

WHITE PAPER

Simplifying Tax Credit Applications

Using Impact Analysis



Closing the funding gap

Demonstrating the value and ROI of an investment can be tricky. Here's how to simplify the process.

Contents

Intro	1
-------	---

Laying the Groundwork	2
-----------------------	---

Interpreting Results	3
----------------------	---

Talking to a CDE or other funding entity	4
--	---

Save Everything	5
-----------------	---

Conclusion	6
------------	---

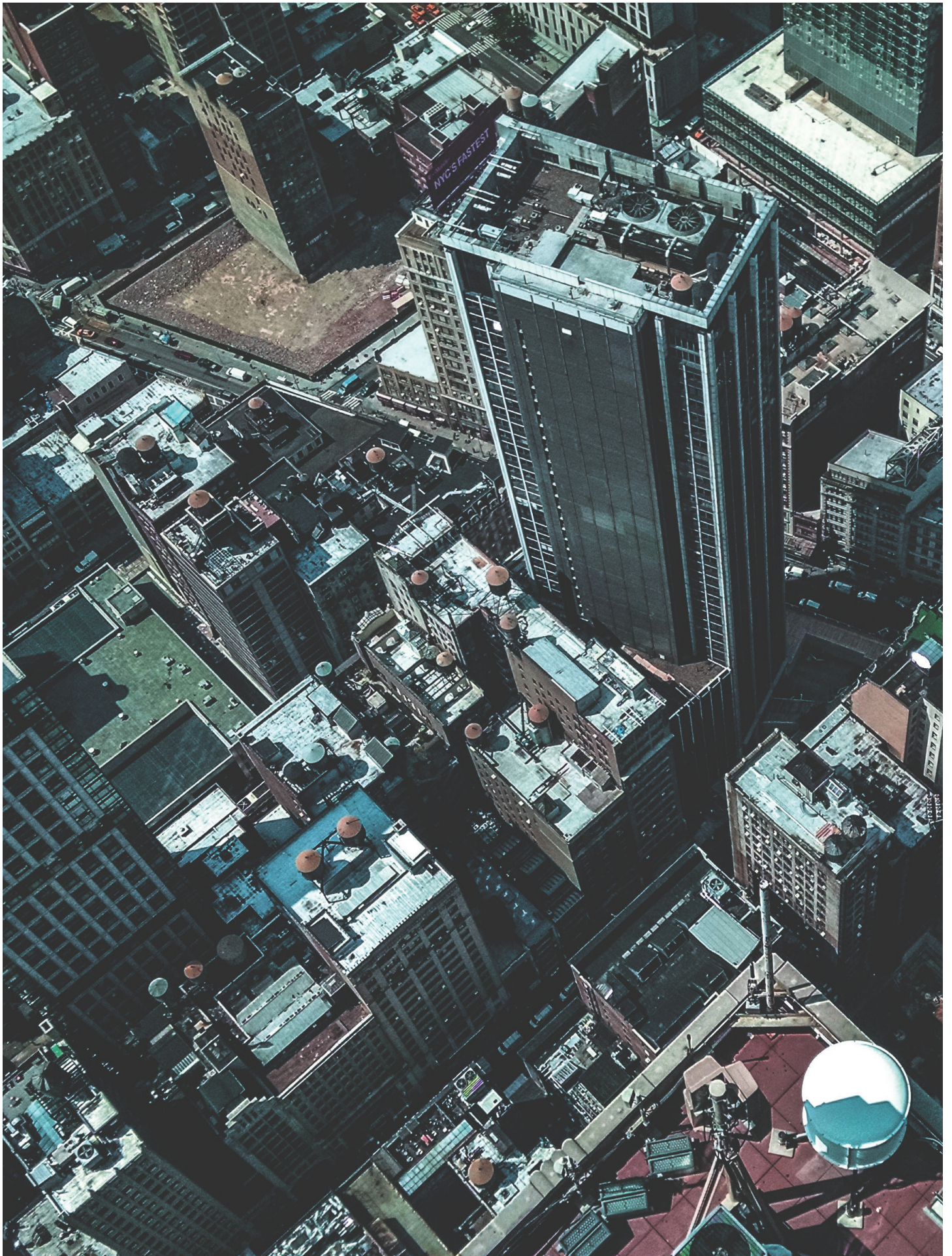
Intro

Governments (most frequently states) offer a wide range of tax credits that are designed to shape their economies into diverse, robust, and ever-growing hotbeds of industry.

