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June 13, 2016

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Request for the Reallocation of Early Stage Business Investment Tax Credits to the Business Development Tax Credit -- Agenda Item V

REQUEST

On June 2, 2016, the Joint Committee on Finance (JFC) received a request from the Wisconsin Economic Development Corporation (WEDC) for authorization to reallocate $8,000,000 in unused angel and early stage seed investment tax credits for use as business development tax credits under s. 238.15(3)(d) and s. 238.308 of the statutes.

Under s. 238.15(3)(d), WEDC may reallocate nonrefundable angel and early stage seed investment credits in any calendar year that are unused in that calendar year to a person eligible to receive refundable business development tax credits under a 14-day passive review by JFC. An objection was raised shortly after JFC received the request. If the Committee approves the request, the statutory limit under s. 238.308(4)(b) for the amount of refundable business development tax credits tax credits that WEDC may allocate in 2016 would increase from $17 million to $25 million.

BACKGROUND

Early Stage Business Investment Tax Credits. The early stage business investment program includes two nonrefundable credits: (a) the angel investment tax credit, which can be claimed under the individual income tax; and (b) the early stage seed investment tax credit, which can be claimed under the individual income tax, the corporate income/franchise tax, and the insurance premiums tax.

The angel investment tax credit equals 25% of the claimant's bona fide angel investment made directly in a qualified new business venture (QNBV) certified by WEDC. The early stage seed investment tax credit is equal to 25% of the claimant's investment paid to a certified fund manager that the fund manager invests in a QNBV certified by WEDC. Pursuant to 2015 Wisconsin Act 55 (the biennial budget bill), the annual limit on the amount of angel and early stage seed investment tax credits that can be verified by WEDC as eligible to receive the credits is $30 million per calendar year. Act 55 further specified that if less than $30 million in angel and early stage seed investment credits are verified and awarded by WEDC in a given year, the balance cannot be carried forward. However, WEDC can request a reallocation of angel and early stage seed investment tax credits that have not been verified to receive credits in that year to increase the credit amounts that can be claimed under the refundable business development tax credit. The proposed reallocation is subject to a 14-day passive review by JFC.

Business Development Tax Credit. A refundable credit can be claimed against the individual income tax and the corporate income/franchise tax, for: (a) up to 10% of the amount of wages paid to an eligible employee; (b) up to an additional 5% of wages paid to an eligible employee if employed in an economically distressed area, as determined by WEDC; (c) up to 50% of training costs incurred to train or develop skills of an eligible employee; (d) up to 3% of a personal property investment; (e) up to 5% of a real property investment in capital investment projects; and (f) a percentage, as determined by WEDC, equal to a percentage of wages paid to an eligible employee involved in the performance of corporate headquarters functions if that employee's job was created or retained in connection with a corporate headquarters location of retention in Wisconsin.

In order for a person to be certified to receive business development tax credits, that person must operate or intend to operate a business in the state and enter into a contract with WEDC. Certifications can remain in effect for up to 10 years. WEDC may allocate up to $17 million of business development tax credits in calendar year 2016 and up to $22 million annually thereafter. Under the state accounting system, refundable tax credits are treated as expenditures (rather than revenue offsets) and paid from state appropriations.

The business development tax credit was created under Act 55, which consolidated aspects of the nonrefundable economic development tax credit and the refundable jobs tax credit. Act 55 sunset the jobs tax credit and economic development tax credit for taxable years beginning after December 31, 2015, and the business development tax credit took effect for taxable years beginning in 2016. As previously noted, unused angel and early stage seed tax credits can be reallocated to the business development tax credit, subject to a 14-day passive review by JFC. Prior to 2016, WEDC could request a reallocation of credits under the same process for the refundable jobs tax credit.

ANALYSIS

Angel and early stage seed investment credits have not been reallocated to the business development tax credit to date. However, JFC authorized credit reallocations by WEDC and the former Department of Commerce totaling $26.9 million to the jobs tax credit program in the following years:

Year	Reallocated Amounts
2009	$3,091,375
2010	6,836,288
2011	7,000,000
2012	10,000,000

WEDC submitted a request to reallocate an additional $15 million of early stage seed investment credits to the jobs tax credit in 2015. However, after an objection was raised to the request, WEDC withdrew its request from the Committee.

As previously noted, WEDC cannot verify awards for angel and early stage seed credits in excess of $30 million during a calendar year. Although the annual statutory limits for the amount of credits that WEDC can verify for awards have changed multiple times since the program began, utilization of the credits has been approximately 40% of the aggregate annual statutory limit over the 11 years the program has been in effect and credit awards have not exceeded 77% of the aggregate annual statutory limit in any calendar year. The table below shows the amount of tax credits WEDC verified investors as eligible to receive since the early stage business investment program has been in effect, the aggregate statutory limit of angel and early stage seed credits that could be verified, and the percentage of the annual limit verified compared to the statutory limit. The table does not include: (a) the statutory earmark that existed between 2011 and 2014 for nanotechnology businesses, for which $250,000 could be claimed for investments in nanotechnology businesses under both the angel and early stage seed investment credits; (b) any reduction for credits reallocated in previous passive review processes from 2009 through 2012; or (c) increased allocation authority for credit carry-forwards that were permitted prior to 2015. According to WEDC, angel and early stage seed investments are generally verified as eligible to receive credits in the spring following the year in which the eligible investments were made. As a result, tax credit verifications for eligible investments made in 2016 will not be known until after the spring of 2017.

