Key Considerations in Analyzing Recent Tax Provision Audits

Purpose

The purpose of this document is to react to and provide additional context to the recent audits of tax provisions in the State of Georgia.

Introduction

Anytime policymakers introduce changes to the tax code, it is important to later review those changes and assess the impact on our economy. In the case of business tax credits and incentives, examining the return on investment is a reasonable way to assess if the programs are achieving the desired goals. We also recognize this is a largely new enterprise for state government in Georgia, and it will take time to refine to a point that the resulting work can be considered highly reliable and accurate.

We believe that recent audits of tax provisions in Georgia raise concerns that must be carefully weighed before relying on them as the basis for policy changes, especially as it relates to economic development and as the current methodology leaves room for improvement. Our intent is to offer some specific ideas and recommendations in an effort to improve this work going forward.

We also want to point out that many of the challenges mentioned in this analysis were also discussed by the staff performing these audits. Regardless, these issues cannot be ignored in favor of a "bottom line" ROI number that does not include them and is thus incomplete.

Maximizing Government Revenues as an Objective

A key challenge with these analyses is the assumption that government exists for the sole purpose of maximizing its own revenues. This is reflected throughout the audits as an "alternative use," scenario, namely that absent the provision government would keep the funds and grow itself. The IMPLAN model and software these studies generally chose treats entities as private firms in the economy, specifically that they invest X amount and receive Y amount in return. The flawed assumption here is that government exists for the sole purpose of maximizing its own revenues and growing itself. Recognizing certain returns through an IMPLAN analysis is helpful but is not the only reason for public participation and programming that encourages private investment.

Unfortunately, this entire premise runs counter to what most elected officials and voters actually believe. A recent Pew Center poll asked Americans about their top priorities for government, with responses ranging from protecting Democracy and firearms policy, to abortion policy and job growth.[1] Exactly zero voters responded that their top priority was "collecting higher government revenues and using them to expand the size of government." When you look at voter opinions on government size, the public is almost evenly split between expanding government to do more and shrinking its role relative to the private sector. In general, Georgia has seen such strong economic success recently precisely because public policy has been focused on providing core government services effectively without expanding to a point that an undue burden is placed on the private sector.

In reality, the outcomes that voters want from government do not necessarily rise concurrently with government spending. In fact, the reverse can often be true. Better jobs, higher educational levels, economic growth, low crime, low poverty, and a range of other desired goods cannot be achieved by simply raising taxes in private firms and spending the resulting revenues on government programs. Hence, any assumption that the purpose of a tax provision is to generate more tax revenue suffers from fundamental flaws.

For example, we might offer a historic tax credit to promote preservation of historic buildings, a technology credit to encourage the building of more broadband infrastructure, or a research credit to bring more highly educated residents to our state. While these things do not show up in a narrow input-output analysis, they may in fact be of higher priority to elected officials and the public than total tax collections.

In these instances, the question is not "did the government make/lose money in terms of tax collections as a result," but rather "was the desired public good achieved at a reasonable expenditure."

General Challenges with the IMPLAN Model

Detailed econometric studies that fully account for all facets of economic activity in a given area are highly consumptive of time and generally require highly advanced graduate and post-graduate training to conduct. The IMPLAN software aims to short circuit this issue by providing off the shelf software that can instantly analyze economic impact with minimal training. The company itself advertises that users can "ensure your project is successful" by taking a three-day course and spending an hour with one of the company's experts.[2] There is, of course, nothing wrong with using quick training and some software to take a broad look at an economic issue, but this type of work should not be mistaken for a full academic analysis of an economic question.

Not surprisingly, a recent academic look at the use of IMPLAN found that "the cost differences and ease of accessibility to non-economists explain the dominance of IMPLAN in the U.S."[3] This study recommends the use of more technical computer general equilibrium models (CGE) to

---

[1] Schaeffer, Katherine and Green, Ted. "Key Facts about Voter Priorities Ahead of 2022 Midterm Elections." Pew Research Center. November 3, 2022.
[2] Lucas, Maria. "IMPLAN Live Training Workshop." Implan.com. December 2022.
[3] Crompton, John. "Uses and Abuses of IMPLAN in Economic Impact Studies of Tourism Events in the United States." Tourism Review. Feb 20, 2020.

determine the full picture around a given incentive, while also acknowledging the much higher cost and expertise level associated with this approach.

Regardless, the often-voiced concern that IMPLAN models are used to overstate the value of particular incentives using partial or exaggerated inputs must be considered when similar information shortfalls are used to develop arguments on the other side of the same question. IMPLANS model, since it is focused on a specific segment and is not a general equilibrium model, does not fully account for how changes in one place impact neighboring places either positively or negatively.

