



**Office of the State Auditor**

# Promises to Keep



**Recommendations to Strengthen the Performance  
of Vermont's Economic Advancement  
Tax Incentives Program**

Elizabeth M. Ready  
Vermont State Auditor  
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## **Mission Statement**

*The mission of the State Auditor's Office is to be a catalyst for good government by promoting reliable and accurate financial reporting as well as promoting economy, efficiency and effectiveness in State government.*

# Office of the State Auditor

## A Program Audit of the Vermont Economic Advancement Tax Incentives Program as Administered by the Vermont Economic Progress Council and the Vermont Department of Taxes

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# Message from the Auditor

Using public resources to stimulate job creation is sound economic policy. Most Vermonters would agree that when public dollars are spent in an effort to create jobs - either as a tax break to a growing company, or as an appropriation for workforce training or infrastructure - these dollars must be spent in compliance with the law and in a cost-effective manner that achieves a clear net benefit.

Vermont's Economic Advancement Tax Incentives (EATI) program has become one of the most extensive new initiatives launched by State government in recent years. The program has authorized \$80.1 million in business tax credits from its inception in 1998 through December 2002 with the goal of stimulating new economic activity and creating quality jobs.

The Vermont Economic Progress Council (the Council) has been very responsive to its legislative mandate, processing applications in a timely and efficient manner. It has done much to comply with legislative amendments passed in the 1999-2000 session.

However, the Department of Taxes has allowed \$24 million of tax credits to be claimed without fully verifying that the promised economic activity, upon which the credits were based, has occurred.

Fortunately, the new Commissioner of Taxes Richard Mallary has adopted the philosophy of our new Governor who said in his inaugural speech: "Change begins today."

In his response to our findings, Commissioner Mallary states: "The clear legislative intent of Act 71 was to make available certain tax credits for entities that performed specified activities promoting economic development ... The Department shall proceed from this point forward on the basis that the language in award letters made all awards conditional, and that the inherent powers of the Department allow it to reduce or deny credits awarded by VEPC." (See Appendix A for entire statement.)

Guided by this new approach, the Department of Taxes and the Council will be able to usher in a new era of accountability regarding this program.

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## Corporate Income Tax on the Decline

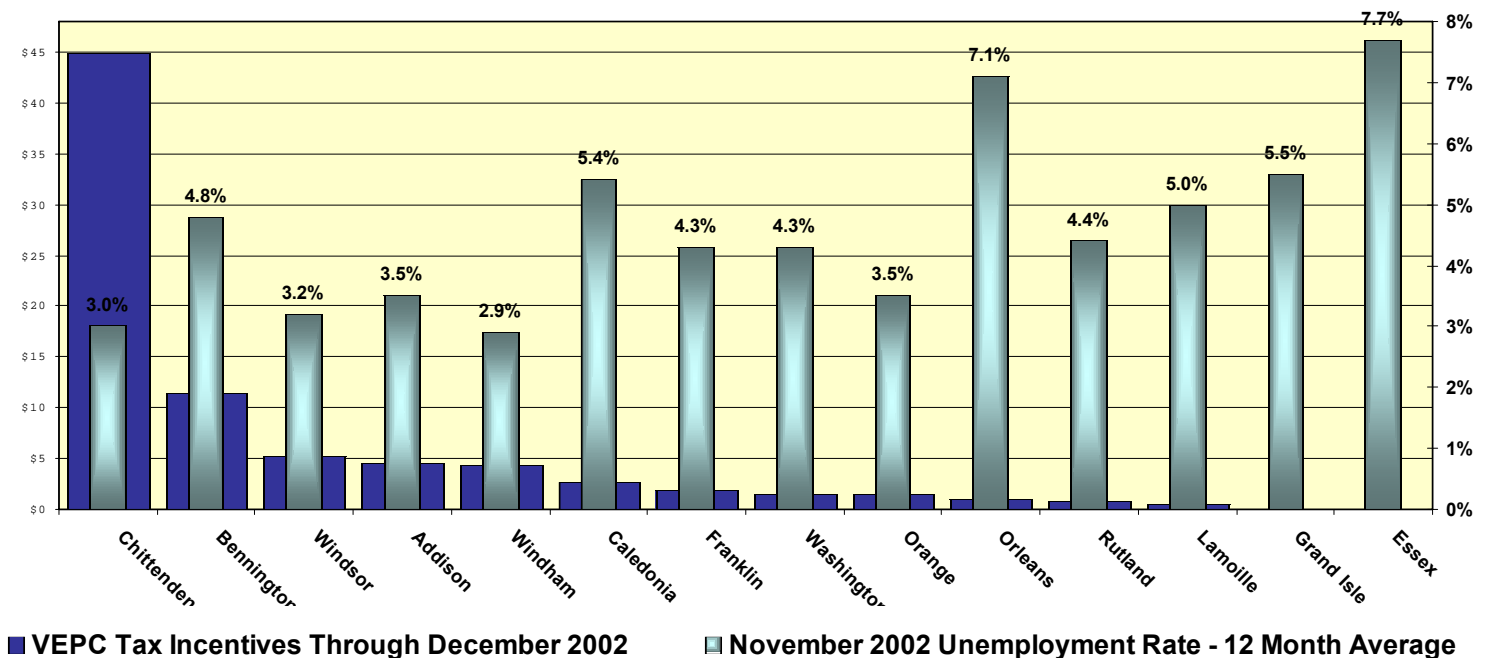
Our findings, and the Department's prudent response, come at a time when fiscal crises beset states from Massachusetts to California. These woes stem partly from the two-decade decline in corporate tax revenues as a share of total State general fund revenues.

Between 1979 and 2000 corporate taxes nationwide fell from 10.2 to 6.3 percent of total state revenues. In Vermont, this trend was even more pronounced, with corporate taxes dropping from 10 to just 3 percent of general fund revenues. Annual corporate tax receipts in this category fell from \$57 million in fiscal year 1999 to just \$32 million in fiscal year 2002.

A number of factors contribute to this decline, including lower corporate profits, increased tax avoidance by corporations, lower effective state tax rates, the increased prevalence of state corporate income tax credits and related incentives, and the increased use of S corporations, and other pass-through entities, which reallocate some forms of corporate income to personal income.

Given these trends, it may well be time for Vermont to take a close look at the policies and the performance behind its corporate income tax. Some states are doing just that, and considering a variety of courses.

## Distribution of Council-Awarded Tax Incentives Compared to Unemployment Rates by County



NOTE: No companies located in Essex and Grand Isle counties have been awarded tax incentives.

Wisconsin is debating whether to eliminate its corporate income tax and join states like Nevada, South Dakota, Texas, and Washington that are corporate income tax-free. Since Vermont's corporate income tax yields relatively little in revenue, the State could consider eliminating it altogether, thus benefitting all Vermont companies and creating a strong tool for economic development. Such a plan would require careful study.

Other states, including Missouri and New Jersey, are eliminating corporate tax loopholes. New Jersey Governor McGreevey said closing these loopholes would generate an additional \$627 million in state revenues.

This report outlines both the success of the current tax incentives program, and the need for improvement. Our recommendations should be considered as part of a larger debate about tax policy in general, and the corporate income tax in particular.

Key findings in our report include:

- The Department of Taxes has allowed \$24 million of tax credits to be claimed without fully verifying that the promised economic activity, upon which the credits were based, has occurred;
- These tax credits are, to a greater extent than known before, contributing to Vermont's decline in the corporate income tax as a revenue source to fund education and essential state services;
- The Council's "but-for" test (see page 36 for definition) is a critical program assumption that cannot be verified;
- There is virtually no limit to the amount of credits the Council can authorize in a given year;
- The Department of Taxes does not know if companies are maintaining minimum employment levels in order to earn their credits; and,
- The program is unnecessarily complicated.

Our recommendations include the following improvements:

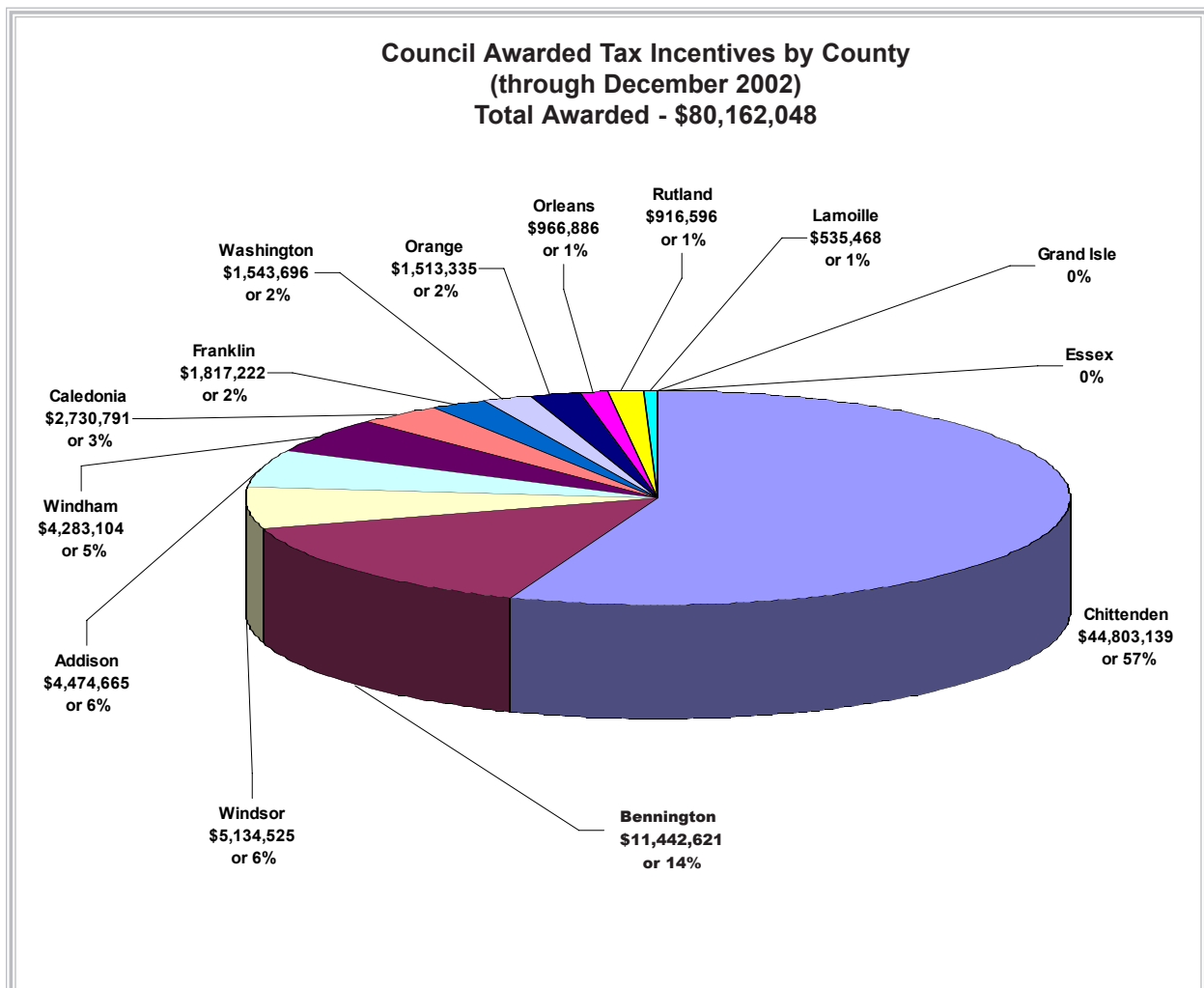
- The Department of Taxes should verify that the promised economic activity upon which a company's tax credit is based has occurred;
- The "but-for" test should be eliminated as the basis for fiscal cost measurement in the Council's program;
- The Legislature should authorize an annual program cap to lessen the annual risk to the State's treasury and allow the Council to consider the merits of each project based on the nine guidelines; and,
- The program should be simplified to make it easier to administer and for businesses to realize its full range of benefits.

## A New Era of Accountability

The Legislature established this economic incentives program with the philosophy that it would be “performance-based.” That is, job creation and economic investments would be accomplished before companies received a tax break.

However, our audit found that the Department of Taxes did not verify the promised economic performance, such as the number of jobs created and the amount of investments made, when companies (or “pass-through” shareholders and partners) claimed their tax credits.

To date, 107 total corporate entity returns (for the 1998-2001 tax years) have resulted in a total of \$8,727,876 million in Council-awarded tax credits being applied against a tax liability. None of the 107 claims have been checked to fully verify that a company has created new jobs, maintained its workforce, or made new investments as promised in its application for tax credits.





An additional \$15,290,102 in tax credits (for the 1998-2001 tax years) is in “carry-forward status,” which means the Department of Taxes has deemed them to have been earned by companies, but they were not applied because the companies did not have enough tax liability. These credits can be applied to reduce a future tax liability.

We recommend, and the Department of Taxes has agreed to, a new era of accountability to ensure that specific job creation and investment activities are verified, and that credits are allowed or disallowed in a timely fashion.

Commissioner Mallery has shown leadership in laying out a three-point plan to apply the procedures of 32 V.S.A. §5930a (l)(1). (See *Appendix A for entire statement.*) He says the Department will:

- Request the Council to provide it with very detailed performance expectations, as required in 32 V.S.A. §5930a (l)(1)(A) for all credits awarded by the Council prior to July 1, 2000;
- Request that the Council provide the Department with benchmarks, as they do for awards authorized after June 2000 pursuant to 32 V.S.A. §5930a(k), by which it can determine whether there is full or partial compliance with the expectations and determine what portion, if any, of the approved credit should be allowed; and,
- Review future requests for the utilization of credits pursuant to these benchmarks and allow or deny credits on that basis.

### **Capping the Risk**

The so-called “but-for” test, and the cost-benefit model, which relies upon this test, are important components of the tax incentives program because they work together to calibrate the award levels to potential fiscal benefits.

The cost-benefit model assumes the “but-for” test to be true in each and every case. In other words, *all* project benefits flow from and are due to the State tax credit incentive. To attribute the entire stream of future economic benefits that result from an investment to a single factor like a tax credit is not accurate, and cannot be verified.

We believe the “but-for” test should be eliminated as the basis for fiscal cost measurement in this program. Instead, the Legislature should set an overall annual program cap. With a program cap, the cost-benefit model would still be of pivotal importance, in that it could identify and rank subsidies with the greatest potential fiscal benefit. Companies could compete for tax credits, rather than lining up for them as they do now.

## Return on Investment

We struggled to answer an essential question during the course of this audit: “*What is the return on investment to the State for the program?*” The statute requires the Council to determine the net fiscal impact of each proposed development or economic investment that is given an incentive.

The true net fiscal impact of this program to date is impossible to pinpoint, because it is predicated on the “but-for” test. The impact can be estimated between a negative \$9 million (the approximate amount of tax credits applied to date) and a positive \$3 million (the net fiscal benefit to the State treasury as of the end of 2001, according to the Council).

Because it is likely that some of the program’s 113 approved projects would probably have occurred in whole, or in part, *without* the State incentive, an arms-length, independent analysis would likely find the net fiscal impact to the State (since the program began) to be negative.

While not all, nor even most, of Vermont’s corporate tax revenue decline (from 1998 to 2002) is attributable to Council-awarded tax credits, our audit revealed the tax credits are a much more significant component of the decline than previously understood.

