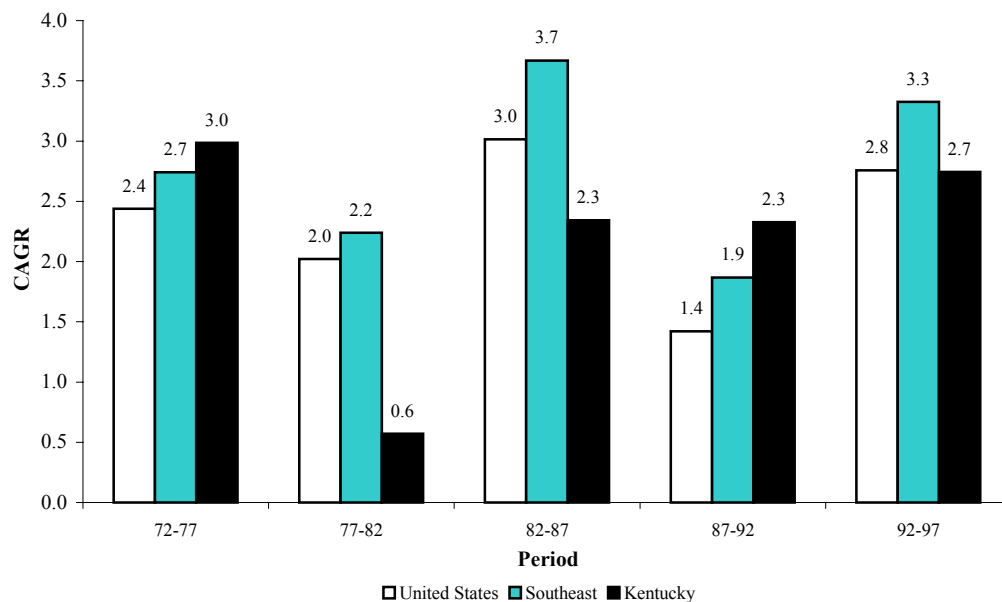
We next investigate the overall employment impact of the Kentucky incentive program, again comparing growth in Kentucky to growth in the Southeast and to the nation as a whole. Figures 4 and 5 compare compound annual employment growth rates (total private employment and manufacturing employment) in Kentucky, the Southeast, and the United States in five-year increments.

Unsurprisingly, information gleaned from comparisons of employment growth rates suggests conclusions similar to those from comparisons of per capita income and earnings. In terms of overall employment growth, Kentucky appears to have performed at about the level of the Southeast as a whole, and appears to have under-performed relative to the nation as a whole, in the immediate five-year period following the initiation of the state's incentive programs in 1992. However, Kentucky significantly out-performed the Southeast and the nation in manufacturing employment growth during the same period, the sector in which the incentives were primarily targeted.¹ Of course, these results are tempered by the fact that the state significantly out-performed the Southeast and the U.S. in manufacturing employment growth during the previous five-year period as well (1987 – 1992). Thus, there is little evidence that the growth in employment in Kentucky increased after 1992 relative to the growth that the nation and the Southeast was experiencing.

¹ Kentucky has a relatively large manufacturing employment base (18.6 percent of total private employment) compared to the Southeast average (15.6 percent) and the U.S. (14.7 percent).

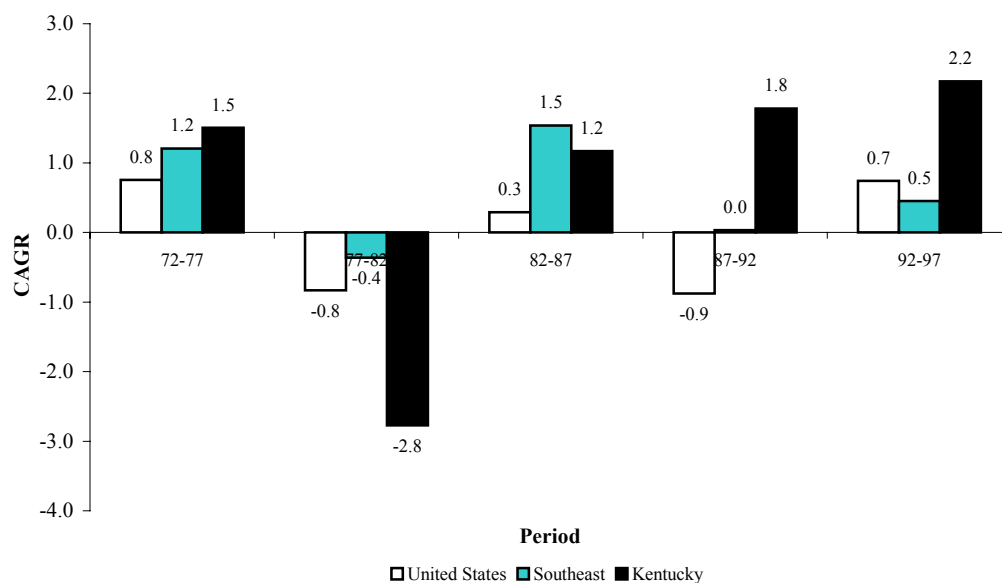
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FIGURE 4. COMPOUND ANNUAL EMPLOYMENT, GROWTH RATES, TOTAL (PRIVATE) EMPLOYMENT KENTUCKY, SOUTHEAST, & UNITED STATES, 1972-1997



Source: Regional Economic Information System, U.S. Bureau of Economic Analysis

FIGURE 5. COMPOUND ANNUAL EMPLOYMENT GROWTH RATES, MANUFACTURING KENTUCKY, SOUTHEAST, & UNITED STATES, 1972-1997



Source: Regional Economic Information System, U.S. Bureau of Economic Analysis

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IV. Analysis of the Proposed Change

In this section we present the results of our analysis of the proposed incentive program for Georgia.

A. Calculation of the Value of the Investment Incentive per Worker

To determine how the value of the existing incentives compares to the proposed incentive, and to calculate the total cost of the proposed incentives, we use investment per worker. In this section we discuss the likely value of investment per worker and we approach the estimation of the value of the investment per worker in three ways.

First, using information from a data set developed by Peter Fisher and Alan Peters, we can calculate the value of investment per worker in manufacturing.² The costs of land, building and equipment are, on average, \$77,358 per worker. The costs of just land and building are, on average, \$20,279 per worker.

Second, the incentive per worker for applications for the KREDA program is \$60,173. The KREDA program comes closest in design to the proposed program. However, the KREDA program's income tax credit per job is lower than what would be available under the proposed Georgia program since the KREDA program limits eligible equipment to \$10,000 per worker. We believe that the average equipment per worker is much higher than that in manufacturing.

Third, from the Department of Industry, Trade and Tourism we obtained a file listing all of the new projects in Georgia for the period 1990 – 2001, regardless of industry. This data file includes the expected value of the investment and the expected employment. The average firm had a reported investment per worker of \$81,453.

