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Missouri State Auditor

Missouri Development Finance Board

Infrastructure Development Tax Credit Program

December 2014

Report No. 2014-142

http://auditor.mo.gov

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CITIZENS SUMMARY

Findings in the audit of the Infrastructure Development Tax Credit Program

Background

The Infrastructure Development Tax Credit (IDTC) program was established in 1985 and has no expiration. The program was designed to assist in the funding of capital improvement costs for qualified public infrastructure and public facilities projects within the state, and is administered by the Missouri Development Finance Board (MDFB). With approximately $19.5 million in redemptions in fiscal year 2014, the IDTC was the state's 5th largest tax credit program. Effective July 1, 2010, the MDFB may authorize $10 million in tax credits in a calendar year, but an additional $15 million may be authorized with the approval of the Director of Department of Economic Development, the Director of Department of Revenue, and the Commissioner of Administration, and they have approved credits in excess of the $10 million cap in each of the 3 years ending June 30, 2014.

Program Efficiency and Effectiveness

The IDTC generally does not make up a significant portion of project costs and does not always appear to be necessary for project completion. The economic impact of the IDTC is overstated due to cost-benefit calculations attributing the full impact of each project to the program. For example, for fiscal year 2014, the MDFB reported the IDTC program would return $13.64 in state revenue for every dollar of tax credit authorized. The MDFB based this calculation on total project investments of $675 million and the creation of 8,300 new jobs, even though IDTC incentives only accounted for 5.7 percent of total project funding. State law does not include a sunset provision for many tax credits, including the IDTC program. By adopting a sunset provision, the General Assembly could better determine if the program is achieving its intended purpose and whether program funding should be increased, decreased, or eliminated.

In the areas audited, the overall performance of this program was **Good**.*

*****The rating(s) cover only audited areas and do not reflect an opinion on the overall operation of the entity. Within that context, the rating scale indicates the following:

Excellent: The audit results indicate this entity is very well managed. The report contains no findings. In addition, if applicable, prior recommendations have been implemented.

Good: The audit results indicate this entity is well managed. The report contains few findings, and the entity has indicated most or all recommendations have already been, or will be, implemented. In addition, if applicable, many of the prior recommendations have been implemented.

Fair: The audit results indicate this entity needs to improve operations in several areas. The report contains several findings, or one or more findings that require management's immediate attention, and/or the entity has indicated several recommendations will not be implemented. In addition, if applicable, several prior recommendations have not been implemented.

Poor: The audit results indicate this entity needs to significantly improve operations. The report contains numerous findings that require management's immediate attention, and/or the entity has indicated most recommendations will not be implemented. In addition, if applicable, most prior recommendations have not been implemented.

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Missouri State Auditor

Honorable Jeremiah W. (Jay) Nixon, Governor
and
Members of the Board of Directors
and
Robert V. Miserez, Executive Director
Missouri Development Finance Board
Jefferson City, Missouri

We have audited certain operations of the Infrastructure Development Tax Credit Program in fulfillment of our duties under Chapter 29, RSMo and Section 620.1300, RSMo. The scope of our audit included, but was not limited to, the 2 years ended June 30, 2014. The objectives of our audit were to:

1. Analyze the costs and benefits of the program to determine if it is an effective and efficient use of state resources.

2. Evaluate the internal controls over significant management and financial functions related to the program.

3. Evaluate compliance with certain legal requirements related to the program.

4. Evaluate the economy and efficiency of certain management practices and operations.

For the areas audited, we (1) determined the current program structure is generally an efficient use of state resources, but due to weaknesses in program data, other aspects of program effectiveness and efficiency could not be adequately determined, (2) identified no significant deficiencies in internal controls, (3) identified no significant instances of noncompliance with legal provisions, and (4) identified the need for improvement in management practices and procedures.

Except for the matter discussed in the last paragraph of the Scope and Methodology Section, we conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

The accompanying Management Advisory Report presents our finding arising from our audit of the Infrastructure Development Tax Credit Program.