Tax incentive programs might attempt to lure and retain specific industries to an area to help achieve those goals. States often use programs like these to compete for film projects or hold onto existing businesses like manufacturing plants whose headquarters are based in another state or (sometimes) country. Other programs are more geography-focused, inviting any industry or business type to benefit from a program as long as they base their operations in a specific tract of land. Governments have used programs like these to attempt to decrease unemployment or increase property values in economically depressed census tracts. Boiled down to its most basic form, a tax credit is simply a transactional agreement between private enterprises and public trust to achieve some desired outcome—usually capital investments or job creation. Private enterprises receive a break in what they would otherwise pay in taxes. What governments get from the transaction, however, can sometimes be a lot less tangible. At best, there's a promise of potential in increased economic activity. But whether governments are getting the better end of the deal in terms of sustained and local economic impacts can be very

hard to pin down. In the best-case scenario, everyone gets what they think they wanted. In the worst-case scenario, there are clawbacks—special contractual clauses stipulating that money already paid must be paid back under certain conditions. Governments have found a pressing need to demonstrate real and reliable economic impacts to measure the ROI for their programs rather than award tax incentives too freely. That pressing need comes largely from fresh federal legislation including the recent “Tax Cuts and Jobs Act” which redesignated some tax incentives as taxable gross income for corporations as well as the GASB 77 from 2015 which pointedly burdens states’ incentive programs with adhering to specific measures of success (including job creation, overall effect of the program on the state economy, and positive influence on business behavior).

However, knowing that your program will bear some scrutiny in the future, there are ways of preparing the application or negotiation for tax incentives which can set up an accurate before-and-after comparison of the effects of a business’s activities after the project is completed. In this white paper we’ll explore some of these preparatory strategies and their benefits.



Laying the Groundwork

The key element for measuring the ROI for development projects (as is built into much of the regulatory legislation) is an *economic impact analysis* which relies on modeling software and data.

The software's model allows an analyst to trace industry and household spending through an economy and measure the cumulative effects of that spending. The need for an economic impact analysis is normally triggered by an economic event, catastrophe, change in government policy, justification for funding, or a need for planning (schools, streets, sewers, public utilities).

The analysis typically estimates changes in activity throughout an economy in response to changes in production in a particular industry or set of industries. It's commonly used to measure the economic ramifications of things like sporting events being hosted in an area, the relocation of large business headquarters to a region, or even to quantify the value of a local organization's projects and efforts. Economies studied using this type of analysis can vary greatly in size: from something as concentrated as a single town or city to regions as expansive as the entire globe.

What you need to know about the modeling process

There are a few foundational aspects of the data and modeling process that will help focus the way in which you gather