Based on these three estimates, the implied investment per worker in manufacturing would be between \$60,173 and \$81,450 for the typical firm. Based on these calculations, a reasonable value of investment per worker is \$70,000. For non-

² For a discussion of the data, see Fisher and Peters (1998).

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manufacturing, non-retail firms we use an investment per worker of \$30,000, which is the approximate average investment for the KJDA program.

B. Comparison of the Values of the Proposed Incentive with the Current Incentives

In order to determine whether firms will choose the proposed incentive or the existing incentive, we need to compare the value of the two programs. In comparing the two programs we consider the existing programs to be the Job Tax Credit and either the Investment Tax Credit or the Optional Investment Tax Credit.

Under the assumption that the firm can take full advantage of either incentive and that the firm is eligible for the Optional Investment Tax Credit, the value of the new incentive is larger provided the investment per worker is not too small. Consider a firm in Tier 1 with an investment of \$19,000 per worker. The value of the proposed incentive is thus \$19,000. Under the current BEST program the firm gets a Job Tax Credit of \$3,500 for each of five years and a 10 percent Investment Tax Credit, for a total incentive of \$19,400. So, in this situation the firm does better under the BEST program. If the investment per worker is greater than \$19,425 in Tier 1, \$13,586 in Tier 2, \$6,648 in Tier 3, and \$3,989 in Tier 4, then the incentive is larger under the proposed incentive than under the existing program. While there will be firms with investment per worker less than \$19,425 per worker, we expect most new projects, particularly in manufacturing to have investments greater than \$19,425 per worker.

However, firms may not be able to take full advantage of either incentive. One issue raised regarding the current incentive program is that many firms do not have the corporate tax liability to be able to take advantage of the incentive. This was the principal reason that the State changed the provisions for the Job Tax Credit for Tier 1 so that firms could use income tax withholding to capture the credit. We therefore consider how the value of the incentives will differ if the firm does not have substantial corporate tax liabilities. We consider several alternative scenarios.

Consider a firm that meets the minimum job creation and investment requirements for the Optional Investment Tax Credit. Assume that the firm pays a salary of \$30,000, that the income tax withholding is \$1,310 per year, and that

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investment per worker is \$70,000. Note that the average production worker in manufacturing in Georgia earned \$26,835 in 2000, and that the annual state income tax withholding for a single individual with an annual gross income of \$30,000 is \$1,310 (the effective tax rate is 4.4 percent).³

For Tier 1, currently the eligible firm can take a job tax credit of \$3500 per worker against the firm's income tax liability for each of five years, with a carry forward of unused credits for another five years. If the firm's tax liability per worker is less than \$3500, then the firm can retain up to 100 percent of the personal income tax withholding. Thus, the maximum job tax credit a firm can receive under the existing program is \$3500 per worker per year. Under the proposed program and without any corporate income tax liability the firm could take a maximum of \$1,310, i.e., the assumed amount of income tax withholding. Under the current job tax credit firms in Tier 1 can claim the job tax credit against total income tax withholding, while under the proposed program the firm can claim the withholding allowance (ITWA) only against the increase in withholding due to the increase in employment.

Table 4 summarizes the effect per new worker for firms in each tier under nine alternative assumptions regarding tax liability and total income tax withholding. For alternatives A, B, and C, it is assumed that the firm has no corporate income tax liability. For alternative D, E, and F the corporate income tax liability per worker is set equal to the assumed value of income tax withholding per worker, while for alternatives G, H, and I the tax liability per worker equals the job tax credit available in Tier 1.

For alternatives A, B, and C, a Tier 1 firm would not do better under the proposed incentive program. For all of the other cases, the proposed incentive has a larger incentive than the BEST program. The magnitude of the difference in the incentive amounts depends upon the corporate tax liability. Thus, as one moves from

³ A full 6 percent on \$30,000 would be \$1,800; however, that does not allow for personal exemptions, deductions, and for the lower tax rates that apply to the first \$7,000 in taxable income. For someone with an annual salary of \$30,000 and with spouse and one child, the withholding would be \$990 per year.

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**TABLE 4. ANALYSIS OF PROPOSED CHANGES FOR ONE NEW WORKER FOR
NINE HYPOTHETICAL FIRM ¹**

| Alternative Assumptions | A | B | C | D | E | F | G | H | I |
|--|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| Withholding per worker per year | \$1,310 | \$1,310 | \$1,310 | \$1,310 | \$1,310 | \$1,310 | \$1,310 | \$1,310 | \$1,310 |
| Tax liability per new worker per year | 0 | 0 | 0 | \$1,310 | \$1,310 | \$1,310 | \$3,500 | \$3,500 | \$3,500 |
| Total withholding from all other employees per new employee per year | 0 | \$9,000 | \$18,000 | 0 | \$9,000 | \$18,000 | 0 | \$9,000 | \$18,000 |
| Tier 1 | | | | | | | | | |
| BEST credit | \$13,100 | \$17,500 | \$17,500 | \$24,500 | \$24,500 | \$24,500 | \$24,500 | \$24,500 | \$24,500 |
| Proposed Program | \$13,100 | \$13,100 | \$13,100 | \$26,200 | \$26,200 | \$26,200 | \$48,100 | \$48,100 | \$48,100 |
| Change | 0 | -\$4,440 | -\$4,440 | \$1,700 | \$1,700 | \$1,700 | \$23,600 | \$23,600 | \$23,600 |
| Tier 2 | | | | | | | | | |
| Best credit | 0 | 0 | 0 | \$13,100 | \$13,100 | \$13,100 | \$18,100 | \$18,100 | \$18,100 |
| Proposed Program | \$10,480 | \$10,480 | \$10,480 | \$23,580 | \$23,580 | \$23,580 | \$45,480 | \$45,480 | \$45,480 |
| Change | \$10,480 | \$10,480 | \$10,480 | \$10,480 | \$10,480 | \$10,480 | \$27,380 | \$27,380 | \$27,380 |
| Tier 3 | | | | | | | | | |
| BEST credit | 0 | 0 | 0 | \$6,550 | \$6,550 | \$6,550 | \$10,450 | \$10,450 | \$10,450 |
| Proposed Program | \$7,860 | \$7,860 | \$7,860 | \$20,960 | \$20,960 | \$20,960 | \$42,860 | \$42,860 | \$42,860 |
| Change | \$7,860 | \$7,860 | \$7,860 | \$14,410 | \$14,410 | \$14,410 | \$32,410 | \$32,410 | \$32,410 |
| Tier 4 | | | | | | | | | |
| BEST credit | 0 | 0 | 0 | \$6,550 | \$6,550 | \$6,550 | \$6,550 | \$6,550 | \$6,550 |
| Proposed Program | \$5,240 | \$5,240 | \$5,240 | \$19,650 | \$19,650 | \$19,650 | \$24,050 | \$24,050 | \$24,050 |
| Change | \$5,240 | \$5,240 | \$5,240 | \$13,100 | \$13,100 | \$13,100 | \$17,500 | \$17,500 | \$17,500 |

¹ The value of the incentive for the existing and proposed program equal the maximum the firm can claim given the tier, tax liability, withholding amount, and an assumed investment per worker of \$70,000. The amount of the incentives is the total over the duration of the incentive (we did not discount the flow of incentive benefits) for each new worker added by the firm.