## Conclusion

It is important to consider this audit of Vermont’s EATI program in the overall context of the state’s fiscal challenges and tax policies, including the significant drop in the corporate income tax.

A number of key issues merit further review by the Legislature and the Administration, and our Office raises them in the hope that they will receive careful research and consideration. They are:

- Should Vermont eliminate the corporate income tax, helping all Vermont businesses and attracting new firms to the State? If so, what fair and equitable revenue sources should be substituted?

*“The Department shall proceed from this point forward on the basis that the language in award letters made all awards conditional, and that the inherent powers of the Department allow it to reduce or deny credits awarded by VEPC.”*

- Richard Mallary  
Commissioner of Taxes

- Should Vermont strengthen and restore the corporate income tax as a revenue workhorse to help fund educational and needed government services?
- To what degree can a small state like Vermont “compete” with larger, wealthier states on the basis of tax subsidies to spur new business?

It will be important for the State to evaluate, on an ongoing basis, where the expenditure of limited public funds can have the greatest beneficial impact on economic development. Even in the best of circumstances, economists increasingly recognize that direct business subsidies are among the most expensive ways to achieve employment and economic growth. As state budgets tighten, the costs and benefits of tax incentives programs must be compared with other policy options for creating jobs and economic growth, like workforce training, low-interest loans, and investments in infrastructure such as roads, water and sewer, and telecommunications.

In the meantime, our findings and recommendations, and the Department of Taxes’ thoughtful response, promise to improve the State’s tax incentives program by strengthening performance verification. In addition, replacing the “but-for” test with a program cap, and simplifying administration would improve the program.

I would like to thank Glen Wright, the Council’s chairman, the Council’s Executive Director Fred Kenney, former Commissioner of Taxes Janet Ancel, current Commissioner of Taxes Richard Mallary, and the staffs of both the Council and the Department of Taxes for their exceptional assistance and cooperation with this audit. We greatly appreciate their willingness to provide information, answer questions and discuss the issues that ultimately impact all Vermonters.

Sincerely,



Elizabeth M. Ready  
State Auditor

February 4, 2003

# Summary: Findings & Recommendations

## **FINDING 1A**

Ninety-four businesses and 19 municipalities have active authorizations for \$80,162,048 in tax credits from the Council.

The Department of Taxes does not have an adequate system of internal controls and written procedures in place to fully verify tax credit claims.

To date, 107 returns from corporations or other business entities (for the 1998-2001 tax years) resulted in a total of \$8,727,876 in Council-awarded tax credits being applied to tax liabilities. None of the 107 claims have been checked to fully verify that a company has created new jobs, maintained its workforce, or made new investments as promised in its application for tax credits.

An additional \$15,290,102 in tax credits (for the 1998-2001 tax years) is in “carry-forward status,” which means the credits have been earned by companies but not yet applied to a tax liability.

## **FINDING 1B**

The Department of Taxes currently has no plan to review the job creation or investment performance by companies with more than \$64 million in tax credits authorized before July 1, 2000, although these awards were issued contingent upon the accomplishment of objectives stated in company applications.

The lack of review undermines the “performance-based” principle of the program and represents a material risk and potential cost of millions of dollars to the State.

## **RECOMMENDATION 1**

The Department of Taxes should develop a strong system of internal controls and procedures, including a manual and web site information, to improve the way Council-awarded tax credit claims are filed and examined.

No further tax credits should be allowed without review and verification of actual job creation and economic investment performance.

The Legislature should amend the EATI statute to clarify that the Department of Taxes should review the performance of all tax credit recipients, including those whose credits were authorized *before* July 1, 2000, representing more than \$64 million in credits, to assure that companies have created the jobs and made the economic investments promised in their application.

The Legislature should consider a range of steps to initiate rapid review and verification of all promised economic performance, while keeping commitments to those companies with Council awards. These options could include:

- Establishing a new tax credit compliance officer;
- Restricting the awards of future tax credit authorizations until a system of accountability is operating; or,
- Providing resources for training and for staff positions needed to review awards and administer the program.

## **FINDING 2**

The Department of Taxes does not collect necessary employment information to enforce 32 V.S.A. §5930h, which insures that tax credits flow only to companies that maintain Vermont jobs.

Neither the Council nor the Department of Taxes has promulgated rules or issued guidelines to clarify the statutory definition of “employee” and the time period in which benchmark employment measurements are taken, two important definitions for complying with the statute’s recapture provisions.

Clear definitions and timely reporting of employment data are vital to the program goal of subsidizing only those companies that maintain Vermont jobs.

## **RECOMMENDATION 2**

The Department of Taxes and the Council should collect the necessary employment data to enforce 32 V.S.A. §5930h.

The Department of Taxes and the Council should agree on a method of defining and counting employees that can be used consistently throughout the application, performance review and recapture processes.

## **FINDING 3**

The Council and its staff rely heavily on certifications from the applicants seeking tax credit authorizations, rather than on independent verification of information submitted by applicants related to employment statistics, sales, and other data. This information is critical because it forms the basis of the tax credit award and becomes the baseline against which all subsequent review and verification of performance will be made.

The Council has met the Legislative mandate of approving or denying completed

applications for economic incentives within 45 days. The Council and its staff have improved internal procedures and guidelines, and have upgraded the application process.

### **RECOMMENDATION 3**

The Council should independently verify and document that application information, which forms the basis of the tax credit award and becomes the baseline against which all subsequent review and verification of performance will be made, is correct.

### **FINDING 4**

The “but-for” test, upon which all claims of fiscal benefit are premised, cannot be verified.

The “but-for” test assumes that total project benefits would not occur “but for” the EATI award. Thus, the costs to the State for the credits are understated, while benefits are overstated.

### **RECOMMENDATION 4**

The “but-for” test should be eliminated as the basis for fiscal cost measurement in the EATI program. It cannot be relied upon as the basis for asserting that there is a positive return on investment, and thus no net fiscal cost to the State from this program. Maximum potential returns and benefits may be reported as such, but program expenditures should be accounted for at face value and governed by legislative budget authorization.

### **FINDING 5**

There is no program expenditure cap or meaningful limitation on the authority to grant tax credits. This constitutes financial exposure and risk to the State.

### **RECOMMENDATION 5**

The Legislature should, as part of its evaluation of economic and budget factors, annually authorize a Council award cap on all tax credit awards.

Alternatively, if the General Assembly finds that reducing corporate income taxes is an optimal strategy for boosting Vermont job creation and economic investment, it could consider the reduction, restructuring, or even the complete elimination of corporate income taxes which would benefit all Vermont businesses. Significant study would be required, however, before embarking on this course to ensure that all impacts are assessed, and that any revenue replacement mechanisms are fair and equitable.

**FINDING 6**

Current economic conditions could create substantial future revenue exposure to the State if companies are “incented” for normal cyclical recovery from the recession in future years.

**RECOMMENDATION 6**

Normal cyclical recovery should not be “incented activity” by the Council. Rules should be adopted that consider employment history over a time period that is consistent with the duration of the typical business cycle, which is about five years, in determining eligibility and establishing benchmarks for “new job creation.”

**FINDING 7**

Modifications to the Council cost-benefit model have not been presented to the Joint Fiscal Committee for review and approval, as required by 32 V.S.A. § 5930a(d).

**RECOMMENDATION 7**

All changes to the Council cost-benefit model and the core REMI model upon which it is based should be thoroughly tested so as to quantify impacts from these changes on model output and award levels. A written summary of proposed model changes, model updates and related test results should be submitted to the Joint Fiscal Committee for its review and approval.

The Council should err on the side of caution in interpreting model “updates” versus “modifications” and submit summaries of all model changes to the Joint Fiscal Committee for their determination as to which model changes merit review under 32 V.S.A. §5930a(d).

**FINDING 8**

The Council may be granting larger tax credit awards than necessary.

**RECOMMENDATION 8**

The Council could minimize program expense by asking all applicants to specify on the application the award level needed in order to make the investment. If this amount is lower than that later calculated by the cost-benefit model, the Council could reduce State expense and still achieve the same investment result.

The Council should improve efforts to obtain firm data on applications to avoid doing multiple cost/benefit model computer runs.

**FINDING 9**

The reassignment of Council awards to various non-applicant companies and individuals is not specifically allowed in statute and could represent significant additional costs to the State.

The potential for cost- and profit-shifting between related entities could result in a higher utilization of awards. It could also present additional, and potentially complex, compliance issues at the Department of Taxes.

**RECOMMENDATION 9**

The Council should limit future reassignments to straightforward administrative issues such as company name changes, acquisitions or clear cases of application error. Such cases should be carefully documented and thoroughly reviewed by the Council to prevent possible abuse and misuse of reassignments.

The Council should seek greater Legislative clarification for any reassignment of credits beyond simple administrative corrections.

**FINDING 10**

There is currently no follow-up procedure at the Department of Taxes or at the Council for municipal property tax exemptions and stabilization agreements.

Despite the fact that all municipal awards are linked to company awards when granted, they are not linked to company performance, recapture or other follow-up provisions by the State.

The absence of municipal award follow-up procedures and policies creates a substantial fiscal cost to the State when a company to which a municipal award is linked does not perform as promised.

**RECOMMENDATION 10**

Municipal awards should be reviewed and claimed in tandem with the private sector awards with which they are linked. Any performance-based adjustment to a private sector award should also trigger an adjustment to the linked municipal award. The Council should implement needed procedures and coordinate them with the Department of Taxes.



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*“I believe not only in advocating economy  
in public expenditure,  
but in its practical application  
and actual accomplishment.”*

Calvin Coolidge

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# Findings & Recommendations

## FINDING 1A

**Ninety-four businesses and 19 municipalities have active authorizations for \$80,162,048 in tax credits from the Council.<sup>1</sup>**

**The Department of Taxes does not have an adequate system of internal controls and written procedures in place to fully verify tax credit claims.**

**To date, 107 returns from corporations or other business entities (for the 1998-2001 tax years) have resulted in a total of \$8,727,876 in Council-awarded tax credits being applied to tax liabilities.<sup>2</sup> None of the 107 claims have been checked to fully verify that a company has created new jobs, maintained its workforce, or made new investments as promised in its application for tax credits.**

**An additional \$15,290,102 in tax credits (for the 1998-2001 tax years) is in “carry-forward status,” which means the credits have been earned by companies but not yet applied to a tax liability.**

## FINDING 1B

**The Department of Taxes currently has no plan to review the job creation or investment performance by companies with more than \$64 million in tax credits authorized *before* July 1, 2000, although these awards were issued contingent upon the accomplishment of objectives stated in company applications.**

**The lack of review undermines the “performance-based” principle of the program and represents a material risk and potential cost of millions of dollars to the State.**

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<sup>1</sup> Total includes: \$17,299,620 in payroll tax credits; \$12,832,105 in research and development tax credits; \$31,177,398 in small business investment tax credits; \$5,343,219 in export tax credits; \$805,315 in workforce development tax credits; \$173,644 in construction in progress property tax exemptions; \$12,530,747 in property tax stabilization, reallocation of education fund revenue, and other exemptions. The total awarded *before* July 1, 2000 was \$64,480,957. Vermont Economic Progress Council, Monthly Update, December 24, 2002.

<sup>2</sup> Data from the Vermont Department of Taxes master EATI spreadsheet, December 9, 2002.

## DISCUSSION

### A Performance-Based Program

Performance and accountability are at the heart of the Economic Advancement Tax Incentives (EATI) program. The Legislature built the program around the notion that those companies creating and retaining good jobs, making new capital investments, and engaging in research and development activities are the state's economic drivers, and are therefore of tremendous value to the Vermont economy.

In order to nurture and encourage these companies, the State of Vermont decided to award tax credits based upon the promise that specific goals would be accomplished.

The Legislature, in the authorizing statute of 1998, laid out in detail eight guiding principles on which the Council should base its awards. For example, the law required that each application be evaluated as to the degree to which the enterprise creates new full-time jobs for Vermonters and the degree to which the new jobs would pay more than the prevailing regional wage, and provide benefits and opportunities for advancement and professional growth. The law further required the Council to apply a cost-benefit model that assesses and measures the fiscal benefit to the State and region of the proposed economic benefit, and directed the Council to report annually on the gross and net values of the incentives granted.<sup>3</sup>

The Council reported on the program to the Legislature in January, 2000, explaining its performance-based nature, declaring:

“Once approved by the Council, award recipients must perform and make the investments represented in their application prior to claiming tax incentives. Several factors may affect when the tax credits are claimed and the amount that can be claimed.

1. Investments must actually be made.
2. Companies must realize profits and have taxable income. Absent taxable income, no credits can be realized.
3. Actual investments may be less, thus reducing the credit amount a company may claim.
4. Timing of job creation and investments may differ from what appeared in the application.”<sup>4</sup>

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<sup>3</sup> Act. No. 71, Sec. 48, Public Acts, 1998 Session, Vermont Legislature.

<sup>4</sup> “Economic Advancement Tax Incentives: Report to the General Assembly,” Vermont Economic Progress Council, January, 2000.

The Council re-emphasized the core principle of accountability in June, 2000 when it responded to findings issued by the Office of the State Auditor in a review of the Council's efforts to implement the EATI program. The Council wrote:

“It is important to understand up front that the program has been set up so **companies cannot claim tax credits until after the investments have been made and verified by the Tax Department.** ... If the company fell below, met or exceeded their financial projections, that will come to light during the Tax Department's review process. Verification takes on a higher level of importance if the Council were providing a grant or loan prior to the activity taking place. **Again, the incentive program has been set up so that companies can claim credits only after investments have been made and verified by the Tax Department.**”<sup>5</sup>  
(Emphasis in original.)

In addition, shortly after the Auditor's report was issued in June of 2000, the Council's executive director sent a letter to all existing award recipients explaining the new performance reporting requirement they would have to follow in order to claim their previously approved credits.

The executive director's letter read, in part:

## **2. Claiming Credits:**

To claim an income tax credit, an award recipient shall file a report with the Department of Taxes and with the Council within 60 days of the close of the applicant's fiscal year in which the economic activity occurred. The report shall respond directly to the performance expectations in the written notification of approval issued by the Council, and shall include a description of the economic activity, including the total number of jobs created, the number of new jobs filled by Vermont residents, the wages for the new jobs, investments made according to the categories of incentives awarded, the nature and extent to which the economic activity was consistent with the guidelines, and any other information required by the Council or the Department of Taxes to assess the performance of the recipient ... .

**NOTE: ALL PROJECTS APPROVED PRIOR TO JULY 1, 2000 WILL NOT HAVE A PERFORMANCE DOCUMENT ASSOCIATED WITH THEM. HOWEVER, THE APPROVED APPLICANT IS RESPONSIBLE FOR FILING A REPORT AS OUTLINED ABOVE.**<sup>6</sup> (Emphasis in original.)

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<sup>5</sup> “Response to the State Auditor's Review,” Vermont Economic Progress Council, June, 2000, p. 9-10.

<sup>6</sup> Communication to Approved Applicant, from Council Executive Director Christopher D'Elia, June 21, 2000, p. 1-2. (See Appendix I for complete letter.)

This letter further supports the Council's views on accountability, indicating that the Department of Taxes would be needing detailed activity reports to help review tax returns applying Council-authorized tax credits.