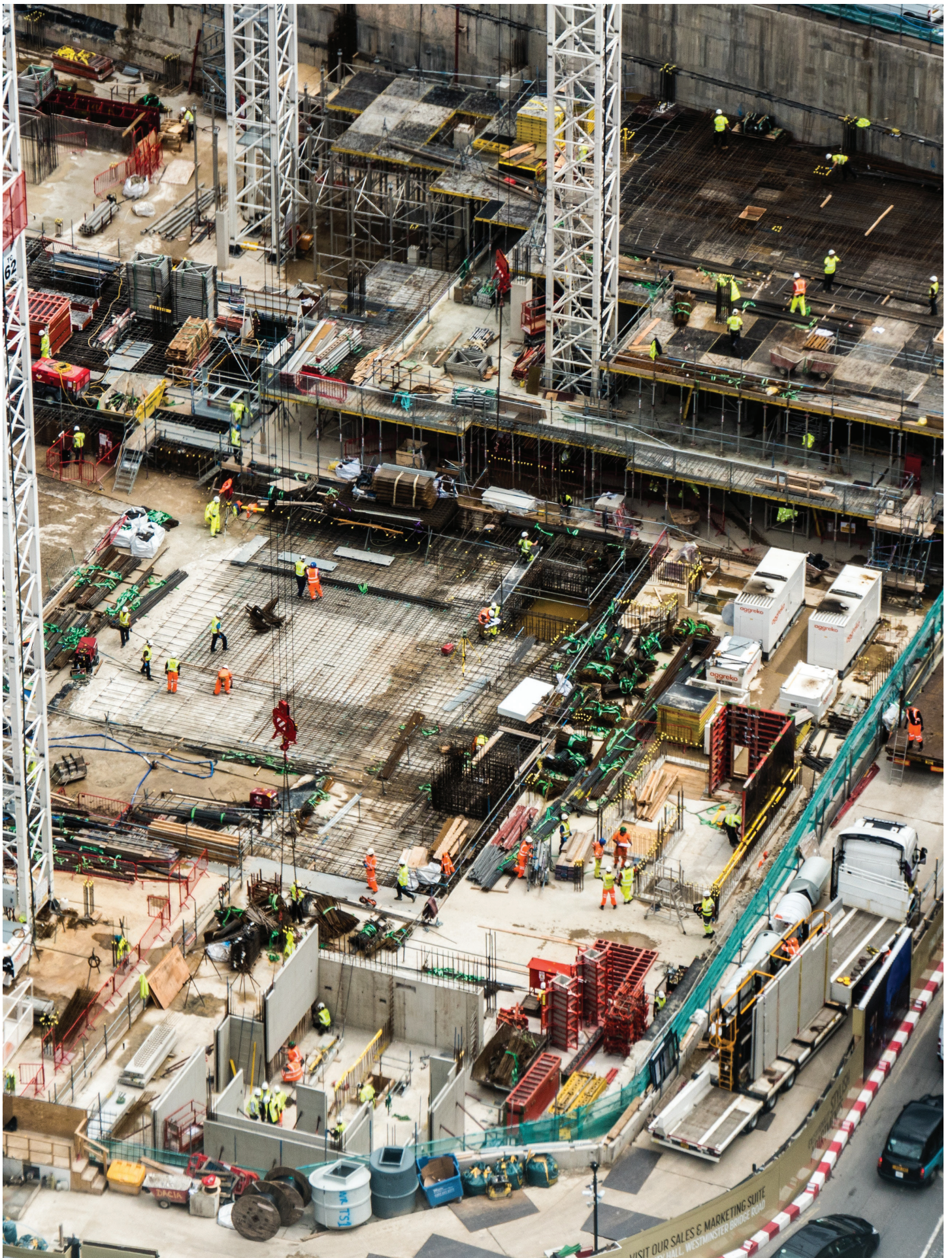
LOOK BEFORE YOU LEAP

Many federal agencies prescribe or outline how an economic impact analysis should fit into the bigger picture of assessing a project from their perspective. If you know that your project will require permits or review by any state or federal authority, it's worthwhile to make sure that your analysis is prepared in a way that's most digestible for those agencies. Here are some examples:

- www.transit.dot.gov/regulations-and-guidance/environmental-programs/social-economic-impacts
- www.gao.gov/products/PAD-81-03
- www.epa.gov/dwregdev/economic-analysis-and-statutory-requirements

information to inform the analysis process.

First, the data used in economic modeling software like IMPLAN is typically annualized. For example, the output per worker in an annualized model is based on the average annual job and its wages. So if an employee works 6 months, they have





half the annual output and that worker will need to be counted as 0.5 jobs when setting up the analysis.

