Legislative Performance Audit Committee

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Senator Annette Dubas
Senator Bob Krist
Senator Heath Mello
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February 11, 2013

Tax Incentive News Release (corrected)

A performance audit of four business tax incentive programs found that the goals Nebraska legislators stated for the incentives were too vague to permit useful evaluations of the programs, according to a report released Monday by the Legislative Performance Audit Committee.

Businesses that qualified for incentives under the Nebraska Advantage Act—the major program of the four reviewed—used nearly $101 million in tax refunds and credits between 2008 and 2011, and earned as much or more in additional tax credits that had not yet been used, according to the report. Yet, whether these amounts, or key data from any of the other three programs, mean that the incentives are doing “'enough'” or that program costs are “'appropriate'” cannot be judged.

“The audit's overarching finding is that the program goals expressed by the Legislature in the statutes and during legislative debate are too general to permit a meaningful evaluation of whether the programs are, in fact, accomplishing what the Legislature hoped they would accomplish,” the report stated.

Senator John Harms, chairman of the Performance Audit Committee, said his committee wants to work with the Revenue Committee to initiate an in-depth review of the programs to determine their value to the state. “We know the businesses that used these incentives have invested millions of dollars in the state and have created new jobs,” Harms said. “What is not clear is how much of that activity may have occurred without the tax incentives.”

Acknowledging research cited in the audit report about the difficulty of measuring tax incentive impacts, Harms nevertheless said the Legislature now has program data for several years that makes this an excellent time to determine if the incentives are producing the intended results at a cost lawmakers can support.

State Tax Commissioner Douglas Ewald worked with the auditors during the audit but declined comment on the findings in the draft report.

In addition to the Nebraska Advantage Act, which offers an array of benefits to companies that invest or create jobs in the state, auditors reviewed the Nebraska Advantage Rural Development Act; the Nebraska Advantage Microenterprise Act; and the Nebraska Advantage Research and Development Act. The Legislature created or modified all four acts in 2005.

Among the key report recommendations are that the performance audit committee or Legislature consider legislation to better articulate program goals and consider ways to improve the state's ability to evaluate tax incentive programs.

The audit also found that:

- The estimated cost-per-job for jobs created under the centerpiece Nebraska Advantage Act ranged from $42,747, considering only compensation tax credits, to $234,568 considering all earned benefits except the property tax exemption.
- The modeling software the Revenue Department uses to project future state revenue gains and losses compares favorably to best practices for economic modeling. However, the software is not useful in forecasting actual program costs (affect on the state budget) and auditors questioned whether the department should continue to include long-term projections in its tax incentive program annual report.
- Ample performance data for the Nebraska Advantage Act is available, but comparable data for the other three programs is sparse. This makes review of these programs' overall impact difficult.
- The Revenue Department is technically complying with the statutory requirement that it make recommendations to the Legislature about incentive programs that should be eliminated, but, by always making "no recommendation," the department may not be complying with the spirit of the requirement.

The audit report is available on the Legislature's Web site, nebraskalegislature.gov., in "Reports" > "Performance Audit," and hard copies are available in the Legislative Audit Office on the 11th Floor of the State Capitol.

Committee Report, Vol. 18, No. 1

Nebraska Department of Revenue: An Examination of Nebraska Advantage Tax Incentive Programs

Performance Audit Committee
Nebraska Legislature

February 2013

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Audit reports are available on the Unicameral's Web site (www.nebraskalegislature.gov) or can be obtained from Martha Carter, Legislative Auditor, at (402) 471-1282.

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Nebraska Department of Revenue: An Examination of Nebraska Advantage Tax Incentive Programs

February 2013

Prepared by
Martha Carter
Kathryn Gudmunson
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I. Committee Recommendations

Audit Summary and Committee Recommendation

This audit was undertaken to provide the Committee and Legislature with information on the performance of four tax incentive programs: the Nebraska Advantage Act; Nebraska Advantage Rural Development Act; Nebraska Advantage Microenterprise Act; and Nebraska Advantage Research and Development Act. The key question was how the programs' performance compared with the goals established by the Legislature when the programs were created. The audit also reviewed the economic modeling program used by the Department of Revenue, which implements the programs, and described challenges in evaluating tax incentive programs.

Committee Recommendation

The Committee will work with the leadership of the Revenue Committee to initiate a comprehensive review of Nebraska's tax incentive programs to assess whether the programs are producing the results the Legislature intended and, if so, whether they are doing so at a cost the Legislature can support. The review should also: identify any data the Legislature needs to make such an assessment that is not currently required to be reported and therefore not available to policy-makers, and review the existing statutory requirement that the Revenue Department make recommendations about incentives that could be limited or eliminated.

Audit Summary

Finding: Need for Measurable Goals

The audit's overarching finding is that the program goals expressed by the Legislature in the statutes and during legislative debate are too general to permit a meaningful evaluation of whether the programs are, in fact, accomplishing what the Legislature hoped they would accomplish. At the broadest level, the Legislature expected the tax incentives to stimulate business activity and expand the state's tax base. Additionally, for two of the programs, including the Advantage Act, which has the largest impact on the state budget, the Legislature set no limit on the programs' costs, in terms of foregone state revenue. By these standards, any activity could be deemed success and any cost acceptable.

In the absence of specific goals against which to compare the programs' performance, this report presents the available program outcome and cost data without making judgments about whether the programs are doing “enough” or whether the costs are “appropriate.”

Finding: Need for Information

The audit points out that while there is ample performance data for the largest incentive program—the Nebraska Advantage Act—there is little performance data for other three programs. The absence of additional performance data makes it difficult to review the overall impact of the State's incentive programs and the report suggests that if the Legislature establishes specific goals for the incentive programs it may also need to enact legislation authorizing the Revenue Department to release comparable information on all the tax incentives programs.

Finding: Economic Modeling Program Good but Value of Projections to Policy-makers Questioned

The audit found the Revenue Department's economic modeling software (TRAIN) compares favorably to best practices but questioned the usefulness of publishing the long-term projections derived from the software. The audit notes that those projections, which appear in the Department's annual report, may easily be misinterpreted as forecasts of the Advantage Act's expected state cost when, in fact, TRAIN is not a forecasting tool.

Finding: Evaluating Tax Incentive Programs is Challenging but Necessary

The research reviewed for this audit identified a number of challenges to evaluation of tax incentive programs including, among other things: (1) the difficulty in determining which business activities resulted from the incentives as opposed to those which would have occurred even without the incentives; (2) the lack of clear program goals; and (3) the need to consider indirect impacts as well as direct impacts.

The audit also indicates that a recent report by the Pew Center on the States indicated Nebraska is ahead of many other states in the steps needed to evaluate such programs, in that the Department of Revenue is required to regularly report information on all of the State's tax incentives programs. To improve its evaluations, the State needs to go beyond available information to conclusions about the effectiveness of the programs and incorporate that information in the policy-making process, according to the Pew Center report.

Specific Audit Findings & Draft Recommendations

Section I: The Nebraska Advantage Act

Program Costs and Goals

FINDING: For 2011, the estimated cost-per-job created under the Advantage Act ranged from $42,747, based only on the cost of compensation tax credits, to $234,568, based on all earned benefits except the property tax exemption. (p. 18)

Recommendation: Additional study of this issue could be incorporated into the general review recommended above or the Committee could conduct a more in-depth performance audit focusing on the per-job cost estimates.

FINDING: While the Advantage Act has made progress in some of the general goals established by the Legislature, in the absence of clear, measurable goals, it is difficult to say whether the Act is doing what the Legislature intended it to do. (p. 20)

Recommendation: The issue of program goals is a policy issue for Senators to consider. If the Committee and Legislature are satisfied with the program results, they do not need to take additional action. However, if the Committee or the Legislature are not satisfied with the program results, they may wish to consider introducing legislation to better articulate program goals.

Economic Modeling and Published Projections

FINDING: The TRAIN modeling program compares favorably to best practices for economic modeling, but cannot be used as a forecasting tool. (p. 21)

FINDING: The projections of "projected future state revenue gains and losses," currently published by the Revenue Department are not program-cost forecasts, and as such their value to policy-makers is questionable. (p. 23)

Recommendations: The Revenue Department should consider whether to continue publication of the long-term projections or whether publication of only shorter projections could be more useful. At a minimum, the Department should add a qualification to the report that projections are not program cost forecasts, which would be in keeping with the existing statutory requirement that the Department "identify limitations that are inherent in the analysis method."

Section II: Selected Other Incentive Acts

In this section, we reviewed the results of three other tax incentive acts: The Nebraska Advantage Rural Development Act, Nebraska Advantage Microenterprise Act, and Nebraska Advantage Research and Development Act.

FINDING: These three programs suffer from the same problem—from an evaluation standpoint—as does the Advantage Act: In the absence of clear, measurable goals and relevant data, it is difficult to say whether they are doing what the Legislature intended them to do. (pgs. 28, 30, 32)

Discussion: While these three programs have a much smaller impact in terms of usage and cost than the Advantage Act, it could be beneficial to know more about program participants, including the types of businesses that have benefited and their geographic locations in the state.

Recommendation: The Committee or the Legislature may want to consider requiring the Department to report additional information on programs that use incentives under these three acts.

Section III: Complexities of Assessing Tax Incentive Programs

FINDING: Research shows that evaluating the impact of tax incentive programs is difficult and suggests that the best evaluations attempt to take both direct and indirect factors into account. Identifying the policy goals for these programs is particularly important. (p. 34)

FINDING: Nebraska's evaluations of its tax incentives are not as effective as they could be. This could mean that some incentives are being funded that are not the best investment and others that would be better investments are not being sufficiently funded. (p. 35)

FINDING: Although the Revenue Department is technically complying with the statutory requirement that it provide recommendations to the Legislature regarding incentives that should be eliminated or limited, it may not be meeting the spirit of the requirement by always having "no recommendation." This response potentially deprives the Legislature of useful information. At the same time, the requirement itself is problematic, in that it may be unrealistic to expect such policy recommendations from Department staff whose responsibility is program administration, not policy development. (p. 39)

Recommendation: The Committee or the Legislature should consider ways of improving the state's ability to evaluate its tax incentive programs. A starting point for such improvement would be to address the two areas noted in a recent Pew Center on the States report.

The first is the need for evaluative information about how well the incentives are working. As noted above this information is not currently being provided by the Revenue Department and the Committee or Legislature may want to consider another source for it. The second recommendation is that evaluative information be better incorporated into the policy-making process, in order to remedy the concern that tax incentive programs often are not reviewed in the way direct expenditure are. The Legislature has a number of options for accomplishing this goal, including increasing the sunset dates in incentive act legislation; establishing review of this information as a priority for a standing committee; or conducing an interim study, among other things.

II. Legislative Audit Office Report

Legislative Audit Office Report

Nebraska Department of Revenue: An Examination of Nebraska Advantage Tax Incentive Programs

February 2013

Prepared by
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Kathryn Gudmunson
Clarence Mabin
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INTRODUCTION

In January 2012, the Legislative Performance Audit Committee (Committee) directed the Legislative Audit Office (Office) to conduct a performance audit of Nebraska tax incentives. That audit was to occur following completion of an audit of the Nebraska Department of Roads approved at the same time. Due to the complexity of the Department of Roads audit and reduced number of audit staff as a result of state budget constraints, the Office was unable to begin the tax incentives audit until September 2012. In addition, the Committee asked that we do what we could in time for the 2013 legislative session.

Given the breadth and complexity of the topic and tight time frame for the audit, the scope of the project was narrowed in two key ways. First, the primary focus of the audit is on the Nebraska Advantage Act (Advantage Act), which is the state's single most-used tax incentive program and also the program for which the most comprehensive data are available. The audit includes to a lesser extent three other incentive programs that were either created in, or greatly modified by, the bill that created the Advantage Act. The second means of narrowing the audit scope was to rely on previously existing data rather than collecting our own.

In October 2012, the Committee directed the Office to answer the following specific questions in the audit.

For the Nebraska Advantage Act, the Nebraska Advantage Rural Development Act, the Nebraska Microenterprise Tax Credit Act, and the Nebraska Research and Development Act:

1. What were these programs created to do, and what were the projected costs and benefits when they were adopted in 2005?

2. How do the programs' actual costs and benefits compare to the projections? How does the modeling done by the Nebraska Department of Revenue for the Nebraska Advantage Act compare to best practices?

In terms of tax incentive programs generally:

3. What does existing research say about the complexities of assessing tax incentive programs?
4. What are the requirements of the Tax Expenditure Reporting Act and is the Nebraska Department of Revenue

complying with those requirements?