### **The Tax Credit Statutes and Verification Issues**

**T**he EATI program, which began in 1998, represents a new and complex program for the Department of Taxes with responsibilities that differ from the traditional functions of the Department.

However, the Department of Taxes has broad statutory authority to administer tax programs, including the EATI program.

32 V.S.A. §3201 lays out the Department's authority to adopt, amend and enforce reasonable rules, orders and regulations in administering the taxes within the commissioner's jurisdiction. It gives the Department broad authority to: examine any books, papers, or records; examine under oath "any matter within the commissioner's jurisdiction;" and, require material documentation. The statute also gives the Department broad authority to determine the form in which returns and reports are to be filed.<sup>7</sup>

The EATI program involves a number of specific tax credit statutes enacted with the purpose of fostering increased economic activity within the State of Vermont. The statutory authority for the program is contained in Title 32, Chapter 151, Subchapter 11E. It was originally enacted as Sec. 48 of Act 71 in 1998, to take effect beginning with the 1998 tax year. As relevant here, Act 71 had two related parts. First, it enacted a number of tax credit statutes, providing that businesses may take various tax credits for engaging in specified economic activities, such as investing in research and development.

Second, Act 71 empowered the Council to approve applications for tax credits by the business entities that sought them. The Council would issue a Certificate of Eligibility for the tax credit, specifying the type and amount of credit authorized. The credit could not be claimed by the taxpayer, however, until the essential economic activity specified in the taxpayer's application actually took place and there was a tax liability that the credit could offset.

*The Department of Taxes has no plan to review and verify the job creation or investment performance by companies which received more than \$64 million in tax credits awarded before July 1, 2000.*

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<sup>7</sup> 32 V.S.A. §3201(1-6).

One of the goals of this audit was to examine how the Department of Taxes evaluates and verifies the job creation and essential economic investment efforts of those companies claiming tax credits.

Some further background and discussion on this issue is important in explaining how the Department of Taxes came to adopt a view that it did not have statutory authority to disallow credits which stem from awards made *before* July 1, 2000.

As the program evolved from its beginning in 1998, observers raised concerns about program assessment and monitoring.<sup>8</sup> In response, the Legislature amended the EATI program during the 2000 legislative session (Act 159, Sec. 4) to provide greater accountability for the performance of the objectives of the program. For tax credit awards made by the Council *after* July 1, 2000, the effective date of Act 159, the Council must attach a written notice containing specific performance expectations on which continuing approval for the tax credits is conditioned. In order to claim a tax credit in any given year, the taxpayer is required to submit a report to the Department of Taxes that responds directly to the performance expectations in the Council's approval. The Department of Taxes is then required to compare the taxpayer's report with the performance expectations in the Council's approval, and to allow the tax credit only when the expectations have been met. (See *Appendix F for statute language.*)

It is clear that after July 1, 2000 (the effective date of Act 159) the Department of Taxes had specific statutory responsibility, with detailed procedures set forth in law, to review and allow (or disallow) credits based on whether or not a taxpayer complied with performance expectations specifically set forth in the Council's approval. (As of December 9, 2002, however, no tax credit claims had been received by the Department of Taxes related to awards made by the Council after July 1, 2000 which contain these specific performance expectation documents. All the returns have come from companies with pre-July, 2000 awards.)

For awards made after July 1, 2000 to conform with the amended statute, the Council created a detailed "performance expectations document" for all new firms receiving authorization for tax credits; each performance expectation document is based on the company's projected job creation and economic investments described in its application. These performance expectation documents are also forwarded to the Department of Taxes for use in reviewing compliance before allowing a credit on a taxpayer's return.

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<sup>8</sup> The June 6, 2000 report by this Office, "State Auditor's Review of the Vermont Economic Progress Council's Implementation of Act 71 of 1998," highlighted the lack of statutory authority for the Council to monitor the companies receiving approval for tax credits. Finding 5.1 (p. 8) of that report stated:

"The Council has no means of monitoring the fiscal costs and benefits associated with the tax credits and no way of determining whether the companies awarded credits have actually undertaken the planned investments, hired the projected new workers, or adhered to the Guidelines as stipulated in their applications."

A September 3, 1999 "Legislative Oversight Report" on the program to the Joint Fiscal Committee, by Tom Kavet, Consulting Economist for the Legislature, also recommended improved award follow-up procedures on the promised economic activities.

But what about verifying the tax credit claims stemming from awards made *before* July 1, 2000?

Our audit found that the Department of Taxes had no plan to review and verify the job creation or investment performance by companies which received authorization for more than \$64 million in tax credits *before* July 1, 2000, although these awards were issued contingent upon the accomplishment of key objectives stated in company applications. Approximately \$40 million of the \$64 million in tax credit awards remains to be claimed.

The Department of Taxes indicated that it need only review company performance when returns are filed claiming tax credits that were awarded *after* July 1, 2000, and for which a specific performance expectation document is on file.<sup>9</sup> The Commissioner recently explained the Department's position to the Auditor, saying, "Effective July 1, 2000 section 5930a(l)(1) was added to the tax code, authorizing the Department, *for the first time*, to disallow Council-authorized credits. The statute was changed in 2000 precisely because performance expectations did not exist prior to that."<sup>10</sup>

The question at hand, then, is to what extent does the Department of Taxes have the authority to review credits claimed to determine compliance with the purposes of the tax incentives program in cases where the Council's awards were made *prior* to July 1, 2000?

As mentioned above, we believe that the Department of Taxes has always had broad statutory authority in 32 V.S.A. §3201 to review all tax incentive credit claims by a taxpayer, and to determine whether credits were properly taken under the specific statutes creating the credits.

An example helps to illustrate the point:

§5930d creates the Economic Advancement Research and Development Tax Credit. The relevant language is as follows:

"A person, upon obtaining approval of the Vermont Economic Progress Council pursuant to §5930a of this title, may receive a credit against its income tax liability imposed by this chapter in the amount of ten percent of qualified research and development expenditures undertaken within the State of Vermont in the tax year for which the credit is claimed."

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<sup>9</sup> Discussion with Janet Ancel, Commissioner of Taxes, George Phillips, Tax Policy Analyst, Susan Mesner, Economist, Chuck Barnum, Tax Examiner, September 16, 2002.

<sup>10</sup> Communication, Janet Ancel, Commissioner of Taxes, December 27, 2002.



Thus, in addition to gaining the approval of the Council, the taxpayer must actually make qualified research and development expenditures (as defined later in statute); a taxpayer must make these expenditures within the State of Vermont; and, the taxpayer must make these expenditures in the tax year for which the credit is claimed.

Council approval is thus a necessary, but not a sufficient, condition for taxpayers taking the tax credit. The fact of expenditure, place of expenditure, time of expenditure, and type of expenditure – all matters that would have been unknown or merely anticipatory at the time of the Council application and approval – are thus properly subject to review by the Department of Taxes, as would be any other representation on a taxpayer's return.

Another example offers further clarification:

Under §5930g a business may obtain an investment tax credit against income taxes for making certain investments within the State of Vermont. Under the statute, investment must be “in plants or facilities and machinery and equipment,” and investments must exceed \$150,000 in any applicable tax year. The percentage of the tax credit varies from 5 to 10 percent, depending upon the number of employees employed by the taxpayer – the smaller the business, the larger the credit. The statute further defines certain types of long-term capital leases as meeting the definition of “investment,” despite the fact that the taxpayer does not acquire an ownership interest by nature of the investment.

Thus, to claim a small business investment tax credit, a person must:

- Obtain approval of the Council under §5930a;
- Make an investment of over \$150,000;
- Make the right type of investment;
- Make the investment within the State;
- Make the investment within the applicable tax year; and,
- Base the allowable credit on the number of employees during the tax year for which the credit is claimed.

Thus, a number of factors control the amount of the tax credit, and whether the tax credit can be claimed, in whole or in part, in any particular tax year. As with any representation made on a tax return, the Department of Taxes would have broad authority to determine whether the credit is properly claimed.

It is important to remember that every company, since the program's inception, was informed by the Council at the time a tax credit was approved that the company must live up to performance expectations in order to later claim the tax credit.



## The Downward Trend: Corporate Tax as State Revenue Source

State corporate income tax revenues have declined more than any other single state tax source, at a time when states from coast to coast are facing budget crises. Vermont's corporate income tax decline is even more pronounced than the national average.

A report issued in April 2002 by the Washington, D.C.-based Center on Budget and Policy Priorities, found that between 1979 and 2000 corporate taxes across the country fell from 10.2 percent to 6.3 percent of state general fund revenues.

Economists attribute the decline to a number of factors, including lower corporate profits, increased use of tax loopholes; lower effective state tax rates; the increasing prevalence of state corporate income tax credits and related incentives; and, the increased use of S Corporations and other pass-through entities, which have reallocated some corporate income to personal income.

In Vermont, this decline was even more precipitous with corporate taxes falling from 10 to 3 percent of general fund revenues since 1979.

To put this in terms of actual dollars: In fiscal year 1999, general fund revenue generated from corporate income taxes in Vermont was \$57 million; in fiscal year 2002 it was \$32 million, a decline of \$25 million.

Several states are taking steps to either steady, or reverse, this trend. Others are considering eliminating the corporate tax as a tool for economic development.

For example, the corporate tax in New Jersey was 15 percent of the state's revenue in 1982. In Fiscal Year 2003, it was projected to drop to 4 percent. As a result, New Jersey Governor James McGreevey proposed closing loopholes in the state's tax system, generating an additional \$627 million for the state.

"We're going to restore the integrity of the corporate income tax by eliminating the loopholes and gimmicks that have allowed companies to shirk their responsibilities," said McGreevey in his Fiscal Year 2003 budget address.

Four states have no corporate income tax: Nevada, South Dakota, Texas and Washington. Washington, however, has a tiered gross receipts tax, and South Dakota has a tiered tax on a bank's net income.

Wisconsin is currently debating whether to eliminate its corporate income tax. Its current system is "loophole-riddled," according to the state's former chief tax collector Cate Zeuske. In 1979, the corporate income tax accounted for 11.3 percent of the state's tax collections. In 2001 that figure dropped to 4.6 percent. "It'd be better to just get rid of the corporate tax," Zeuske told the *Milwaukee Journal Sentinel*, rather than try to develop new rules or hire new auditors to enforce it.

For more information about national and state tax structures and policies visit these sites on the Internet:

- The Center on Budget and Policy Priorities: [www.cbpp.org](http://www.cbpp.org)
- The Institute on Taxation and Economic Policy: [www.goodjobsfirst.org](http://www.goodjobsfirst.org)
- The Tax Foundation: [www.taxfoundation.org](http://www.taxfoundation.org)

Before July 1, 2000, the Council informed each company receiving tax credit awards that it would have to “*actually perform and make the investments as noted in the application.*”<sup>11</sup> A copy of the notification, along with a “Certificate of Eligibility” for each category of tax credit award, was forwarded to the Department of Taxes.

Much of the information required under the new version of the statute – such as the detailed application made to the Council – is easily obtainable by the Department of Taxes for those companies whose awards date before July 1, 2000.

We agree that neither the original Council statute nor the amended version is a model of perfect clarity. There is no section of the amended statute, for example, specifically dealing with applications that were approved by the Council prior to the amendment (July 1, 2000), but where outstanding credits have not yet been claimed.

Nonetheless, the purpose of the program had not changed, and the amendments put in place by Act 159 were primarily procedural in nature. The amendments did not purport to affect any right, privilege, obligation or tax liability accrued prior to their effective date. They did, however, evidence the Legislature’s desire to ensure that the purposes of the tax credit incentive program were being met.

By putting in place a specific review of the tax credits approved by the Council, the Legislature made clear that it wanted the Department of Taxes to assure that the taxpayers were actually doing what they set out to do to claim the tax credits.

We believe that, while not specifically authorized in the amended statute, there is nothing in statute that prohibits the Department of Taxes from employing its existing authority under its general review powers to determine whether any taxpayer is entitled to take any of the specific tax credits in any given year. With pre-July 1, 2000 approvals, the Department, if it chooses to do so, could require a more detailed return or report from the taxpayer and compare it to the award letter and original application.

The Department of Taxes clearly has authority to assure compliance with the specific tax credit statutes at issue and with any conditions set forth in the Council’s approval.

To remove any confusion on the issue, the Auditor suggested during this audit that the Commissioner of Taxes consider asking for an opinion from the Attorney General about the legal duties of the Department in verifying the economic performance of claimants.<sup>12</sup>

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<sup>11</sup> SAO review of Council applicant files and award notification letters.

<sup>12</sup> Letter from State Auditor Elizabeth Ready to Janet Ancel, then Commissioner of Taxes, September 19, 2002.

## Audit Test Work

At the beginning of our audit, we noted that authorizations for tax incentive credits were approaching a total of \$80 million. (Subsequently it was determined that \$8,727,876 in Council-awarded tax credits had been applied against tax liabilities by taxpayers, with another \$15,290,102 in tax credits carried forward by companies to apply against a future state income tax liability.)

Only a few of the tax returns from the 1998 tax year had been reviewed for accuracy and completeness when we began the audit. Less than 10 percent of the returns from tax years 1999, 2000 and 2001 had been reviewed at that time, but progress has been made in the intervening months. (It should be noted that corporate returns are due two and a half months after the close of the year, but are often filed later under extensions, according to the Department.)

Only one tax examiner was assigned to reviewing tax returns containing the Council-awarded credits and approximately 10 percent of his time was devoted to this effort. Also of concern was the fact that other tax returns had not yet been completely reviewed and were poised to pass the three-year statute of limitations for adjustment by the Department.

There is a risk in untimely reviews of tax returns. In early September, the Department of Taxes reported to us that at least one tax credit claim from the 1998 tax year had been processed, but not reviewed for errors or completeness, and thus the entity could argue that the three-year statute of limitations for possible tax adjustment action by the Department had passed. (The statute of limitations is three years from the date a return is filed, or the due-date if later, according to the Department.)

Based on these concerns, the Auditor immediately held a meeting with representatives of the Department of Taxes and the Agency of Administration on September 19, 2002 to address these issues and to ask that action be taken to preserve the State's ability to review all claims "applied," but not yet fully reviewed.

As a result of this meeting, such action was taken and the tax examiner's duties were adjusted so that 100 percent of his time would address the review backlog. Commissioner of Taxes Janet Ancel wrote, "It is our responsibility to review returns and that responsibility is going to increase, in number, intensity of review, and complexity."<sup>13</sup> Although no claims are now likely to pass the statute of limitations before being reviewed, it may still take six to nine months or more at the present staff allocation to become current with all EATI credits claimed.

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<sup>13</sup> Memorandum from Janet Ancel, Commissioner of Taxes, to Elizabeth Ready, State Auditor, October 4, 2002, p. 2.

Our test work detected an error that could have cost taxpayers \$118,460 if it had gone undetected in subsequent reviews over time by the Department.

Here is a summary of that situation:

We reviewed an amended return the Department of Taxes received in 2002, which included a Council-awarded tax credit that had been earned in 1998.

This company's amended 1998 tax return resulted in a tax refund of \$475,204, as well as an interest payment from the State of \$117,470, for a total check of \$593,664. This refund and interest were given without any verification of the job-creation and investment performance required to claim the tax credits.