Severe Limitations in "But-For Analysis"

Based on our analysis of this group of audits, there does not appear to have been a foundational theory or direction from the state on how to methodologically address what is often the most crucial question: but for this provision, what economic activity would be occurring in the state? In other words, what did the provision cause and what did it contribute to the private sector without any resulting public good?

- **Interactive Gaming**: There was no real consideration of the issue at all.
- **Research and Development**: The audit team used a comparison between growth of R&D in Georgia and three other states: South Carolina, Florida, and North Carolina in an attempt to answer how much the incentive has impacted R&D growth in our state. In reality, recruiting experts have repeatedly said that competition for R&D oriented firms is national and global in nature, with California, New York, Massachusetts, Texas, Washington, Maryland and New Jersey heading the list of states we compete with for research jobs.
- **Computing Equipment**: The team found little data to set a number, so it chose to assume that 7.35% of computing equipment purchases were incented by the tax provision. This number came from a study of an R&D credit in Washington state, and broad looks at incentives in Tennessee and Florida, none of which specifically addressed computing equipment.
- **Manufacturing Equipment**: A single year survey of the relative ranking of taxation from a magazine was used to suggest that between 2% and 25% of manufacturing operations that located in Georgia would not locate here if the tax environment were "bad." There's no real evidence for what constitutes "bad," only a general assumption about how taxation ranks relative to other factors. In reality, the question about how much of a factor tax policy plays in location decisions is not a binary one. If taxation is "bad" enough, a state will have zero jobs. And, if it is "good" to taxpayers in an absolute sense, the state will have no tax revenues. The negative feedback loop that would come from being a state with a "bad" tax environment is not accounted for in such an approach.

- **Job Tax Credit**: The audit team used a literature review of academic studies attempting to impute a percentage of jobs directly incented by job credits. The studies were all over the map, and the team did projections assuming that 100%, 5%, and 11.4% of credited jobs were "caused" by the credit. Given the wide range in these findings and the theoretical nature of the studies generating them, it is hard to see how this assumption is a reliable one.
- **Historic Tax Credit**: Researchers counted the number of historic preservation projects in TN, FL, and GA in an attempt to model the impact of the credit on preservation projects. This idiosyncratic set of states induces some flaws. For example, according to the National Historic Landmarks list, Tennessee has about 40% fewer sites than Georgia.

We acknowledge the task set before researchers here was a difficult one. Our objective in going over this is to point out two facts. One, there is no standardized methodology for answering what most would say is the single most important question regarding any tax expenditure. Two, the lack of input from private sector firms who are actually making the decisions on where to locate, rehabilitate, purchase and hire is striking. In reality, the best measure of the role a particular incentive plays in a firm's economic decision making is to ask the site selectors, real estate professionals, corporate leaders and technical experts who actually make these decisions.

Uncertainty: The Impact of Tax Changes on Firm Decision-making

Private employers place a high value on certainty on core economic conditions, and the tax environment in a given location often tops this list. There is wide variation in state taxation structures, and any major location decision by a private sector firm puts tax policy at the top of the list of factors to consider.

A core factor considered in these analyses is the stability of a tax structure in a given state. If a state is prone to constant changes in taxation, site selectors and corporate leaders generally place a lower value on tax benefits offered by the state and perceive a higher level of risk associated with future tax changes. In turn, this makes the state less likely to achieve a high ranking when site selection professionals consider tax policy in location decisions. Moreover, the community of professionals who handle tax matters for large firms is fairly small, and – not surprisingly – they talk to one another. Hence, a large firm that experiences a highly unfavorable tax change in a state becomes very likely to discourage not only its own jobs from going there, but also those being considered by peers.

This factor is so important in private sector investment decisions that the G20 group of leaders of the world's largest economy directed OECD and the IMF to begin a focused effort to quantify and improve tax certainty. In a recent report, the group stated that "the need to ensure a predictable and stable investment environment" remains a "fundamental component."[4]

Given that some of the best economists in the world have concluded tax certainty has a fundamental impact on the movement of jobs and capital across national borders, it would be

[4] "Progress Report on Tax Certainty." Report for G20 Finance Ministers and Central Bank Governors. June 2019.

foolish to assume the same fact does not pertain across state borders. In fact, tax professionals in the U.S. are increasingly offering firms advice on putting flexible measures in place to mitigate tax uncertainty, such as remote working, flexible shipping networks, legal restructuring, nexus exposure reduction, and facility location.[5]

Finally, we would add that uncertainty issues around a particular incentive are more reputational in nature than tied to that particular incentive. In other words, a high level of uncertainty around one tax provision inevitably leads to uncertainty around other tax provisions. The resulting spillover effect can become quite significant to economic growth in a state over time.