Thomas A. Schweich
State Auditor

The following auditors participated in the preparation of this report:

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Infrastructure Development Tax Credit Program Introduction

Background

The Infrastructure Development Tax Credit (IDTC) program was established in 1985 under Section 100.286(6), RSMo, and has no expiration. The program was designed to assist in the funding of capital improvement costs for qualified public infrastructure and public facilities projects within the state. The Missouri Development Finance Board (MDFB) administers the program and is responsible for the issuance of all tax credits based upon verification of contribution to the Infrastructure Development Fund. With approximately $19.5 million in redemptions in fiscal year 2014, the IDTC was the state's 5th largest tax credit program. See Appendix B for redemption information on all state tax credits.

The IDTC is a tax credit for contribution program. The MDFB is authorized to grant tax credits in the amount of 50 percent of the value of any eligible contribution to the MDFB by any taxpayer. Section 100.270(24), RSMo states the Board is the sole state agency authorized to set guidelines and priorities for the IDTC program. Per MDFB policy, there are four eligibility requirements under this program:

1. Applicant Eligibility - An applicant must be a local political subdivision, a local government entity created on behalf of or for the benefit of a local political subdivision, or a state agency.

2. Project Eligibility - The project must qualify as a public infrastructure facility as determined under Sections 100.255(9) and (14), RSMo. "Infrastructure facility" is defined as highways, streets, bridges, water supply and distribution systems, mass transportation, facilities and equipment, telecommunication facilities, jails and prisons, sewers and sewage treatment facilities, wastewater treatment facilities, airports, railroads, reservoirs, dams and waterways in this state, acquisition of blighted real estate and the improvements thereon, demolition of existing structures and preparation of sites in anticipation of development, public facilities, and any other improvements provided by any form of government or development agency. A "public facility" is defined as any facility or improvements available for use by the general public including facilities for which user or other fees are charged on a nondiscriminatory basis.

   Our review showed the majority of projects authorized tax credits through the IDTC program were for the acquisition of blighted real estate and the improvements thereon, and for public facilities.

3. Contributor/donor Eligibility - Any taxpayer making a contribution to the MDFB, including any charitable organization that is exempt from federal income tax and whose Missouri unrelated business taxable income, if any, would be subject to the state income tax imposed under Chapter 143, RSMo, may, subject to certain limitations, be eligible to receive the credit.

4. Contribution/Donation Eligibility - Contributions may be in cash, marketable securities, or real property. Marketable securities shall be the proceeds received by MDFB from the liquidation of the securities, while real property must have a free and clear title.

The MDFB encourages contributors to reinvest the proceeds from selling tax credits to benefit the project. Though the MDFD does not require this provision for an application's approval, the tax credit agreement (TCA) for 3 of the 8 projects we reviewed included such a requirement. For example, the Kansas City Chiefs Football Club contributed $75 million to the MDFB for additions and improvements to Arrowhead Stadium. The TCA stipulated the Jackson County Sports Authority use the proceeds from the contributor's sale of $37.5 million in tax credits to cover project costs.

The IDTC can be freely transferred, sold, or assigned, but is not refundable. The credits cannot be carried back to offset prior tax liability, however, Section 100.286(7), RSMo, allows the credits to be carried forward for 5 years to offset future tax liabilities of any assignee, but requires all credits must be claimed within 10 years of the date the contribution was made. The tax credits can be applied against the taxes imposed pursuant to Chapters 143, 147, and 148, RSMo, except for Sections 143.191 to 143.261, RSMo; including the insurance premium tax, and the financial institution tax.

Legislative changes

In 2009, the General Assembly passed legislation imposing new annual limits on the amount of tax credits authorized by the MDFB. Effective July 1, 2010, the MDFB may authorize $10 million in infrastructure tax credits in a calendar year. The $10 million in tax credits available annually do not carry forward to the following year if not approved. An additional $15 million in infrastructure tax credits may be authorized with the approval of the Director of the Department of Economic Development, the Director of the Department of Revenue, and the Commissioner of Administration. The Board cannot approve more than $25 million in tax credits during any calendar year. Credits in excess of the $10 million cap have been authorized in each of the 3 years ending June 30, 2014. See Appendix A for credits authorized, issued, and redeemed.