During this particular review, we noted a serious error. Because the company did not use all of its tax credit award earned in the 1998 tax year, the company (and the Department) must carry forward the unused amount to future tax years. The Department miscalculated the amount to carry forward, allowing an excess of \$118,460 in future credits. The original approved credits, less the tax liability for that year, should have resulted in a credit carry-forward of \$232,355. The Department, however, used the refund amount instead of the tax liability in its calculation, and incorrectly allowed a carry-forward of \$350,815, which was \$118,460 too high. The error could have been detected in a future year, but after being alerted to the issue, the Department indicated it would quickly send a correcting notice to the taxpayer.

### **Status of Tax Credit Review**

**A**s of December 9, 2002, the Department of Taxes has received 107 returns from corporations or other business entities (for the 1998-2001 tax years) resulting in \$8,727,876 in Council-awarded tax credits applied against tax liabilities. An additional \$15,290,102 in tax credits (for the 1998-2001 tax years) is available in "carry-forward status," which means the credits have been earned by companies but have not yet been applied to a tax liability.<sup>14</sup>

All the claims and carry-forward amounts have been allowed without any performance review.<sup>15</sup> In returns that have been reviewed, the returns are checked to make sure the appropriate tax schedules are attached and that calculations on those schedules are reasonable and accurate. For example, data on a state tax credit schedule may be compared to appropriate data on the accompanying federal return.

<sup>14</sup> Communication, Department of Taxes, December 17, 2002. Credits are typically carried ahead to a future year because the pre-credit tax liability was insufficient to absorb the full credit earned that year.

<sup>15</sup> Vermont Department of Taxes data, November, 2002, and SAO interviews with Department of Taxes examiners and supervisors, September - December, 2002.

The scope and complexity of the new tax credit program have resulted in significant additional responsibilities for the Department of Taxes in processing these tax credits that can be applied against both corporate and, in the case of pass-through entities, personal income tax liability. The EATI program, unlike the traditional tax revenue collection of the Department, represents an effort by the State to produce specific social and economic benefits.

The Department has not yet produced written guidance for filers and its tax examiners, despite receiving its first tax return in the EATI program on March 3, 1999.

Thus, at this time there is no formal manual of procedures and internal controls to process these tax credit claims.

The Department of Taxes has explained to auditors that a number of steps are involved in reviewing a Council-awarded tax credit claim, even without verification of the company's performance. These steps include examination of:

- Federal and State income tax returns, required schedules and eligibility certificates;
- Interaction with other tax credits being claimed;
- Amounts claimed by category of tax credit;
- Award calculation by category;
- Payroll cost definition and timing of payroll increases;
- Carry-forward amounts;
- Individual tax returns if credits are part of an S corporation<sup>16</sup> or other "pass-through" entity which "passes through" the tax credit benefits awarded to the corporation to individual shareholders who claim them on personal income tax returns;
- Tax credit amounts, to assure that no more than 80 percent of a tax liability is claimed;
- Capital leases;
- Research and development credit expenditures only after approval date; and,
- Double-weighted sales factor in export credits.<sup>17</sup>

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<sup>16</sup> An S corporation does not pay federal or state income tax directly, but instead passes its income or losses and other tax items onto its shareholders, much like a partnership. It provides the legal liability protection of a corporation to its shareholders while avoiding corporate double taxation.

<sup>17</sup> Communication from George Phillips, Tax Policy Analyst, Department of Taxes, December 12, 2002, discussing possible issues to be addressed in a bulletin for taxpayers with Council tax credit approvals.

According to the Department of Taxes, some corporate income tax information is computerized but the corporate income tax has not yet been moved to the Vermont Integrated Revenue Collection System (VIRCS) used by the Department for individual income tax, sales and use tax, meals and rooms tax, and withholding tax. Because of corporate income tax factors such as consolidated returns, apportionment schedules, loss carryovers, and various aspects regarding state credits, review of corporate income tax returns are, and will be for the foreseeable future, a manual operation, according to the Department.<sup>18</sup>

This workload will only grow as taxpayer performance reviews and changes in the EATI program, such as the high-tech incentives approved by the Legislature in 2002, are added to the task list.

## **RECOMMENDATION 1**

**The Department of Taxes should develop a strong system of internal controls and procedures, including a manual and web site information, to improve the way Council-awarded tax credit claims are filed and examined.**

**No further tax credits should be allowed without review and verification of actual job creation and economic investment performance.<sup>19</sup>**

**The Legislature should amend the EATI statute to clarify that the Department of Taxes should review the performance of *all* award recipients, including those whose credits were authorized *before* July 1, 2000, representing more than \$64 million in credits. This will assure that companies have created the jobs and made the economic investments promised in their application.**

**The Legislature should consider a range of steps to initiate rapid review and verification of all promised economic performance, while keeping commitments to those companies with Council awards. These options could include:**

- Establishing a new tax credit compliance officer;**
- Restricting the awards of future tax credit authorizations until a system of accountability is operating; or,**
- Providing resources for training and for staff positions needed to review awards and administer the program.**

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<sup>18</sup> Communication, Department of Taxes, December 27, 2002.

<sup>19</sup> Vermont law (32 V.S.A. §5930a(l)(1)(A)) requires the company to report to the Council and the Department of Taxes the total number of jobs created, the number of new jobs filled by Vermont residents, the wages for the new jobs, investments made according to the categories of incentives awarded, and the extent to which the economic activity was consistent with the nine program guidelines before claiming a Council-awarded tax credit.



## FINDING 2

The Department of Taxes does not collect necessary employment information to enforce 32 V.S.A. §5930h, which insures that tax credits flow only to companies that maintain Vermont jobs.

Neither the Council nor the Department of Taxes has promulgated rules or issued guidelines to clarify the statutory definition of “employee” and the time period in which benchmark employment measurements are taken, two important definitions for complying with the statute’s recapture provisions.

Clear definitions and timely reporting of employment data are vital to the program goal of subsidizing only those companies that maintain Vermont jobs.

## DISCUSSION

The EATI program can be viewed as a jobs-related program, because the tax credits are generally awarded for two reasons:

1. A company promises to *increase* the number of well-paying jobs; or,
2. A company promises to *maintain* the number of jobs it currently has and receives an incentive that is not tied to increasing jobs, such as a Research and Development Tax Credit.

Thus, when a company applies a Council-awarded tax credit to reduce its future state tax liability, it is essential that the State check to see if the business maintained minimal employment levels.

This issue is discussed and codified in 32 V.S.A. §5930h. The recapture, or “claw-back,” provision states:

“In the event a person that has obtained the approval of the Vermont economic progress council under section 5930a of this title ceases to employ in Vermont, for a period of 120 consecutive days, at least 75 percent of the number of employees it employed in Vermont as of the year in which a credit was utilized under this subchapter, then for any such year and all succeeding years, any unused credit shall be disallowed. Furthermore,

# Vermont's Top 15 Tax Incentive Recipients

**S**ince the inception of the EATI program, the Council has authorized more than \$80 million in tax credits to 94 businesses and 19 municipalities (See Appendix D for the complete list as of December 2002). Below are the top 15 awards granted to companies (including related municipal awards):



C&S Wholesale Grocers



IDX



Resolution, Inc.



Gardener's Supply



Burton Snowboards

1. Husky, Milton: \$17,406,600 (includes a \$6,808,500 related municipal award to the Town of Milton); November 1998.
2. IDX, South Burlington: \$9,964,514 (includes a \$2,693,000 related municipal award to the City of South Burlington); November 1998.
3. Mack Molding, Arlington: \$6,418,100; December 1998.
4. Huber & Suhner Corporation, Colchester: \$2,441,602; August 2000.
5. B.F. Goodrich, Vergennes: \$2,006,991; August 1999.
6. C&S Wholesale Grocers, Brattleboro: \$1,945,642; December 1998.
7. Northern Lights Cable, Bennington: \$1,914,361; April 1999 & October 2000.
8. Burton Snowboards, Burlington: \$1,870,742; April 2001.
9. Homebound Mortgage, Colchester: \$1,860,261; January 2002.
10. City of Burlington (Gilbane): \$1,551,709; March 1999.
11. Hanover Capital Management, Hartford: \$1,339,220; September 2000.
12. Resolution, Inc., South Burlington: \$1,325,177; August 1999.
13. Riser Management Systems, Burlington: \$1,293,490; June 2000.
14. Specialty Filaments, Middlebury & Burlington: \$1,287,656; December 1998 & July 2002.
15. Gardener's Supply, Burlington: \$1,268,818; October 1999.



there shall be imposed upon each such employer a recapture penalty equal to a percentage of the total credit used, computed in accordance with the following table:

<b>Years between close of tax year when credit became available and year when business became ineligible:</b>	<b>Percent of credit recaptured</b>
Two or less	100%
More than 2, up to 4	50%
More than 4, up to 6	25%

The recapture shall be reported on the taxpayer's income tax return for the tax year in which the 120 consecutive-day threshold occurred.”<sup>20</sup>

Thus, reliable information about year-to-year employment from each company in the program is very important, and must be provided to the Council and the Department of Taxes for up to six years after it has “utilized” or applied its tax credits. And, because companies have five years to use their tax credits and can employ a five-year carry-forward period for each economic incentive, a company may have to provide employment data for up to 16 years.

We have found that companies are not providing employment updates to the Department of Taxes, nor does the Department have a base employment number against which to compare changes in employment levels.

Companies are, however, providing employment information to the Council in annual activity reports, but the information is not forwarded to the Department of Taxes. In any event, the employment information is difficult to use due to vagueness in the statute. The law says recapture is based on “the number of employees” but does not say if only full-time employees should be counted, or full-time equivalents, or all employees, full and part time. Are numbers of employees determined at an-end-of-period employment, or averaged annually or quarterly? The time periods for utilizing credits and counting employees can be misunderstood, too, leading some companies to report by calendar years, others by their company's fiscal year, or by the state's fiscal year.

The Council and the Department of Taxes have not worked together to develop rules on these issues, nor have they asked the Legislature to clarify the terms. Until this occurs, complying with the law by careful review of employment figures will be difficult.

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<sup>20</sup> 32 V.S.A. §5930h.

*Companies are not providing employment updates to the Department of Taxes, nor does the Department have a base employment number against which to compare changes in employment levels.*

Potential benefits from this program are all predicated on employment performance measures that will be increasingly difficult for many applicants to meet in tough economic times. Clear definitions and timely employment data are vital to the program goal of subsidizing only those companies that maintain Vermont jobs.

#### **RECOMMENDATION 2**

**The Department of Taxes and the Council should collect the necessary employment data to enforce 32 V.S.A. §5930h.**

**The Department of Taxes and the Council should agree on a method of defining and counting employees that can be used consistently throughout the application, performance review and recapture processes.**

### FINDING 3

The Council and its staff rely heavily on certifications from the applicants seeking tax credit authorizations, rather than on independent verification of information submitted by applicants related to employment statistics, sales, and other data. This information is critical because it forms the basis of the tax credit award and becomes the baseline against which all subsequent review and verification of performance will be made.

The Council has met the Legislative mandate of approving or denying completed applications for economic incentives within 45 days. The Council and its staff have improved internal procedures and guidelines, and have upgraded the application process.

### DISCUSSION

The Council has efficiently processed applications for a variety of economic investment and job-creation projects from almost every county in the State within 45 days of accepting an application as complete, as required by statute.

In addition, the Council and its staff have responded to legislative changes and past recommendations from this Office to improve its internal procedures and accountability, and have educated regional development corporation staff members, who help attract Council applicants, about the process.

More than two years ago, this Office recommended that:

*“The Council should formally – and publicly – adopt policies and procedures related to the applicant review process.”<sup>21</sup>*

The Council has adopted a mission statement and new internal procedures and guidelines for reviewing applications. As an example, Council staff and its cost/benefit model consultants now require a description of the business activity of the applicant along with its Standard Industrial Classification (SIC) code as part of the application.

This is because in January, 1999 the Council made an award based on an incorrect SIC code entry.<sup>22</sup> Using the proper SIC code in the cost-benefit model would not have yielded any net fiscal benefit from this award due to job substitution with other in-state competitors. (Despite the detection of the problem and a positive change in the application forms, the award was not rescinded when the error was later discovered.)

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<sup>21</sup> “State Auditor’s Review of the Vermont Economic Progress Council’s Implementation of Act 71 of 1998,” June 6, 2000, p. 31.

<sup>22</sup> Telephone conversations and e-mail correspondence with Economic and Policy Resources, Inc., Williston, Vermont, November – December 2002.

The Council has also adopted policy amendments to help it clarify such issues as what to do if a previously-approved applicant is interested in applying for tax credits for a different project, or for additional credits on the previously-approved project.

However, we note that some complexities in the program, such as the requests by some applicants to have their tax credit awards reassigned to different entities, or the issue of rescissions, did not yet have policy statements.

In one area, however, the Council and its staff have not made significant changes since the June 6, 2000 report by the State Auditor. The report found then that the Council's procedures for reviewing the financial information submitted by applicants were "inadequate and seriously flawed because no effort is made to substantiate the information submitted by the applicants."<sup>23</sup>

While reviewing data for reasonableness, and questioning applicants about data, usually by telephone or e-mail, the Council does not seek independent verification of important financial details on applications. The Council relies on certification by a corporate officer who is asked to sign this statement:

*"I declare under penalties of perjury this application and all documents attached in support of this application are true, correct and complete to the best of my knowledge."*

Critical to the performance-based goals of the program are the starting points for each company. When a company in the future claims a tax credit, its performance against a baseline of data on the application is what will be measured.

Future accountability depends on what the company reports on its Council application as its current total business sales, total Vermont sales, its percent of sales in Vermont, its dollar expenditure for Vermont payroll, total number of Vermont-based full-time employees, and expenses for job training, and other data.

What was said in the State Auditor's review in 2000 is accurate today: "The decision to accept such data without ensuring its accuracy represents a serious internal control weakness."<sup>24</sup>

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<sup>23</sup> "State Auditor's Review of the Vermont Economic Progress Council's Implementation of Act 71 of 1998," June 6, 2000, p. 20.

<sup>24</sup> *Ibid.*, p. 21.

### RECOMMENDATION 3

The Council should independently verify and document that application information, which forms the basis of the tax credit award and becomes the baseline against which all subsequent review and verification of performance will be made, is correct.

## A Tale of Two States

### Massachusetts

**What:** Massachusetts Economic Development Incentive Program

**Administrator:** Massachusetts Office of Business Development

**Created:** 1994

**Tax Incentives Granted:** \$43 million in tax incentives to 759 projects

Massachusetts claims these incentives have resulted in:

- An estimated 48,195 jobs created; and,
- \$7.9 billion in private investment in Massachusetts communities.

*These numbers remain unsubstantiated because there has never been a formal review of actual levels of job creation, job retention or private investment, according to a recent report released by the Massachusetts Senate Post Audit and Oversight Bureau.*

### Vermont

**What:** Vermont Economic Advancement Tax Incentives Program

**Administrators:** Economic Progress Council and Department of Taxes

**Created:** 1998

**Tax Incentives Granted:** \$80.1 million to 113 entities

Vermont estimates that by 2006 these incentives could result in:

- An estimated 10,157 jobs created; and,
- An estimated \$1.7 billion in private investment in Vermont communities.

## FINDING 4

The “but-for” test, upon which all claims of fiscal benefit are premised, cannot be verified.

