



## **Credits & Incentives talk with Deloitte**

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*CREDITS & INCENTIVES TALK WITH DELOITTE*

## Missouri Tax Credit and Incentive Restructuring

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On June 1, 2018, Missouri enacted legislation reducing the Missouri corporate income tax rate for corporations (effective for tax years beginning on or after January 1, 2020) from 6.25% to 4%.<sup>1</sup> In addition to this significant corporate tax rate reduction, certain Missouri credits and incentive programs were also amended after a multi-year review which sought to evaluate the effectiveness, efficiency and overall economic benefit of Missouri's tax credit and incentive offerings.

This article offers a brief background of the efforts at the state level to analyze the overall effectiveness of Missouri's tax credit and incentive offerings as well as a summary of the modifications which resulted from this effort.

## Background

One of Missouri's first tax credit programs, the Senior Citizen's Property Tax Credit enacted in 1973,<sup>2</sup> sought to provide a public benefit of supporting senior citizens and the disabled. Another program, the Low-Income Housing Tax Credit program, was created in 1990, for the purpose of encouraging the creation of housing available to low-income families.<sup>3</sup> The Missouri Works tax incentive program, enacted in 2013, was intended to encourage job creation in the state.<sup>4</sup>

Certain Missouri credit programs have been the subject of news articles and studies in the last several years that have questioned their overall effectiveness. For example, the Low-Income Housing Tax Credit program has been characterized as "inefficient" and "troubled"<sup>5</sup> while, the Missouri Works program has received unfavorable press in the context of an economic development "border war" between Missouri and Kansas.<sup>6</sup>

## June 2017 Missouri State Auditor's tax credit program report

As a result of the increased scrutiny of state-level Missouri tax credit and incentive programs, the Missouri State Auditor released an audit of tax credit programs in June 2017. It was noted that the following tax credit programs represented approximately 76 percent of credit redemptions:

- Low Income Housing Tax Credit (LIHTC)
- Historic Preservation Tax Credit (HPTC)
- Senior Citizen Property Tax Credit
- Missouri Quality Jobs (and its replacement Missouri Works)
- New Markets Tax Credit
- Infrastructure Development Tax Credit.<sup>7</sup>

The Auditor's report also noted that the state of Missouri had 63 active tax credit programs (as of the date of the report),<sup>8</sup> resulting in \$500 million in tax credits redeemed each year since 2009.<sup>9</sup> Additionally, the total redemption of tax credits increased an average of 2.8% per year from 2007 through 2017.<sup>10</sup>

The Auditor's report further noted that the total amount of tax credits authorized, but unredeemed was approximately \$3 billion as of June 30, 2016, creating significant fiscal stress on future Missouri budgets.<sup>11</sup> Approximately 85% of the outstanding credits were associated with the tax credit programs noted above, with the LIHTC program accounting for 72% of that 85% total.<sup>12</sup>

The Auditor's report ultimately made various recommendations to the Missouri General Assembly aimed at addressing both fiscal and effectiveness concerns, including:

- Consider changes to tax credit programs to reduce carryforward provision timeframes to reduce outstanding and obligated tax credit balances.<sup>13</sup>
- Evaluate the LIHTC and HPTC and consider making changes to improve the efficiency of the programs.<sup>14</sup>
- Consider changes to current entitlement programs to make the authorizations more competitive.<sup>15</sup>
- Establish clearly defined annual or cumulative funding limits for all tax credit programs, and ensure limits are set at appropriate levels.<sup>16</sup>
- Establish sunset provisions or expiration dates for all tax credits.<sup>17</sup>
- Require administrative agencies to establish procedures to ensure the economic benefit projections provide a realistic assessment of program performance.<sup>18</sup>
- Evaluate the benefit/cost ratio of all tax credits to determine each program's budget impact and whether each program's non-financial benefits justify future financial costs.<sup>19</sup>