Approval process

Applicants submit an application to the MDFB detailing the project and its expected costs. Once MDFB personnel determine that the application is complete and the project is eligible for tax credits, the application is reviewed for the following criteria:

- State economic impact
- Level of local government financial participation in the project
- Ratio of total private to public investment in the project
- The likelihood the project would be completed without the tax incentive
- Level of public purpose

Using project rankings and overall evaluations of the project, the MDFB personnel then make recommendations to the MDFB. In addition, applicants make a presentation to the MDFB describing the project and explaining why the project should be considered for tax credits. Project approval occurs at meetings of the MDFB.

After a project is approved, the MDFB notifies applicants of the authorization of a specific amount of tax credits. These authorizations of tax credits are the basis for calculating the annual dollar limit for the program. The MDFB and the applicant sign a TCA that defines the relationship between the two parties and governs the use of contributions made available to the applicant for the project.

The MDFB receives contributions and issues the donor a tax credit certificate for 50 percent of the contribution amount. The contribution is then held by the MDFB and disbursed, less a 4 percent contribution fee, to the applicant based upon approved disbursement requests for project costs.

Reporting

The MDFB provides the General Assembly and the public key program information for the IDTC program through tax credit activity reports.

Agencies administering tax credit programs are required under Section 33.282, RSMo, to submit the estimated amount of tax credit activity for the next fiscal year to the State Budget Director for submission to the Chairmen of the Senate Appropriations and House Budget Committees. In addition to the estimates of tax credit activity, the agencies must also include a cost-benefit analysis of the program for the preceding fiscal year. The annual estimates and cost benefit analyses are submitted on forms called tax credit activity reports. State law requires submission of the tax credit activity report to the State Budget Director by October of each year and to the Chairmen of the Senate Appropriation and House Budget Committees by January 1st of each year.

Scope and Methodology

To gain an understanding of the IDTC program, we interviewed MDFB officials involved in the application and approval process.

To determine whether required procedures were followed, we reviewed 8 tax credit project files, interviewed MDFB staff, and reviewed documentation submitted by the applicants. The projects included additions and improvements to Arrowhead and Kauffman Stadiums in Kansas City, the construction of the Kansas City Chiefs Football Club's training facility on the campus of Missouri Western State University, the construction of student housing and a parking garage at the University of Missouri-Kansas City, the acquisition of real estate and facilities to improve the former Bannister Mall area in Kansas City, the construction of new facilities at the Donald Danforth Plant Science Center in St. Louis, the construction of a hangar at the Wheeler Downtown Airport in Kansas City, and, the St. Louis

Arch grounds project. The MDFB issued approximately $113 million in credits related to these seven projects. An eighth project authorized $6 million in tax credits to fund a mix use development project around Brown Shoe Company in Clayton, Missouri; however, the project was not completed and no tax credits were issued.

To understand how the economic impact of the IDTC program is calculated, we met with representatives of the MDFB responsible for generating the economic impact estimates. We interviewed MDFB staff regarding assumptions provided by the entities to calculate the economic impact of the tax credit.

We obtained aggregate totals of annual tax credit redemptions from the DOR. In accordance with the Missouri Supreme Court decision in the case of *Director of Revenue v. State Auditor* 511 S.W.2d 779 (Mo. 1974), auditors are not provided individual tax returns. As a result, auditors were not able to verify the completeness and accuracy of redemption data provided.

1. Program Efficiency and Effectiveness

The Infrastructure Development Tax Credit (IDTC) is not always a significant factor in whether projects are completed, which reduces program efficiency. In addition, the economic impact of the program is overstated on tax credit activity reports provided to the General Assembly and the program does not include a sunset provision.

1.1 Level of funding

The IDTC generally does not make up a significant portion of project costs, and does not always appear to be necessary for project completion. According to Missouri Development Finance Board (MDFB) data for the 4 years ended June 30, 2014, the tax credit benefit was 5.7 percent of total project costs.