The “but-for” test assumes that total project benefits would not occur “*but for*” the EATI award. Thus, the costs to the State for the credits are understated, while benefits are overstated.

## DISCUSSION

All measurements of the State’s return on investment and related fiscal benefits associated with Council tax expenditures rely upon the assumption that “but for” the incentive, the investment would not occur in whole or in part. The Council bases the theoretical positive or negative return to the State for each project on the cost-benefit model; however, the model assumes the “but-for” test to be true in each and every model run. If the cost-benefit model has a negative “but-for” response, the model always produces a net negative return on investment for the State.

Therefore, the “but-for” test is critical in determining fiscal benefits because any State expenditure to “incent” an investment that would occur *without* the incentive would be an unnecessary expenditure.

Simply put, it is not necessary to make a public expenditure for something that would occur without a public expenditure.

The determination of whether or not an applicant’s intended investment would proceed in the absence of a State subsidy is called the “but-for” test. This test is administered by the Council and is entirely validated by the subjective judgment of the Council. The law states:

The Council shall first review each application under subsection (b) of this section and ascertain, to the best of its judgment, that **but for** the economic incentive to be offered, the proposed economic development would not occur or would occur in a significantly different and significantly less desirable manner.<sup>25</sup> (Emphasis added.)

Despite sincere efforts by the members of the Council, however, it is impossible to know with certainty whether a proposed investment would have occurred in the absence of a Council subsidy.

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<sup>25</sup> 32 V.S.A. §5930a(c).

This critical test, upon which the entire fiscal claims of the program are based, is subjective, with no quantifiable standards, and essentially without falsification risk to the applicant, unless via self-incrimination.

Increasingly, academic literature minimizes the role of state tax incentives in company investment decisions.<sup>26</sup> Research shows that businesses poised to make a large investment consider such critical issues as basic market demand, transportation systems, workforce quality, cost and availability, facility options and many other central factors affecting the cost and return on an investment. In some cases, a State subsidy may tilt the balance and critically affect a decision, but it is not usually the only, or even the primary factor.

In Vermont, there have been well-publicized statements by Vermont firms receiving Council credits about the true influence these credits had on their investment decisions. Only the threat of award rescission prompted later retraction of these public statements.

For example, after receiving a Council award and attesting to a “very real, very urgent ‘but for’ argument,” one company reported in a major U.S. business publication that workforce quality and labor availability were more important in their Vermont business investment decision than was the Council credit.<sup>27</sup> After being called before the Council to reconsider their award approval because of this public statement, the company submitted a three-page apology, stating “we...feel we should be the ‘poster boys’ of VEPC and the magnificent programs you administer.”

After claiming a portion of its credit, the company began laying off workers, but discounted rumors it was closing down its facility, reporting in the local press a “100 percent guarantee that we will be there this time next year.” The company has since closed its plant, has had its tax credit authorizations rescinded by the Council, is no longer doing business in Vermont, and is the subject of recapture review at the Department of Taxes.

This case, which occurred during the time period covered by this audit, illustrates the difficulty in verifying the “but-for” test and other application information based solely on a company’s representations. With a great deal of money at stake and no verification possible, this test should not be the basis of net fiscal calculations by the program.

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<sup>26</sup> See, for example, “Tax Incentives and the Disappearing State Corporate Income Tax,” by Dr. Peter Fisher, *State Tax Notes*, March 4, 2002, Vol. 23 , No. 9.

<sup>27</sup> Jeffrey Krasner, “Did Vermont’s Tax Credits Really Sway Firms?” *The Wall Street Journal*, September 20, 2000. The article adds that, “Only two of the 21 companies contacted by The Wall Street Journal say [VEPC] credits were the deciding factor in moving ahead with expansion in Vermont.”

To attribute the entire stream of future economic benefits from an investment to this single factor is not accurate. Yet this is precisely the assumption behind the Council's cost-benefit model and the assertion that there is a positive return on investment – and no net fiscal cost to the State – from this program.

#### **RECOMMENDATION 4**

**The “but-for” test should be eliminated as the basis for fiscal cost measurement in the EATI program. It cannot be relied upon as the basis for asserting that there is a positive return on investment, and thus no net fiscal cost to the State from this program. Maximum potential returns and benefits may be reported as such, but program expenditures should be accounted for at face value and governed by legislative budget authorization.**

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*“Only two of the 21 companies contacted by The Wall Street Journal say [VEPC] credits were the deciding factor in moving ahead with expansion in Vermont.”*

*from Jeffrey Krasner, “Did Vermont’s Tax Credits Really Sway Firms?”  
The Wall Street Journal, September 20, 2000*

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## FINDING 5

**There is no program expenditure cap or meaningful limitation on the authority to grant tax credits. This constitutes financial exposure and risk to the State.**

## DISCUSSION

State tax revenues have declined precipitously in the last fiscal year, creating budgetary crises from Massachusetts to California. The corporate income tax has been among the revenue sources experiencing the largest percentage declines.<sup>28</sup>

Despite long-term growth in corporate profits, total state corporate income tax revenue in the United States has been declining as a share of all state revenues for the past 20 years.

In 1980, total state corporate income taxes represented about 10 percent of all state revenues.

In 2000, total state corporate income taxes accounted for only about 6 percent of all state revenues.<sup>29</sup>

In Vermont, this decline has been even more pronounced (see chart, page 40). Corporate income tax revenues accounted for nearly 11 percent of all general fund revenue in Fiscal Year 1979 and dropped to less than 3.5 percent in Fiscal Year 2002. Through the first six months of Fiscal Year 2003, (July 1 - December 31, 2002) the decline in corporate income tax revenue has accelerated, with revenues (\$10.3 million) reported at about half the level of the same period in Fiscal Year 2002 (\$20 million).<sup>30</sup>

The long-term national decline in state corporate income tax revenues as a share of total state tax revenues has been attributed to a number of factors, including:

- Increased tax avoidance – through legal, “quasi-legal” and illegal tax shelters and related tax avoidance mechanisms,<sup>31</sup>

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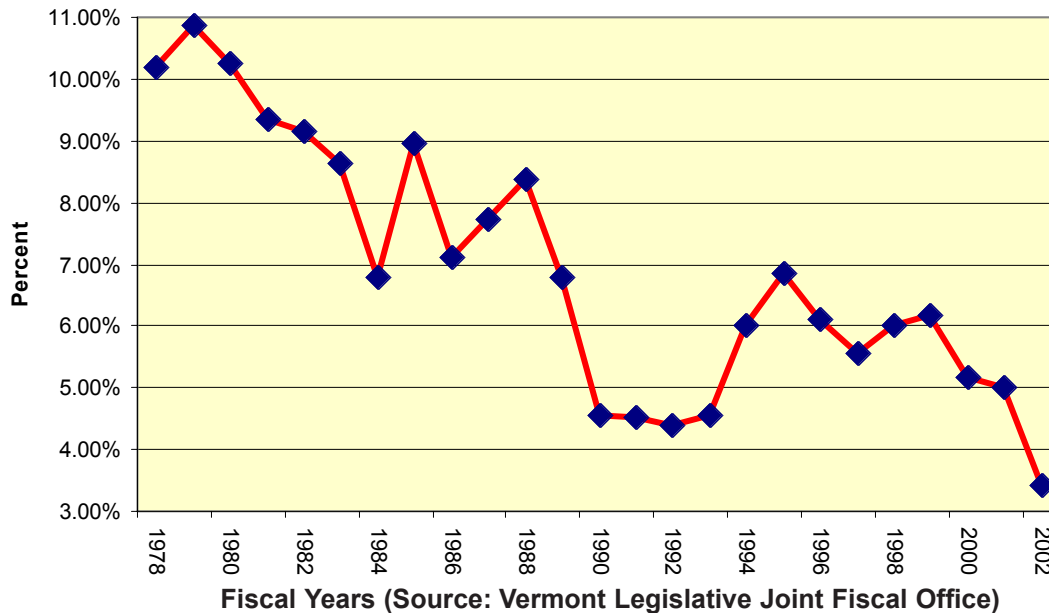
<sup>28</sup> See The Nelson A. Rockefeller Institute of Government, Fiscal Studies Program, *State Revenue Report*: September 2002; No. 49, “State Tax Revenue Decline Accelerates,” June 2002; No. 48, “Worst Quarter of State Tax Revenue Decline,” March 2002; No. 47, “A Second Quarter of Decline in State Tax Revenues,” December 2001; No. 46, “Severe Decline in State Tax Revenue.”

<sup>29</sup> Dr. Peter Fisher, op.cit.

<sup>30</sup> Tax Receipts Summary, Revenue Accounting System, Vermont Department of Taxes, December 31, 2002.

<sup>31</sup> See David Cay Johnston, “Corporations’ Taxes Are Falling Even as Individuals’ Burden Rises,” *The New York Times*, February 20, 2000.

### Corporate Income Tax Revenue as a Percentage of Total General Fund Revenue in Vermont



- A decline in the effective state and local corporate income tax rate, as states lower statutory rates, adjust apportionment formulas and enact other tax reductions;<sup>32</sup>
- The increasing prevalence of state corporate income tax credits and related incentives, such as those offered in the Vermont's EATI program;<sup>33</sup> and,
- The increased use of S Corporations and other pass-through entities, which has reallocated some corporate income to personal income.

Vermont corporate income tax revenues have declined more than 40 percent - from \$57 million to \$32 million - between the inception of the EATI program in fiscal year 1999 and fiscal year 2002.<sup>34</sup>

<sup>32</sup> See Michael Mazerov, "The Single Sales Factor for State Corporate Taxes," Center on Budget and Policy Priorities, Washington, D.C., 2001; and also, Robert Gavin, "States' Tax Plan Could Backfire," *The Wall Street Journal*, February 14, 2001.

<sup>33</sup> For a review of recent major state tax and incentive changes in 20 states, see Alan Peters and Peter Fisher, "State Enterprise Zone Programs: Have They Worked?" W.E. Upjohn Institute for Employment Research, 2002.

<sup>34</sup> Data from the Vermont Department of Finance and Management.

While not all, nor even most, of Vermont's corporate income tax revenue loss is attributable to Council tax credits, this audit reveals these credits to be a much more significant component of this decline than previously understood.

Previous revenue estimates had been based on incomplete information from the Department of Taxes summarizing smaller tax credit amounts that had been reviewed and allowed, rather than on the larger applied amounts claimants have been regularly taking against their tax liabilities.

According to the Department, of the \$8,727,876 total credits applied against a tax liability to date, \$5,578,583, or 64 percent, is attributable to C corporations, and thus to corporate income tax revenue, with the remainder applied by pass-through shareholders and partners on individual income tax returns.

Of the total carry-forward amounts of \$15,290,102, about 77 percent, or \$11,719,246, is attributable to corporate income tax returns.<sup>35</sup>

Although the precise net fiscal cost of this program is impossible to know, it is somewhere between a negative \$9 million (approximate amount of tax credits applied to date) and a positive \$3 million (net fiscal benefit to the State treasury as of end of 2001, assuming none of the investments would have occurred "but-for" the Council incentives<sup>36</sup>). With a program approval rate of more than 85 percent (149 applicants through July, 2002, with 129 approved) and little State variance in relative manufacturing sector performance since the program's inception<sup>37</sup>, (see chart, page 42) it is difficult to conclusively discern a net fiscal impact that is positive.

The potential State tax liability from this program in any given year, however, is virtually unlimited and could easily exceed \$10 million or more. The EATI program is currently only limited by award levels set by the cost-benefit model (with the exception of a \$2 million cap on projects that do not generate positive fiscal impacts as measured by the cost-benefit model<sup>38</sup>) and the "but-for" test. There is currently no total program expenditure cap or other award authorization limit associated with this program.

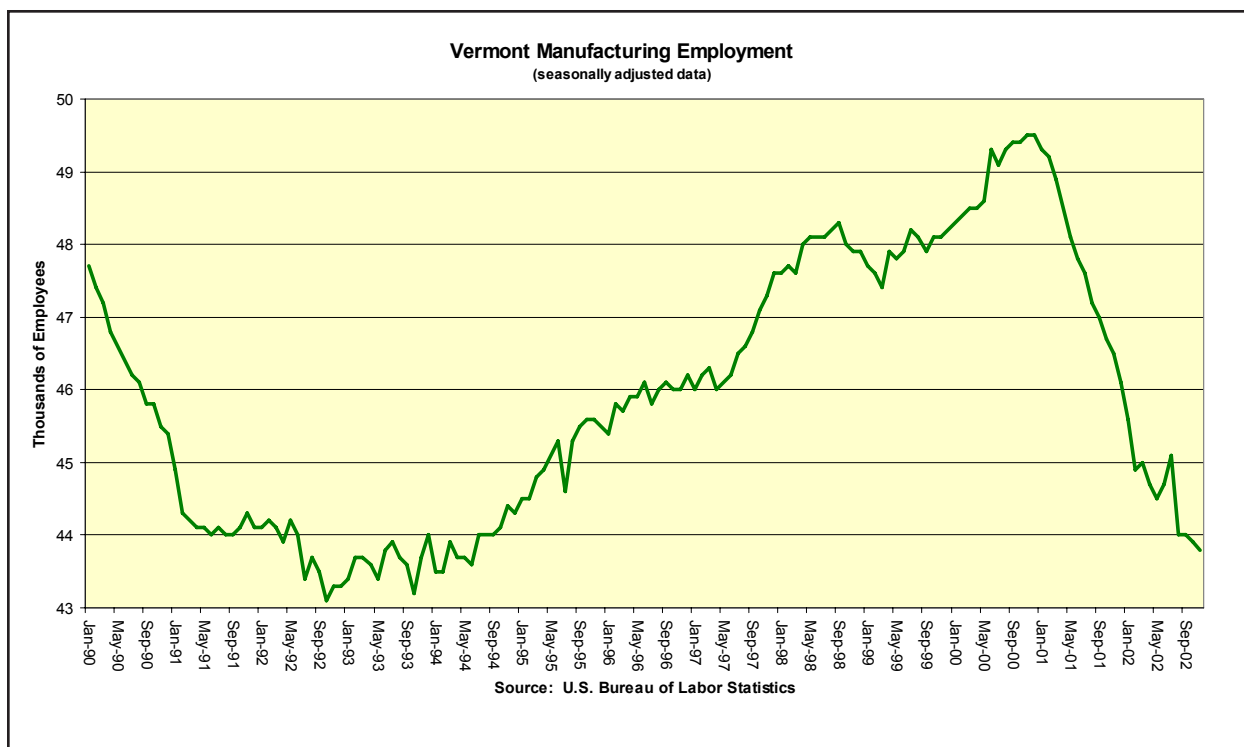
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<sup>35</sup> Data from the Vermont Department of Taxes master EATI spreadsheet, December 9, 2002.

<sup>36</sup> Communication, Vermont Economic Progress Council, December 27, 2002.

<sup>37</sup> According to the U.S. Department of Labor's Bureau of Labor Statistics, seasonally adjusted U.S. manufacturing employment has declined 10.6 percent since its cyclical peak in July of 2000 and 10.0 percent since November of 2000, whereas seasonally adjusted Vermont manufacturing employment has declined 11.5 percent since its cyclical peak in November of 2000.