Early State Business Investment Credits Verified by WEDC

Year	Angel Credits	Early Stage Seed Credits	Total Credits	Aggregate Annual Statutory Limit	Percentage of Annual Limit Utilized
2005	$2,990,000	$126,000	$3,116,000	$6,500,000	47.9%
2006	2,418,000	1,423,000	3,841,000	6,500,000	59.1
2007	2,050,000	2,600,000	4,650,000	6,500,000	71.5
2008	3,106,000	4,284,000	7,390,000	11,500,000	64.3
2009	5,529,000	3,226,000	8,755,000	11,500,000	76.1
2010	5,032,000	2,567,000	7,599,000	14,500,000	52.4
2011	6,701,000	4,622,000	11,323,000	40,500,000	28.0
2012	8,209,000	3,807,000	12,016,000	40,500,000	29.7
2013	6,025,000	2,803,000	8,828,000	40,500,000	21.8
2014	6,959,000	5,474,000	12,433,000	40,500,000	30.7
2015	12,359,000	5,923,000	18,282,000	30,000,000	60.9

Under WEDC's reallocation request, it anticipates that angel and early stage seed tax credits that will be issued for eligible investments made in 2016 will be in the range of $16 million to $20 million. This assumption is not unreasonable considering 2015 investments were verified as eligible to receive $18.3 million of credits. If JFC approved the reallocation request, it is estimated that the remaining $22 million of WEDC's statutory limit for verifying angel and early stage seed investment credits in 2016 would be sufficient without requiring WEDC deny credits for otherwise eligible investments.

The business development tax credit program became effective on January 1, 2016. Since the effective date of the program, eight businesses have entered into contracts with WEDC for up to $2.5 million of business development tax credits. WEDC indicates that an additional $8.1 million of credits have been committed (preliminarily allocated, but still in the contracting phase) to an additional 18 businesses. The table below shows the amount of credits contracted, committed, the statutory limit, and the remaining amount of business development tax credits that WEDC can allocate through contracts for the remainder of 2016.

Credits Contracted	Credits Committed	2016 Statutory Limit	Available Balance
$2,490,000	$8,114,000	$17,000,000	$6,396,000

WEDC's request states that, at the current utilization rate for the business development tax credit, it anticipates obligating the remainder of its available balance for 2016 prior to the end of the year. If the Committee were to approve WEDC's request, the available balance of business development tax credits would increase to $14,396,000 for the remainder of calendar year 2016. Under current law, any unused allocation authority may be carried forward to the following year. If the Committee approved the reallocation request and a portion of the $8.0 million that was reallocated from unused angel and early stage seed investment tax credits was not allocated during the remainder of 2016, WEDC's business development tax credit authority would increase above its $22.0 million statutory limit for 2017 by the amount carried forward.

FISCAL EFFECT

Under the request, $8,000,000 in early stage business investment credits would be reallocated in 2016 for business development tax credits. It is difficult to estimate the timing for when individuals and businesses will be verified by WEDC as eligible to receive business development tax credits and then claim those credits from the Department of Revenue. The program took effect on January 1, 2016, and no verifications or credit claims have been made under the program. Under the policies and procedures adopted by WEDC's Board, business development credits for jobs created or retained can generally be earned over three years, credits for capital investment expenditures and for incurred employee training costs can be awarded after the eligible investment or training activity occurred, and credits for wages earned for jobs created or retained in connection with a capitol headquarters relocation or retention can be earned on an equal basis over three years.

Since the business development credit is refundable and unused allocation authority can be carried forward to future years, approval of this request would increase sum sufficient GPR expenditures by $8 million in future years. It is estimated that approval of this request would increase GPR expenditures by $2.0 million in 2016-17 and by $6.0 million in 2017-18. However, to the extent the credits are not allocated in 2016 and are carried forward to 2017, and to the extent that credits are claimed and earned over a longer period of time, a portion of this fiscal effect could be delayed to future years.

ALTERNATIVES

1. Approve the WEDC request under s. 238.15(3)(d) to reallocate $8 million in angel and early stage seed investment tax credits for use as business development tax credits under s. 238.308(4)(b). Increase estimated sum sufficient expenditures from the business development credit appropriation [s. 20.835(2)(bg)] by $2,000,000 GPR in 2016-17. In addition, estimate increased expenditures in the business development tax credit appropriation of $6,000,000 in 2017-18.

2. Approve the WEDC request, but reallocate a different amount of angel and early stage seed investment tax credits for use as business development tax credits.

3. Deny the request.

Prepared by: Sean Moran