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left to right across the table, the difference becomes larger. The difference also increases as one moves down the table from Tier 1 through Tier 3, but then the difference decreases for Tier 4.

C. Total Value of Credits Taken

We estimate the total value of the proposed incentive that might be taken under two alternative assumptions. First, we consider a situation in which the State allows all firms that satisfy the eligibility requirements to take the maximum incentive they are allowed given their corporate income tax liability and personal income tax withholding. We refer to this as the entitlement assumption. Second, we consider the situation in which the State decides on the incentives a firm will receive on a case-by-case basis. We refer to this as the discretionary assumption.

Assumption A: Entitlement Assumption

We first consider the total cost of the proposed program if the state allows all eligible firms to take as much of the incentive as they can, i.e., up to the amount of the firm's eligible corporate tax liability and income tax withholding. We develop our estimate based on investment per worker. The first step is to calculate the increase in the number of workers in firms that are eligible for the proposed investment incentive. Given the likely investment per worker, most firms that satisfy the requirement for increasing the number of workers will also satisfy the minimum investment requirement.

We have calculated the average annual number of workers for which firms in each tier would have qualified for the proposed incentive over the period 1998 – 2000, the average annual salary of these workers, and based on average effective Georgia personal income tax rates (Table 5), their subsequent personal income tax liabilities.

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TABLE 5. AVERAGE PERSONAL INCOME TAX RATES IN GEORGIA, BY INCOME CLASS

| Income Class | Range | Avg Tax Rate (%) |
|------------------------------------|-------------|------------------|
| 1 st Quintile | < 23K | 0.9 |
| 2 nd Quintile | 23K – 39K | 2.8 |
| 3 rd Quintile | 39K – 52K | 3.5 |
| 4 th Quintile | 52K – 74K | 3.8 |
| 5 th Quintile: Next 15% | 74K – 126K | 4.0 |
| 5 th Quintile: Next 4% | 126K – 396K | 4.0 |
| 5 th Quintile: Next 1% | > 396K | 4.6 |

Source: ITEP Personal Income Tax Model, as reported in Citizens for Tax Justice and The Institute on Taxation & Economic Policy, “Who Pays? A Distributional Analysis of the Tax Systems in All 50 States,” 1996.

Using data available from the Fiscal Research Program’s ES-202 database, we identified each Georgia business that increased employment by the threshold required for their respective tiers, whether they be new or expanding businesses, and hence would have qualified for the proposed program. We then averaged the annual number of eligible workers over the 1998 – 2000 period for each tier. The results of these calculations are reported by tier and broad industry group in Table 6, along with the number of establishments and associated average weekly wage for each group.

Tier 3, which includes 35 (22 percent) of Georgia’s 159 counties,⁴ enjoyed by far the greatest number of new workers that would have qualified their employer for the proposed incentive. Over the 1998 – 2000 period, an average of 1,464 firms in Tier 3 would have met the criteria, employing roughly 82,286 new workers, of which 72,789 were non-manufacturing, non-retail. The applicable number of non-manufacturing, non-retail workers per year in Tiers 1, 2, and 4 are 11,910, 18,326, and 30,529, respectively.

From DITT’s list of project we calculated that for the period 1995-2000, the annual average total investment was about \$5.5 billion. If all of these projects were eligible for the proposed incentive, if firms had no limit on their ability to take the full value of the investment incentive, and if all firms took the incentive, then the annual cost of the proposed incentive would be \$5.5 billion. We estimate that about

⁴ There are 71 counties in Tier 1, 35 counties in each of Tiers 2 and 3, and 18 counties in Tier 4.

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\$1.6 billion would be the total potential cost of the incentives if just manufacturing firms were eligible. (This figure was derived by multiplying \$70,000, which is the assumed investment per worker, times the number of new workers in manufacturing as reported in Table 6.)

Doing a similar calculation for non-manufacturing, non-retail firms, and assuming, based on our analysis, that only 75 percent of these firms will satisfy the condition that 75 percent of their sales will be out-of-state, we estimate a potential cost of \$2.5 billion. The sum of these estimates is \$4.1 billion, which is somewhat smaller than the total value of new projects, i.e., \$5.5 billion.

Many firms may not have sufficient corporate income tax liability and income tax withholding to take the entire incentive. To calculate the total annual amount of income tax withholding that might be available to firms eligible for the proposed incentives, we used the data in Tables 5 and 6 to estimate the available ITWA for the proposed incentive. The results of which are reported in Table 7.

**TABLE 6. NEW AND EXPANDING BUSINESSES IN GEORGIA,
MEETING KIP EMPLOYMENT REQUIREMENTS, 1998 – 2000 AVERAGE**

| <u>Tier 1 Counties</u> Establishments with 5+ New Employees (New and Expanding) | | | | <u>Tier 2 Counties</u> Establishments with 10+ New Employees (New and Expanding) | | | |
|---|---------------|------------------|-----------------|---|---------------|------------------|-----------------|
| Industry | Estab. | Avg. Wage | New Empl | Industry | Estab. | Avg. Wage | New Empl |
| Manufacturing | 172 | 491.59 | 4,483 | Manufacturing | 132 | 530.56 | 5,392 |
| Retail | 184 | 210.43 | 2,558 | Retail | 145 | 272.04 | 4,223 |
| NonMan/NonRet | 442 | 334.96 | 7,426 | NonMan/NonRet | 355 | 347.14 | 12,934 |
| Total | 798 | 361.45 | 14,468 | Total | 632 | 371.01 | 22,549 |
| <u>Tier 3 Counties</u> Establishments with 15+ New Employees (New and Expanding) | | | | <u>Tier 4 Counties</u> Establishments with 25+ New Employees (New and Expanding) | | | |
| Industry | Estab. | Avg. Wage | New Empl | Industry | Estab. | Avg. Wage | New Empl |
| Manufacturing | 164 | 712.01 | 7,778 | Manufacturing | 80 | 733.34 | 5,643 |
| Retail | 240 | 342.20 | 9,497 | Retail | 88 | 506.06 | 6,441 |
| NonMan/NonRet | 1,060 | 714.38 | 65,010 | NonMan/NonRet | 359 | 573.16 | 24,885 |
| Total | 1,464 | 671.19 | 82,286 | Total | 526 | 585.90 | 36,970 |