It also means, since economic data is collected by various agencies over the course of a year, that a complete data set used to execute an impact analysis can only base its calculations on a prior year's economic activity as a reference point for how an economy might behave in the "event year." The "event year" pertains to the year in which your "change in production" occurs. The "data year" pertains to the year of your dataset. If the "data year" and the "event year" are the same (e.g. measuring the impact of 10 million (2018) dollars of spending at a tourist event that occurs in 2018), then the deflator (or relative ratio in value of the dollar from one year to another) equals 1. If they are not the same, then the deflator will adjust the inputs (expressed in 'nominal dollars') into 'real dollars'. IMPLAN provides the necessary deflators for such adjustments.

Second, due to regulations that protect how much economic data can be publicly reported by the government entities that collect the data, the data contain non-disclosures. In other words, the government is not allowed to disclose data that would allow anyone to identify a specific business. Effectively, the government purposely "hides" many values when making the data publicly available.

IMPLAN provides estimates which makes the data complete and incorporates geographic detail using other sources through a process which has been honed over the course of more than 20 years. The smaller the geographic entity (e.g., counties, zip-codes), the fewer raw data available for them. In these cases, we have procedures to distribute national values among the states, state values among the counties, and county values among the zip-codes, using other data as distributors.

For industries or sectors, IMPLAN also disaggregates into finer sector details. The vast majority of publicly available data sources have less sector detail than IMPLAN. These data are distributed into IMPLAN sectors based on other data that do have the necessary sector detail (Bureau of Labor Statistics CEW data which is classified using 6-digit NAICS codes, for example).

The annual nature of the data and that firm activities are represented on the industry level are key concepts that are inherent in economic impact modeling that will affect the way in which you or your consulting economist frame the analysis for your project. Selecting the appropriate industry, annual expenditure, and a headcount that best accounts for the time frame of the project will yield more reliable results and repeatable methodology.

What you need to know about your project

Now that we've covered some foundational aspects of the data and modeling process, it's time to turn to how to translate the economic activities associated with your project into "inputs" or numbers that the model can use to run an analysis. First, here are some common input categories and how they're defined:

- **Industry Sales:** measure of value of goods and services sold and a component of output where $\text{output} = \text{industry sales} + \text{net inventory change}$.
- **Employment:** includes full-time, part-time, and seasonal workers and therefore does not represent full-time-equivalents (FTEs). IMPLAN employment includes wage and salary employees as well as proprietors (self-employed individuals and unincorporated business owners).
- **Employee Compensation:** the total payroll cost of employees. This includes wages and salaries, all benefits (e.g., health, retirement) and payroll taxes (both sides of social security, unemployment insurance taxes, etc.). Also referred to as fully-loaded payroll.
- **Proprietor Income:** consists of payments received by self-employed individuals and unincorporated business owners.

These inputs can be broken out into segments depending on how many years you intend to model in an analysis or whether the economic activity involves more than one industry. Take, for example, a simple construction project.

Suppose that a company qualifies for a tax incentive program that would help offset the cost of constructing a new office location. The company already coordinated with the local zoning board, an architect, and a general contractor to estimate the cost and time that the construction would require. They found that the project would cost a total of \$900,000 for all materials, permitting, and labor and would take 18 months to complete, breaking ground on 1 July 2020.

To measure the economic impact of the project, we'd need to first determine how much of the budget would be spent during the first six months of the project in 2020 and what remainder would be spent in the final 12 months in 2021 leading up to its completion. The 2020 and 2021 numbers would be entered as Industry Sales in the

BONUS ACTIVITIES

If there are things about your business or project that can be translated into inputs for an economic impact analysis but that may not be pertinent to qualifying for a tax incentive program, model them anyway—but separately. These impacts are a great addition to the usual stack of paperwork because they paint a bigger picture about your economic influence. They can include:

- Budgeted philanthropic initiatives/donations
- Value of employee volunteer time during company hours
- Equivalent value of allowing community groups to use property or resources for free

analysis. Since cost of labor was included in the budget, the analysis would show how many jobs would be supported by the project and supply an employment count for you based on the average cost per worker based on the study area data. However, since the individual construction workers involved in the project are likely to remain from one year to the next, you would only want to count that number once, rather than summing up all employment counts for every year of the project.