Tax credit agreements reviewed indicate that the Board's participation is either a material precondition or essential to the completion of the project, and the project would not proceed without the assistance provided by the Board. However, our review of projects identified several examples where it is likely the project would have proceeded without the IDTC:

- One project in St. Louis was awarded $4.5 million in IDTCs, but had an estimated total project cost of $45 million that was primarily privately funded.

- Another St. Louis project was authorized $15 million in IDTCs, but had an estimated total project cost of $380 million. This project was funded by a combination of private and public funds, including $10.8 million annually from sales tax proceeds.

- A project in Kansas City was authorized $10.9 million in IDTCs, but had an estimated total project cost of $197 million. This project was primarily funded by a combination of the project developer's equity and public funding in the form of tax increment financing.

An important factor in determining a tax credit program's efficiency and effectiveness is how much economic activity was caused by the incentive, versus how much activity would have occurred without the incentive. Accordingly, MDFB policy requires the evaluation of "the extent to which the project would not proceed but for the approval of the assistance requested from the Board," known as the "but for" test. While project evaluation documentation includes comments that indicate the incentive is a significant factor in the completion of the project, Board policy and project documentation does not include any criteria to assess the "but for" test. However, based on the low levels of tax credit incentive relative to the high level of project costs, it does not appear the IDTC is a significant cause of the economic activity associated with the program. Awarding IDTCs to projects that would proceed without tax credit incentives unnecessarily increases the costs of the IDTC program, and reduces the efficiency of the program.

1.2 Economic impact

The economic impact of the IDTC is overstated due to cost-benefit calculations attributing the full impact of each project to the program. As previously discussed, IDTC funding is generally a small portion of project costs, so attributing the full economic impact of those projects to the IDTC program is not reasonable.

Projects authorized tax credits through the IDTC program can have several sources of funding, including both private and public. For example, for the fiscal year ended June 30, 2014, the MDFB reported the IDTC program would result in a significant economic impact for the state, returning $13.64 in state revenue for every dollar of tax credits authorized. The significant economic impact is a result of the MDFB reporting project investments totaling $675 million and the creation of 8,300 new jobs. However, IDTC incentives only accounted for 5.7 percent of total project funding, and Missouri Works tax credit incentives of approximately $312 million are proposed for the creation of 7,474 of the 8,300 jobs to be created.

In addition, the economic activity projections provided by the MDFB assume 100 percent of projects authorized tax credits will be completed. However, a review of IDTC historic data showed approximately 11 percent of authorized tax credits were never issued and utilized. It is unreasonable to assume all applicants will complete their projects because some applicants voluntarily withdraw or fail to proceed with construction for various reasons such as lack of financing, changes in economic conditions, or discovery of additional damages to the building.

1.3 Sunset provision

As noted in Report No. 2010-47, *Tax Credit Cost Controls*, issued in April 2010, state law does not include a sunset provision for many tax credits, including the IDTC program. The Sunset Act, passed in 2003, provides for new programs to sunset after a period of not more than 6 years unless reauthorized by the General Assembly or the program is exempted from the Sunset Act. The Act requires the Committee on Legislative Research to review applicable programs before the sunset dates and present a report to the General Assembly regarding the sunset, continuation, or reorganization of each affected program. However, the IDTC program was created prior to the Sunset Act and is exempted.

By adopting a sunset provision for the IDTC program, the General Assembly can better determine whether the program is achieving its intended purpose and whether program funding should be increased, decreased, or eliminated.

Recommendations

The MDFB:

1.1 Develop criteria to evaluate the extent to which the project would not proceed but for IDTC incentives, and emphasize the approval of projects that would not proceed without the assistance of the tax credit.

1.2 Report economic benefit projections to the General Assembly that more accurately reflect program performance.

The General Assembly:

1.3 Establish a sunset provision for the IDTC program.

Auditee's Response

1.1 The benefit conferred on and derived by the project is the amount of the contribution net of fees. The credits are 50 percent of the contribution so the actual participation benefit is approximately double the number cited by the SAO report.