Source: Fiscal Research Program calculations using the ES-202 database

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TABLE 7. ESTIMATED REVENUE LOSSES, INCOME TAX WITHHOLDING COMPONENT

| Industry (% of income tax withholding) | Tier 1 (100%) | Tier 2 (80%) | Tier 3 (60%) | Subtotal Tiers 1-3 | Tier 4 (40%) | Grand Total |
|--|------------------|-----------------|-----------------|-----------------------|-----------------|-------------|
| Manufacturing | 3,208,970 | 3,332,256 | 4,838,234 | 11,379,460 | 2,410,241 | 13,789,701 |
| Non-Manufacturing / Non-Retail | 1,164,173 | 1,681,053 | 40,571,868 | 43,417,094 | 8,306,774 | 51,723,868 |
| All Firms | 4,373,143 | 5,013,309 | 45,410,102 | 54,796,554 | 10,717,015 | 65,513,569 |

We estimate that the maximum ITWA available to manufacturing firms is \$13.8 million per year. However, not all firms are likely to take the credit. A reasonable estimate of the participation rate among eligible firms in the proposed program is 60 percent. Thus, the likely value of ITWA taken per year would be \$8.23 million. This amount could be taken for each of 10 years; in any given year there will be firms taking the incentives for the first time and firms taking incentives for the 10th time. Thus, the annual cost after the program has been in place for ten years will be \$82.3 million. This is substantially less than the \$1.6 billion maximum potential reported above.

If non-manufacturing, non-retail firms are also eligible for the proposed incentive program, we estimate an additional cost of the proposed program of \$294.8 million. (This assumes, based on our analysis, that only 75 percent of the non-manufacturing, non-retail firms meet the requirement that 75 percent of sales be made out of state, and assumes a 60 percent participation rate.) These estimates do not consider the increase in employment that might result from the larger incentives.

In addition to the ITWA, firms can use their corporate tax liability to take the proposed investment incentive. To investigate the extent to which firms may have the income tax liability to take the investment tax credit, we used corporate income tax data to estimate the tax liability of firms that created a minimum number of jobs. (We have no way of determining whether these firms had the required minimum investment, but if the firms create the minimum number of jobs, they are very likely to meet the minimum investment requirement.) For firms that created at least five new jobs, we estimate that the total income tax liability is \$9.9 million. For firms that created 25 or more jobs, we estimate the total tax liability for these firms to be \$7.8 million. In any given year, there will be firms taking the incentives for the first time and firms taking incentives for the 10th time. Thus, we multiple these annual amounts

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by 10 to get an estimate of the total income tax liability for exemption under the income tax credit part of the proposed program. Thus, the total tax liability available for the exemption is between \$78 million and \$99 million. While some firms may not have sufficient income tax liability to take full advantage of the income tax credit, in the aggregate, the investment tax credit proportion of the proposed incentive program could reach \$78 to \$99 million per year.

To estimate the available tax liability to take the credit for just manufacturing firms, we multiply by the percentage of workers who are in manufacturing, i.e., by 15.6 percent. Assuming a participation rate of 60 percent, we estimate the likely annual cost of the corporate income tax credit component for manufacturing firms to be \$7.3 million to \$9.2 million per year. Doing a similar calculation for non-manufacturing, non-retail firms, again assuming that only 75 percent of non-manufacturing, non-retail firms satisfy the condition that 75 percent of sales must be made to out-of-state buyers, the implied revenue loss is \$22.0 million to \$27.9 million.

Thus, combining the two components, i.e., the ITWA and the investment tax credit, the estimated total annual revenue loss to the State, assuming that the State allows all eligible firms to take as much incentive as feasible, is between \$89.6 million and \$91.5 million for manufacturing firms, and between \$316.8 million and \$322.7 million for non-manufacturing, non-retail firms.

Estimation of Discretionary Program

It is not possible to predict how restrictive the State would be in allowing firms to take the incentives. However, Kentucky's program is discretionary, and so we can estimate the revenue cost to Georgia if Georgia was as restrictive as Kentucky has been. Employment in Georgia is 2.2 times as large as in Kentucky, and between 1989 and 2000, employment increased by 32 percent in Georgia and by 16 percent in Kentucky, or twice as rapidly. The KREDA program is closest to the proposed program, but there are some differences with the proposed program. KREDA is restricted to certain counties and to manufacturing firms, so the value of the KREDA has to be increased for it to reflect the entire state and all industries. To get a

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statewide estimated value of the incentives, we take the \$25.0 million in KREDA benefits for 1998 and use the relative number of jobs associated with the KREDA in the application data to inflate the KREDA to get a statewide estimate. The result is \$63.8 million. Multiplying this by 2.2 yields \$140.4 million.

KREDA allows 100 percent of the investment to be applied to the income tax exemption, while the proposed program has a declining percentage across the tiers. To adjust for this, and since most of the jobs are created in Tiers 3 and 4, we take 60 percent of the \$140.4. This yields an estimate of the annual revenue loss of \$84.2 million for just manufacturing firms, which is only slightly smaller than the approximately \$90 million estimate of the potential cost. The estimate may be smaller than what Georgia might expect since the minimum number of new jobs required in the KREDA program is 15, which is higher than required in Georgia for Tiers 1 and 2. We do not adjust the estimate for that difference.

Summary of Estimates

The revenue loss to the state will depend upon how restrictive the State is in granting incentives to eligible firms and whether non-manufacturing, non-retail firms are eligible. If the State exercises the same discretion as Kentucky has, we estimate the cost of the proposed program for just manufacturing firms to be \$84.2 million per year. Allowing non-manufacturing, non-retail firms to take the credit could increase the cost by an additional \$317 million to \$323 million, but that could well be less if the State exercised its discretion and restricted the number of non-manufacturing, non-retail firms that were granted incentives.

D. Effect of the Proposed Program on State Revenue

In this subsection we present an analysis of the additional revenue, less additional expenditures, that the state government will receive from the increase in economic activity due to the jobs created by the proposed incentive. To estimate the net revenue effect from an additional incentive requires the following information. First, we need to know whether the project that receives an incentive under the proposed program would have located in the state without the incentive. Second, we

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need to know whether the jobs created directly and indirectly (i.e., through the multiplier effect) are taken by current residents or individuals who move into the State to take the jobs. For the former, the State is already covering the services provided to those residents. Thus, if the jobs go to current residents, the State gets the additional revenue and has no additional expenditures. For individuals who move into the State, the State will get additional revenue, but will also have to increase expenditures, e.g., to provide education for the new residents' children. Our analysis suggests that the growth in jobs between 1985 and 1990 was approximately equal to the increase in workers who moved into the State during that period. However, it is possible and likely that if several new jobs are created, some will go to current residents and some to new residents. Mindful of this, we produce estimates under two alternative scenarios: first, that all jobs go to new residents, and second, that only 50 percent of new jobs go to new residents.

Third, in order to determine the number of jobs that are subsequently created through the multiplier effect, we need to know the industry in which the original job was created. We adopt two assumptions. First, we assume that jobs are created in manufacturing industries in proportion to the actual job growth in those industries. Second, we assume that jobs are created in all eligible industries in proportion to the actual job growth in those industries. (Eligible industries here are those that are eligible in all tiers.)