Section I of this report addresses the Nebraska Advantage Act and Section II addresses the other acts. Section III addresses the research question as well as the Department of Revenue's compliance with the requirements of the Tax Expenditure Reporting Act.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on the audit objectives. The methodologies used are described briefly at the beginning of each section, with further detail provided as needed in the appendices.

We appreciate the cooperation and assistance of the Department of Revenue staff during the audit.

SECTION I: The Nebraska Advantage Act

In this section we present the results of our assessment of the Nebraska Advantage Act (Advantage Act), including the intent of the act, the projected costs and benefits, and the actual costs and benefits. We also discuss the Department of Revenue (Revenue Department or Department) projection process and evaluate how that process compares to best practices.

Background

The Advantage Act, created by LB 312 (2005), is a multifaceted business tax incentive bill that replaced LB 775 (1987), the Employment and Investment Growth Act, as the primary tax incentive package in Nebraska. Though the Advantage Act used the same framework as the Employment and Investment Growth Act, the terms of the incentives were modified and significant new reporting requirements were added.

Benefits

The Advantage Act provides a variety of benefits to companies that invest or create jobs in Nebraska, including direct refunds of sales and use taxes, exemptions from personal property taxes, and credits that may be used to: offset payroll withholding; reduce personal or corporation income taxes; obtain sales and use tax refunds; and to obtain reimbursement of real estate taxes.

The Act creates tiers that award greater benefits for higher levels of investments or job creation. For example, under Tier 1, a company that invests $1 million and creates 10 new jobs is eligible for a 50 percent sales tax refund as well as a percentage of job and investment credits. Under Tier 2, a company that invests $3 million and creates 30 new jobs is eligible for a 100 percent sales tax refund and higher job and investment credits. Some tiers have a broad availability, while others target specific industries. (See Appendix 1 for details on the individual tiers.)

Originally, the Advantage Act only had five tiers, but it has been amended to include more industries and larger investments. Special Tier 2 was added to provide new benefits for large data centers (LB 1118, 2012), and Tier 6 was added to include incentives for higher paying jobs (LB 895, 2008). The amount of investment and wage limits to qualify have also changed since the 2005 bill, as each adjusts with inflation. Allowing for this adjustment was one of the major changes between the Advantage Act and the former Employment and Investment Growth Act.

Time-line for Qualifying and Receiving Benefits

To receive Advantage Act benefits, a company must apply to the Revenue Department. The application date is important because it affects key program factors, such as:

- which tier a company can apply under,
- which investments can be considered,
- what the required wage levels will be for new employees, and
- how long the company can collect benefits for the project.

By law, all information in the application must be kept confidential except the name of the taxpayer (in this case the business), the location of the project, the amounts of increased employment and investment, and information required to be reported by statute.

The project is approved by the Tax Commissioner once it meets the requirements under the relevant tier. Once the project is approved, the business and the Tax Commissioner enter into a signed agreement stating the requirements the project must meet, the time frame for meeting such requirements, and additional information. The business has 10 to 15 years, depending on the tier, in which to earn and receive benefits.

Generally speaking, in order to receive benefits, a business must first complete an attainment period, during which it must reach the agreed-upon levels of investment or hiring. The business then enters the entitlement period, in which it may use benefits earned in the attainment period, as well as earn and use additional benefits. Under some circumstances, a business that has not used all of its earned credits in the entitlement period may qualify for additional time, called the carryover period, in which to use them. Table 1.1, on page 5, provides an overview of this process.

By statute, if a project is not attaining or maintaining the minimum required levels of investment and employment within the required time period, the Department must take steps to recapture all or a portion of the incentives already used by the company.

Table 1.1. Project Phases Under the Nebraska Advantage Act

Time Limit (Depending on Tier)	Project Phase
5 to 7 years	**Attainment Period** A business must reach required investment and hiring levels during this period. Some benefits can be earned during this period.
6 to 10 years	**Entitlement Period** A business may earn and use benefits during this period.
0 to 8 years	**Carryover Period** A business that did not use all its earned benefits during the entitlement period may use them during this period.
10 to 15 years	**Maximum Life** The three project phases cannot extend beyond this limit.

Source: Table prepared by the Legislative Audit Office.

Projected State Costs and Benefits

To identify the costs and benefits legislators were considering when the Advantage Act was adopted we reviewed the fiscal notes and legislative histories for the Employment and Investment Growth Act and for the Advantage Act. During debate on the Advantage Act, the Legislature discussed potential costs, however there was no definitive statement about how much the incentives given out under the Advantage Act were expected to cost in the long-term.

Similarly, we found that neither history contained specific goals for the benefits the Legislature expected the Acts to provide. In general, legislative debate on the Employment and Investment Growth Act focused on retaining the state's existing businesses, while the general intent of the Advantage Act was to reignite economic development in Nebraska, which had slowed since the passage of the Employment and Investment Growth Act.

Intent language in the Advantage Act specifically states that the Legislature chose to revise Nebraska's tax structure in order to "encourage new businesses to relocate to Nebraska, retain existing businesses and aid in their expansion, promote the creation and retention of new jobs in Nebraska, and attract and retain investment capital in the State of Nebraska." In addition to general economic development, the Advantage Act was intended to improve transparency in the tax incentive process and prevent out-migration from Nebraska.

Actual Costs and Benefits

It is difficult to determine the Advantage Act's full costs or its exact impact on the state because the available cost and benefit figures are known to have important limitations. As with the other information in this report, the discussion of costs and benefits is based on the program's activities between 2008 and December 31, 2011.

Tax incentives represent a "cost" to the state in revenue the state would have collected in the absence of the incentives. For 2008 to 2011, the Department reported that 33 businesses used almost $101 million in Advantage Act incentives[1] but acknowledged that the figure underestimates the full state cost. The underestimate is due to (1) additional tax credits the 33 businesses had earned but not used, and (2) additional businesses the Department expects will be found eligible for incentives based on actions taken between 2008 and 2011.

The amount of the unused tax credits is almost $104 million, although Department staff said it was possible that businesses will not use all of those credits, based on the experience of the previous tax incentive program. The credits can be used for one or more years after 2011 and will not become part of the state's cost until they are used.

There will be additional businesses that benefit from incentives earned prior to December 31, 2011 because the Department is still reviewing business activities that took place between 2008 and 2011. A business cannot receive tax benefits until the Department has verified that it met all program requirements. Again, the state will not incur the cost for those incentives until after 2011.[2]

For the same period of time, the Department reports that the 33 businesses that used the Advantage Act benefits invested almost $1.4 billion in the state and created 4,079 jobs. One important limitation on those figures is that research on similar programs has shown that it is very difficult to determine whether the investments and jobs occurred *as a result of* the incentives or

1 This figure consists of approximately $67 million in tax credits used, $19 million in direct refunds, and $15 million in property tax exemptions.

2 A note on terminology: We refer to the Advantage Act tax provisions as "incentives" from the perspective of the state but as "benefits" from the perspective of the businesses that use them.

whether all or a portion would have happened without the incentives. There are other challenges to determining the exact impact of tax incentive programs as discussed in Section III of this report.

Information specific to the businesses that have received benefits under the Advantage Act is limited by what the Revenue Department is allowed to report. State law protecting the confidentiality of tax-related information prohibits the Department from releasing any information unless there is a specific statutory requirement that they do so. While the Advantage Act requires the publication of significantly more information than do the other acts discussed in this report, some limitations remain, which we discuss as needed in reporting the program's results.

The following discussion describes the program's costs and benefits in these ways:

- the relative size of the Advantage Act incentives compared to other incentives;
- the types of industries of participating businesses;
- the geographic location of the businesses' proposed projects; and
- the amount of benefits used by specific businesses.

We report information about the businesses that have signed agreements—meaning they are eligible to earn benefits—because they represent the potential total program costs and benefits. We also report the information about the actual costs and benefits as of December 31, 2011 to show what has occurred as of that date.

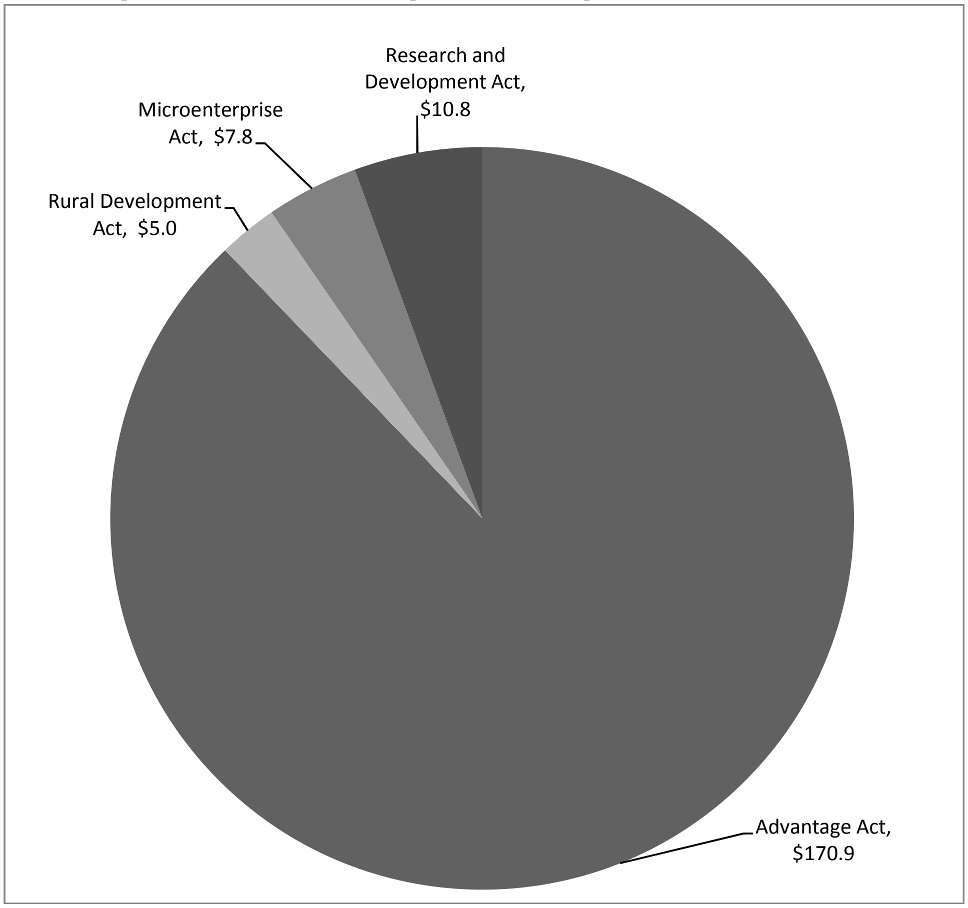
Relative Size of Advantage Act Compared to Other Incentives

As stated previously, the Advantage Act is the state's most-used tax incentive program. There have been 339 applications to the program since 2006. Of those, 143 resulted in signed agreements and, as of December 31, 2011, the Department has verified that 33 businesses have met the required investment and job creation thresholds and begun receiving benefits.

As of the end of 2011, these 33 businesses earned a total of almost $171 million in tax credits. In comparison to the other programs discussed in this report, businesses have earned $5 million in tax credits under the Rural Advantage Act; almost $11 million under the Research and Development Act; and almost $8 million under the Microenterprise Act. Chart 1.1 shows this comparison.

This graphic reflects the maximum amount earned by businesses as of December 31, 2011, which represents the total *potential* cost to the state as of that date. According to the Revenue Department, historically, not all earned credits have been used, so the actual cost to the state may be less.

Chart 1.1. Credits Earned Under the Four Acts Reviewed in This Report 2006-2011* (in millions)



Source: Chart created by the Legislative Audit Office using data from Department of Revenue, Nebraska Tax Incentives: 2011 Annual Report to the Nebraska Legislature.
*Advantage Act benefits were not earned until 2008.

