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FISCAL IMPACT STATEMENT

LS 6943
BILL NUMBER: SB 236

NOTE PREPARED: Feb 1, 2010
BILL AMENDED: Feb 1, 2010

SUBJECT: State Tax Matters.

FIRST AUTHOR: Sen. Hershman
FIRST SPONSOR:

BILL STATUS: 2nd Reading - 1st House

FUNDS AFFECTED: X **GENERAL**
DEDICATED
FEDERAL

IMPACT: State

Summary of Legislation: (Amended) *Internal Revenue Code Reference Update:* The bill amends the definition of federal "Internal Revenue Code" used in Indiana statutes and rules to refer to the Internal Revenue Code in effect on January 1, 2010. It requires that two years be used for the net operating loss carryback period for taxpayers (instead of the five years allowed under the federal Worker, Homeownership, and Business Assistance Act of 2009).

Electronic Filing of Tax Withholding Forms: The bill requires that federal income tax withholding statements and annual withholding tax reports must be filed electronically with the Department of State Revenue if an employer or a person or entity acting on behalf of an employer files more than 25 federal income tax withholding statements with the Department in the calendar year.

EDGE Tax Credit: The bill provides that any entity that submits incremental income tax withholdings, including a nonprofit organization, and that is a high growth company with new high skilled jobs, could qualify for the Economic Development for a Growing Economy (EDGE) tax credit if approved for the credit by the Indiana Economic Development Corporation. The bill repeals the power of Indiana Economic Development Corporation to grant the credit to a specified nonprofit organization.

Suspension of Patent Income Exemption: The bill suspends, for taxable years beginning in 2010 and 2011, the taking of the patent income exemption.

Suspension of Tax Credits: The bill suspends, for taxable years beginning in 2010 and 2011, the taking of the teacher summer employment tax credit, enterprise zone loan interest credit, neighborhood assistance credit, maternity home tax credit, enterprise zone investment cost tax credit, community revitalization enhancement district tax credit, the tax credit for making available a health benefit plan, and the small employer qualified wellness program tax credit.

Effective Date: November 6, 2009 (retroactive); January 1, 2010 (retroactive); July 1, 2010.

Explanation of State Expenditures: *Electronic Filing of Tax Withholding Forms*: The bill requires an employer to electronically file employee W-2 forms and the WH-3 form with the Department of State Revenue (DOR) in any calendar year that the employer files more than 25 W-2 forms with the DOR. This requirement also applies to a person or entity such as a payroll company that files these forms on behalf of an employer. The electronic filing requirement begins in 2011. The requirement is expected to result in a cost savings to DOR by significantly reducing the number of paper W-2 and WH-3 forms that must be imaged and stored and by reducing manual data entry from the paper forms.

The W-2 is an Internal Revenue Service form on which an employer annually files reporting wages, salaries, and other compensation paid to an employee and the federal, state, and local income taxes and FICA taxes withheld on the compensation. The WH-3 is a DOR form that an Indiana employer must submit along with W-2s reporting the state income tax and local option income tax withheld by the employer, including county-by-county breakdown of local option income tax withholdings.

Tax Exemption/Credit Suspensions: DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to accommodate the suspension of the patent income exemption and of various tax credits in 2010 and 2011. The DOR's current level of resources should be sufficient to implement these changes.

Explanation of State Revenues: *Summary:* The bill makes the following changes to state adjusted gross income (AGI) tax provisions.

(1) The bill updates the reference to the Internal Revenue Code (IRC) to incorporate all federal tax law changes made up to January 1, 2010. The reference update is not expected to have a material fiscal impact because the bill decouples from changes to federal loss carryback provisions enacted by the Congress in November 2009.

(Revised) (2) The bill extends the EDGE tax credit to not-for-profit entities that receive approval for credits from the Indiana Economic Development Corporation (IEDC). This would result as the bill specifically changes the definition of a taxpayer for purposes of the EDGE tax credit to include an entity that while not having a state tax liability does report incremental income tax withholdings of employees. In conjunction with the definition change, the bill also repeals a provision that allows EDGE credits to be awarded to Midwest ISO which is a tax exempt entity pursuant to Federal Code Section 501(c)(4). The potential fiscal impact of this change is indeterminable. The fiscal impact would depend on action by the IEDC in the future to award EDGE credits to nonprofit entities, and would depend on the extent that credits induce new investment or retain existing businesses. EDGE credits claimed in 2007 totaled approximately $40.3 M for corporate taxpayers and $1.3 M for individual taxpayers.

(3) The bill suspends the patent-derived income exemption in 2010 and 2011. Preliminary data from 2008 tax returns (the first year the exemption was in effect) suggests that the revenue loss from the exemption was minimal in that year.

(4) The bill suspends eight tax credits (listed and described below) in 2010 and 2011. The average annual

credit amounts claimed by taxpayers during tax years 2005, 2006, and 2007 under the eight tax credits totaled about $8.1 M.