Fourth, we need to know the increase in State tax revenues that result from a new job, and in the case of a new resident, the additional State expenditures. The Center for Economic Development Services at Georgia Institute of Technology has estimated these numbers as part of the development of a State-level LOCI (for Local Impact) model. The model, which includes the multiplier effects of a new job, provides estimates of the additional revenue and expenditures.

To measure the fiscal effect of a job created by the new incentives, we first determine the fiscal effects of a new job in each of the eligible industries. We then create a weighted average by multiplying these fiscal effects by the fraction of the actual growth in jobs in the relevant industries. The result is a measure of the net fiscal effect of a typical new job created because of the incentive.

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The two scenarios regarding who gets new jobs and the two scenarios regarding the industry in which the new job is located yield four alternatives sets of assumptions. Table 8 shows for each assumption the net fiscal benefit (additional revenue less additional expenditures) to the State per year per job created by the incentive, gross of the value of the incentive. As can be seen, under the assumption that all jobs go to new residents and using the weighted average of the fiscal effect across all eligible industries the net fiscal benefit to the State, gross of the incentive, is \$794 per year. If we use the weighted average of the fiscal effect across just manufacturing industries, the net fiscal effect, gross of the incentive, falls to \$359. The net fiscal effect, gross of the incentive, increases substantially under the assumption that half of the jobs go to current residents.

TABLE 8. FISCAL BENEFIT TO THE STATE FROM ONE NEW JOB

| Assumption | Net Fiscal Benefit to State Government Per Year Per Job |
|---|--|
| Job growth equal to actual, new jobs go to non-resident | \$794 |
| Job growth equal to actual in manufacturing, new jobs go to non-resident | \$359 |
| Job growth equal to actual, half of new jobs go to non-resident | \$6,045 |
| Job growth equal to actual in manufacturing, half new jobs go to non-resident | \$5,936 |

The fiscal benefit net of the incentive depends upon how well the State does in awarding incentives only to firms that would not otherwise have located in Georgia. If the State does a perfect job, then each job can be credited to the incentive. In that case the net fiscal benefit described in Table 8 can be associated with each job that receives an incentive. But if the State does an extremely bad job of picking firm to which it provides an incentive, i.e., incentives go to firms that would have located in Georgia without the incentive, then little of the benefits described in Table 8 can be credited to the incentives.

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A previous report provided estimates of the number of job tax credits that resulted in new jobs.⁵ That estimate was that 30 percent of the credits were for new jobs. Thus, if the State were to grant an incentive to every firm that applied, we would expect that it would be a “success” 30 percent of the time, where success means giving an incentive to a firm that would not have otherwise located in Georgia. It is an open question as to whether the State could be more successful than that, and it is possible that it could do worse.

Based on the analysis above, we assume that the investment per worker will be about \$70,000 per worker. But the typical firm will not be able to take full advantage of the incentive because of limited corporate income tax liability and income tax withholding. We assume that 25 percent of the incentive will be taken by the firm. Thus, the typical incentive would be about \$1750 per worker. This is higher than the first two entries in Table 8. However, if 50 percent of the new jobs are taken by current Georgia residents, then the incentive would yield a positive fiscal benefit, net of the incentive, to the State if one out of three firms that the State gave incentive to would not have located in Georgia in the absence of the incentive.

E. Other Benefits of Development Incentives

There are many benefits from creating new jobs beyond simply the revenue to the state. These benefits, which are not quantifiable, are discussed below.

Job Creation

One of the principal objectives of the tax credit program is the creation of a new job. The value of the benefit of this new job can be obtained by answering the question, how much would the State be willing to pay for one more job, even if the job generates no additional tax revenues? The benefit of creating a job depends on where it is located, what it pays, and who receives it. A new job in the rural part of the state is undoubtedly worth more than an additional job in the Atlanta metropolitan area because of the high growth rate in the Atlanta area. And, certainly a job paying

⁵ See Faulk, et al. (2000).

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\$14.00 an hour is worth more than one paying \$6.00 an hour. Finally, a job going to a current unemployed resident is worth more than if the job goes to someone moving in from out of state.

Improved Business Climate

The existence of the tax incentives improves the perception of the business climate in the State. One of the aspects of the attractiveness of a site is the perception of how friendly government is toward business. The provision of tax incentives is one such indicator. Furthermore, as noted in Appendix A, site location specialists use the existence of economic development incentives as one factor in site decision. The site decision is actually a multi-step process in which sites are eliminated in each round of consideration based on increasingly refined criteria. It is thought that to make it very far in the winnowing process, tax credits and other incentives must be in place.

Synergistic or Clustering Effects

The tax credit incentives may attract a firm in an industry new to the state and which serves as a magnet for attracting additional firms in the industry. This benefit, which is separate from the multiplier effect, means that it is easier in the future to attract other firms in that industry. However, given that the tax credits are not highly targeted and by themselves are not likely to attract a major firm in a highly desired industry, these benefits are likely to be quite small for the tax credit incentives.

F. Other Issues

The proposal would require an application. The state would review the application and determine the maximum incentive allowed. This adds to the complexity and costs that do not exist in the current program. However, given that the magnitude of the incentive would be significantly increased, this review is probably necessary. However, this is a fundamental change from the entitlement program of BEST to a discretionary program.

An additional eligibility requirement is added, namely a minimum investment per new employee. The proposed value of the minimum investment is small, i.e.,

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\$10,000 per new worker if there is just the minimum number of workers. Thus, we expect it is to have little effect on the total number of firms that are eligible. We expect that few service sector firms will qualify since the capital to labor ratio is small in many of these firms. Firms that add workers as part of a second shift will not likely qualify.

Basing the income tax withholding allowance on the amount of withholding means that the value of the incentive will vary with the filing status of the worker. Since individuals who are single are likely to have the largest withholding for any given salary, the program provides an incentive for the firm to hire singles rather than married workers. The program also provides an incentive for the firm to encourage the worker to take extra withholding.

There does not appear to be any new legal barriers to adopting the proposed program. The existing BEST program allows income tax credits and, at least in Tier 1, allows firms to retain payroll withholding. Thus, the proposed program adds no new components. However, this is not a legal opinion.

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V. Update on Incentives in Southeastern States

In a previous report we provided a review of economic development incentives offered in Southeastern states.⁶ Here we list selected changes that have been made to the incentives in these states. Georgia's recent change in its BEST program, with its focus on rural areas, and the initiation of the One Georgia program are among the noteworthy of the changes in the Southeast.

A. Alabama

Alabama's corporate income tax was substantially modified effective January 1, 2001. Pursuant to a constitutional amendment approved by voters on March 21, 2000, the corporate income tax rate was increased from 5 percent to its current rate of 6.5 percent.