Following this report, then-Governor Eric Greitens issued an Executive Order establishing the Committee on Simple, Fair, and Low Taxes ("The Committee") with a purpose of investigating tax credit reform.<sup>20</sup>

## Committee on Simple, Fair, and Low Taxes

The Committee, made up of current and former elected state officials and two officials appointed by the Governor, invited subject matter experts and members of the public to public hearings, to town hall meetings, and to provide written comment.<sup>21</sup>

The Committee had four objectives:

1. Compare Missouri's tax credit programs and its tax rates to those of peer states.
2. Assess the economic impact of existing Missouri tax credit programs.
3. Assess the possibility of financing cuts to overall Missouri tax rates with cuts to tax credit programs.
4. Recommend comprehensive legislation to the Governor no later than June 30, 2017.<sup>22</sup>

The Committee issued its recommendation on June 30, 2017. Similar to the 2017 Missouri State Auditor's Report on Tax Credits, the Committee noted the significant amount of tax credits being redeemed each year,<sup>23</sup> estimating more than \$575 million in redemptions in FY 2016.<sup>24</sup> Additionally, the Committee report

also noted that the level of tax credit redemption had increased annually since 2010.<sup>25</sup> The Committee made a number of process recommendations in the report, encouraging additional oversight of and accountability for the tax credits:

- Allow denial of any tax credit application that fails to meet a public purpose.
- Allow denial of a tax credit application if the activity would occur without state incentives.
- For economic development tax credits, allow denial of applications that fail to demonstrate a positive fiscal return to the state.
- Allow the Department of Economic Development to deny applications for failure to show technical or financial ability to perform.
- Annually appropriate the amount of tax credits for each program and allow for gubernatorial withholding.
- Enact a general false claims act to rein in fraud, waste, and abuse.<sup>26</sup>

In addition, the Committee made specific recommendations intended for the three largest tax credit programs: the LIHTC, HPTC, and Missouri Works.

- The Committee recommended modification of the LIHTC benefit, to convert the program from a tax credit to a low- or no-interest loan program.<sup>27</sup> Additionally, the Committee recommended that the state should repurchase outstanding LIHTCs and include a five-year sunset provision.<sup>28</sup>
- The Committee recommended tying the HPTC program to a Brownfield Tax Credit, subject to reduced funding, reducing the carryback and carryforward provisions, include a five-year sunset provision, exclude private residences from eligibility, and institute a per project cap of \$2 million.<sup>29</sup>
- The Committee recommended that the withholding tax retention benefit of the Missouri Works program be subject to Department of Economic Development discretionary approval and expanding the jobs training component to include retained jobs.<sup>30</sup>

## 2018 Missouri tax legislation

Following the issuance of the Auditor's report and Governor's Committee report, the Missouri Legislature amended elements of the state's tax credits and incentives system in May 2018, effectively reducing the amount of Missouri tax credits available in the future.

Senate Bill 590 lowered the annual credit issuance cap for HPTC from \$140 million to \$90 million beginning in fiscal years after July 1, 2018.<sup>31</sup> However, the revised program will include an additional \$30 million in tax credits that are dedicated to projects located in qualifying census tracts creating an effective

annual credit issuance cap of \$120 million.<sup>32</sup> Senate Bill 629 reduced the annual Missouri Supplemental Tax Increment Financing Fund cap from \$32 million to \$10 million for projects applying after August 28, 2018.<sup>33</sup>

The Legislature did extend the sunset of certain public benefit tax credits, such as the Champion for Children Tax Credit, Maternity Homes and Pregnancy Resource Centers Tax Credit, Diaper Bank Tax Credit, Donated Food Tax Credit, and Schoolchildren Health and Hunger Tax Credit.<sup>34</sup>

No legislative action was taken on the LIHTC program. However, from a regulatory perspective, the House Budget Committee administratively effectively limited the LIHTC by not approving the issuance of any LIHTC for the fiscal year July 1, 2018 through June 30, 2019.<sup>35</sup>

