SPONSOR'S FISCAL NOTE

SENATE TAXATION
EXHIBIT NO. 2
DATE 1/14/05
BILL NO. SB 66

Bill #: SB 66 **Title:** Investment tax credit

Primary Sponsor: Sam Kitzenberg **Status:** As Introduced

Sam Kitzenberg 1-13-05
Sponsor signature Date

Fiscal Summary

The purpose of this fiscal note is to demonstrate that the revenue impact of an investment tax credit as proposed in SB 66 has two sides. The original fiscal note shows only one side (the loss of revenue from the tax credit). Because the purpose in implementing an investment tax credit is to encourage investment that in turn results in new jobs, this fiscal note provides a scenario to demonstrate the positive revenue impacts as well the revenue loss from application of the credit. It is revised to coordinate information to the executive's fiscal note that was not initially available.

	FY2004 Difference	FY2005 Difference
Expenditures:		
General Fund		$61,657
Revenue:		
General Fund		$0
Net Impact on General Fund Balance:		**($61,657)**

Yes	No		Yes	No	
X		Significant Local Gov. Impact		X	Technical Concerns
	X	Included in the Executive Budget	X		Significant Long-Term Impacts
	X	Dedicated Revenue Form Attached	X		Needs to be included in HB 2

Fiscal Analysis

ASSUMPTIONS:

1. The credit of 3 percent on qualified investments is effective January 1, 2006, which means that the tax credit sought for investments made beginning in calendar year 2006 will be included in returns filed in the first half of calendar year 2007 (which is the last half of fiscal year 2007) and years thereafter.
2. This "Sponsor's Fiscal Note" assumes that the fiscal impact of the executive's fiscal note is accurate to the extent that it shows the Department of Revenue cost of implementation and the direct negative revenue impact that occurs with application of the credit in individual and corporate tax returns. The executive fiscal note shows the cost of implementation to be $61,657 in the second year of the biennium. The reduction in general fund revenue resulting from the credit is shown to be $4,943,000 in the second year and $8,749,000 annually in subsequent years. This assumes that filings for the credit will occur beginning in the second half of the second year. The executive's fiscal note assumes that 100% of the credits taken in individual returns will occur in this period. It assumes that 30% of the credits taken in corporate returns will occur in this time period, resulting in a partial impact in the second fiscal year of the biennium and then a full impact in subsequent years.
3. The estimated investment applied to the credit in fiscal year 2007 is $164.8 million and in fiscal year 2008 would be $291.6 million. (Divided DOR revenue loss estimates by 3%.)
4. New jobs will be created as a result of business investments. For purposes of this fiscal note, it is assumed that the average salary plus benefits for new jobs would be $35,000 per year.
5. The "multiplier effect" for creation of new jobs would be 1.7. This means that an investment in the economy results in an additional 70 percent created elsewhere in the economy as those moneys cycle through the economy. Another way to look at this is that 41% of the $35,000 income is spent in the local economy, and 41% of that portion is spent in the local economy, and so on. If continued through 10 iterations, the result is that the total amount of impact in the local economy is $59,327 (1.7 times $35,000). A table is attached that demonstrates the model used.
6. The tax liability (gain in tax revenue) attributable to the new position would be $1,402 assuming a 20% deduction, $2,505 for exemptions, and a 5.5% tax rate. Applying the 1.7 multiplier results in an estimated tax liability of $2,376 resulting from the overall impact of adding the one job.
7. Dividing $2,376 by the investment tax rate of 3% indicates that a job would need to be created for each $79,200 of investment in order to offset the loss of revenue (resulting from the credit) in the year that the credit is taken. For fiscal year 2007, the number of jobs created would need to be 2,080. In fiscal year 2008, the number of jobs created would need to be 3,682. (In reality, the impact of a job created would occur every year that the new job continues to be in place and filled. Therefore, if the average life of new jobs were 7 years, then only about 297 jobs would need to be created in fiscal year 2007, and 526 jobs would need to be created in fiscal year 2008. This translates to the need for one new job for every $550,000 in investment. However, this would mean that the negative impact of the credit could occur in one year and the positive impact would occur over a period of seven years. The fact that the tax credit cannot exceed 45% of the taxpayer's liability would likely spread the negative impact over a period of years – from one to seven based upon the ability to carry the unused credit forward for 7 years.)

FISCAL IMPACT:

		FY2006 Difference	FY2007 Difference
FTE			1.00
Expenditures:			
Personal Services			$42,229
Operating Expenses			7,828
Equipment			11,600
TOTAL			$61,657
Funding:			
General Fund (01)			$61,657
TOTAL			
Revenues:			
General Fund (01)	**(see assumptions #3-7)**		$0
Net Impact to Fund Balance (Revenue minus Expenditure):			
General Fund (01)			($61,657)

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

The creation of jobs in a community may result in positive impacts, such as increasing the tax base.

LONG-RANGE IMPACTS:

Because of the delayed implementation date of this bill, the full impact of this proposal for both the individual income tax and corporation license tax will not occur until fiscal 2008. It is estimated that in FY 2008, the credit provided for in this bill will reduce corporation tax revenue by $5.437 million and will reduce individual income tax liabilities by $3.312 million, for a total reduction in revenue of $8.749 million. Impacts of this magnitude will continue in subsequent years. As indicated in assumptions 3 through 7, there are expected to be positive revenue impacts that would offset the loss of revenue, if not in the first year then over a period of years.

Fiscal Note Prepared by: Sen. Sam Kitzenberg

Attachment

Figure 1
Example of Income-Multiplier Effect

A	B	C	D	E	F	G
Worker	Before tax income including benefits	Spending (70% of income)	Local spending (90% of spending)	Wholesale purchases outside region (34.9% of local spending)	Purchases or wages paid inside region	Percent Column G is of Column B
1	35,000	24,500	22,050	7,695	14,355	41.0%
2	14,355	10,048	9,043	3,156	5,887	41.0%
3	5,887	4,121	3,709	1,294	2,415	41.0%
4	2,415	1,690	1,521	531	990	41.0%
5	990	693	624	218	406	41.0%
6	406	284	256	89	167	41.0%
7	167	117	105	37	68	41.0%
8	68	48	43	15	28	41.0%
9	28	20	18	6	11	41.0%
10	11	8	7	3	5	41.0%
Total	59,327					

Note: The "multiplier" is 1.7 (59,327 divided by 35,000)