Credit for investment in Alabama State Port Authority: Legislation in 2001 offers tax credit incentives for new and existing business who invest in the Alabama State Port Authority infrastructure. A qualifying project must have a capital cost of not less than \$8 million and the predominant trade or business activity conducted must constitute industrial, warehousing, or research activity. The credit will be against any Alabama income tax liability generated by an investment will be equal to 5 percent of the capital costs annually for 20 years. Each taxpayer wishing to claim the credit must obtain the prior written approval of the Governor, Finance Director, and Alabama State Port Authority and must also file with the Department of Revenue. The sum of the capital credit may not exceed the capital costs of the project and will not be available for new projects after December 31, 2005 unless continued by the legislature. (Alabama Code Sections 40-9B-3, 40-9B-6, and 40-9B-9.)

Tax credits for rural development: A new law provides tax credits to businesses locating or expanding in rural or undeveloped counties. The law provides the criteria for such counties (change in population, per capita income, and percent of employment) and the eligibility requirements for receiving the tax credits. The

⁶See Thomas (2000).

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investment must be \$500,000 or more and the predominant trade or business activity conducted must be industrial, warehousing, or research activities. Effective 2001. (Alabama Code Section 40-18-190 and 40-18-193.)

B. Florida

Enterprise Zone Program: HB 1225 in 2001 was a substantial rewrite of the Enterprise Zone Program which grew from an assessment and recommendations of the previous law by the Senate Committee on Commerce and Economic Opportunities. It includes provisions for community development, workforce education, comprehensive planning, and economic development, as well as \$2.8 million appropriation. The new law affects both rural and urban zones by making the jobs tax credits against sales and corporate income taxes dependent upon the creation of new full-time jobs rather than being based upon the hiring of new individuals into existing jobs. The bill doubles the value of the previous incentive and provides the incentive for two years instead of one, which is intended to provide four times the current incentive value for the creation of a new job. In addition, there are new provisions for which a taxpayer may receive a credit of 50 percent against sales taxes for a community contribution. This is an alternative to the present corporate income tax or insurance premium tax credit. The sales tax refund may be submitted for the prior 12 months without waiting a year for the credit. With respect to rural areas, the bill triples the value of the jobs tax credit for rural areas and provides the incentive for two years instead of one, which provides a rural business with six times the current value of the tax credit for full-time job creation. The bill defines rural zones and authorizes their expansion to reflect rural land usage patterns and population densities. It revises some existing rural economic development programs in order to duplicate the package-of-incentives approach that appears to be successful in urban enterprise zones. The new statute adds broadband communications investments to the “eligible project” list for the community contribution tax program if a project increases access to high-speed broadband capability in rural communities with enterprise zones. In addition, Quick Action Closing Funds are made available to allow a privately owned broadband infrastructure investment to receive state funds if

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the project increases capacity in a rural zone. With respect to housing, the act addresses the effects of gentrification by creating incentives for property owners to sell rental property in distressed areas to low-income residents.

C. Kentucky

Kentucky Economic Opportunity Zone Credit (KEOZ) This Act focuses on qualified development in areas with high unemployment and poverty levels. A qualified zone consists of 1 to 5 contiguous census tracts but not more than one per county. KREDA-certified counties are exempt from the census tract criteria and may have the entire county certified as a zone. Eligible companies include new or expanded firms in manufacturing, service, or technology industries which invest at least \$100,000 in the project and create at least ten new full-time jobs for residents of the zone. An approved company may receive up to a 100 percent credit against income tax liability created by the project. The carry forward period is 10 years. (KRS 54.23-005 through 154.23-079, Acts 2000, ch 528 Section 2, effective 7/14/00.)

Basic Skills Employee Training Credit: Under this program a credit is allowed for corporations that assist certain full-time employees to complete a qualified high school equivalency diploma program. The credit is equal to 50 percent of a portion of the hours released for employees' study multiplied by their hourly salary, not to exceed \$1,250 per employee. Effective 7/14/00. (KRS 151B.127, Acts 2000, ch 526, Section 12.)

Coal Incentive Credit: To qualify for this credit, a taxpayer must use more Kentucky coal in the production of electricity than was used in 1999. The credit equals \$2 per ton of qualifying coal used. The law is applicable to returns filed after July 15, 2001 and the credit sunsets in 2011. (KRS Chapter 131.)

Governor's Vetoes: In 2000, the Governor vetoed two economic development bills: (1) HB 902, which would have amended the requirements for technology businesses to receive tax credits; (2) HB 201, which would have amended KREDA particular certification qualifications.

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D. North Carolina

The Department of Commerce was required to study the effect of tax incentives on tax equity. [N.C. General Statutes 105-129.2A] These studies are noted in the bibliography and may be accessed through www.commerce.state.nc.us/publicaffairs/.

Amendments to the William S. Lee Act: Included in the changes to the Act in 1999 are the following provisions: (1) the sunset on Act was extended from 2002 to 2007; (2) credits to customer service centers and electronic mail order houses in Tier 1 and 2 were added, effective January 1, 2000; (3) an annual refund of 6 percent sales taxes paid on capitalized machinery and equipment sold to eligible businesses in Tiers 1 or 2 was added; (4) more favorable tier designations were provided for small counties, effective January 2000; (5) a 25 percent credit is available for contributions to nonprofits for capital projects within development zones, effective January 2000; (6) credits are allowed against insurance premiums tax (in addition to corporate income and franchise tax), effective January 1999; (7) businesses must provide a portion of health insurance costs and meet environmental, safety, and health standards in order to qualify for credits, effective January 2000; (8) the application fee for credits in Tiers 1 and 2 is eliminated while the fee is increased to \$500 per credit in other tiers, with a cap of \$1,500 per applicant; (9) applications for credits must provide additional information to enable the Department of Commerce to evaluate the effectiveness of the credits in development zones, effective July 1999; and (10) credits for interstate air carriers were clarified. In addition to the changes in the Lee Act, a credit (equal to 25 percent of the federal credit) was created for rehabilitating or constructing affordable housing. Effective January 2000.

In 2000, the Lee Act was amended to change “central administrative office” to “central office or aircraft facility”, adding aircraft facilities to businesses eligible for credits. Another exception to county tier designations was made in 2000. These exceptions are for small counties to extend the re-designation provision for counties unless their new (better) status is maintained for two years.

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E. South Carolina

Community Development Corporation Investment Credit: Code Section 12-6-3530 has been added to provide an income tax, bank tax, or insurance premium tax credit equal to 33 percent of an investment (with some exceptions) in a community development corporation or community development financial institution. The total credit that may be claimed by all taxpayers is \$1 million in one year and \$5 million for all years. Any unused credit may be carried forward; however, the carry forward must be used before the taxable year that begins on or after 10 years from the date of the acquisition of stock or other equity interest that is the basis for the credit. The term “community development corporation” (Code Section 34-43-20(2)) means a nonprofit corporation that has a primary mission of developing and improving low-income communities and neighborhoods through economic and related development. This act is effective in tax years beginning after 2000 and the provisions terminate on June 30, 2005. (Act No. A314, Senate Bill 80, 2000.)