<sup>38</sup> Only when a project's cost is predicted to be "net negative" to the State does the Council deduct the net fiscal cost from the \$2 million annual spending authorization the Council now has. Over the past two years, there have been no such projects, according to the Council.



Few, if any, major State government programs have the authority to authorize tax reductions or approve direct expenditures without spending limits.

The Council essentially operates without a cap because, in almost all cases, it approves awards for projects that the theoretical cost-benefit model predicts will create a “net positive” return on investment for the State. These projects are all assumed, of course, to have passed the “but-for” test and would not have occurred in whole or part except for the Council subsidy.

We also noted that while the Council does consider the nine guidelines during the application process, there are a number of prominent examples where goals set out in guidelines were not achieved.

For example, at least one large project received significant incentives for a major development requiring new infrastructure outside an existing downtown and counter to Vermont’s historic settlement pattern (guidelines 5 and 8):

“(5) The enterprise should protect or improve Vermont’s natural, historical, and cultural resources, and enhance Vermont’s historic settlement patterns.”

“(8) It is desirable for the enterprise to use existing infrastructure or to locate in an existing downtown redevelopment project.”

Also, the majority of tax credit authorizations have been awarded to areas of the State with the lowest level of unemployment and the highest level of economic activity (see chart, page 60), the opposite of the goal in Guideline 1:

“(1) ... Preference should be given to projects that enhance economic activity in areas of the state with the highest levels of unemployment and the lowest levels of economic activity.”

The guidelines are not binding on the Council, so businesses may receive credits even if they do not meet all of the goals of the guidelines. However, the goals of the nine guidelines could be reinforced in the context of an award cap where the Council would award credits to those businesses that provide the most economic benefit and most clearly adhere to the guidelines. The statute, in fact, envisioned a certain amount of competition for awards:

“In reviewing the application of a business or municipality ... the council shall apply a cost-benefit model to determine the return on investment to the state, *relative to other applicants*, and to assist in establishing appropriate award levels for individual applicants.” (Emphasis added.)

The lack of a program cap, coupled with the lack of performance review by the Department of Taxes, is a serious weakness in the state’s system of internal controls and represents a significant adverse risk to the State as well as hindering its ability to accurately project state revenues.

As more and more state governments offer ever-increasing tax incentives and other subsidies to lure businesses to their states, it may be that reduced state corporate tax revenues as a result of these subsidies are now a “fact of life.” If so, this fiscal reality should be understood as a real cost that must be paid for by raising other taxes or reducing State expenditures to compensate for this revenue loss.

The presence of cost-benefit output from a theoretical model that relies on a questionable “but-for” test cannot guarantee fiscal benefits to the State. Although the State’s Joint Fiscal Committee approved the initial cost-benefit model, it continues to be maintained and operated by the agency whose award expenditure authorization it controls. This represents an additional fiscal risk.

Only an overall program cap on awards expended can definitively control potential financial risks to the State.

## RECOMMENDATION 5

The Legislature should, as part of its evaluation of economic and budget factors, annually authorize a Council award cap on all tax credit awards.

Alternatively, if the General Assembly finds that reducing corporate income taxes is an optimal strategy for boosting Vermont job creation and economic investment, it could consider the reduction, restructuring, or even the complete elimination of corporate income taxes which would benefit all Vermont businesses. Significant study would be required, however, before embarking on this course to ensure that all impacts are assessed, and that any revenue replacement mechanisms are fair and equitable.

### The Council Giveth, The Council Rescindeth

The Vermont Economic Progress Council voted to rescind 10 tax credit awards totalling \$4,586,634 at its August 21, 2002 meeting. Prior to this decision, the Council had voted to rescind only five tax credits in its four-year history.

The \$4,586,634 in rescinded tax incentives, available over five years, were authorized based on business activity that must occur prior to the credits being claimed through the Department of Taxes. In some cases, the recipients told the Council that the projects represented in their applications would not go forward. In other cases, the recipients did not comply with state law or conditions represented in the applications.

The Council's rescissions were as follows:

American Flatbread, Inc., Waitsfield: \$67,367; project not going forward.  
American Paper Mills of Vermont, Inc., Gilman: \$1,730,483; plant closed.  
Blodgett Corporation, Inc., Burlington: \$1,069,093; project not going forward.  
Saint Gobain Performance Plastics (CHEMFAB), Inc., Bennington: \$239,021; plant closed.  
Knight Industries, Inc., Rutland: \$238,852; company stated will not utilize credits.  
MacDermid, Inc., Springfield: \$121,000; did not file Activity Report.  
North East Precision, St. Johnsbury: \$324,345; company will not utilize credits.  
Sheftex USA, St. Johnsbury: \$275,336; plant closed.  
Vermont Fastener Sales Corp., St. Albans: \$157,009; did not file Activity Report.  
Vermont Fasteners Manufacturing, St. Albans: \$364,128; did not file Activity Report.

These awards were made from 1999 to 2002.

## FINDING 6

**Current economic conditions could create substantial future revenue exposure to the State if companies are “incented” for normal cyclical recovery from the recession in future years.**

## DISCUSSION

Business cycles are a regular feature of the U.S. and Vermont economy. A sluggish economy in recent years has taken its toll on Vermont firms, especially those in the manufacturing sector where most Council tax credits have been awarded. In fact, total manufacturing employment in the State is now at levels last seen in June of 1994.

Some prior Council awardees have postponed, scaled back, or canceled investments, laid off workers and closed plants. Some firms have gone so far as to reject their awards as unusable and these awards have now been formally rescinded by the Council.

As the economy recovers, a normal cyclical upturn will result in significant rehiring of laid off workers.

There is currently nothing in the Council review process that would prevent a firm from reapplying (or applying for the first time), after a couple of declining years, for new credits with a new and lower job base from which to calculate an “expansion.” This could result in a large number of awards that simply “follow the business cycle” and do not represent real net new investment as intended in the enabling legislation.

Adjusting for this cyclical factor in the economy could save millions of dollars in cost to this program.

The Council’s Guideline Number 1 suggests (but does not require) that applicant employment levels should exceed their “average annual employment level in Vermont for the two preceding fiscal years.”<sup>39</sup> This is an inadequate period of time against which to measure peak employment levels.

The average U.S. business cycle is closer to five years in duration than two. According to the National Bureau of Economic Research, which officially dates all U.S. business cycles, the average business cycle duration (from peak to peak or trough to trough) since 1854 is 53 months, or about four and a half years.<sup>40</sup> The average duration of the last nine U.S. business cycles since 1945 is 61 months, or just over five years.

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<sup>39</sup> See §5930a(5)(c)(1).

<sup>40</sup> See National Bureau of Economic Research, <http://www.nber.org/cycles/>, and the U.S. Department of Commerce, *Survey of Current Business*, October 1994, Table C-51.



Thus, in order to protect against “incenting” economic activity that could be a part of the normal business cycle, consideration of maximum employment levels should be over a time period consistent with the U.S. business cycle, or about five years.

## RECOMMENDATION 6

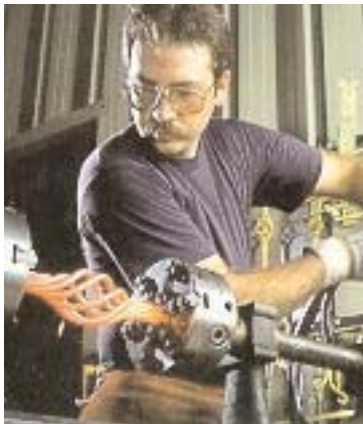
**Normal cyclical recovery should not be “incented activity” by the Council. Rules should be adopted that consider employment history over a time period that is consistent with the duration of the typical business cycle, which is about five years, in determining eligibility and establishing benchmarks for “new job creation.”**

### Tax Incentives Help Company Forge Ahead

**H**ubbardton Forge, a manufacturer of hand-forged lighting products, was the first company to be awarded tax credit incentives in 1998 by the Council. Since then, things have really started to shine for the company.

“We’ve met every expectation set out for us in terms of new employees and economic performance,” says chief financial officer Don Merkle. “We’ve gone from 79 employees in 1998 to 150 now, and we’ve added 37,000 square feet of plant, for a total of 83,000 square feet. We’re almost at our limits again,” he said. “Our sales have more than doubled since the application, going from \$6 to \$14 million.”

For Merkle, the ever-present sense of risk that a company faces when pondering an expansion in uncertain times is tempered by a partnership with the State. “There’s always a risk factor when you think about an expansion, especially these days. There’s a possible war, terrorism, and international competition.



“About 80 percent of lighting today is manufactured in China; when we come up with a new design, in about nine months we’ll see foreign knock-offs of that design on the street. When the State is a participant with you, and if you are able to make the investments and take the risk, that helps mitigate the risk; it’s a good partnership,” he says.

While many local manufacturing companies have had tough times recently, Hubbardton Forge, started in 1974, has been a bright light in the Rutland region. Merkle is proud that his company has been able to boost the workforce by 60 employees.

“We are an open book company; we share all financial information with the employees and have a strong profit-sharing plan. About one-third of our net revenue goes to taxes, one-third to profit-sharing, and one-third is kept to grow the company. We’re paying out \$715,000 in profit-sharing this year,” he notes.



## FINDING 7

**Modifications to the Council cost-benefit model have not been presented to the Joint Fiscal Committee for review and approval, as required by 32 V.S.A. §5930a(d).**

## DISCUSSION

The central roles of the Council cost-benefit model in calibrating award levels, focusing awards on “basic” export-oriented industries, and controlling program expenditures, make it a critical component of the overall program. The model is currently maintained and run for the Council by Economic and Policy Resources, Inc. of Williston, Vermont.

The model is generally well-managed. However, model modifications that have been made in recent years have not been brought to the Joint Fiscal Committee for formal review and approval as specified in 32 V.S.A. §5930a(d):

*Any modification of the cost-benefit model shall be subject to the approval of the joint fiscal committee.*

Most model changes have been associated with data updates, tax law changes and technical corrections. However, more significant model changes have occurred with the REMI (Regional Economic Models, Inc. of Amherst, MA) input-output model that is at the core of the Council cost-benefit model.

Even small changes in the REMI and cost-benefit model can have significant impacts on model output and, consequently, Council award levels and program costs. For this reason, all model changes must be tested with a review of “before” and “after” runs on at least three prior applications to gauge potential impacts. Furthermore, a thorough written review of all model changes and model change test results should be submitted at least annually to the Joint Fiscal Committee for review and approval.

Whereas an annual memo from Economic and Policy Resources, Inc. to the Council summarizing “updates to the VEPC fiscal cost-benefit model” has been generated each year, there is no record of parallel model runs when a new REMI model has been integrated into the Council cost-benefit model. Although we were told that such parallel runs had been made to assess the impact of REMI model changes on the cost-benefit model, no documentation could be found to substantiate this claim, nor were there any electronic or hard copy output files saved showing these test results.

Problems with new REMI model “updates” are not uncommon. These have included software bugs that yield inaccurate results, model specification problems that have required substantial model customization to address, and non-trivial data input errors.

In fact, the annual update to the REMI model, which is normally issued in the spring or summer, did not occur in 2002 until October, and was so riddled with problems that it is still not operative, despite two subsequent releases.<sup>41</sup> These continuing problems may preclude its use in the Council cost-benefit model for an entire year and necessitate the use of the prior year’s REMI model as the core component of the Council cost-benefit model.

At the request of this audit, output from one sample parallel run was generated using the prior year’s REMI model and the new model and provided to the Auditor. This analysis revealed differences in the net present value estimates (which determine Council award levels) of about 8 percent and differences in gross aggregate fiscal benefits of more than 14 percent. These differences may be justifiable; however, they are significant enough to merit clear and comprehensive documentation, further analysis of other award types, and review of such test results by the Joint Fiscal Committee or its staff.

## **RECOMMENDATION 7**

**All changes to the Council cost-benefit model and the core REMI model upon which it is based should be thoroughly tested so as to quantify impacts from these changes on model output and award levels. A written summary of proposed model changes, model updates and related test results should be submitted to the Joint Fiscal Committee for its review and approval.**

**The Council should err on the side of caution in interpreting model “updates” versus “modifications” and submit summaries of all model changes to the Joint Fiscal Committee for their determination as to which model changes merit review under 32 V.S.A. §5930a(d).**

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<sup>41</sup> REMI client letter, December 16, 2002.

## **FINDING 8**

**The Council may be granting larger tax credit awards than necessary.**

### **DISCUSSION**

The Council currently offers award levels based on minimally positive fiscal returns over seven years as calculated by the cost-benefit model. These award levels, however, in some cases, may be greater than necessary to help spur a particular investment.

Currently the Council's staff collects the financial details of the proposed new project, and forwards the information to the cost/benefit model economists. The model is sometimes run on a preliminary basis to determine the maximum amount of credits for which the company can qualify. It was reported to us that occasionally firms submit revised statistics if the first run of the model shows too small an award.<sup>42</sup>

There would be no drawback to asking a company as a part of their award application, in advance of the cost-benefit model run, exactly how large a State subsidy is needed to "incent" a given investment. If the amount requested is below the maximum amount calculated by the cost-benefit model, the activity could be incented at lower cost to the State.

Although there would be no disincentive to exaggerating the need for, and "minimum" size of, a State subsidy, this information would be as reliable as all other applicant attestations, including their "but-for" statement, and could in some cases result in lower State revenue exposure with the same beneficial results.

### **RECOMMENDATION 8**

**The Council could minimize program expense by asking all applicants to specify on the application the award level needed in order to make the investment. If this amount is lower than that later calculated by the cost-benefit model, the Council could reduce State expense and still achieve the same investment result.**

**The Council should improve efforts to obtain firm data on applications to avoid doing multiple cost/benefit model computer runs.**

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<sup>42</sup> Discussions with staff of Economic and Policy Resources, Inc., September 10, 2002.

## FINDING 9

**The reassignment of Council awards to various non-applicant companies and individuals is not specifically allowed in statute and could represent significant additional costs to the State.**

**The potential for cost- and profit-shifting between related entities could result in a higher utilization of awards. It could also present additional, and potentially complex, compliance issues at the Department of Taxes.**

## DISCUSSION

The Council has reassigned approved awards to other related companies, upon applicant request. Reassignment may be justified in straightforward situations such as a corporate name change, sale or acquisition, some business reorganizations, or because of an honest error at the time of application. However, reassignment of tax credits could also be associated with companies created for the sole purpose of capturing unused credits. This may not be appropriate as such reassignments could be counter to the careful consideration initially given each award, and the potential fiscal benefits measured as a part of this process.

One Tax Department expert expressed the opinion that the practice of reassigning awards to newly created entities and various shell companies could open a “Pandora’s Box” of potential tax credit abuse and misuse.<sup>43</sup> Another observed that, when reallocating credits, “the Council should be careful because an after-the-fact allocation allowed the possibility of maximizing the allocation with the benefit of hindsight.” It was further noted that this practice involved a “risk of supporting ‘trafficking’ in credits, allowing credits which would otherwise be lost or saved.”<sup>44</sup>

We communicated our general concerns about the process of reassigning tax credits to new entities when the Council considered a reassignment request in November of 2002. Subsequently, on December 19, 2002, the Council amended its procedures to formally put in place a process to consider requests to amend applications, including reassigning the Certificate of Eligibility to the proper entity.