Similarly, some companies moving into an area may bring some of their own employees from elsewhere, so not all jobs will be filled by currently local people. Also, IMPLAN won't tell you if the jobs are going to be permanent (as might be the case with movie production, which can be temporary).



Interpreting Results

A completed analysis classifies results into direct, indirect, induced, and total effects. All of these results sets show the industries between which money flows as a result of your spending, which industries would be most affected by households of various income levels spending their earnings, and what taxes would be paid at various government levels after everything is said and done. Here's how those result types are defined:

- **Direct Effects:** In a traditional Industry Change activity type, direct effects are the direct spend, including labor costs, taxes, and profits. In the case of a construction impact, the direct effect would be the entire value of the structure. Applying these initial changes/dollars to the multipliers in an IMPLAN model will then display how the region will respond, economically, to these purchases by way of spurring indirect and induced effects.
- **Indirect Effects:** Indirect impacts stem from local industries' purchases of inputs (goods and services) from other local industries. These purchases are also known as intermediate expenditures. For example, if the direct impact is the construction of a building, the first round of indirect effects will include a purchase of ready-mix concrete. This purchase of ready-mix concrete spurs the ready-mix concrete manufacturing industry to in turn purchase more sand and gravel. This purchase of sand and gravel is part of the second round of indirect effects. This cycle of spending continues to work

its way backward through the supply chain, with each round of impacts getting smaller and smaller until all money leaks from the local economy by way of imports, taxes, and profits, which do not generate additional impacts locally.

- **Induced Effects:** IMPLAN models account for commuting patterns; thus, induced impacts will only reflect the spending of wages by residents. IMPLAN removes payroll taxes, personal taxes, and savings before allowing the remainder to be spent on goods and services. IMPLAN also accounts for imports and does not assume that all purchases of goods and services are made within the study area.
- **Total Effects:** the summation of the direct, indirect, and induced effects as representative of the entire net economic impact.

The advantage in separating out the results into these categories is that it gives you or your economist an opportunity to qualify the results as reported as part of the application or negotiations for a tax credit. Most Community Development Entities (CDEs) that offer New Markets Tax Credits (NMTC), for example, exclude all but direct job effects because administrators of those tax credits on the Community Development Financial Institution (CDFI) level tend to focus on the employee headcount as a measure of success for a project rather than the jobs supported in the area by the economic activity of the project (which can be more difficult to manually count).

Talking to a CDE or Other Funding Entity

Even non-competitive tax incentives are not a guaranteed done deal.

For the NMTC program specifically, since 2002 no more than 30% on average of the CDEs which applied for allocations received them. And of the allocations awarded, no more than 50% of developers or project managers who apply for funding have been approved since the program's inception.

Naturally, CDEs and other investment organizations which receive NMTC allocations tend to be very judicious about which projects they fund at the risk of losing their qualifying status with the CDFI. Some CDEs don't even accept applications for funding, opting rather to scout projects on their own which match the sort of financial management with which the CDE's have a successful history. That's generally why it's so hard to get their attention. But there are a few things that you can do to make your application stand out.

Do your research

Many CDEs specifically operate within a local or targeted geography and may be associated with economic development groups in that area of interest. Take the time to find out what sorts of relationships exist between a CDE and their like-minded neighbors to help you further justify your project to that aggregate audience. You may find that they tend to support projects of a specific type or that there are gaps in their portfolio for which your project may be well-suited.

Though it may seem counter-intuitive, write a letter of intent for the project from the beginning in case no tax incentive is awarded. This helps those who craft incentive programs gauge what kinds of activities they can affect. If, for example, the project will still move forward without the incentives but at a slower pace or in a different location, then lawmakers can use that information to determine whether a program is too strict or not adequately focused. One of the criticisms of tax incentive programs is that many businesses would move forward with a project with or without any financial help from the state. Expressing your intent alongside the project's feasibility and impact analyses with and without added financial support helps explain both scenarios.