Job Development Credits: These amendments provide changes to some definitions in the law, modifications to criteria that a business must satisfy to qualify for benefits, and some changes in procedures for claiming the job development credit. Effective August 17, 2000. (Act No A399, Senate Bill 575, Sections 3.A.2 and 3.B.1. through 6.)

Job Tax Credit - Technology Intensive Facility: Job tax credits for certain businesses creating new full time jobs has been expanded to include “technology intensive facilities” as a qualifying type of business as defined. Effective June 30, 2001. (Act No A283, HB 3782, Sections 5.A. and B.) In addition, job development credits for technology facilities are included for Enterprise Zones. (Act No. A283, HB 3782, Sections 5D.E. and F., 2000.)

Corporate Tax Moratorium Code Section 12-6-3365 has been added to grant a 10-year, or in some cases a 15-year, moratorium on a taxpayer’s corporate income tax that represents the ratio of the company’s new investment in the qualifying county to its total South Carolina investment. The moratorium begins the first full taxable year after the taxpayer qualifies and ends either at the earlier of (a)

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10 years from that date, or (b) the year when the taxpayers number of new full time jobs falls below 100. The moratorium is available to a taxpayer who: (1) creates and maintains at least 100 new full times jobs within five years from the date it creates the first new full time job; (2) creates a maintains the new full time jobs at a facility in a specified county with low unemployment and per capita income; and (3) places at least 90 percent of its investment in South Carolina in the qualifying county. If the taxpayer creates and maintains at least 200 new full time jobs within five years, the moratorium period is extended to 15 years. The effective date is for tax years beginning after 1999 and provisions are repealed July 1, 2005. (Act No A277, Senate Bill 1210, Section 1.)

Fee-in-lieu tax revisions: These changes seek to simplify and clarify the provisions of the fee program to make explicit the General Assembly's intent that businesses be afforded broad flexibility in their choice of financing techniques. The legislation also allows two businesses, which are not part of a controlled group, which are involved in a simple project to execute a single fee-in-lieu with a county where the aggregate investment equals or exceeds the statutory minimum which is \$5 million within five years. This does not expand the incentive itself. Effective May 2000. (South Carolina Code Sections 4-12-10 and 4-12-30.)

F. Tennessee

Business enterprise investment: If a business enterprise makes a capital investment in excess of \$1 billion (or \$500 million) to be invested over a period not to exceed three years and creates not less than 1,000 full time jobs with wages equal to or greater than 150 percent of Tennessee's average industrial wage, the enterprise shall be allowed \$5,000 for each net job. In addition to the credits allowed for the first tax year, a portion of the credits may also apply on an annual basis to offset taxpayer's franchise tax and excise tax liability for each subsequent year up to a total of 20 years. The Commissioner of Economic and Community Development with written concurrence of the Comptroller must determine that the location and nature of the investment is economically desirable and in the best interests of the citizens. Effective July 1, 2000. (TCA 67-4-2109(c)(2) (G) and (H).)

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Business tax credits for personal property taxes: If there is an agreement between the property owner and a local governmental unit when property is transferred to a governmental unit, credits are prohibited if the city or county government has rejected the credit by a 2/3 vote. Prior law provided that such provision must be “approved” by 2/3 vote. Effective May 22, 2001 and retroactively applicable to tax years beginning January 1, 1999 for agreements in effect on that date. (TCA Section 67-4-713(a)(6)(C).)

G. Virginia

Credit for machinery purchase of equipment used for processing recyclable materials was extended from January 1, 2001 to January 1, 2004. This credit allows individuals and corporations an income tax credit equal to 10 percent of the purchase price paid for machinery and equipment, as certified by the Department of Environmental Quality, used to process recycled materials for sale. The total credit allowed cannot exceed 40 percent of the taxpayer’s Virginia income tax liability in the year of purchase. Effective July 1, 2001. (Code Section 58.1-439.7.)

Low Income Housing Tax Credits were modified to reduce the maximum amount authorized annually from \$3.5 million to \$500,000. Taxpayers may now take the credit against the bank franchise tax and the gross receipts tax on insurance premiums. The tax credit applies to any five taxable years in which a federal low-income housing tax credit is allowed instead of the first five taxable years in the federal credit is allowed. Any unused credit may be carried over for five taxable years or until the full credit is used, whichever occurs first. Effective for taxable years beginning January 1, 2001. (Code section 36-55.63 and 58.10435.)

Information Technology or Biotechnology Capital Credit: The Technology Initiative in Tobacco-Dependent Localities Fund will be used to fund tax credits and/or grants for capital, debt, cash, and stock investments in technology companies located in tobacco-dependent communities and for qualified research taking place in these communities. Credits for capital investments are limited to 5 percent of the amount of the investment up to \$500,000 in aggregate per taxpayer. Tax credits for qualified research taking place in the specified localities is limited to

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50 percent of the amount paid or incurred for such research and may be taken in the year in which such R&D activity occurred. Effective January 2000 and expiring January 2010. (H.B. 402, 2000 Session Code Section 58-1-439.12.)

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Appendix

Descriptions of Kentucky's Incentive Programs

KENTUCKY INDUSTRIAL DEVELOPMENT ACT (KIDA)

Eligible Companies

Any business entity that establishes new manufacturing plants or expands existing manufacturing operations in Kentucky.

Eligible Projects

The project must involve a minimum investment of \$100,000 and create at least 15 new full-time jobs for persons subject to Kentucky income tax. Land, building fixtures, and equipment for new and expanding manufacturing companies, together with storage, warehousing, and related office facilities. Eligible costs include expenditures for land acquisition, site development, utility extensions, architectural and engineering services, building, construction or rehabilitation, purchases of building fixtures including installation costs, and manufacturing equipment. The project's real estate must be acquired by the approved company through either the transfer of title to the company or through a capital lease as defined under FASB 13. Eligible manufacturing equipment cost is limited to \$10,000 tax credit for every full-time job created.

Tax Credits

A KIDA approved company chooses to receive either a 100 percent credit against the Kentucky income tax liability generated by the project or to utilize a 3

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percent Job Development Assessment Fee (JDAF). This entails a withholding from the employees hired as a result of the KIDA approved project for 3 percent of the employees gross wages. The employees recoup the JDAF through a state income tax credit equal to the amount withheld. Either option is limited to the annual amount of debt service (principal and interest) paid to a lender in connection with the eligible financing. However, the maximum KIDA incentive (the tax credit or job development assessment fee) cannot exceed the original principal amount of debt used as the basis for the transaction. The tax credit or JDAF remains in place for the term of the financing or 10 years, whichever occurs first. Unused credits may be carried forward for the term of the KIDA agreement.