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<sup>43</sup> Based on discussions with the principle EATI Tax Examiner at the Vermont Department of Taxes during the period from September to December 2002.

<sup>44</sup> Based on discussions with George Phillips, Tax Policy Analyst, Vermont Department of Taxes. Mr. Phillips stated that he believed the situation that precipitated the discussion involved an appropriate matter for credit reassignment by the Council and that the Department disagreed with our recommendation to impose limits on the Council’s authority for reassignment.

The new procedure reads:

- c. An approved applicant may request an amendment to an approved application for issues that do not substantially change the application. Any amendment must not be inconsistent with the original “but-for,” guidelines, and cost-benefit model. The amendment must be requested and justified in writing and be requested within the five-year period that commenced with the approval of the original application.<sup>45</sup>

## **RECOMMENDATION 9**

**The Council should limit future reassignments to straightforward administrative issues such as company name changes, acquisitions or clear cases of application error. Such cases should be carefully documented and thoroughly reviewed by the Council to prevent possible abuse and misuse of reassignments.**

**The Council should seek greater Legislative clarification for any reassignment of credits beyond simple administrative corrections.**

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*“I favor the policy of economy, not because  
I wish to save money, but because  
I wish to save people.”*

**Calvin Coolidge**

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<sup>45</sup> Correspondence from Fred Kenney, Council Executive Director, January 2, 2003.

## FINDING 10

There is currently no follow-up procedure at the Department of Taxes or at the Council for municipal property tax exemptions and stabilization agreements.

Despite the fact that all municipal awards are linked to company awards when granted, they are not linked to company performance, recapture or other follow-up provisions by the State.

The absence of municipal award follow-up procedures and policies creates substantial additional fiscal costs to the State when a company to which a municipal award is linked does not perform as promised.

## DISCUSSION

There have been more than \$12 million in Council awards granted to municipalities between September, 1998 and June, 2002 (see table below) for one of five education property tax incentives available to applicants.

<b><u>MUNICIPAL AWARDS THROUGH JUNE 2002</u></b>					
<b>Award</b>	<b>Town</b>	<b>County</b>	<b>Date</b>	<b>Municipality</b>	<b>Linked Company</b>
\$47,400	Castleton	Rutland	Oct-98	Town of Castleton	Hubbardton Forge
\$2,693,000	So. Burlington	Chittenden	Nov-98	City of South Burlington	IDX
\$6,808,500	Milton	Chittenden	Nov-98	Town of Milton	Husky
\$25,600	Randolph	Orange	Nov-98	Town of Randolph	Clifford of VT/NE Precision
\$120,000	Cavendish	Windsor	Jan-99	Town of Cavendish	Black River Produce
\$77,963	Bennington	Bennington	Feb-99	Town of Bennington	Abacus
\$15,657	Bennington	Bennington	Aug-99	Town of Bennington	Bennington Iron Works
\$301,490	St. Johnsbury	Caledonia	Aug-99	Town of St. Johnsbury	Lydall Westex
\$101,289	Randolph	Orange	Sep-99	Town of Randolph	Vermont Pure
\$43,700	Montpelier	Washington	Apr-00	City of Montpelier	Connor Construction
\$15,158	Newport	Orleans	Apr-00	City of Newport	N. Pediatrics & Adol. Med.
\$14,906	White River Jct.	Windsor	Aug-00	Town of Hartford	Alans Vending
\$91,700	Hartford	Windsor	Sep-00	Town of Hartford	Hanover Capital Mgt.
\$1,551,709	Burlington	Chittenden	Dec-00	City of Burlington	Gilbane
\$19,520	Bennington	Bennington	Apr-01	Town of Bennington	Global Z
\$108,700	Randolph	Orange	May-02	Town of Randolph	Dubois & King
\$142,428	Berlin	Washington	Jun-02	Town of Berlin	Connor Group
<b>TOTAL</b>	<b>\$12,178,720</b>				

The Council's property tax exemptions have been distributed as follows:

Property Tax Stabilization Agreements	14 awards
Reallocation of Education Fund Revenue	3 awards
Tax Increment Financing Districts	2 awards
Construction in Progress Tax Exemption	4 awards
Brownfields Property Tax Exemption	1 award

According to the Council, "there are two general approaches to education property tax abatements: (1) a specific, temporary percentage reduction in the incremental Grand List value for a period of time for up to 10 calendar years; or (2) a specific reduction in the municipal tax rate for a period of up to 10 calendar years."<sup>46</sup>

Every municipal award is linked to a Council application from a private-sector company and is analyzed in tandem with the company's application. The cost-benefit model considers the cost of the municipal awards when calculating net fiscal benefits and calibrates these benefits based on the expected fiscal return from the private sector investments to be made.

If the private-sector firm does not make the promised investments, the municipal award should be adjusted accordingly. However, currently, there is no award follow-up procedure by either the Department of Taxes or the Council with respect to municipal awards. In order for the program to be "performance-based," such follow-up is essential.

This follow-up could originate with either the Council or the Department of Taxes. However, the division handling these awards would not be the corporate income tax section, which handles all other Council award reviews, but the property valuation and review section, which handles all State property tax payments from municipalities.

Upon discussion of this issue with the Council, the Council's Executive Director suggested the following corrective procedures be implemented:

"Upon review of the annual reports required by §5930a(l)(2), the Council shall determine compliance by the company and municipality with the performance expectations upon which the award was conditioned. In the case of noncompliance, the Council shall review the circumstances and determine if the award should be disallowed under §5930a(m). If so, the Council will notify the company, municipality, and the Department of Taxes. The Department would have to make appropriate adjustments to the municipality's tax liability to the state and in the case of property tax stabilization agreements, construction-in-progress exemptions, and brownfields exemptions, the municipality, in turn, would make adjustments

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<sup>46</sup> "Vermont Economic Progress Council Benefit/Cost Model," p. 52.

to the business' tax liability to the municipality for the statewide property tax share already exercised."<sup>47</sup>

In addition, municipalities should be clearly informed of the performance-based nature of the program when they are granted the award. They should understand the procedures for adjustment if the linked company does not perform as promised. There should also be an annual schedule for claiming municipal awards that is consistent with annual company claims and performance, and clear communication between the Council and the property valuation and review section at the Department of Taxes regarding these awards.

## **RECOMMENDATION 10**

**Municipal awards should be reviewed and claimed in tandem with the private sector awards with which they are linked. Any performance-based adjustment to a private sector award should also trigger an adjustment to the linked municipal award. The Council should implement needed procedures and coordinate them with the Department of Taxes.**

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<sup>47</sup> Communication, Fred Kenney, Executive Director, Vermont Economic Progress Council, December 9, 2002.



# Purpose, Authority, Scope & Methodology

## Purpose

The Office of the State Auditor has conducted a program audit of the Vermont Economic Advancement Tax Incentives (EATI) program, which has been established by the Vermont Legislature. It is administered by the Vermont Economic Progress Council (Council), an independent Council attached to the Department of Economic Development for administrative support, and by the Vermont Department of Taxes, a department within the Agency of Administration. The purpose of this program audit is:

- To provide reasonable assurance about compliance with relevant laws, rules, and regulations pertaining to the economic advancement tax incentive award activities; and,
- To review the design and implementation of internal control systems that are in place and to determine that established procedures and controls are effective and continue to be appropriate.

## Authority

This program audit was conducted pursuant to the State Auditor's authority contained in 32 V.S.A. §§163 and 167, and also §163(12) which says:

In addition to any other duties prescribed by law, the Auditor of Accounts shall:

(12) Biennially audit the economic advancement tax incentives program established under chapter 151, subchapter 11E of this title to determine compliance with that subchapter and all other applicable statutes and regulations. The auditor's report shall be made available to the general assembly during the fourth quarter of the second year of each biennium.

- Amended 1999, No. 159 (Adj. Sess) §15.

This program audit was performed in accordance with generally accepted government auditing standards.

## Scope & Methodology

The scope of this program audit included a review of compliance issues related to the program as established under chapter 151, subchapter 11E of Title 32, entitled “Economic Advancement Tax Incentives.”

Compliance is a component of a program audit, which is a type of performance audit as defined in Government Auditing Standards by the Comptroller General of the United States. These Standards define a performance audit as “an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.”<sup>48</sup>

Specifically, as outlined in Government Auditing Standards, program audits may, for example:

- a. Assess whether the objectives of a new, or ongoing program are proper, suitable, or relevant;
- b. Determine the extent to which a program achieves a desired level of program results;
- c. Assess the effectiveness of the program and/or of individual program components;
- d. Identify factors inhibiting satisfactory performance;
- e. Determine whether management has considered alternatives for carrying out the program that might yield desired results more effectively or at a lower cost;
- f. Determine whether the program complements, duplicates, overlaps, or conflicts with other related programs;
- g. Identify ways of making programs work better;
- h. Assess compliance with laws and regulations applicable to the program;
- i. Assess the adequacy of the management control system for measuring, reporting and monitoring a program’s effectiveness; and,
- j. Determine whether management has reported measures of program effectiveness that are valid and reliable.

According to Government Auditing Standards, program audits include determining “the extent to which the desired results or benefits established by the legislature are being achieved.” Additionally program audits may, for example, “assess compliance with laws and regulations applicable to the program.”<sup>49</sup>

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<sup>48</sup> Government Auditing Standards, 2.6, United States General Accounting Office, 1994, p. 14.

<sup>49</sup> Government Auditing Standards, 2.9 (h), United States General Accounting Office, 1994, p. 16.

These audits may also identify ways of making programs work better; may determine if reported measures of program effectiveness are valid and reliable; and may evaluate whether the entity being examined is using efficient operating procedures.

We focused primarily on program activities between July 1, 2000 and June 30, 2002, the last two completed fiscal years for state government. However, due to the complexity of the program, we reviewed some issues before and after the above dates.

The methodology included an examination of the policies and procedures of the Department of Taxes for processing and reviewing EATI tax credit claims in returns received before July 1, 2002.

We paid special attention to the question of how the State of Vermont reviews the economic activity a claimant pledged in its application because the fiscal benefits of the program rest on the fact that it is performance-based.

We also reviewed the application and review process employed by the Council in awarding a variety of tax credits, reviewed files, and attended monthly council meetings.

We reviewed the cost-benefit model used by the Council to evaluate the potential net fiscal benefit, or return on investment, to the State for the economic project being considered for a tax incentive.

We examined supporting documents including periodic reports by the Council on the status of the program, lists of computer modeling adjustments, internal correspondence, written policies and procedures, and similar materials.

We conducted interviews with officials at the Department of Taxes, the Council and their subcontractors, and reviewed correspondence between the two organizations.

As required by Government Auditing Standards, we also considered significant findings from the State Auditor's Review of the Vermont Economic Progress Council's Implementation of Act 71 of 1998, issued June 6, 2000.

One section of subchapter 11E - that of long-range planning (§5930j) - was not assessed for compliance issues because it does not pertain to the EATI program. The Legislature added new categories of "high-tech" tax incentives in 2002, but compliance with these provisions was not assessed because the State has just begun to offer these incentives.

# Background

The Economic Advancement Tax Incentives (EATI) legislation was adopted in 1998 as part of the Act 60 technical corrections bill. On March 11, 1998, Governor Howard Dean signed into law H. 577, also known as Act 71, “An Act Relating to Education, Taxation and Education Financing.”<sup>50</sup>

According to the Vermont Department of Economic Development, the business tax incentive program is “a package of income tax and property tax based incentives that are designed to achieve three goals: create quality jobs; close the wage gap between Vermont and the national average; and maintain and enhance Vermont’s quality of life.”<sup>51</sup> Simply put, eligible businesses pledge to stimulate new economic activity in Vermont and the State agrees to reduce the businesses’ taxes either through property tax exemptions or stabilization agreements, or when the activity is accomplished and the appropriate credit is claimed on a state income tax return.

Business entities eligible for the tax incentive program include a sole proprietor, C corporation, partnership, limited liability companies, subchapter S corporation, or trust.

The Vermont Economic Progress Council (the Council), established in 1994 by the Vermont Legislature, focused in its early years on long-term economic planning and development of economic policy. With the passage of Act 71, the Council was charged with implementing the EATI program.

## The Incentives

Today, the Council must, within 45 days<sup>52</sup> of receiving a completed application, approve or deny the following economic incentives in these categories:

- Income Tax Credits;
- Payroll Tax Credit Incentive;
- Research and Development Tax Credit Incentive;
- Workforce Development Tax Credit Incentive;
- Vermont Export Tax Credit Incentive;
- Small Business Investment Tax Credit Incentive;
- High Tech Growth Tax Credit Incentive (new in 2002);
- Property Tax Incentives;

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<sup>50</sup> Economic Advancement Tax Incentives Report, Vermont Economic Progress Council, January 8, 1999.

<sup>51</sup> Vermont Department of Economic Development web site: [www.thinkvermont.com](http://www.thinkvermont.com)

<sup>52</sup> 32 V.S.A. §5930a(b).

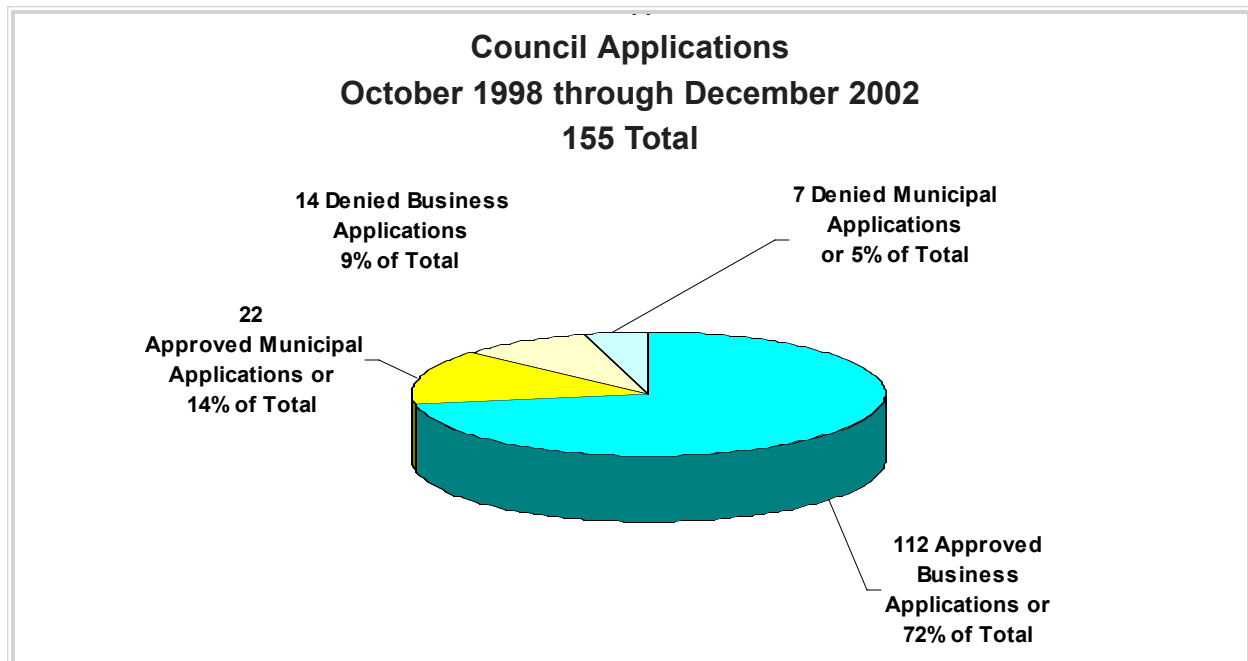
Stabilization Agreements;  
Allocation of Education Fund Revenue;  
Tax Increment Financing Districts;  
Construction in Progress Exemption;  
Brownfields Exemption;  
Sales and Use Tax Exemptions; or,  
Exemption for Purchases of Building Materials.