## Conclusion

While tax credits and incentives have been a fundamental part of Missouri's tax system for decades, focus on the budget impact and effectiveness of such programs can be expected to continue. Utilizing the results of the Auditor's report and Governor's Committee report, the Missouri Legislature in 2018 limited certain tax credits and incentives. The potential for further credit and incentive amendments in the 2019 Missouri General Assembly (scheduled to begin on January 9, 2019) should be monitored, notably in the LIHTC area, as Governor Mike Parsons has indicated that no LIHTC funding will be approved until legislative reform occurs.<sup>36</sup>

<sup>1</sup> S.B. 884, amending Mo. Rev. Stat. § 143.071.2.

<sup>2</sup> The Senior Citizen's Property Tax Credit provides an income tax credit to senior citizens or disabled people based on whether they rent or own and their level of income.

<sup>3</sup> Mo. Rev. Stat. §§ 135.350–135.363.

<sup>4</sup> Mo. Rev. Stat. §§ 620.2000–620.2020.

<sup>5</sup> J. Suntrup, *Gov. Mike Parson calls for reforming troubled tax credit program, names two to housing board*, St. Louis Post Dispatch, Sept. 24, 2018. Retrieved from <http://www.stltoday.com>.

<sup>6</sup> *Why the Kansas-Missouri economic border war is a waste of time and money*, The Kansas City Star, Oct. 29, 2017. Retrieved from <http://www.kansascity.com>.

<sup>7</sup> Office of Missouri State Auditor, Report No. 2017-051, June 2017, p. 10.

<sup>8</sup> Report No. 2017-051, June 2017, p. 2.

<sup>9</sup> *Id.* at 8.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at 11. This approximate \$3 billion total consists of *outstanding* tax credits issued by the administering agency but not redeemed or expired, of approximately \$1.15 billion, and *obligated* tax credits, credits which have been authorized to a particular project or company by the administering agency, but have not been issued, and therefore not redeemed, of approximately \$1.84 billion.

<sup>12</sup> Report No. 2017-051, June 2017, p. 12.

<sup>13</sup> *Id.* at 14.

<sup>14</sup> *Id.* at 18.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> Report No. 2017-051, June 2017, p. 18.

<sup>18</sup> *Id.* at 21.

<sup>19</sup> *Id.*

<sup>20</sup> Exec. Order No. 17-07 (2017), <http://www.sos.mo.gov/CMSImages/Library/Reference/Orders/2017/17-07.pdf>

<sup>21</sup> *Tax Credit Reform: Recommendations to Make Missouri a Best-In-Class State*, The Governor's Committee on Simple, Fair, and Low Taxes, June 30, 2017.

<sup>22</sup> *Id.* at 3.

<sup>23</sup> *Id.* at 6.

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> *Tax Credit Reform: Recommendations to Make Missouri a Best-In-Class State*, The Governor's Committee on Simple, Fair, and Low Taxes, June 30, 2017, pp. 8-12.

<sup>27</sup> *Id.* at 19.

<sup>28</sup> *Id.* at 20.

<sup>29</sup> *Tax Credit Reform*, June 30, 2017, pp. 20-25.

<sup>30</sup> *Id.* at 25.

<sup>31</sup> S.B. 590, Sec. A (9)(1).

<sup>32</sup> S.B. 590, Sec. A (9)(2).

<sup>33</sup> S.B. 629, Sec. A (1)(10)(4).

<sup>34</sup> H.B. 1288.

<sup>35</sup> *Tax credits for low-income housing are "dead" amid scrutiny from lawmakers, Greitens*, The Kansas City Star, May 26, 2018. Retrieved from <http://www.kansascity.com>.

<sup>36</sup> *Parsons Calls for Change to Low-Income Housing Tax Credits*, U.S. News & World Report, Sept. 25, 2018. Retrieved from <http://usnews.com>.