Industries

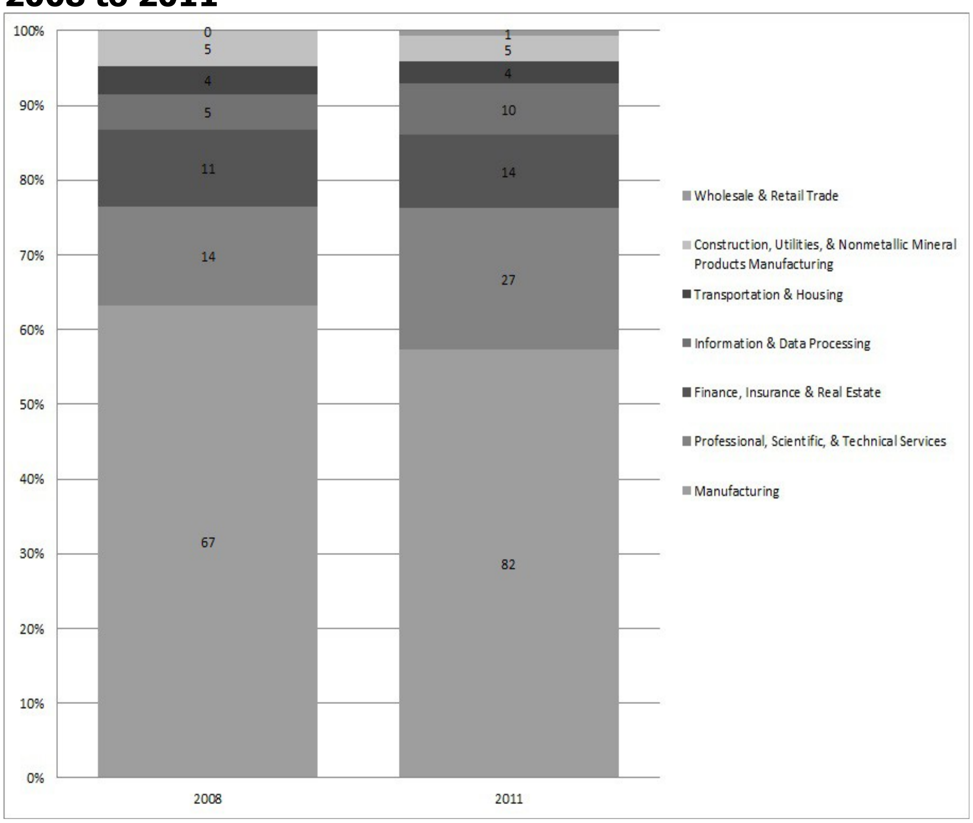
By law, the Revenue Department is required to report the industries of the businesses that earn and use tax benefits under the Advantage Act.

Industries of Businesses with Signed Agreements

The businesses with signed agreements represent all of the businesses that may be eligible to earn tax benefits.
Chart 1.2 shows the number of businesses with signed agreements in 2008 and 2011 in each of the seven industry categories used by the Department. In that period, the number of agreements increased from 106 to 143, most of the agreements being in the Manufacturing category and the Professional, Scientific & Technical category.

The proportion of each industry type changed very little between 2008 and 2011. The biggest changes were in Manufacturing, which decreased about six percent, and Professional, Scientific, & Technical Services, which increased by six percent. The remaining categories varied only one to two percent each.

Chart 1.2. Industries of Businesses with Signed Agreements 2008 to 2011



Source: Chart created by the Legislative Audit Office using data from Department of Revenue, Nebraska Tax Incentives: 2011 Annual Report to the Nebraska Legislature.

Industries of Businesses that Have Used Benefits

For the businesses that have actually used tax benefits, the Department does not report all seven of the categories it uses for businesses that have signed agreements. Instead, it reports Manufacturing as one group and combines the other industries into a "Non-manufacturing" group. The latter protects the identities of businesses in industries with few members that have started using benefits. The Department expects to report on additional groups as the number of businesses increases and confidentiality can be ensured.

Charts 1.3 and 1.4, on page 11, show the benefits actually used in 2011 by businesses in the Manufacturing and Non-manufacturing groups. For 2011, exemption from personal property tax was the most used benefit in the Manufacturing group, while corporate income tax credit was the most used benefit in the non-manufacturing sector. Neither group has used the available reimbursement for real property taxes.

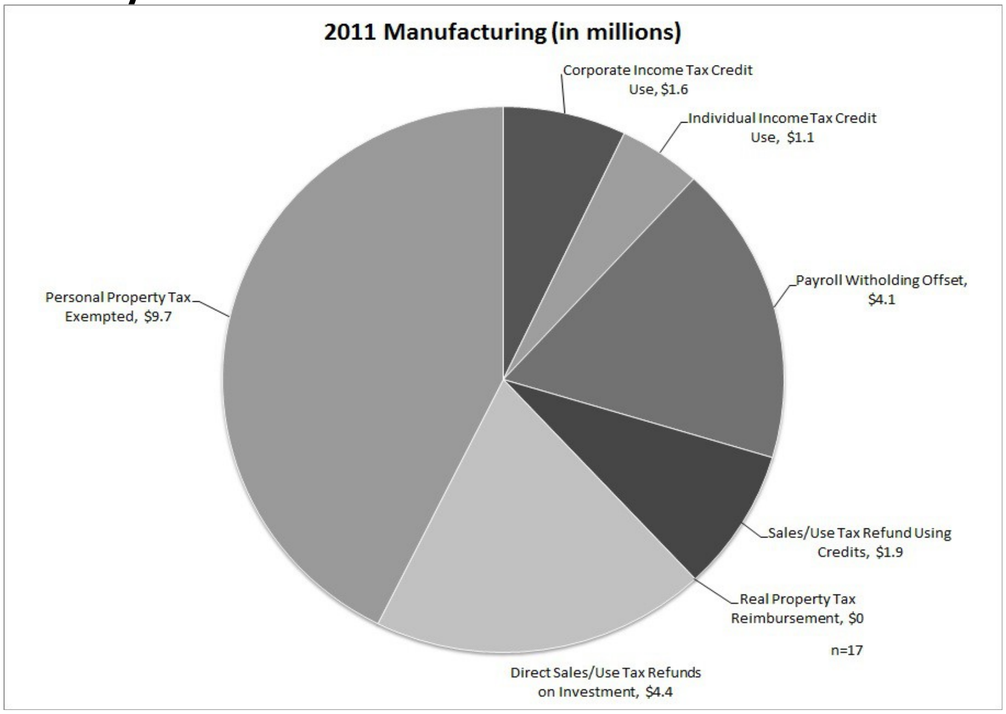
Broadly speaking the tax benefits fall into three categories:

*Direct refunds of sales and use taxe*s: A taxpayer (individual or business) paid the tax and the payment was later refunded;

Exemptions from personal property tax: A taxpayer's exempt property is not listed on the tax rolls; and

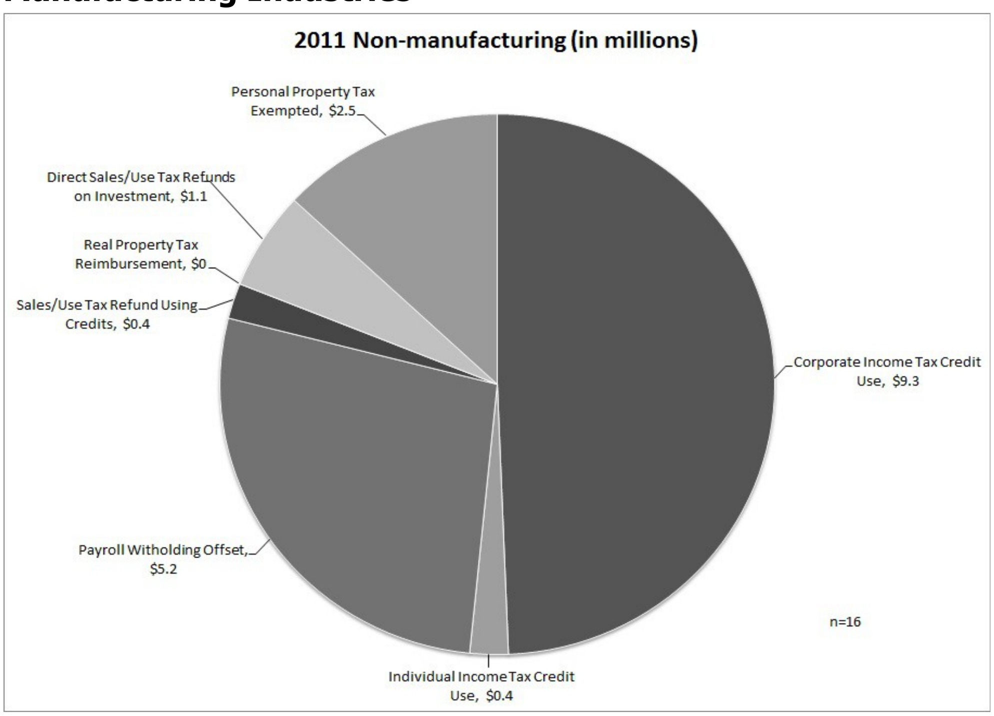
Tax credits: A taxpayer earns credits equal to a dollar amount, and can use that amount to reduce certain taxes, including payroll tax, personal or corporate income tax, sales and use taxes, and real estate taxes. (Appendix 1 contains a detailed description of each incentive.)

Chart 1.3. 2011 Actual Use of Benefits by Manufacturing Industry



Source: Chart created by the Legislative Audit Office using data from Department of Revenue, Nebraska Tax Incentives: 2011 Annual Report to the Nebraska Legislature, as well as additional property tax information provided by the Department.

Chart 1.4. 2011 Actual Use of Benefits by the Non-Manufacturing Industries



Source: Chart created by Audit Office using data from Nebraska Tax Incentives: 2011 Annual Report, as well as additional property tax information provided by the Department.

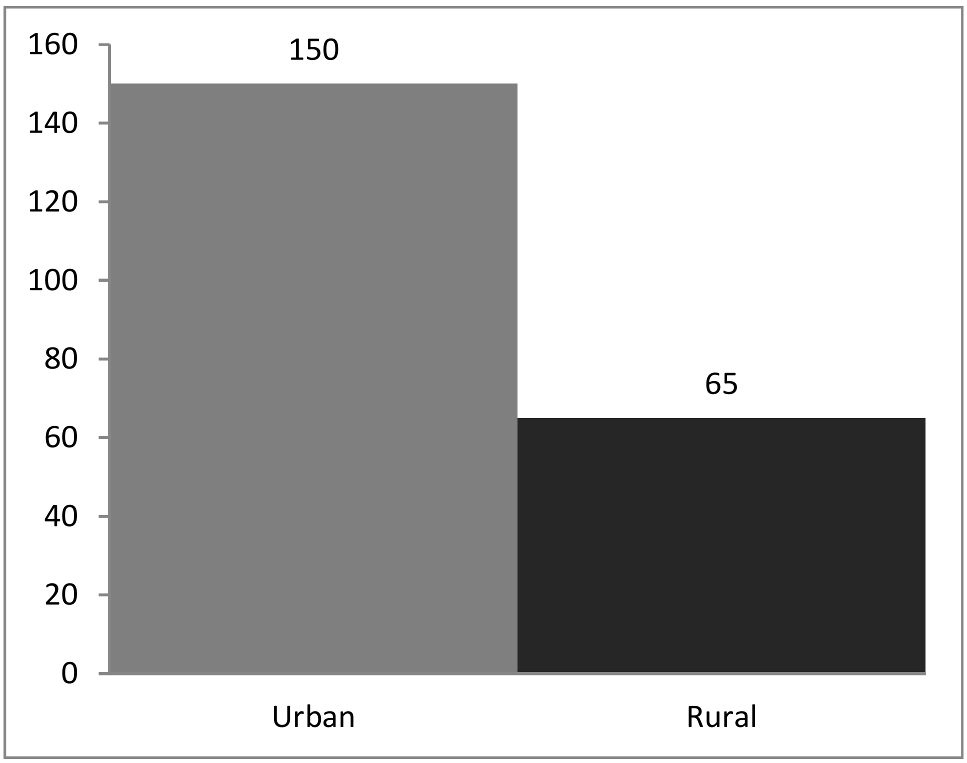
Geographical Location

The Revenue Department also reports the proposed locations of the businesses that earn and use benefits under the Act. The 143 agreements signed between 2007 and 2011 proposed 216 project locations: one statewide and the rest in 79 cities.[3]

Proposed Project Locations—Businesses With Signed Agreements
Urban and Rural Counties

Of the 216 proposed project locations, 150 locations (69 percent) were in urban counties and the remaining 65 (31 percent) were in rural counties,[4] as shown in Chart 1.5. This graphic does not include the BNSF Railway project, which is statewide.

Chart 1.5. Proposed Locations: Urban and Rural Counties, 2007-2011



Source: Department of Revenue, Nebraska Tax Incentives: 2011 Annual Report to the Nebraska Legislature.
Note: Does not include one statewide project.