Ignoring Partial Inputs

In virtually every case, these audits rely primarily on tabulating the tax collections to the State of Georgia from the full-time employee positions that are directly created for the purpose to which each tax provision is attached. In reality, private sector firms spend large sums in taxable salaries, retail purchases, travel, contractor hires, and other areas that support a range of economic activities.

For example, a firm primarily engaged in a specific technology activity supports that work through hiring construction workers, engineers, custodians, landscapers, security guards, IT contractors, and a long list of other occupations. Employee travel, legal support, marketing and other functions create spending that does not attach directly to the salary of full-time employees engaged in supporting multiple corporate functions.

In looking at research and development spending, for example, the Tax Foundation reported that "[f]or mature research and development (R&D) facilities, for instance, corporate income and similar business-specific taxes only accounted for 11 percent of tax liability overall."[6] Because these studies primarily weigh the costs of business-specific incentives against the taxes paid by firms conducting those activities, this number would imply the audits may have ignored up to 89 percent of taxes being collected and thus showed a markedly lower return on investment than might otherwise have been found.

In several cases, researchers acknowledged this shortfall. However, that does not mean that a properly conducted study would not involve reaching out to employers or obtaining data from other sources regarding tax collections on indirect spending by firms. By not including this data in the reporting, auditors provide only a partial quantitative look at what private sector employers actually spend to support specific activities.

[5] Siegel, Mark and Cronic, Anna. "Managing State Taxes in an Uncertain World." The Tax Adviser. April 1, 2021.
[6] Walczak, Jared. "What Location Matters Can Tell Us About State Tax Competitiveness." Tax Foundation. May 5, 2021.

Understanding Broader Economic Benefits

Large employers provide a range of other civic goods to the State of Georgia beyond simply the amount the state can collect in taxes from them. Increases in wages, targeting of high-impact industries, and redevelopment of underutilized locations are specifically noted by companies and communities as benefits to the public in relation to tax policy. Some of these public goods include:

- **Educational Investment**: Firms generally spend substantial amounts of money educating their employees, much of which goes directly to state sponsored institutions.
- **Telecommunications Infrastructure**: Virtually any large employer requires significant broadband capacity. In many cases, corporate relocation and growth drives the deployment of new broadband capacity, which in turn makes more capacity available to other users in the same area.
- **Healthcare**: No single issue is more important to stable and affordable hospitals and care networks than commercially ensured patients. These patients cover the lions share of operating revenues for our healthcare system and make it possible for facilities to provide care to Medicaid and indigent patients below cost. Increasing the percentage of commercially ensured patients is critical to the stability of our healthcare system.
- **Energy Transmission and Generation**: Large facilities consume electricity, and their owners pay for the ability to do so. This supports the installation of generation and transmission capacity that enhances reliable energy in the state.
- **Water and Sewer**: Many types of employers require expanded water and sewer capacity to support operations. The resulting expansions are usually sized beyond the single user, and then become available to provide services to other commercial and residential uses.
- **Civic Engagement**: Good paying jobs create a large base of citizens who care about the operation of government, form relationships with policymakers and even go on to run for state, local and federal office.
- **Supplier Recruitment**: Large firms always have a large network of suppliers. Over time, the growth of large firms supports the growth of smaller businesses which serve multiple customers.
- **Favorable Marketing**: When corporate leaders are pleased with the economic environment in a state where they locate, they are prone to say this to other decision-makers. This helps drive a positive reputation and continued growth for Georgia.
- **Transportation Infrastructure**: From shipping through the Georgia Ports to using Georgia railroads and supporting expanded roads to growing regional airports, large employers are instrumental in supporting the transportation infrastructure in Georgia.

- **Spin-Off Companies**: Large firms bring talent, capital, research and capacity to states where they locate. Over time, these factors lead directly to the formation of new homegrown companies.
- **Housing Stock**: Stable corporate employment leads to higher income and credit. In turn, this grows the lending environment, supports home construction and makes additional housing capacity available in a state.
- **Local Tax Revenues**: Firms pay a broad range of local taxes, which support the core services our citizens rely upon.
- **Business Philanthropy**: Corporate giving supports a range of art, assistance, educational, healthcare and other activities in Georgia.
- **Individual Tax Revenues**: Individuals working at companies go on to invest in equities, real estate, venture capital and other areas, as well as participating in the economy. The resulting tax collections directly hit the state bottom line, and would not exist but for the employer.

While we are all generally aware of these other benefits, they absolutely should be quantified and considered in any study examining the cost-benefit of a particular tax provision. These data are available in general form, and are direct benefits of tax provisions that encourage businesses to locate and grow in Georgia.