Financing

Since the benefits under the KIDA program are related to debt service payments, the company must incur debt for the project's fixed asset financing. The debt financing may be provided through any source such as bank loans, industrial revenue bonds, inter-company loans or shareholder loans. The debt must be structured as a term loan to be included in the KIDA Financing Agreement for recovery through the tax incentives.

The Process

1. The company makes application to KEDFA
2. KEDFA approves the applicant as a preliminarily approved company, approves the project, and enters into a memorandum of agreement with the company.
3. The company provides KEDFA with the debt instruments to be used for the project financing.
4. A KIDA Financing Agreement is drafted by KEDFA based on the debt instruments.
5. The final KIDA Financing Agreement is approved by KEDFA.

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Fees

There is a \$500 non-refundable application fee payable upon submission of the KIDA application. Fees which the company may expect to incur as a result of final approval include an administrative fee equal to 1/4 of 1 percent (\$40,000 maximum) of the principal amount of debt used as the basis for the transaction. In addition, the company will incur legal fees necessary for the preparation of the Financing Agreement.

KENTUCKY RURAL ECONOMIC DEVELOPMENT ACT (KREDA)

Eligible Companies

Any business entity that establishes new manufacturing plants or expands existing manufacturing operations in qualifying Kentucky counties.

Qualified Counties

Kentucky counties whose average annual unemployment rate has exceeded the state average annual unemployment rate in the five preceding calendar years or counties whose unemployment rate is 200 percent of the statewide unemployment rate for the preceding year are eligible. Once a company is operating under a KREDA agreement, the company maintains its KREDA benefits regardless of the county's KREDA status.

Eligible Projects

All fixed assets of the project that are financed via a term loan are eligible for recovery through the KREDA tax incentives. The project's real estate must be

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acquired by the approved company through either the acquisition of title or through a capital lease as defined under FASB 13. The project must also create and maintain a minimum of 15 new jobs for persons subject to Kentucky income tax and the project's total capital investment must exceed \$100,000.

Tax Credits

A KREDA approved company receives a 100 percent credit against the Kentucky income tax liability on taxable income generated by the project limited to the annual amount of debt service (principal and interest) paid to a lender in connection with the eligible project financing. However, the maximum KREDA incentives (the tax credit and job development assessment fee) cannot exceed the original principal amount of debt used as the basis for the transaction. The tax credit remains in place for the term of the financing or 15 years, whichever occurs first. Unused credits used may be carried forward through the term of the KEDA agreement.

Job Development Assessment Fees

An approved company may also utilize the Job Development Assessment Fee ("JDAF") in connection with the KREDA project. This entails a withholding equal to 4 percent of the gross wages from the employees hired as a result of the KREDA approved project. The employees recoup the JDAF through a state income tax credit equal to the amount of JDAF withheld. As a convenience, the JDAF is offset against normal state income tax for each pay period and the employee receives credit on the W-2 statement as if the JDAF was withheld and remitted to the state.

Financing

Since the benefits under the KREDA program are related to debt service payments, the company must incur debt for the project's fixed asset financing. The

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financing may be provided through any source such as bank loans, industrial revenue bonds, inter-company loans or shareholder loans. The debt must be structured as a term loan to be included in the KREDA Financing Agreement for recovery through the tax incentives.

The Process

1. The company makes application to KEDFA.
2. KEDFA approves the applicant as a preliminarily approved company, preliminarily approves the project and enters into a memorandum of agreement with the company.
3. The company provides KEDFA with the debt instrument(s) to be used for the project fixed asset financing.
4. A Financing Agreement is drafted by KEDFA based on the debt instruments.
5. The final Financing Agreement is approved by KEDFA.

Fees

There is a \$500 non-refundable application fee payable upon submission of the KREDA application. Fees which the company may expect to incur as a result of final approval include an administrative fee equal to 1/4 of 1 percent (\$40,000 maximum) of the principal amount of debt used as the basis for the transaction. In addition, the company will incur legal fees necessary for the preparation of the Financing Agreement.

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KENTUCKY JOBS DEVELOPMENT ACT (KJDA)

Eligible Companies

Eligible companies that may receive KJDA benefits are service or technology related companies such as data processing, research and development, and other non-manufacturing, non-retail "white collar" companies. These companies must provide more than 75 percent of their services, as generated through revenues, to persons located outside the state. Additionally, the company must increase its employment of Kentucky residents by a minimum of 25 new, full-time jobs at the project.

Approved Costs

Approved costs are defined as 50 percent of the start-up costs which include the costs associated with furnishing and equipping the facility and 50 percent of the annual rent costs. Maximum approved start-up costs are \$10,000 per new full time job for Kentucky residents subject to personal income tax.

Inducements

The company receives a 100 percent credit against the state income tax arising from the project, and a wage assessment of up to 5 percent of the increased gross payroll of the new employment resulting from the project. Total assessments and credits cannot exceed the approved costs, and cannot be taken beyond a 10-year period.

Employee Tax Credit

If the company uses the wage assessment portion of the program, each employee is

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entitled to an income tax credit against their Kentucky income tax equal to 4/5 of the total wage assessment. In addition, the employee is entitled to credit against local occupational tax equal to 1/5 of the total wage assessment.

Fees

There is a \$500 non-refundable application fee payable upon submission of the KJDA application. Fees which the company may expect to incur as a result of final approval include an administrative fee equal to 1/10 of 1 percent with a minimum of \$1,000. In addition, the company will incur legal fees necessary for the preparation of the Agreement.

Process

1. A completed application is submitted by the company to KEDFA and local jurisdiction before the last Friday of the month prior to the KEDFA Board meeting.
2. A letter from the company describing the project and outlining the company's compliance with the criteria for the program is submitted with the application.
3. A letter from the local jurisdiction supporting the project is submitted with the application.
4. A Preliminary Resolution is executed by KEDFA approving the project which occurs at the board meeting held approximately 30 days after submission of the application.
5. At the time of Preliminary approval, a Memorandum of Agreement is sent to the company to be executed.
6. A public hearing is held approximately 3-6 months prior to Final approval.
7. A resolution is adopted by the local jurisdiction prior to Final approval.

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8. Final approval and execution of the Service and Technology Agreement will occur within 1 year from the date of Preliminary approval. The Agreement must be fully negotiated at the time of Final approval. All fees must be paid and the Activation date of the project must be set in order to finalize the Agreement. Activation of the project can occur no later than one year from Final approval. Verification of the start-up costs and rental payments will occur after Activation.
9. After Activation, exhibits included within the Agreement will be submitted every year for the duration of the company's participation within the program for up to ten years.

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The Fiscal Research Program provides nonpartisan research, technical assistance, and education in the evaluation and design of state and local fiscal and economic policy, including both tax and expenditure issues. The Program's mission is to promote development of sound public policy and public understanding of issues of concern to state and local governments.

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An Analysis of a Proposed New Economic Development Incentive

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