3 According to the Department, a project could have more than one physical location within a single city. Because this section is intended to show only the general geographic location of each business, we count all locations within a single city as one project location.

4 Nebraska has 81 rural counties, using the Rural Development Act definition of rural, which is counties with fewer than 25,000 residents. (The urban counties are Adams, Buffalo, Cass, Dodge, Douglas, Hall, Lancaster, Lincoln, Madison, Platte, Sarpy, and Scotts Bluff.)

The proposed project locations were in 50 of Nebraska's 93 counties. Three counties—Douglas, Lancaster and Sarpy—contained 107 proposed locations, which is almost half of the total. Of the remaining 47 counties, the number ranged from one project to nine per county. Table 1.3 shows the number of proposed projects by county and identifies cities with five or more proposed projects each. (Appendix 2 contains a breakdown that includes all cities.)

Table 1.3. Proposed Project Locations, 2007-2011

County & Major Cities	Proposed Locations	
	#	% of total
Douglas County: Omaha (64)	67	31%
Lancaster County: Lincoln (23)	26	12%
Sarpy County: Bellevue (6), LaVista (5)	14	6%
Hall County: Grand Island (7)	9	4%
Dodge County: Fremont (6)	7	3%
Platte County: Columbus (6)	7	3%
Perkins County	7	3%
Buffalo County	6	3%
Counties with 4 projects each: Dawson; Madison; Scotts Bluff	12	6%
Counties with 3 projects each: Adams; Gage; Richardson; Saunders	12	6%
Counties with 2 projects each: Custer; Dakota; Fillmore; Holt; Kearney; Lincoln; Otoe; Phelps; Red Willow; Saline; Thayer; Valley; Washington	26	12%
Counties with 1 project each: Antelope; Boone; Box Butte; Cass; Chase; Cheyenne; Cuming; Dawes; Deuel; Garfield; Hamilton; Hitchcock; Howard; Jefferson; Johnson; Knox; Merrick; Nemaha; Pawnee; Pierce; Thurston; York	22	10%
1 statewide	1	<1%
Total	**216**	**100%**

Source: Table created by the Audit Office using data from the Revenue Department's Nebraska Tax Incentives: 2011 Annual Report to the Nebraska Legislature.

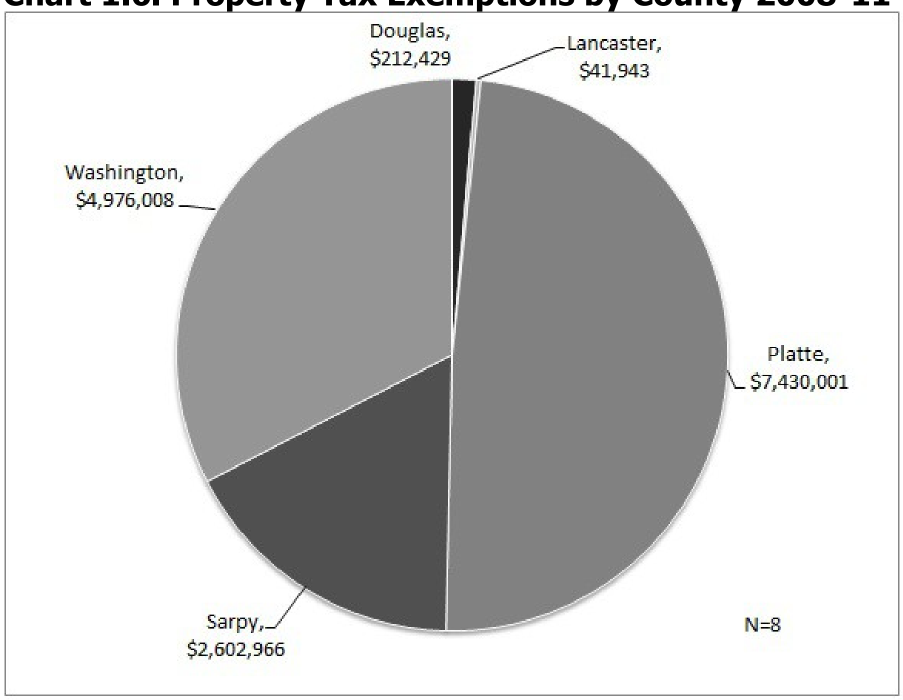
Project Locations—Businesses That Have Used Benefits

Between 2008 and 2011, 33 businesses received $101 million in Advantage Act benefits—approximately $86 million in tax credits and refunds and $15 million in property tax exemptions. As discussed earlier in this section, those figures underestimate the total program cost.

Personal Property Tax Exemption

The $15 million in property tax exemptions was earned by eight businesses, with locations in five counties. The exemptions have been used for computer systems from 2008-2011 in Douglas, Lancaster, Sarpy and Washington counties, and for agricultural product processing equipment from 2010-2011 in Washington and Platte counties. Platte county has claimed the majority of the exemptions, with $7.4 million (or 49 percent) of the total. Washington county has the second highest amount, nearly $5 million (33 percent).

Chart 1.6. Property Tax Exemptions by County 2008-11



Source: Chart created by the Legislative Audit Office using data from Department of Revenue, Nebraska Tax Incentives: 2011 Annual Report to the Nebraska Legislature, as well as additional property tax data provided by the Department.

Refunds and Credits

For tax refunds and credits, the Revenue Department may only report actual usage figures for individual businesses that have used benefits for two years or more. As of December 31, 2011, 21 businesses were eligible for such reporting.

The dollar amount of tax refunds and credits used by a single business ranges from $175,219, by CAMACO, LLC, to just over $46 million, by BNSF Railway. The BNSF Railway portion made up 61 percent of the total. Of the remaining businesses, one used about $6.7 million (nine percent) and another used about $4.3 million (six percent). The remaining 17 businesses each used three percent or less.

The businesses and benefit amounts used are shown in Table 1.4.

Table 1.4. Benefits (Direct Refunds and Tax Credits) Used 2008 to 2011

Project Name	County	Incentives Used	Percent of Total
BNSF Railway	Statewide	$46,007,744	61%
TD Ameritrade Holding Co.	Douglas; Sarpy	6,776,977	9%
Advanced BioEnergy, LLC	Fillmore	4,370,853	6%
Rotella's Italian Bakery	Douglas	2,621,188	3%
PayFlex Systems USA, Inc.	Douglas	1,999,392	3%
Lindsay Manufacturing Co.	Douglas; Platte	1,915,304	3%
Sandhills Publishing Company	Lancaster	1,888,810	2%
Central States Indemnity Co.	Hall	1,358,583	2%
Molex Incorporated	Lancaster	1,326,508	2%
Case New Holland, Inc.	Hall	1,254,252	2%
Hornady Manufacturing	Hall	1,175,431	2%
Verizon Wireless	Buffalo; Cass; Dodge; Douglas; Hall; Lancaster; Scotts Bluff	993,440	1%

Project Name	County	Incentives Used	Percent of Total
C & A Industries	Douglas; Lancaster	897,792	1%
TierOne Bank	Multiple	632,427	1%
Smeal Fire Apparatus, Co.	Antelope; Dodge	598,127	1%
Aspen Holdings, Inc.	Douglas	547,850	1%
Novartis Pharmaceuticals Corp.	Lancaster	452,433	1%
Chief Industries, Inc.	Adams; Buffalo; Hall	449,962	1%
Medical Solutions, Inc.	Douglas	257,632	0.3%
Majors Plastics, Inc.	Douglas	215,944	0.3%
CAMACO, LLC	Platte	175,219	0.2%
Total		**$75,915,868**	**100%**

Source: Table created by the Legislative Audit Office using data from Department of Revenue, Nebraska Tax Incentives: 2011 Annual Report to the Nebraska Legislature.

Cost Effectiveness

Measuring the cost effectiveness of incentives is difficult primarily because it cannot be known what businesses would have done in the absence of the incentive. Additionally, cost estimates can be calculated in different ways and there is no single standard against which to compare those estimates. From previous studies, we determined that one way to measure cost-effectiveness is to look at the cost to the state per job created by an incentive. As with other aspects of this report, because time constraints limited how much we could do, we present the following as an example of how to look at the question of cost effectiveness, not an exhaustive discussion of the topic.

Cost Per Job

The estimate of cost-per-job can vary significantly depending on which incentive dollars are included and how the number of jobs created is estimated. We calculated the cost-per-job in two ways: first using just the dollar value of compensation credits, which only benefits businesses that create jobs, and second using the dollar value of all benefits except property tax exemptions.[5] Although

5 We omitted property tax exemptions because only a small number of businesses used them. We did not include dollar amounts for pending refunds which have not yet occurred and we subtracted the dollar amount the Department has

the other benefits do not compensate directly for hiring, all but one of the Advantage Act tiers require job creation and many businesses use the other benefits, so arguably they play a role in job creation as well. For both, we used figures from FY2010-11, the most recent complete fiscal year reported by the Revenue Department.[6]

For the number of jobs created, we used the Department's estimate, which is calculated annually using the economic modeling program, TRAIN. For FY2010-11 the number was 373, or 23.5 percent of all the jobs created that year. However, that figure represents the highest potential estimate, because it includes both jobs that TRAIN calculates were created directly by the incentives as well as those created indirectly.

As shown in the table below, if only compensation credits are used, the estimated cost-per-job is $42,747, whereas if all benefits are used, the estimated cost increases to $234,568 per job. As noted earlier in this report, historically, not all credits earned are actually used, so this estimate represents the highest potential cost per job.

Table 1.5. Range of Estimated Cost Per New Job, FY 2010-11

Based on Compensation Credits Only

	No. of New Jobs		
Compensation Credits Earned	Total	From Incentives	Cost Per Incentive-created Job
$15,944,728	1,585	373	$42,747

Based on All Earned Benefits

	No. of New Jobs		
All Earned Benefits Except Property Tax Exemption	Total	From Incentives	Cost Per Incentive-Created Job
$87,493,933	1,585	373	$234,568

Source: Tables created by the Legislative Audit Office using data from Department of Revenue, Nebraska Tax Incentives: 2011 Annual Report to the Nebraska Legislature.
Note: The estimate of jobs due to the incentive includes both those directly resulting from the incentives as well as those resulting indirectly.

recaptured. In short, the calculation is this: estimated cost per job = (total credits + direct refunds – recapture)/number of jobs.

6 For direct refunds, we used the actual dollars businesses received. For credits, we used earned credits, which are more applicable (than credits used) because a business earns them during the same time period in which it creates jobs.

Finding: For 2011, the estimated cost-per-job created under the Advantage Act ranged from $42,747, based only on the cost of compensation tax credits, to $234,568, based on all earned benefits except the property tax exemption.

Once a cost-per-job is estimated, there is room for interpretation in what the estimate actually means. In the absence of a single standard, we suggest the following as ways policy-makers may want to view the cost.

Comparison to Other States

We reviewed estimates by other states, but found a wide variety in both the types of incentives offered and the ways of estimating the cost-per-job. This is an area that may warrant further study.

Comparison to Average Cost of Jobs Created

In calendar year 2011, the Department reported that jobs created under the Advantage Act had to have salaries between $21,986 and $54,966, depending on the tier, and the estimated average salary for those jobs was $39,541. Comparing the average salary to the cost-per-job range suggests that the state paid between more than one year's salary ($42,747) to more than five years' salary ($234,568) for each job created by the incentives.

Context of State Competition

The Department suggested to us that it is important to consider program performance data, including costs, in the context of the reality that Nebraska is competing with other states to attract and retain businesses. We agree that policy-makers need to have this broader view in mind and weigh it along with the specific program costs. Arguably, if competitiveness is a very high priority, and if the existing credits are needed to meet that priority, the cost per individual job may be less important by comparison.

Comparing Projected Costs and Benefits to Actual Costs and Benefits

As noted at the beginning of this section, neither the Employment and Investment Growth Act nor the Advantage Act contained specific goals or expected costs. In addition, it is difficult to determine the exact impact to the state because some benefits would have occurred even without tax incentives and the total cost is spread out over many years. In the absence of such specifics, we cannot determine with any specificity whether the program's performance is meeting the Legislature's intention.