Background Information: *Internal Revenue Code Reference Update* - The bill updates the reference to the Internal Revenue Code to incorporate all the federal changes made up to January 1, 2010. The current reference to the IRC pertains to all IRC provisions amended and in effect on February 17, 2009. The update would include changes as a result of the *Worker, Homeownership, and Business Assistance Act of 2009* (P. L. 111-92), signed into law on November 6, 2009. This federal act should not generate a material fiscal impact because the bill decouples from provisions of the federal act allowing a special 5-year (instead of 2-year) carryback for 2008 and 2009 net operating losses incurred by businesses.

(Revised) *EDGE Tax Credit:* A taxpayer is eligible for the EDGE tax credit for undertaking a project that create new investment and jobs in Indiana or that retains existing jobs in Indiana. The IEDC determines the amount and duration of the EDGE credits awarded for a project. For a job creation project, the credit can't exceed the incremental income tax withholdings from the project. The duration of EDGE credits for job creation or job retention can't exceed 10 years. Current statute also limits the amount of job retention credits that may be awarded to $10 M annually. There is no aggregate credit limit for job creation credits. The credits may be claimed against the taxpayer's adjusted gross income tax liability, Insurance Premiums Tax liability, or Financial Institutions Tax liability. However, the IEDC is authorized to provide refundable credits at its discretion. The bill would allow EDGE credits to taken by a taxpayer that doesn't have a tax liability but does remit income tax withholdings on employees. Current statute also contains a special provision that authorized the awarding of EDGE credits to Midwest ISO, which is a nonprofit entity. The bill repeals this provision.

The EDGE tax credit for job creation projects is designed to provide a revenue-neutral incentive for businesses to create new investment and jobs. A business that undertakes a job creation project receives EDGE credits in relation to the individual income taxes withheld for employees filling the newly created positions. Consequently, the tax credit does not represent a net revenue loss, provided the investment and employment would not occur but for the tax credit. However, if the investment and employment would have occurred in the absence of the tax credit, the state incurs a revenue loss equal to the total amount of credits taken by the business. For job retention projects, no new revenue would be realized since no new jobs would be created. As a result, EDGE credits for job retention are paid from existing revenues, resulting in a net loss to the state equal to the amount of EDGE credits granted to a business for job retention. However, if a business were to select a more profitable alternative project site and move out of Indiana, there could be an even greater loss of revenue from the reduction in individual (employee's) and corporate taxes.

Patent Income Exemption - The bill prohibits a taxpayer from claiming the patent-derived income exemption during tax year 2010 and tax year 2011. This exemption was first effective in tax year 2008. Preliminary data for tax year 2008 indicates that 5 individual taxpayers claimed exemptions totaling $26,216, and 10 corporate taxpayers claimed exemptions totaling $43,276.

The exemption applies to income derived by an individual or corporate taxpayer from utility patents or plant patents issued after December 31, 2007. The income can be from: (1) licensing fees or other income received for the use of a patent; (2) royalties received for the infringement of a patent; (3) receipts from the sale of a patent; and (4) certain income from the taxpayer's own use of the qualified patent to produce the claimed invention. A taxpayer may claim the exemption for 10 years with respect to a particular patent. During the first five taxable years the exemption is equal to 50% of the income derived from a patent, with the exemption percentage declining by 10 percentage points per year during the 6^{th} through 10^{th} year of the exemption. The total exemption amount that a taxpayer may claim in a taxable year is $5 M. The bill specifies that for a particular patent the number of years the exemption may be claimed and the exemption percentages are not affected by the suspension.

Tax Credits -The bill prohibits taxpayers from taking the income tax credits described below during tax years 2010 and 2011.The two tables following the descriptions of the affected tax credits report the number of individual and corporate taxpayers claiming each credit in 2005, 2006, and 2007, and the total credit amount claimed each year.

(1) <u>Teacher Summer Employment Compensation Credit:</u> This is a nonrefundable tax credit that may be claimed by an individual or corporate taxpayer employing a teacher in a qualified position during school summer recess. The credit is equal to the lesser of 50% of the compensation paid to the teacher during the taxable year or $2,500.

(2) <u>Enterprise Zone (EZ) Loan Interest Credit:</u> This is a nonrefundable tax credit that may be claimed by an individual or corporate taxpayer for interest income earned by the taxpayer from a loan that directly benefits an EZ business, increases EZ property values, or is used to rehabilitate, repair, or improve an EZ residence. The credit is equal to 5% of the loan interest received during the taxable year. (Note: This credit is also allowed for interest on qualified loans to businesses in Airport Development Zones.)

(3) <u>Neighborhood Assistance Credit:</u> This is a nonrefundable tax credit that may be claimed by an individual or corporate taxpayer contributing to individuals, groups, or neighborhood organizations, or engaging in activities to upgrade economically disadvantaged areas for economically disadvantaged households. The credit is limited to the lesser of 50% of the amount contributed or invested during the taxable year or $25,000. Total credits awarded during any state fiscal year is limited to $2.5 M.