Next, be selective with the incentives which you pursue. No two programs are created equally. Some are competitive and only awarded to top applicants while others are non-competitive but may be capped by state or federal standards. To make sure your

CASE STUDY

Of Curds and Whey Making the Most of a Tax Incentive Program

Charlotte, NC

IMPLAN

"Of Curds and Whey: Making the Most of a Tax Incentive Program" tells the story of how one company and a CDE used impact data from IMPLAN to evaluate their whey processing plant's economic activity to qualify for funding through part of the NMTC program and helped carry the dairy industry in Wisconsin out of recession.

Read the study at [IMPLAN.com/case-studies/of-curds-and-whey](https://implan.com/case-studies/of-curds-and-whey)



application doesn't land on the wrong desk, dig into some specific aspects of programs which may not be very visible on the surface. Ask questions like:

- Are there deadlines or timelines and are they negotiable?
- Are the tax credits refundable if the company does not incur sufficient tax liability to benefit from them?
- Are there clawbacks associated with any part of the incentive program?
- Is there ongoing compliance associated with the program (and will the costs of compliance outweigh the benefits)?

No matter the CDE or state you end up working with, they're going to need to do some

research of their own before awarding grants or tax incentives—and they'll appreciate a little preparatory legwork on your part. When including the impact analysis, take the time to write an abstract or introduction which specifically highlights the results that the tax incentive program was designed to foster. You can never go wrong calling attention to tax impacts at each level since those numbers are particularly tied to determining the ROI for the program. Jobs impacts or even the total employee compensation effect are worth emphasizing as well since many programs are designed to improve the socio-economic status of its citizens or decrease unemployment in an area. Ultimately, the important thing is to communicate your story before anyone can tell it for you.

Save Everything

There's a little bit of housekeeping to do once a tax incentive is secured to ensure that program administrators can revisit the project's performance. Being awarded a tax incentive in the first place is just the first step in establishing a baseline along a path toward compliance and demonstrating a reliable measure for ROI.

First, save the analysis methodology in hard copy as well as digitally so it can be reliably repeated years after your project is funded to continue to tell your story. Take care to note special considerations

which were made while framing the analysis whether it was how you counted the labor of seasonal workers or whether there was debate over which industry or sector best represented the major firms involved in the project. Even though the underlying economy will change (hopefully for the better!), the framework for defining what took place in the analysis should be as detailed and fixed as possible, accounting for all assumptions along the way. Save copies of all paperwork even if you weren't directly responsible for it. Ask for anyone who helped defend your project during the application process to share any government forms which would have circulated between CDEs and CDFIs if available, supply key communication (whether digital or analog), and keep track of everyone who was involved in the project. This may seem like overkill, but it ensures that your project will never be held hostage by a filing error on someone else's part. And you'll have the materials on-hand in the event that you apply for another tax credit or funding program elsewhere with a similar project. Publish your success story. Write a press release. Find an interested local journalist and do an interview. Get the word out about your project and start creating ties between it and the local community. Be transparent about the project's goals and why the tax incentive program will help you achieve them as well as the state's, CDE's, or local municipality's goals for how your project will benefit the area. This goes hand-in-hand with telling your economic story before someone else does, ensuring that people understand that a change occurring in a community as a result of your operations is intended for mutual benefit.

Conclusion

Securing tax credits is as much an art as it might be a science. But the process becomes increasingly simple with the right foresight, project, and tools. Having a strong understanding and firm grasp of the process from beginning to end can only set your project up for success in the long run whether successfully wrapping up a program or applying for additional support.

Take the first step now! To start your economic impact analysis today visit IMPLAN.com.

For more information about how economic impact analysis can benefit your organization or to inquire about IMPLAN's host of exciting products, give us a call at (800) 507-9426.

16905 Northcross Drive, Suite 120

Huntersville, NC 28078

(800) 507-9426

IMPLAN.com

IMPLAN