However, Legislators may be interested in several points described above, including that as of December 31, 2011:

Tax Credits Only

- 33 businesses have earned $171 million in tax credits and as of December 31, 2011, have used $67 million of those;
- 57 percent of the businesses that have earned credits are in the manufacturing industry, for which the personal property tax exemption is the most-used incentive;
- 43 percent are in non-manufacturing industries, for which the corporate income tax credits are the most-used benefit;

Tax Credits and Refunds

- the 21 businesses for which the Department is permitted to report actual benefits used have used approximately $79.5 million;
- of the approximately $79.5 benefits used by December 31, 2011, the BNSF Railway has used 61 percent of that amount;

Locations

- the 143 signed agreements proposed 216 project locations, about 70 percent of which are in urban counties;
- of the 21 businesses for which the Department is permitted to report actual benefits (credits and refunds) used, the BNSF Railway has used the most and its location is statewide.
- property tax exemptions have been used in five counties, with about half used in Platte County; and

Cost Per Job

- using compensation credits only, the estimated cost per new job for FY2010-11 was $42,747 and using all earned benefits was $234,568.

Based on these results, we conclude that in general terms, the Advantage Act has, at a minimum, made progress towards the goals stated in the Legislative Findings contained in the Act to “retain existing businesses and aid in their expansion” and to “promote the creation and retention of new jobs in Nebraska.” The Act's impact on the other stated finding, to “encourage new businesses to relocate to Nebraska, and attract and retain investment capital in the State of Nebraska” are unclear. In addition, because discussion of the Act's likely cost was minimal at the time it was passed, it is unclear whether policy-makers will find the cost to-date to be within their expectations.

Finally, the Act's reporting requirements have improved program transparency as they were intended to do.

FINDING: While the Advantage Act has made progress towards some of the general goals established by the Legislature, in the absence of clear, measurable goals, it is difficult to say whether the Act is doing what the Legislature intended it to do.

Economic Modeling

As indicated at the beginning of this section, we conclude with our analysis of how the Revenue Department's economic modeling compares to best practices.

By law, the Department is required to include in its annual report to the Legislature “the projected future state revenue gains and losses” for taxpayers who are parties to signed agreements. In reporting these estimates, the Department is required to identify several supporting pieces of information including the methodology utilized and limitations that are inherent in the analysis method.

In the Revenue Department's 2011 tax incentives annual report (the most recent available), the majority of this information is presented in a table titled “Fiscal Analysis of the Nebraska Advantage Act.” This table contains figures for FY2010-11, and projections through FY2021-22 for several factors including revenue generated, tax credits used, direct sales and use tax refunds, and estimated employment. The Department creates these projections using a Nebraska-specific modeling program called TRAIN (Tax Revenue Analysis In Nebraska). Using data from past years, as well as data from another modeling program called IMPLAN, projections of how the incentives will impact the Nebraska economy are made.

A recent report by the Pew Center on the States (*discussed more in Section III*) found TRAIN to be a strength of the state, as its use indicated a high degree of evaluation on the impacts of tax incentives in Nebraska. Additionally, a recent review of economic modeling software conducted by the University of Arizona (Arizona Review), compared TRAIN with other well-known modeling programs, such as REMI and IMPLAN. The review concluded that no single program is best for all circumstances – all of the programs have strengths and weaknesses.

Strengths of TRAIN noted were its specificity to Nebraska, its ease of data manipulation, and its ability to calculate the impact of a tax change while holding expenditures and public services constant. The Arizona Review also noted that the dynamic version of TRAIN (which the Department currently uses) can analyze impacts for up to 20 years.

One weakness of TRAIN cited in the Arizona Report was that it is not particularly useful for forecasting actual program costs—a weakness shared by all of the reviewed programs. These programs can only evaluate the information and data that is entered into them, and do not take outside influences into consideration. That is, TRAIN looks at the effect of a specific tax incentive only and holds everything else constant, which does not provide an accurate prediction for how that incentive will affect the overall economy or the state budget.

The Department itself acknowledges that TRAIN has weaknesses. Though it trusts TRAIN to determine values such as the amount of credits that companies will earn and use, there are other values that the program does not estimate as well. For example, it can project how many new jobs will be created each year and how many are due to the incentive, but the numbers "leak" between years—meaning some jobs are counted in more than just the year in which they were created.

FINDING: The TRAIN modeling program compares favorably to best practices for economic modeling, but cannot be used as a forecasting tool.

Although we found that TRAIN is a reasonable tool for the Department's modeling, we are concerned about the usefulness of the 10-year projections published in the annual report. We initially assumed the projections could be compared to actual program costs to give an idea of how accurate the projections were and had planned to do so in this report, but the Department insisted that such an analysis was inappropriate. In an e-mail on this point, we were told that the projections are "not for forecasting, that is, not for comparing with real numbers." However, we note that there is no such qualification in the report in which the projections are published.

According to the Department, what the projections estimate is how the state's economic environment will be impacted by a particular incentive, *holding all other factors equal*. In other words, the projections give a theoretical estimate of how only the incentive itself will progress over time. The projections are recreated annually, and based on our review of the projections made over time, the shorter-term projections are more accurate than the longer-term ones. The longer-term projections produce only a very broad brush estimate, reflecting that the incentives will likely have a major impact on the state's economy, as well as the state budget, over a long period of time.

The problem, then, is that people may easily mistake the reported long-term projections with estimates of program costs, which they are not. In addition, based on our review of the projections (discussed below), they are also not very useful in providing even a general estimate of the incentive's impact. As such, their publication value is questionable.

Projections vs. Actual Costs

Following is a comparison of the Department's projections to actual costs. We acknowledge that the Department's projections are not intended as program-cost forecasts and therefore are not directly comparable. However, we include this comparison to show that the projections do not seem particularly useful even for identifying the general long term trends.

We reviewed the Department's projections for FY2010-11 from 2007, the first year such projections were made under the Advantage Act, to 2010. We found that the projections became much more accurate the closer they were to FY2010-11.

Table 1.7, on page 23, shows the values for FY2010-11 compared to what was projected for that year in 2007 and 2010. Of the six factors projected, the closest in 2007 was off by more than 20 percent and four were off by more than 50 percent. The highest, Net Revenue Gain (Loss) was off by more than five thousand percent. In contrast, the closest estimate in 2010 was off by less than one-half of one percent and the highest was off only 33 percent.

Given the large difference between the longer-term, four-year projections from 2007 to 2010, the value of even longer projections is questionable.

Table 1.7. Fiscal Year 2010-11, Projections Compared to Reported Values

	FY2010-11 Reported Values	2007 Projection of FY10-11 Values	Difference: 2007 Projection to Reported Values		2010 Projection of FY10-11 Values	Difference: 2010 Projection to Reported Values	
Revenue Generated by ITC*	$17,510,895 (Estimated)	$25,290,728	$7,779,833	30.8%	$13,144,425	($4,366,470)	-33.2%
Tax Credits Earned	79,055,041 (Actual)	51,027,028	(28,028,013)	-54.9%	69,184,184	(9,870,857)	-14.3%
Tax Credits Used	32,900,480 (Actual)	14,375,213	(18,525,267)	-128.9%	27,178,862	(5,721,618)	-21.1%
Direct Sales and Use Tax Refunds	8,814,299 (Actual)	11,351,489	2,537,190	22.4%	10,086,800	1,272,501	12.6%
Net Revenue Gain (Loss)	(24,203,883) (Estimated)	(435,974)	23,767,909	-5451.7%	(24,121,237)	82,646	-0.3%
Cumulative Revenue Gain (Loss)	(41,626,540) (Estimated)	17,292,228	58,918,768	340.7%	(41,543,894)	82,646	-0.2%

Source: Table created by the Legislative Audit Office using data from Department of Revenue, Nebraska Tax Incentives: 2007-2011 Annual Reports to the Nebraska Legislature.
*ITC stands for Incentive Tax Credit.

FINDING: The projections of "projected future state revenue gains and losses," currently published by the Revenue Department are not program-cost forecasts, and as such their value to policy-makers is questionable.

SECTION II: Other Selected Tax Incentive Programs

In this section we present the results of our examination of three tax incentive acts that were created or modified by LB 312, the 2005 legislation that also established the Nebraska Advantage Act: the Nebraska Advantage Rural Development Act, the Nebraska Advantage Microenterprise Act, and the Nebraska Advantage Research and Development Act. We describe the purpose of each act, and compare the projected costs and benefits expressed by legislators when it was passed with the actual costs and benefits as reported by the Revenue Department.

Nebraska Advantage Rural Development Act

The Nebraska Advantage Rural Development Act (Rural Development Act) replaced the 1986 Employment Expansion and Investment Incentive Act (EEII Act). Similar to the Advantage Act discussed in Section I of this report, the Rural Development Act provides investment and jobs credits based on multiple application levels—originally two, with a third added in 2008. However, the Rural Development Act differs from the Advantage Act in several ways. First, it requires a much lower level of investment and does not include direct tax refunds or exemptions. Second, the tiers are targeted to different geographic areas: some to rural areas, which include lower population counties and cities or any village, and others to economically distressed, major metropolitan areas.

Changes from the EEII Act included an increase in the required amount of investment and the inclusion of teleworkers as eligible employees. LB 895 (2008) added the Livestock Modernization level, which is available statewide, without the geographic restrictions that apply to the other levels.

Table 2.1 shows the requirements for the different Rural Development Act levels and the incentives businesses are eligible to receive.

Table 2.1: Qualifications and Incentives Under the Nebraska Advantage Rural Development Act

Level	Requirements to Qualify	Type of Incentive	Amount of Incentive
1	Amount: $125,000 new investment, 2 new FTE jobs Location: County with less than 15,000 inhabitants, an economically distressed area or a village	Jobs credit	$3,000 credit for each new FTE employee
		Investment credit	$2,750 credit for each $50,000 gain in qualified investment
2	Amount: $250,000 new investment, 5 new FTE jobs Location: County with less than 25,000 inhabitants, an enterprise zone, or a city of second class	Jobs credit	$3,000 credit for each new FTE employee
		Investment credit	$2,750 credit for each $50,000 gain in qualified investment
Livestock Modernization	Construction, improvement, or acquisition of depreciable agricultural assets. $50,000 new investment. Any county, no jobs requirement.	Investment credit	10% investment credit, limited to $30,000

Source: Table created by the Legislative Audit Office using data from Department of Revenue, Nebraska Tax Incentives: 2011 Annual Report to the Nebraska Legislature.

Projected Costs and Benefits

To identify the costs and benefits legislators were considering when the Rural Development Act was adopted, we reviewed the fiscal notes and legislative histories for the original EEII Act and for LB 312.

Lawmakers did not have specific, reliable projections regarding the cost of the Rural Development Act, although the sponsor characterized the bill as a no-lose proposition because businesses had to show results to earn the credits. The bill's final fiscal note cautioned that accurate projections of tax credit use could not be made, but it estimated a “possible range” of from $200,000 in the first year to about $1 million, annually, in a few years.

The fiscal note attached to LB 312 (2005) projected an aggregate loss of $24.1 million in tax revenue for fiscal year 2006-07. The document did not provide separate revenue projections for each of the four tax incentive programs included in the bill. However, the program has always had a statutory limit on the amount of benefits that could be paid annually. The limit was $3 million for approximately the first half of the time period reviewed by this audit and $4 million for the latter half.[7]

Similarly, we found that neither history contained specific goals for the benefits the Legislature expected the Acts to provide. Legislative proponents of the EEII Act did not identify specific benefits or specific problems the measure was designed to solve, but these lawmakers generally stated the bill would stimulate business activity and improve Nebraska's chances of attracting firms to the state. They did not identify certain types of businesses the bill was intended to expand or attract.

During floor debate on LB 312, a number of legislators applauded what they predicted would be the positive economic impact of the bill, as a whole, on rural Nebraska. In terms of the Rural Development Act specifically, several senators stated that inclusion of telecommuting jobs as eligible new jobs would be a boon to small communities. But this was the exception; as was the case with the EEII Act, lawmakers who spoke in favor of the Rural Development Act generally did not identify specific categories of businesses that the measure would expand or attract to rural Nebraska.

Actual Costs and Benefits

The Department of Revenue's 2011 tax incentives annual report indicated that, since 2004, taxpayers have used $4.7 million in tax credits, created 274 FTEs, and invested $88.3 million. The requests have not reached the statutory limit of $4 million annually for the past three years.

Table 2.2. Rural Development Business Activity through 2011

Year	FTE	Investment	Tax Credits Used
2011	20	$3,537,625	$818,043
2010	32	$39,801,633	$1,072,976
2009	90	$28,288,702	$1,859,036
2008 & Before	132	$16,754,580	$996.547
Total	**274**	**$88,382,540**	**$4,746,602**

Source: Table created by the Legislative Audit Office using data from Department of Revenue, Nebraska Tax Incentives: 2011 Annual Report to the Nebraska Legislature.