The size of credits requested, and approved, vary considerably per project in proportion to total project costs. For smaller projects the proportion of credit to total costs is generally higher than for larger projects. The percentage of contributions, and therefore credits, per project is impacted by a number of factors. These factors include: the annual maximum amount of credits that can be approved—the Board credit cap is $10 million per calendar year however, the cap can go to a maximum of $25 million per calendar year with the consent of three cabinet officials; a reasoned determination by staff and the Board on whether a project can be completed with a reduced level of contribution thereby reducing the amount of credits approved; a desire to allocate the credits toward the most beneficial projects while maintaining as broad a distribution as possible in both the number of projects that can be done and in increased regional distribution. In the larger projects the cap plays a significant role in the amount of credits that can be authorized per project.

The Board will continue to apply its best reasoned judgment in the consideration and approval of credits to strive to participate only in projects that need its support.

1.2 The approval of the credit is predicated upon a legislative finding by the Board that the project would not be done without the tax credit. The finding is buttressed by representations by the public entity and the beneficiary that the project would not proceed without the Board's assistance. Therefore the full benefits projected to be derived from the project are considered in the impact analysis.

At the same time the economic benefit projections performed by MDFB through the Department of Economic Development for the IDTC program are performed in accordance with Section 33.282.2, RSMo. This reporting recognizes a cost benefit result both with and without other state incentive funding included.

The MFDB will continue to look at separating out immediate and long-term project benefits not directly caused by the use of the credit and discount these from the impact analysis.

Infrastructure Development Tax Credit Activity

The following table lists the Infrastructure Development tax credits authorized, issued, and redeemed for fiscal years 2004 through 2014. The figures presented reflect amounts provided as of our fieldwork completion and may not reflect amounts reported by the MDFB on past or future tax credit activity reports.

Fiscal Year		Amount Authorized	Amount Issued	Amount Redeemed
2004	$	74,454,462	73,145,278	10,020,578
2005		5,048,747	4,279,873	25,953,799
2006		70,680,399	70,338,009	21,858,725
2007		7,841,375	4,519,875	24,706,809
2008		22,645,080	13,397,933	19,877,329
2009		35,424,600	33,416,100	26,916,508
2010		6,500,000	6,497,827	13,970,215
2011		693,000	303,143	25,597,348
2012		13,313,670	12,818,688	33,444,754
2013		15,612,310	11,021,969	14,804,416
2014		16,434,161	11,021,710	19,474,878
Totals	$	268,647,804	240,760,405	236,625,359

Source: Reports obtained from MDFB using the Department of Economic Development Customer Management System and the Department of Revenue.

Tax Credit Redemptions

The following table shows redeemed tax credits for fiscal years 2011 through 2014 for all state tax credit programs. We did not audit the information.