(4) <u>Enterprise Zone Investment Cost Credit:</u> This is a nonrefundable tax credit that may be claimed by an individual or corporate taxpayer purchasing an ownership interest in an EZ business. The credit varies depending on the type of investment, the type of business, and the number of jobs created. The maximum credit is 30% of the qualified investment. (Note: This credit is also allowed for qualified investment in Airport Development Zones.)

(5) <u>Maternity Home Tax Credit:</u> This is a nonrefundable tax credit that may be claimed by a taxpayer owning and operating a registered maternity home that provides a temporary residence for at least 60 days to an unrelated pregnant woman. The maximum credit is $3,000 for a taxable year. Total credits awarded during any state fiscal year is limited to $500,000.

(6) <u>Community Revitalization Enhancement District (CRED) Tax Credit:</u> This is a nonrefundable tax credit that may be claimed by an individual or corporate taxpayer making qualified investment for the redevelopment or rehabilitation of property located within a CRED. The credit is equal to 25% of the qualified investment during the taxable year.

(7) <u>Credit for Offering Health Benefit Plans:</u> This is a nonrefundable tax credit that may be claimed in each of the first two years that an employer makes a health benefit plan available to employees. The credit is equal to $50 per employee enrolled in the employer's health benefit plan, up to a maximum of $2,500 per year in each of the first two years the plan is offered. An employer claiming the credit must offer health insurance for at least 24 consecutive months after the taxable year in which the health benefit plan is initially offered.

(8) <u>Small Employer Qualified Wellness Program Credit:</u> This is a nonrefundable tax credit that may be claimed by an employer providing a qualified employee wellness program certified by the Indiana State Department of Health. The tax credit is equal to 50% of the cost incurred by the taxpayer to provide the wellness program during the taxable year.

Individual Income Taxpayers	**2005**	**2006**	**2007**
Teacher Summer Employment Compensation Credit			
Taxpayers Claiming Credit	17	22	21
Credits Claimed	$14,262	$11,917	$15,855
Enterprise Zone Loan Interest Credit*			
Taxpayers Claiming Credit	28	22	75
Credits Claimed	$71,096	$13,510	$77,854
Neighborhood Assistance Credit			
Taxpayers Claiming Credit	3,895	3,208	3,488
Credits Claimed	$2,287,740	$1,415,197	$2,232,736
Enterprise Zone Investment Cost Credit**			
Taxpayers Claiming Credit	11	7	40
Credits Claimed	$151,875	$22,071	$171,502
Maternity Home Tax Credit			
Taxpayers Claiming Credit	10	15	13
Credits Claimed	$3,914	$6,615	$4,718
Community Revitalization Enhancement District Tax Credit			
Taxpayers Claiming Credit	94	84	55
Credits Claimed	$291,249	$54,228	$416,447
Credit for Offering Health Benefit Plans^			
Taxpayers Claiming Credit			214
Credits Claimed			$137,189
Small Employer Qualified Wellness Program Credit^			
Taxpayers Claiming Credit			83
Credits Claimed			$81,631
*Includes Airport Development Zone Loan Interest Credit. **Includes Airport Development Zone Investment Cost Credit. ^Effective beginning in tax year 2007.			

Corporate Income Taxpayers	2005	2006	2007
Teacher Summer Employment Compensation Credit			
Taxpayers Claiming Credit	N/A	1	1
Credits Claimed	N/A	$2,500	$2,500
Enterprise Zone Loan Interest Credit*			
Taxpayers Claiming Credit	28	28	20
Credits Claimed	$2,291,921	$2,441,498	$2,490,933
Neighborhood Assistance Credit			
Taxpayers Claiming Credit	41	18	16
Credits Claimed	$42,956	$26,450	$19,050
Enterprise Zone Investment Cost Credit**			
Taxpayers Claiming Credit	N/A	0	1
Credits Claimed	N/A	$0	$1,358
Maternity Home Tax Credit			
Taxpayers Claiming Credit	N/A	0	0
Credits Claimed		$0	$0
Community Revitalization Enhancement District Tax Credit			
Taxpayers Claiming Credit	N/A	4	3
Credits Claimed	N/A	$3,224,231	$2,663,171
Credit for Offering Health Benefit Plans^			
Taxpayers Claiming Credit			2
Credits Claimed			$2,550
Small Employer Qualified Wellness Program Credit^			
Taxpayers Claiming Credit			9
Credits Claimed			$20,681
N/A=Data not available for 2005. *Includes Airport Development Zone Loan Interest Credit. **Includes Airport Development Zone Investment Cost Credit. ^Effective beginning in tax year 2007.			

Explanation of Local Expenditures:

Explanation of Local Revenues: The bill would temporarily eliminate the potential reductions in taxable income during 2010 and 2011 from the patent-derived income exemption. This would eliminate potential revenue loss from this exemption to counties imposing local option income taxes during those years. The precise impact is indeterminable at this point.

State Agencies Affected: DOR; IEDC.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: Tom Conley, DOR, 317-232-2107. OFMA Income Tax databases 2005-2007.

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