7 The annual limit became $1 million beginning with applications filed in 2012.

Discussion

Based on the information shown above, legislators may be interested to note the drop in FTEs created—from 90 in 2009 to 20 in 2011—and the drop in the amount invested in 2011 compared to earlier years. According to the Department, the decrease in the number of jobs created is partially due to use of the Livestock Modernization tier, which does not require job creation. Because there are limited dollars available for this program, when dollars are used for that tier, there are fewer available dollars for the tiers that do have job creation requirements and, ultimately, fewer jobs are created.

Since the Legislature did not articulate job creation or investment goals, we can not determine whether these changes indicate that the program is no longer meeting the Legislature's intention or is operating within the acceptable range. In addition, because the Revenue Department is not required to report additional information, we can not assess whether the Act is meeting these goals discussed by the Legislature when the bill was passed:

1. Has the Act helped rural areas more after the 2005 addition of telecommuting employees as qualifying?
2. Has the Act helped livestock businesses after the 2008 addition of livestock modernization credits?
3. Has the Act improved the State's attractiveness to out-of-state businesses?

FINDING: In the absence of clear, measurable goals and relevant data, it is difficult to say whether the Act is doing what the Legislature intended it to do.

Nebraska Advantage Microenterprise Act

The Nebraska Advantage Microenterprise Act (Microenterprise Act) provides a tax credit to entrepreneurs who start or expand businesses with five or fewer full-time equivalent employees in economically distressed areas. Economic distress is determined by the unemployment rate, *per capita* income and population trends in a given area. The tax credit is equal to 20% of the new investment or employment in the business during the tax year.

Projected Costs and Benefits

The microenterprise measure was originally introduced in 2005 as a separate bill (LB 309) and was ultimately amended into LB 312. To identify the costs and benefits legislators were considering when the Microenterprise Act was adopted, we reviewed the fiscal notes and legislative histories for LB 309 and LB 312.

The cost of the program was established in the legislation. The Act limits the total tax credits available to $2 million annually to eligible businesses and it includes a limit of $10,000 over the lifetime of any one taxpayer or related person.

We found that neither history contained specific goals or measurable benefits legislators expected the Microenterprise Act to achieve. The introducer of LB 309 sought to support businesses with five or fewer full-time equivalent employees with tax credits, awarded based partly on whether or not the enterprise was likely to help stimulate revitalization of an economically depressed area.

Generalized statements about the benefits of the Microenterprise Act continued during the LB 312 floor debate. Typical was the remark of one legislator who described the entire bill, including its microenterprise and research and development components, as the "next generation of economic development incentives" for the state. Another lawmaker predicted the Microenterprise Act would "help get some entrepreneurial spirit fired up, perhaps in rural Nebraska in the R&D [research and development] area."

Actual Costs and Benefits

The Revenue Department's 2011 annual report indicated businesses used approximately $1.48 million in microenterprise tax credits in 2010, the most recent year available. Those businesses had a total payroll compensation of nearly $11 million and investments of more than $8.6 million for the year, according to the report. From 2006 through 2010, businesses used nearly $7.8 million in microenterprise tax credits and had a combined payroll of $46.8 million, the report indicated.

Table 2.3 shows the Microenterprise Act investments, compensation and used tax credits by year from 2006 through 2010.

Table 2.3: Microenterprise Business Activity, Returns Processed As Of 12/31/2011

Application Year	Actual Investment	Actual Compensation	Tax Credits Used
2010	$8,667,291	$10,936,403	$1,474,887
2009	$8,518,430	$9,803,399	$1,087,160
2008	$31,605,604	$7,201,292	$1,635,372
2007	$17,529,894	$3,846,107	$1,725,078
2006	$16,325,229	$15,065,667	$1,852,720
Total	**$82,646,448**	**$46,852,868**	**$7,775,217**

Source: Table created by the Legislative Audit Office using data from Department of Revenue, Nebraska Tax Incentives: 2011 Annual Report to the Nebraska Legislature.

Discussion

Similar to our discussion of the Rural Development Act, the absence of clear, measurable goals for the Microenterprise program makes it difficult to make a reliable assessment of whether the Act is accomplishing what the Legislature intended. We have no standard of comparison to use in answering whether the investment and compensation amounts are within what the Legislature expected compared to the amount of credits used.

In addition, because the Revenue Department is not required to report additional information, we cannot assess whether the Act is meeting these goals discussed by the Legislature:

1. Whether the Act has been a stimulus in the revitalization of economically distressed areas in the state?
2. How many microenterprises have been established or supported by the Act since its implementation in 2006 and how many of these small businesses remain viable?

FINDING: In the absence of clear, measurable goals and relevant reporting information, it is difficult to say whether the Act is accomplishing what the Legislature intended.

Nebraska Advantage Research and Development Act

The Nebraska Advantage Research and Development Act (Research and Development Act) provides tax credits to businesses that incur research and development costs. For businesses that make research investments at a Nebraska college or university, a credit of 35 percent of the federal research credit (Internal Revenue Code § 41) may be claimed. If the investment takes place off campus, the firm can claim a credit of 15 percent of the federal credit. This credit can be claimed for up to twenty-one years, as amended by LB 983 in 2012.

Projected Costs and Benefits

The Research and Development Act, like the microenterprise measure, was originally introduced as a separate bill (LB 672) in 2005 and was later amended into LB 312. To identify the costs and benefits legislators considered when the Research and Development Act was adopted, we reviewed the legislative histories and fiscal notes for LB 672 and LB 312.

Supporters of the original bill did not identify specific problems or specific goals the measure was designed to solve or achieve. The broad intent of the bill was to stimulate an increase in business expenditures for research and development. At a legislative hearing on the bill, lawmakers noted that Nebraska was one of only a few states that did not offer tax credits for investments in research and development, and they stated that the bill would make the state competitive with other states in the development of research and development activity.

The LB 672 fiscal note estimated $4.47 million in tax credits would be used in fiscal year 2006-07 and $4.9 million in fiscal year 2008-09.

Statements about measurable goals and benefits of the Research and Development Act were also lacking in the LB 312 floor debate. At least one lawmaker said the Research and Development Act would provide an incentive to ethanol plants to conduct research on sequestration of carbon dioxide emissions. Otherwise, legislators expressed support of the act in general terms, e.g., the Research and Development credit "will put us on an even keel with (other states)."

Actual Costs and Benefits

The Revenue Department's 2011 annual report indicated program participants earned approximately $2.3 million in Research and Development tax credits that year, and $10.8 million since 2006.

Table 2.4, on page 31, shows the Research and Development Act tax credits approved by year from 2006 through 2011.

Table 2.4: Research and Development Income Tax Credits Approved

Fiscal Year Projected		Calendar Year Actual	
Year	**Amount**	**Year**	**Amount**
NA		2011	$2,354,048
NA	$4,900,000	2010	$4,075,519
FY2008-09		2009	$2,234,741
NA	$4,700,000	2008	$2,103,626
FY2006-07		2007	$64,166
NA		2006	$0
		Total	**$10,832,100**

Source: LB 672 (2005) fiscal note and Department of Revenue, Nebraska Tax Incentives: 2011 Annual Report to the Nebraska Legislature.

Discussion

As with the other two acts discussed in this section, the absence of clear, measurable goals and relevant reporting information, makes it difficult to make a reliable assessment of whether the Act is accomplishing what the Legislature intended. It can be noted that for most years, the actual cost has been less than the amount projected in the bill's fiscal note.

However, because the Revenue Department is not required to report any additional information, we cannot assess whether the Act is meeting these goals discussed by the Legislature:

1. Whether the Act has made Nebraska competitive with other states in the development or expansion of research and development activity.
2. Whether the Act has attracted research and development firms to Nebraska.
3. Whether the Act has caused an appreciable increase in research and development activity in the state.

FINDING: In the absence of clear, measurable goals and relevant reporting information, it is difficult to say whether the Act is accomplishing what the Legislature intended.

SECTION III: Complexities of Assessing Tax Incentive Programs

In the first part of this section we: summarize the results of research on the complexities inherent in the assessment of tax incentive programs; describe a recent report that looked at what state policy-makers need in order to effectively evaluate these programs; and provide three examples of states that have undertaken comprehensive reviews of their incentive programs. In the second part, we present our assessment of the Revenue Department's compliance with the Nebraska Tax Expenditure Reporting Act.

Evaluation Challenges

To identify evaluation challenges, we reviewed two reports that examine these issues in depth—a 2012 report by the Pew Center on the States, titled *Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth,* and a 2009 report by the New England Public Policy Center titled *State Business Tax Incentives: Examining Evidence of their Effectiveness*. We also reviewed a number of audit reports from other states. (A full list of reports reviewed for this audit is contained in Appendix 3.) The short time-frame for this audit limited our review of this area, and we recommend viewing this section as an introduction to, not an exhaustive study of, the relevant issues.

We grouped common evaluation challenges into two categories: direct and in-direct. Direct challenges are related to the business or industry the incentive is trying to impact. One of the most significant direct challenges is lack of a clear, measurable goal for what policy-makers intend the incentive to accomplish. We noted this problem in earlier sections of this report—without a clear goal, an evaluation can draw no conclusion about whether a program is accomplishing what legislators intended.

In-direct evaluation challenges involve considerations beyond the business or industry the incentive is trying to impact. This is a broad category including considerations reaching into the business's community, other businesses in that industry and the potential loss of funds for other programs and services.

The details on each of the common challenges we identified are summarized in the following table.

Table 3.1. Common Challenges in Evaluating Tax Incentive Programs

Category	Challenge	Evaluation Question
Direct considerations	Unclear &/or unmeasurable goals	What is the goal(s) of the incentive? What do policy-makers intend to accomplish?
	Cause and Effect	Did the tax incentives change businesses' decisions? To what extent did they reward what would have happened anyway?
	Timing	When will the costs and benefits of the incentive occur, and how long will they last?
In-direct considerations	Winners and Losers	Did the incentive benefit some businesses or individuals at the expense of others?
	Unintended Beneficiaries	Did the benefit of the incentive flow across state borders?
	Indirect Impacts	To what extent do the investments of companies receiving incentives filter into the broader economy, causing further economic gain? For example, increasing business for those that provide materials and services to the business that received the credit.
	Economics of budget trade-offs	What were the adverse economic impacts of tax increases or spending cuts made to fund the incentive? Do the benefits of the incentive outweigh those impacts?
	Net Public Cost	Is there a public cost beyond the foregone tax revenue? For example, public costs may be reduced if unemployment decreases and fewer people need services; however, public costs may increase if population increases and additional services (schools, roads, etc.) are needed.
	Cost-effectiveness	Once you know the incentive's cost, how do you determine if the cost is "worth it?" Could other policies achieve a similar result at a lower cost?

Sources: Pew Center Report, Public Policy Center Report, and state reports from: Kansas, Hawaii and Washington.

FINDING: Research shows that evaluating the impact of tax incentive programs is difficult and suggests that the best evaluations attempt to take both direct and indirect factors into account. Identifying the policy goals for these programs is particularly important.

Effective Evaluations—Pew Center State Rankings

The Pew Center report's discussion of evaluation challenges described above is part of a broader examination of whether state policymakers are getting the type and quality of information they need to evaluate these programs. The report concluded that while no state has a complete picture of what its tax incentives are doing, some states are much better off than others.

The report compared each state to four criteria for effective evaluations and found that half of the states are not meeting any of the criteria. The report divided the remaining states into those that are "leading the way" (13 states) in this area and those with "mixed results" (12 states, including Nebraska).

Nebraska's scores were based on two legislatively required reports prepared by the Revenue Department—a biennial Tax Expenditure Report and an annual Tax Incentives Report to the Legislature. The Tax Expenditure report, discussed more at the end of this section, requires the Department to report to the Legislature on the state's major tax exemptions, while the Tax Incentives Report provides information on eight tax incentive programs, as required by provisions in each of the programs' statutes. The amount of information required to be reported varies considerably, with the most required for the Nebraska Advantage Act, the largest program in terms of its impact on state revenue, and less for programs with smaller budget impacts.

Based on those reports, the Pew Center concluded Nebraska met two criteria, which relate to review of all major tax incentives and for measuring economic impact. However, Nebraska failed to meet two other criteria relating to having clear conclusions about the effectiveness of the tax incentives in the reports and for integration of the reports into the policy-making process. Clear conclusions are necessary in order for policy-makers to make sound decisions about whether to continue, eliminate, or modify tax incentive programs. The need to better integrate information into the policy making process reflects the fact that often incentive programs—especially their costs in terms of foregone revenue—are not regularly reviewed in a manner comparable to direct appropriations.