Tax Credit Redemptions by Program

Program		Year Ended June 30, 2011	2012	2013	2014
Adoption (Special Needs)	$	1,346,454	1,036,226	744,155	718,495
Affordable Housing Assistance		4,880,797	5,629,466	7,406,988	5,620,750
Agricultural Product Utilization Contributor		466,048	1,468,156	1,267,239	2,022,953
Alternative Fuel Vehicle Refueling Property[1]		23,365	45,690	69,454	784
Bank Franchise		4,233,673	2,333,619	2,559,444	3,224,212
Bank Tax Credit for S Corporation Shareholders		2,787,708	5,523,276	4,533,837	2,607,870
Brownfield Jobs/Investment		1,620,384	1,660,626	68,693	105,842
Brownfield Remediation		11,432,109	16,967,400	6,378,613	5,354,819
Business Use Incentives for Large-Scale Development (BUILD)		10,976,914	6,591,948	8,212,533	8,533,926
Business Facility		5,682,965	4,867,041	4,572,711	6,622,467
Certified Capital Business[2]		586,135	411,014	590,235	345,678
Charcoal Producers[1]		521,380	59,595	0	0
Children in Crisis		587,137	629,456	792,368	930,769
Community Development Corporation[2]		22,703	224	231	261
Development Tax[1]		1,001,142	3,856,648	3,863,814	3,301,504
Developmental Disability Care Program		n/a	0	7,819	92,993
Disabled Access		26,273	24,791	14,603	13,340
Distressed Areas Land Assemblage		13,534,347	7,558,203	1,651,415	9,491,328
Domestic Violence		757,609	988,996	851,517	1,079,795
Dry Fire Hydrant[1]		7,715	3,124	0	264
Enhanced Enterprise Zone		4,000,689	7,324,093	6,451,698	7,423,842
Enterprise Zone[1]		1,128,432	232,990	557,312	504,129
Examination Fees and Other Fees		4,974,981	4,926,191	5,886,105	5,042,337
Family Development Account		25,000	10,616	95	0
Family Farms Act		49,825	53,948	32,032	22,770
Film Production		1,563,218	4,839,217	56,665	119,800
Food Pantry		1,081,076	796,156	72,822	840,234
Historic Preservation		107,767,393	133,937,747	78,814,711	59,829,671
Homestead Preservation[1]		773,465	0	0	0
Life and Health Guarantee Association		3,260,829	3,306,409	5,664,124	6,520,591
Low Income Housing		143,055,387	164,208,547	144,082,976	155,168,645
Maternity Home		726,355	1,354,431	1,138,969	2,051,028
MDFB Bond Guarantee		0	0	0	0
MDFB Infrastructure Development		25,597,348	33,444,754	14,804,416	19,474,878

Appendix B
Tax Credit Redemptions

Program	Year Ended June 30, 2011	2012	2013	2014
Missouri Automotive Manufacturing Jobs Act	0	0	0	5,419,607
Missouri Health Insurance Pool	10,931,565	14,318,218	16,874,865	17,830,771
Missouri Property and Casualty Guarantee Association	(53)	0	0	0
Missouri Quality Jobs[1]	27,936,799	35,431,828	39,278,156	46,021,490
Missouri Works	n/a	n/a	n/a	7,641,691
Neighborhood Assistance	8,513,472	9,757,095	7,392,113	10,848,983
Neighborhood Preservation	4,427,639	2,159,654	1,232,214	1,789,898
New Enterprise Creation[2]	11,499	25,000	0	0
New Generation Cooperative Incentive	1,984,424	826,953	2,100,091	4,747,230
New Jobs Training	3,175,559	4,090,193	3,081,261	6,236,452
New Market	1,199,285	15,385,989	12,934,464	18,620,744
Pregnancy Resource	1,103,384	1,892,183	1,194,477	1,715,600
Property Tax	114,886,668	117,603,638	113,962,551	107,556,467
Public Safety Officer Surviving Spouse	16,861	32,793	78,249	76,533
Qualified Beef	9,447	219,062	522,858	305,552
Rebuilding Communities[1]	1,277,135	1,388,190	1,430,329	2,095,225
Residential Dwelling Accessibility	20,086	6,501	10,258	6,759
Residential Treatment Agency	323,376	283,501	292,396	490,033
Retain Jobs	5,758,163	2,403,687	1,960,931	n/a
Self-Employed Health Insurance	1,428,143	1,847,045	1,811,060	2,959,063
Shared Care	44,152	70,004	41,645	64,991
Small Business Incubator	107,549	166,336	68,441	142,685
Small Business Investment (Capital)[1]	1,701	(19,395)	0	0
Transportation Development[1]	52,124	9,342	12,510	5,415
Wine and Grape Production	29,411	61,598	15,301	26,597
Wood Energy	3,818,378	2,282,401	3,563,209	2,853,117
Youth Opportunities	3,589,991	4,979,138	3,906,263	5,239,666
Total	$ 545,145,614	629,311,552	512,911,236	549,760,544

n/a - Tax credit did not exist in this fiscal year.

[1] The tax credit has expired or has been repealed. Redemptions may be reported due to carry forward provisions.
[2] The tax credit program has met the cumulative program cap.

Source: Office of Administration, Department of Revenue, and tax credit administering agencies