Understanding Economic Ripple Downside Risks

When firms begin or grow operations, a range of smaller businesses orient their activities around serving them. Banking, law, real estate development, accounting, building maintenance, trucking, landscaping and a host of other small businesses make decisions to invest in real estate, people and equipment specifically to serve large firms in a given area.

In many cases, large firms facing higher costs from increased taxation will first look to contractors and suppliers to reduce spending. Any study of the impact of an incentive that would raise corporate taxes that does not look at the resulting impact on small business is fundamentally incomplete in nature.

Long Term Impact of Growing Government vs. Growing Private Jobs

These audits are all founded on the assumption of an A-B choice on the part of policymakers. Choice A is to incent private sector growth using tax provisions. Choice B is to keep the money and spend it on government activities.

Putting ideological concerns aside, an important point to note in this choice is that government spending for the purpose of growing government is not a static expenditure. In virtually every case, building new government facilities, starting new government programs or hiring new government employees results in a permanent ratcheting up of costs. Facility maintenance, salary increases, post-employment obligations, healthcare costs and bureaucratic program expansion all cost more over time.

The point here is simply than an alternative use analysis should reflect the long term burden of government expansion on taxpayers in order to be accurate.

Tax Impact on Bond Ratings

When rating agencies examine state fiscal stability, one of the core issues is analyzed is the long term stability of the tax base. Large private firms are a core component of this stability. In recently announcing the state's first positive rating movement in over two decades, Connecticut's Governor explicitly acknowledged the relationship between past failed corporate tax policies and recent successes, saying that "[n]ow is not the time to disrupt the fragile economic and financial environment by levying large-scale tax increases or creating massive new spending program."[7] In addition to the high profile departure of General Electric's corporate headquarters from the state, Connecticut has lost numerus other large employers due to tax policy. At the peak of this problem, the state saw a 45% reduction in collections from its top 100 taxpayers.[8]

The departures of large companies led to a very weak environment for the entire state economy in Connecticut. In part, as a result of an uncompetitive tax policy, the total number of jobs in Connecticut has not grown in more than 20 years. In January 1990, payroll employment in Connecticut was 1.65 million; the most recent data from November 2022 shows Connecticut total employment was virtually unchanged 22 years later at 1.67 million. Connecticut job growth underperformed both neighboring New York and Massachusetts and stands in sharp contrast to Georgia's 60% growth in payrolls over the same period with jobs rising from 3.02 million to 4.83 million. Few models would have predicted the negative feedback loops that prevented Connecticut's economy from growing over the past two decades.[9] Moody's most recent credit opinion for the state cited long term economic and demographic factors as both existing drags on the current rating and states that the "rapid acceleration of revenue/economic/demographic weakness" could lead to a downgrade.[10]

A study by the Tax Foundation cited onerous and unpredictable tax policies enacted in the state as a key factor behind job losses, writing that "policymakers have pursued a range of tax hikes which have created uncertainty and undermined the state's competitiveness."[11]

As Georgia considers tax policy, it would be wise to consult with rating agencies and other sources about the resulting tax losses and volatility from changes that have been shown to reduce the presence and size of large employers. The resulting information should be factored

[7] Press Release from the Office of Governor Ned Lemont. May 14, 2021.
[8] Woods, Bob. "Another Fleeing Corporate Giant: Connecticut is Facing a Business Migration Crisis." CNBC. July 13, 2017.
[9] Bureau of Labor Statistics. (2023, January 20). *November 2023 and January 1990 SAE Data*. Current Employment Statistics. U.S. Department of Labor. https://www.bls.gov/sae/data
[10] "Moody's assigns Aa3 to Connecticut's GO bonds; outlook stable." Moody's. November 22, 2022
[11] Walczak, Jared. "Enhancing Tax Competitiveness in Connecticut." Tax Foundation Fiscal Fact. July 2018.

into any examination, given that higher borrowing costs could well absorb any gains resulting from business tax increases.

Recommendations for Future Audits

In order to continue to improve work product in this area, these are some key changes we recommend for future audits:

- Give researchers clear guidance on how maximizing government spending ranks as a public policy priority relative to other impacts of tax incentives.
- Evaluate whether the IMPLAN model and software provides accurate estimates of economic impact.
- Establish a uniform "but-for" analysis approach, and inform that approach by surveying private sector decision-makers.
- Require future audits to examine tax certainty impacts of major changes and estimate the economic losses resulting from them.
- Quantify tax revenues from related business units and contractors that serve a particular corporate function.
- Quantify the losses to small business serving large firms that may result from tax policy changes.
- Fully examine the long-term costs of government expansions.
- Quantify credit risks resulting from contraction in the business tax base in Georgia over time.