FINDING: Nebraska's evaluations of its tax incentives are not as effective as they could be. This could mean that some incentives are being funded that are not the best investment and others that would be better investments are not being sufficiently funded.

Examples of Comprehensive Tax Incentive Reviews in Other States

In the course of our research on challenges in evaluating tax incentive programs, we identified three examples of ways other states have gone about a comprehensive review of their tax incentives. First, Delaware has for many years required the Executive Branch tax agency to evaluate all incentives. In contrast, Oklahoma created a one-year joint legislative task force to review its incentives. Finally, the Washington Legislature has required legislative audits of all tax incentives every 10 years.

We recognize that not all of the specifics addressed in the following examples are relevant to Nebraska and we are not making recommendations related to those specifics. These examples are included simply to give the Committee a sense of how some other states have gone about evaluating their tax incentive programs.

Delaware Tax Preference Report

By law, the Delaware Division of Revenue must prepare biennial reports that "estimate the fiscal impact of all newly enacted and existing tax preferences within selected revenue sources." Specifically, the report includes: personal income tax; corporate income tax; motor fuel/special fuel tax; and public utility. The reporting requirement has been in place since the mid-1980s, although the report in its current form has existed only since 1993.

The purpose of the report is to increase awareness about the role of tax preferences on the state budget. The report notes that the statute that requires it "acknowledges that state governmental policy objectives may be achieved through direct expenditures and indirectly through the use of tax preferences. Unlike direct expenditure programs, however, tax preferences do not receive regular review or require annual appropriations."

The report goes on to explain the need for additional information on and review of tax preferences, stating: "preferences may remain in place indefinitely, with no review of their effectiveness and no system to monitor their cost. The primary purpose of this Report is to identify all tax preferences within specified revenue sources, and assess them quantitatively and qualitatively."

The report also notes the importance of reviewing the state's whole tax picture. Individually, each preference may make sense but problems can arise if there is no evaluation taking place or there is a lack of monitoring to see how they fit together. And, over time some incentives become less meaningful; others may have a larger market than expected—thus the need to review periodically.

Oklahoma Task Force

In 2001, the Oklahoma Legislature created the 10-member Task Force on State Tax Credits and Economic Incentives. By law, the task force existed for one year and was authorized to “conduct a study regarding all state tax credits regardless of the tax type against which such credit may be claimed and any other economic incentives that affect state or local tax liabilities.” The study was authorized to include:

1. The justification for the enactment of any state tax credits based upon the relevant economics of the applicable industry or economic sector affected;
2. The economic impact related to the utilization of state tax credits;
3. Analysis of the utilization of the credits by tax credit purchasers;
4. The impact of tax credits on any and all economic sectors of the state economy;
5. The adequacy or inadequacy of state tax credits or other economic incentives; and
6. Such other matters related to state tax credits or economic incentives as the Task Force deems relevant.

Membership on the task force consisted of the Chairs of the House and Senate appropriations committees; the Chairs of the House and Senate finance or revenue committees or subcommittees; the House and Senate minority leaders; the State Treasurer or designee; the Secretary of State or designee; the Director of the Office of State Finance or designee; and the State Auditor and Inspector.

The Committee ultimately released a six-page final report of their recommendations, along with more than 600 pages of documents reviewed during the study. The report reiterated the Task Force's goal “to develop a system for evaluating state tax credits and economic incentives” and recommended a set of criteria for such evaluations.

Washington Citizen Commission for Performance Measurement of Tax Preferences

In 2006, the Washington Legislature created the seven-member Citizen Commission for Performance Measurement of Tax Preferences.

The Commission annually develops a schedule to review all of the state's approximately 600 tax preferences (defined broadly to include exemptions, deductions, credits, deferrals, preferential rates, etc.). By law, some types of preferences are excluded from review and the Commission is authorized to exempt any it determines to be a "critical part of the structure of the tax system." The reviews are conducted independently by Joint Legislative Audit and Review Committee (JLARC) and the Commission is authorized to comment on the reviews.

For each preference, JLARC (1) evaluates whether the public policy objective is being met and (2) makes recommendations to continue, modify or terminate the preference.

The seven-member Commission consists of five voting members: two appointed by the House, two by the Senate, and one by the Governor. The State Auditor and the Chair of the Joint Legislative Audit and Review Committee Commission participate as non-voting members. There are no qualification requirements for the appointed members, although for the legislatively appointed "should be individuals who represent a balance of perspectives and constituencies, and have a basic understanding of state tax policy, government operations, and public services," among other things. The Commission must meet at least four times a year.

The following table shows the JLARC staff recommendations and the Commission actions for the 135 incentives reviewed from 2007 to 2011.

Table 3.2. Action on Washington JLARC Tax Incentives Recommendations

JLARC Recommendation	Implemented	Bill introduced, not passed	Different policy choice	Allowed to expire	No action required	No action taken	Total
Allow to Expire			3	7	2		12
Continue					77		77
Continue & Modify Expiration Date	9			3			12
Review & Clarify	1	21		1		5	28
Terminate		4				2	6
Total	10	25	3	11	79	7	135

Source: Commission Web site.

As noted at the beginning of this section, we conclude with an analysis of the Department's compliance with the Tax Expenditure Reporting Act.

Nebraska Revenue Department Compliance with the Tax Expenditure Reporting Act

The Tax Expenditure Reporting Act (§§ 77-379 to 77-385) requires the Revenue Department to report to the Legislature on the "major tax exemptions for which state general funds are used to reduce the impact of revenue lost due to a tax expenditure." The Department's 2012 report includes all tax programs that generate state or local revenue in excess of $2 million annually. For each program, the report contains a general description as well as details on each exemption, including when it was enacted and the estimated cost. The Act also requires the Revenue Department to make recommendations for eliminating or limiting tax expenditures.

We found that the Revenue Department is reporting the detailed program information as required by the Act but is not making the required recommendations. Instead, for each program the recommendation is "The Nebraska Department of Revenue has no recommendations." We reviewed prior versions of the report and found that some—from the first years of the requirement—did include recommendations but most did not. None of the reports since 2000 have included them.

This omission is raised in the Pew Center Report, in respect to the need for tax incentive evaluations to have clear conclusions. However the report also notes that it may be difficult for agency staff to make such recommendation, stating: "Governors and legislators often have staked out positions for or against tax incentives, so agency staff might not be comfortable passing judgment on them."

FINDING: Although the Revenue Department is technically complying with the statutory requirement that it provide recommendations to the Legislature regarding incentives that should be eliminated or limited, it may not be meeting the spirit of the requirement by consistently having "no recommendation." This response potentially deprives the Legislature of useful information. At the same time, the requirement itself is problematic, in that it may be unrealistic to expect such policy recommendations from Department staff whose responsibility is program administration, not policy development.

APPENDIX 1: Nebraska Advantage Act Details

Nebraska Advantage Act Qualifications and Benefits

<table>
<tr><th></th><th colspan="2">Business</th><th colspan="2">Benefit</th></tr>
<tr><th>Tier</th><th>Qualifications</th><th>Eligible Industries</th><th>Type of Incentive</th><th>Amount of Incentive</th></tr>
<tr><td rowspan="3">1</td><td rowspan="3">$1 million new investment, 10 new jobs</td><td rowspan="3">Research and development, testing, manufacturing, and export of specific technology services and products*</td><td>Direct refund</td><td>50% sales tax refund for qualified purchases</td></tr>
<tr><td>Jobs credit</td><td>3% of increased compensation for pay between 60-75% of state average wage; 4% for pay between 75-100%; 5% for pay between 100-125%; 6% for more than 125%</td></tr>
<tr><td>Investment credit</td><td>3% investment credit</td></tr>
<tr><td rowspan="3">2</td><td rowspan="3">$3 million new investment, 30 new jobs</td><td rowspan="3">Research & development, testing, data processing, telecommunications, insurance, financial services, manufacturing, distribution, storage/warehousing, transportation, headquarters (administrative), export of technology services & products, data centers, internet web portals, retail sales if a specific amount of export or wholesale sales are met*</td><td>Direct refund</td><td>100% sales tax refund for project purchases</td></tr>
<tr><td>Jobs credit</td><td>3% of increased compensation for pay between 60-75% of state average wage; 4% for pay between 75-100%; 5% for pay between 100-125%; 6% for more than 125%</td></tr>
<tr><td>Investment credit</td><td>10% investment credit</td></tr>
<tr><td rowspan="4">Special 2</td><td rowspan="4">$200 million new investment, 30 new jobs</td><td rowspan="4">Data Centers. Any Tier 2 qualified business activity may also be included if the data center requirement is met</td><td>Direct refund</td><td>100% sales tax refund for project purchases</td></tr>
<tr><td>Jobs credit</td><td>3% of increased compensation for pay between 60-75% of state average wage; 4% for pay between 75-100%; 5% for pay between 100-125%; 6% for more than 125%</td></tr>
<tr><td>Investment credit</td><td>10% investment credit</td></tr>
<tr><td>Tax exemption</td><td>Personal property tax exemption for all project purchases, up to 10 years</td></tr>
</table>

	Business		Benefit	
Tier	**Qualifications**	**Eligible Industries**	**Type of Incentive**	**Amount of Incentive**
3	$0 investment, 30 new jobs	Same as Tier 2	Jobs credit	3% of increased compensation for pay between 60-75% of state average wage; 4% for pay between 75-100%; 5% for pay between 100-125%; 6% for more than 125%
4	$12 million investment, 100 new jobs	Same as Tier 2	Direct refund	100% sales tax refund for project purchases
			Jobs credit	3% of increased compensation for pay between 60-75% of state average wage; 4% for pay between 75-100%; 5% for pay between 100-125%; 6% for more than 125%
			Investment credit	10% investment credit
			Tax exemption	Personal property tax exemption for turbine-powered aircraft, mainframe computers, agricultural processing machinery, and distribution facility equipment
5	$36 million investment, no jobs requirement**	Same as Tier 2	Direct refund	100% sales tax refund for project purchases
6	$10 million investment, 75 new jobs OR $106 mil, 50 new jobs**	Any business activity other than retail, unless specific conditions are met*	Direct refund	100% sales tax refund for project purchases
			Jobs credit	10% credit on employee compensation (threshold per new position is the greater of 200% county average wage or 150% NE average wage)
			Investment credit	15% investment credit
			Tax exemption	Personal property tax exemption for project purchases, up to 10 years

Source: Table prepared by the Legislative Audit Office using information from the Nebraska Department of Revenue Advantage Act Application (*http://www.revenue.state.ne.us/incentiv/neb_adv/Ne_Avantage_App_ _2012.pdf*) and 2011 Annual Tax Incentive Report (*http://www.revenue.state.ne.us/incentiv/annrep/11an_rep/ neb_adv/neb_adv_narrative.html*).

*For further information on these eligible industry descriptions, please see the Department of Revenue 2011 Annual Tax Incentive Report.

**In 2013, Tier 5 will be raised to a $37 million requirement, and Tier 6 will be raised from $106 to $109 million.

Brief Description of Benefits

Type of Benefit	Description
Corporate Income Tax	Credits may be used to reduce the income tax liability of the taxpayer's entire group from the year the credit is earned for credits claimed by the applicant, or the year of tax credit distribution through the end of the entitlement period or carryover period, whichever is later.
Individual Income Tax	Credits earned by a partnership, S corporation, limited liability company, cooperative, limited cooperative association, or an estate or trust may be distributed in the same ratio as income. The recipient of the distributed credit may use the credit to reduce their income tax liability from the year of distribution through the end of the entitlement period or carryover period, whichever is later.
Payroll Withholding Offset	Compensation credits may be used to receive a refund of, or to reduce the taxpayer's payroll withholding liability, excluding compensation in excess of $1 million paid to any one employee.
Sales & Use Tax Refund Using Credits	A refund of Nebraska and local sales and use taxes paid on otherwise non-refundable purchases.
Real Property Tax Reimbursement	Tier 6 only. Credits may be used for a reimbursement from the State equal to real property taxes due after the year the project met the minimum required levels of investment and employment through the end of the carryover period on investment made after the date of application.
Direct Sales & Use Tax Refunds on Investment	A refund of Nebraska and local sales and use taxes paid on the purchase or lease of qualified property for use at the project, or on the purchase or lease of an aircraft for use in connection with the project, which is placed in service during the attainment or entitlement period.
Personal Property Tax Exempted	An exemption on personal property taxes on specific types of property acquired after the date of application. Qualifying property is dependent on tier.
Real Property Tax Exempted	An exemption on real property taxes acquired after the date of application. (This benefit has never been used as part of the Advantage Act.)

Source: Table prepared by the Legislative Audit Office using information from Department of Revenue 2011 Annual Tax Incentive Report.

APPENDIX 2: Additional Detail on Proposed Project Locations

Project Locations		
	County	
County & Cities (projects)	#	% of total
Douglas County: Omaha (64), Valley (2), Waterloo (1)	67	31%
Lancaster County: Lincoln (23), Waverly (3)	26	12%
Sarpy County: Bellevue (6), LaVista (5), Gretna (2), Papillion (1)	14	6%
Hall County: Grand Island (7), Alda (1), Wood River (1)	9	4%
Dodge County: Fremont (6), Snyder (1)	7	3%
Platte County: Columbus (6), Lindsay (1)	7	4%
Perkins County: Brandon (1), Elsie (1), Grainton (1), Grant (1), Madrid (1), Venango (1)	6	3%
Buffalo County: Kearney (4), Gibbon (2)	6	3%
Dawson County: Cozad (1), Gothenburg (2), Lexington (1)	4	2%
Madison County: Norfolk (3), Madison (1)	4	2%
Scotts Bluff: Scottsbluff (3), Gering (1)	4	2%
Adams County: Hastings (3)	3	1%
Gage County: Beatrice (2), Adams (1)	3	1%
Richardson County: Falls City (2), Humboldt (1)	3	1%
Saunders County: Wahoo (2), Ashland (1)	3	1%
Counties with 2 projects each: *Custer* (Broken Bow, Callaway); *Dakota* (Dakota City, South Sioux City); *Fillmore* (Fairmont, Geneva); *Holt* (Atkinson, O'Neill); *Kearney* (Minden); *Lincoln* (North Platte, Wallace); *Otoe* (Nebraska City); *Phelps* (Holdrege); *Red Willow* (McCook); *Saline* (Crete); *Thayer* (Carleton; Hebron); *Valley* (Ord); *Washington* (Blair)	26	12%
Counties with 1 project each: *Antelope* (Neligh); *Boone* (Albion); *Box Butte* (Alliance); *Cass* (Plattsmouth); *Cheyenne* (Sidney); *Chase* (Lamar); *Cuming* (West Point); *Dawes* (Chadron); *Deuel* (Big Springs); *Garfield* (Burwell); *Hamilton* (Aurora); *Hitchcock* (Stratton), *Howard* (St. Paul); *Jefferson* (Fairbury), *Johnson* (Tecumseh); *Knox* (Bloomfield); *Merrick* (Central City); *Nemaha* (Auburn); *Pawnee* (Pawnee City); *Pierce* (Plainview); *Thurston* (Pender); *York* (Waco)	22	10%
1 state-wide, 1 location unknown	2	1%
	216	**100%**

APPENDIX 3: Materials Reviewed for the Section III Analysis of Tax Incentive Evaluation Challenges

Audit of the Department of Taxation's Administrative Oversight of High-Technology Business Investment and Research Activities Tax Credits, Office of the Auditor, Report No. 12-05, July 2012. http://www.state.hi.us/auditor/Reports/2012/12-05.pdf

Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth, Pew Center on the States, 2012. http://www.pewstates.org/research/reports/evidence-counts-85899378806

Kansas Tax Revenues, Part I: Reviewing Tax Credits, Kansas Legislative Division of Post Audit, February 2010. http://www.kslpa.org/docs/reports/10pa03-1a.pdf

Rethinking Property Tax Incentives for Business, Daphne A. Kenyon, Adam H. Langley, and Bethany P. Paquin, Lincoln Institute of Land Policy, 2012. https://www.lincolninst.edu/pubs/dl/2024_1423_Rethinking%20Property%20Tax%20Incentives%20for%20Business.pdf

Review of the Effectiveness of Virginia Tax Preferences, Virginia Joint Legislative Audit and Review Commission, January 2012. http://jlarc.virginia.gov/reports/Rpt425.pdf

State Business Tax Incentives: Examining Evidence of their Effectiveness, New England Public Policy Center, Discussion Paper 09-3, December 2009. http://www.bos.frb.org/economic/neppc/dp/2009/neppcdp0903.pdf

Tax Preference Report (No title page, "Tax Preference Report" is what the report is called on the Web site.) http://finance.delaware.gov/publications/tax_prefer/report_11.pdf

Final Report, HB 1285 Task Force on Tax Credits and Economic Incentives, December 31, 2011. https://www.documentcloud.org/documents/279161-tax-credit-task-force-final-report.html

2012 Tax Preferences Performance Reviews, Preliminary Report, July 18, 2012. http://www.leg.wa.gov/JLARC/AuditAndStudyReports/2012/Documents/2012TaxPreferencesPreliminaryReport.pdf Also see generally, Washington Citizen Commission for Performance Measurement of Tax Preferences, http://www.citizentaxpref.wa.gov/reports.htm.

We reviewed additional reports that were not ultimately used as sources for information contained in Section III.

III. Fiscal Analyst's Opinion

State of Nebraska

LEGISLATIVE COUNCIL

2012
EXECUTIVE BOARD
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Clerk of the Legislature

NANCY CYR
Director of Research

MARTHA CARTER
Legislative Auditor

JOANNE PEPPERL
Revisor of Statutes

MICHAEL CALVERT
Legislative Fiscal Analyst

MARSHALL LUX
Ombudsman

www.nebraskalegislature.gov

Legislative Fiscal Office
PO Box 94604, State Capitol
Lincoln, NE 68509-4604

December 6, 2012

Martha Carter, Legislative Auditor
Legislative Performance Audit Committee
Nebraska Legislature
State Capitol, Room 1201
Lincoln, NE 68509

Dear Martha:

We have completed our review of the Performance Audit Committee's audit report of the Nebraska Department of Revenue. Pursuant to Nebraska Revised Statute Section 50-1210(2), the Legislative Fiscal Office is required to offer an opinion as to whether the department can implement the committee's recommendations within its current appropriation. It is our opinion that, in general, the department can implement the committee's recommendations within its current appropriation.

Sincerely,

Douglas Gibbs
Budget Analyst

Michael Calvert
Fiscal Analyst

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IV. Background Materials

BACKGROUND MATERIALS

The "background materials" provided here are materials (in addition to the Office's report) that were available to the Committee when it issued the findings and recommendations contained in Part I of this report. They include:

- the Office's draft findings and recommendations (provided for context);
- the agency's response to a draft of the Office's report; and
- the Legislative Auditor's summary of the agencies' response.

Draft Findings and Recommendations

This section contains the Legislative Audit Office's findings and recommendations. Before we present our individual findings and recommendations, we make one general recommendation that incorporates many of the specifics that follow.

FINDING: The four programs we reviewed lacked specific, measurable program goals and cost projections.

Recommendation: The Performance Audit Committee or the Legislature may wish to initiate or support a comprehensive review of Nebraska's tax incentive programs to assess whether the programs are producing the results the Legislature intended and, if so, whether it is doing so at a cost the Legislature can support. The review should also identify any data the Legislature needs to make such an assessment that is not currently required to be reported and therefore not available to policy-makers.

Section I: The Nebraska Advantage Act

Program Costs and Goals

FINDING: While the Advantage Act has made progress in some of the general goals established by the Legislature, in the absence of clear, measurable goals, it is difficult to say whether the Act is doing what the Legislature intended it to do.

Recommendation: The issue of program goals is a policy issue for Senators to consider. If the Committee and Legislature are satisfied with the program results, they do not need to take additional action. However, if the Committee or the Legislature are not satisfied with the program results, they may wish to consider introducing legislation to better articulate program goals.

Economic Modeling and Published Projections

FINDING: The TRAIN modeling program compares favorably to best practices for economic modeling, but cannot be used as a forecasting tool.

FINDING: The projections of "projected future state revenue gains and losses," currently published by the Revenue Department are not program-cost forecasts, and as such their value to policy-makers is questionable.

Recommendations: The Revenue Department should consider whether to continue publication of the long-term projections or whether publication of only shorter projections could be more useful. At a minimum, the Department should add a qualification to the report that projections are not program cost forecasts, which would be in keeping with the existing statutory requirement that the Department "identify limitations that are inherent in the analysis method."

Section II: Selected Other Incentive Acts

In this section, we reviewed the results of three other tax incentive acts: The Nebraska Advantage Rural Development Act, Nebraska Advantage Microenterprise Act, and Nebraska Advantage Research and Development Act.

The statutes authorizing these tax incentives often referred to specific categories of business activity – e.g. livestock modernization, teleworkers, research and development activity – or targeted specific geographic areas. However, the legislature did not develop yardsticks against which to measure the effectiveness of these programs: lawmakers expected the tax incentives to stimulate business activity and expand the tax base in the state, but by how much?

FINDING: These three programs suffer from the same problem—from an evaluation standpoint—as does the Advantage Act: In the absence of clear, measurable goals and relevant data, it is difficult to say whether the Act is doing what the Legislature intended it to do.

Discussion: Unlike the Advantage Act requirements, these Acts do not require the Department to report much program data. While these three programs have a much smaller impact in terms of usage and cost than the Advantage Act, it could be beneficial to know more about program participants, including the types of businesses that have benefited and their geographic locations in the state.

Recommendation: The Committee or the Legislature may want to consider requiring the Department to report additional information on programs that use incentives under these three acts.

Section III: Complexities of Assessing Tax Incentive Programs

FINDING: Research shows that evaluating the impact of tax incentive programs is difficult and suggests that the best evaluations attempt to take both direct and indirect factors into account. Identifying the policy goals for these programs is particularly important.

FINDING: Nebraska's evaluations of its tax incentives are not as effective as they could be. This could mean that some incentives are being funded that are not the best investment and others that would be better investments are not being funded.

FINDING: Although the Revenue Department is technically complying with the statutory requirement that it provide recommendations to the Legislature regarding incentives that should be eliminated or limited, it may not be meeting the spirit of the requirement by consistently having “no recommendation.” This response potentially deprives the Legislature of useful information. At the same time, the requirement itself is problematic, in that it may be unrealistic to expect such policy recommendations from Department staff whose responsibility is administration, not policy development.

Recommendation: The Committee or the Legislature should consider ways of improving the state's ability to evaluate its tax incentive programs. A starting point for such improvement would be to address the two areas noted in a recent Pew Center on the States report.

The first is the need for evaluative information about how well the incentives are working. As noted above this information is not currently being provided by the Revenue Department and the Committee or Legislature may want to consider another source for it. The second recommendation is that evaluative information be better incorporated into the policy-making process, in order to remedy the concern that tax incentive programs often are not reviewed in the way direct expenditure are. The Legislature has a number of options for accomplishing this goal, including increasing the sunset dates in incentive act legislation; establishing review of this information as a priority for a standing committee; or conducting an interim study, among other things.

Dave Heineman
Governor

STATE OF NEBRASKA
DEPARTMENT OF REVENUE
Douglas A. Ewald, *Tax Commissioner*
P.O. Box 94818 • Lincoln, Nebraska 68509-4818
Phone: (402) 471-5729 • www.revenue.ne.gov

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DEC 21 2012

LEGISLATIVE AUDIT

December 19, 2012

Martha Carter
Legislative Audit Office
PO Box 94604
Lincoln, NE 68509-4604

Dear Ms. Carter:

I am in receipt of the Performance Audit Section Draft Report of "Nebraska Department of Revenue: An Examination of Nebraska Advantage Tax Incentive Programs" which was initially provided to the Department of Revenue (Department) on December 3, 2012, with a revised draft furnished on December 17, 2012.

The Department does not have any comments to the findings stated in the draft report. Thank you for the time and effort expended by the Legislative Audit Office in conducting this audit. We enjoyed working with you and the other members of the audit team.

Sincerely,

Douglas A. Ewald

Douglas A. Ewald
Tax Commissioner

DAE: LM:mra

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Legislative Auditor's Summary of Agency Response

This summary meets the requirement of Neb. Rev. Stat. § 50-1210 that the Legislative Auditor briefly summarize the agency's response and describe any significant disagreements the agency has with the report or recommendations.

In December 2012, the Performance Audit Section worked with the Department of Revenue to incorporate technical corrections and other suggestions into the final version of this report. On December 21, 2012, the Tax Commissioner submitted the Department's written response, which contained no further comments. We believe the Audit Office and the Department agree about the accuracy of the audit report; however, the Department made no comments about the findings and recommendations.

The Section appreciates the Department's assistance and especially their willingness to work within the tight time-frame we had for this report.