No application fee is charged.

### The Awards

Beginning in October, 1998, the Council has considered 155 applications through December, 2002 (See chart below).<sup>53</sup> Of those applications, 126 came from businesses, and 29 from municipalities. The governing statute calls for the use of a cost-benefit model to evaluate the fiscal impacts of proposals and requires the consideration of a number of guidelines related to economic, community and environmental values and principles.

The Council has authorized incentives for 134 applicants: 112 from businesses, and 22 from municipalities, (or 86 percent of those whose completed applications reached the Council). Some potential applications are screened out by the Council's staff and the regional development corporations early in the process. The Council has denied authorization for 21 applicants: 14 from businesses, and seven from municipalities.



<sup>53</sup> Statistics on the following three pages are based on the Council staff presentation at the Council Summer Retreat, Kirk Alumni Center, Middlebury College, August 29, 2002, and on the Council monthly update, "Economic Advancement Tax Incentives – Program Activity October 1998 Through December 2002," updated December, 2002.

Twenty-one authorizations are currently considered “inactive” for various reasons. The Legislature revoked authority for the incentive in one case, and nine companies notified the Council that they would not be utilizing incentives for other reasons or submitted a replacement application. The Council reported in August, 2002, that eight companies failed to meet performance expectations which included business closures. Three failed to meet reporting requirements.

The dollar value of the 113 active Council tax credit authorizations issued since the program’s inception is now at \$80,162,048.

Sixty-three percent of the incentives authorized have been to companies with under 100 employees. Seventy-nine percent of businesses have headquarters in Vermont.

The benefits of the program fall into three main categories, according to the Council:

1. New jobs are created;
2. New investments are made; and,
3. Net incremental taxes are paid to the state.

The Council estimates that in the period of October 1998 through December 2006, businesses with active tax credit authorizations could theoretically create 10,157 new jobs (see table below).

<b>Projected New Jobs and Investments by County for VEPC Awarded Tax Incentives through December 2002 and Unemployment Rates By County as of November 2002</b>							
<b>County</b>	<b>Dollar Value of Active Authorizations</b>	<b>Percent of Total</b>	<b>November 2002 Unemployment Rate - 12 Month Average</b>	<b>Projected New Jobs</b>	<b>Percent of Total</b>	<b>Projected New Investments</b>	<b>Percent of Total</b>
Chittenden	\$ 44,803,139	55.89%	3.0%	5,347	52.64%	\$ 851,021,325	49.70%
Bennington	11,442,621	14.27%	4.8%	1,384	13.63%	246,528,815	14.40%
Windsor	5,134,525	6.41%	3.2%	878	8.64%	109,048,123	6.37%
Addison	4,474,665	5.58%	3.5%	438	4.31%	177,098,737	10.34%
Windham	4,283,104	5.34%	2.9%	479	4.72%	75,009,160	4.38%
Caledonia	2,730,791	3.41%	5.4%	232	2.28%	67,729,074	3.96%
Franklin	1,817,222	2.27%	4.3%	143	1.41%	64,627,463	3.77%
Washington	1,543,696	1.93%	4.3%	406	4.00%	45,931,929	2.68%
Orange	1,513,335	1.89%	3.5%	149	1.47%	33,549,727	1.96%
Orleans	966,886	1.21%	7.1%	414	4.08%	17,856,956	1.04%
Rutland	916,596	1.14%	4.4%	139	1.37%	15,043,395	0.88%
Lamoille	535,468	0.66%	5.0%	148	1.45%	8,925,291	0.52%
Grand Isle	0	0.00%	5.5%	0	0.00%	0	0.00%
Essex	0	0.00%	7.7%	0	0.00%	0	0.00%
<b>Total</b>	<b>\$ 80,162,048</b>	<b>100%</b>	<b>3.9%</b>	<b>10,157</b>	<b>100%</b>	<b>\$1,712,369,995</b>	<b>100%</b>

Businesses could also make approximately \$1.7 billion worth of new investments. These projections are based on development plans and timelines outlined in each application, and on theoretical impacts as measured by the cost-benefit model.

Some of the jobs have been created and some of the investments already made, according to activity reports submitted by tax credit award recipients to the Council.

But much remains to be accomplished, and firms could delay, scale back, increase, or abandon their plans.

However, if all the pledged investments and job creation activities take place on schedule, the Council projects, based on cost-benefit model calculations for each project, that the State treasury will see a positive benefit. The Council estimates the total potential net incremental revenue to the State of Vermont in the period beginning January 1, 1998 through December 2007, could reach \$46,480,696 for the General Fund and \$5,695,100 for the Education Fund.

## **The Council**

A Council of nine voting members is appointed by the Governor to administer the program, review applications, and authorize incentives.<sup>54</sup> In addition to nine voting members, the Council includes two regional non-voting members from 12 regions of the state, one designated by the regional planning commission of the region and one designated by the regional development corporation of the region. The regional development corporations in the state help the Council inform Vermont businesses about the EATI program and also help companies with the application process.

As of this report, the Council members are:

Name: Ms. Minty Conant  
Affiliation: Lydall Thermal Acoustical,  
Residence: St. Johnsbury  
Term Ends: 5/15/04

Name: Ms. Valerie Dahl  
Affiliation: Northeast Cooperatives, Brattleboro  
Residence: Guilford  
Term Ends: 5/15/05

Name: Ms. Kimet Hand  
Affiliation: Jewelry Designer  
Residence: Manchester  
Term Ends: 5/15/05

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<sup>54</sup> 32 V.S.A. § 5930a(a).

Name: Mr. Chris Keyser  
Affiliation: Owner Services, Inc.  
Residence: Proctor  
Term Ends: 5/15/04

Name: Ms. Karen Marshall  
Affiliation: Clear Channel Communications  
Residence: Burlington  
Term Ends: 5/15/03

Name: Mr. Lawrence Miller  
Affiliation: None  
Residence: Middlebury  
Term Ends: 5/15/03

Name: Mr. Joseph Pieciak, Jr.  
Affiliation: Pieciak & Associates CPA  
Residence: Brattleboro  
Term Ends: 5/15/03

Name: Mr. William Stritzler, Vice Chair  
Affiliation: Smuggler's Notch Resort  
Residence: Jeffersonville  
Term Ends: 5/15/05

Name: Mr. Glen Wright, Chair  
Affiliation: KPMG Burlington  
Residence: South Hero  
Term Ends: 5/15/04

## **The Cost-benefit Model**

Theoretical cost-benefit fiscal projections are a key part of each application review process. State law requires the Council to apply a cost-benefit model “to determine the return on investment to the state, relative to other applicants, and to assist in establishing appropriate award levels for individual applicants.”<sup>55</sup>

The law states that the model “shall be a uniform and comprehensive methodology for assessing and measuring the projected net fiscal benefit to the state of proposed economic development activities ... and may include consideration of the effect of the passage of time and inflation on the value of multi-year fiscal benefits and costs.”<sup>56</sup>

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<sup>55</sup> 32 V.S.A. § 5930a(d).

<sup>56</sup> Ibid.



The law also says that “any modification of the cost-benefit model shall be subject to the approval of the joint fiscal committee.”<sup>57</sup>

The cost-benefit model is maintained and operated by Economic and Policy Resources, Inc., a consulting firm in Williston, Vermont. The foundation of the cost-benefit model is the REMI Model, produced by Regional Economic Models, Inc., (REMI), of Amherst, Massachusetts.

The REMI model estimates the demographic and economic impact of the applicant’s proposed economic activity that is the subject of the tax credits.

According to Economic and Policy Resources, Inc., “Applicant economic activity is described to the model by indicating the incremental change in variables such as the number of employees, dollars of new payroll paid, and dollar investment in fixed assets including facilities and equipment and machinery. The REMI component of the model interprets these incremental measures and calculates the anticipated change in total economic activity assuming the applicant’s development schedule is followed.

“The REMI model output component then indicates the total increase in population, school-age children, employment, and consumer spending – termed, the ‘incremental difference’ relative to the control forecast. These data are then employed in the fiscal component of the benefit/cost model to arrive at the estimates of financial measures – state revenues and cost of government services – which are used in the fiscal impact component of the overall benefit/cost model.

“In the last step, the present value of each future year is calculated and the difference between revenues and costs in present value terms describes the net fiscal benefit to Vermont of the incremental direct and indirect economic activity. The costs include both the estimated value of the credits granted to the applicant and the estimated Education, General, and Transportation Fund cost impacts associated with the economic and demographic impacts related to the applicant’s project. Costs include State education (per equalized pupil block grant and special education amounts), General and Transportation Fund costs that are estimated on a per person basis. Revenues include personal income, sales and use, meals and rooms, corporate income and miscellaneous fee revenues.”<sup>58</sup> (See *Appendix J, “Inventory of Cost and Benefit Elements of Benefit/Cost Model,”* for an overview of the model’s key cost and benefit factors.)

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<sup>57</sup> 32 V.S.A. §5930a(d).

<sup>58</sup> “Benefit/Cost Model,” Vermont Economic Progress Council, p. 15-16.

Since the EATI program is designed to spur “incremental” job growth and economic activity, the cost/benefit model applies a “background growth” factor to attempt to account for “the underlying level of activity in the industry where there is essentially no influence from these economic development incentives.”<sup>59</sup> The types of general industry activity included are payroll growth, research and development expenditures, workforce development expenditures, and other investment spending. Thus, the applicant’s industry and regional trend level of growth is “subtracted from the estimated incremental project data presented on the application to determine the level of activity which is treated as incremental in the fiscal benefit/cost model.”<sup>60</sup>

### The “But-for” Test

The so-called “but-for” test is critical to the Council decision-making process and the measurement of net fiscal impacts of a project. The Council is required to review each application and to “ascertain, to the best of its judgment, that **but for** the economic incentive to be offered, the proposed economic development would not occur or would occur in a significantly different and significantly less desirable manner.”<sup>61</sup> (Emphasis added.) Applications that do not pass this “but-for” test of the Council are not eligible for economic incentives.

### The Nine Guidelines

The application also requires an applicant to file a narrative describing the project while addressing nine guidelines:

(1) The enterprise should create new, full-time jobs to be filled by individuals who are Vermont residents. The new jobs shall not include jobs or employees transferred from an existing business in the state, or replacements for vacant or terminated positions in the applicant’s business. The new jobs include those that exceed the applicant’s average annual employment level in Vermont during the two preceding fiscal years. The enterprise should provide opportunities that increase income, reduce unemployment, and reduce vacancy rates. Preference should be given to projects that enhance economic activity in areas of the state with the highest levels of unemployment and the lowest levels of economic activity.

(2) The new jobs should make a net positive contribution to employment in the area, and meet or exceed the prevailing compensation level, including wages and benefits, for the particular employment sector. The new jobs should offer opportunities for advancement and professional growth consistent with the employment sector.

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<sup>59</sup> “Benefit/Cost Model,” Vermont Economic Progress Council, p. 22.

<sup>60</sup> Ibid.

<sup>61</sup> 32 V.S.A. §5930a(c).

(3) The enterprise should create positive fiscal impacts on the state, the host municipality, and the region as projected by the cost-benefit model applied by the council.

(4) The enterprise should be welcomed by the host municipality, and should conform to all appropriate town and regional plans and to all permit and approval requirements.

(5) The enterprise should protect or improve Vermont's natural, historical, and cultural resources, and enhance Vermont's historic settlement patterns.

(6) It is desirable for the enterprise to make use of Vermont resources.

(7) It is desirable for the enterprise to strengthen the quality of life in the host municipality, and to foster cooperation within the region.

(8) It is desirable for the enterprise to use existing infrastructure or to locate in an existing downtown redevelopment project.

(9) If the enterprise proposes to expand within a limited local market, then the enterprise should not be given an unfair competitive advantage over other Vermont businesses in the same or similar line of business and in the same limited local market as a result of the economic incentive granted.<sup>62</sup>

### **Claiming Credits**

The Legislature instituted a formal process by which tax credits are claimed, reviewed and allowed with legislation that took effect in July, 2000.

To claim an incentive, state law requires an award recipient to file a report with the Department of Taxes and the Council that includes a description of the economic activity, including the total number of jobs created, the number of new jobs filled by Vermont residents, wage levels for the new jobs, and other information.

The Department of Taxes compares the report to the recipient's performance expectations. The statute says: "Upon determining that an award recipient has met all of the performance expectations, the department of taxes shall allow the tax credit and shall provide the council with a report of the credit amount allowed and the basis for allowing the credit."

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<sup>62</sup> 32 V.S.A. §5930a(c)(1-9).

According to the Department of Taxes, the 113 active tax incentive authorizations approved by the Council have resulted in the following claims activity:

- Returns representing 143 entities that have been authorized credits have been filed in the program, 107 with tax credits applied to reduce current-year tax liability;
- \$8,727,876 in tax reductions have been allowed (October, 1998 through December 9, 2002); and,
- An additional \$15,290,102 in tax credits (for the 1998-2001 tax years) is in “carry-forward status,” which means the credits have been earned by companies but not yet applied to a tax liability.

Of the 107 returns with credits applied to tax liabilities, 29 were for the company’s 1998 tax year; 33 for 1999; 29 for 2000; and, 16 for 2001.

The Council states, however, that according to periodic activity reports by recipients, about \$13 million in credits have been earned,<sup>63</sup> while the Department of Taxes reports a total of approximately \$24 million.

The discrepancy in the totals from the Council and the Department of Taxes most likely stems from the fact that companies are estimating lower amounts of tax credits to be claimed in their periodic reports to the Council because these reports are often made months before tax liability is actually determined by the company. The activity reports can be more informal in nature and sometimes are prepared by non-financial company officials.

## **Reporting**

State law requires the Council to report by February 15 of each year to the Legislature and six different legislative committees the “gross and net value of incentives granted” and data on the awards since the program’s inception. The Council also issues periodic updates to the Legislature and the public.

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<sup>63</sup> “Economic Advancement Tax Incentives Program Annual Report,” Vermont Economic Progress Council, February 15, 2002.

## Operating expenses of the program

The Council is affiliated with the Vermont Department of Economic Development, and funded through the Administrative Division of the Agency of Commerce and Community Development.

### Council Budget<sup>64</sup>

	FY 02 Actual	FY 03 Budget
Operating Expenses	\$16,758	\$14,190
Personal Services*	\$147,226	\$155,530
Total:	\$163,984	\$169,720

\* *Personal services include an executive director, an administrative assistant, and contracted services.*

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<sup>64</sup> Communication from Fred Kenney, Executive Director, Vermont Economic Progress Council, October 7, 2002.



# Appendix A

Department of Taxes' Response to Draft Audit





January 31, 2003

Elizabeth M. Ready, Vermont State Auditor  
Office of the State Auditor  
132 State Street  
Montpelier, VT 05633-5101

Dear Ms. Ready:

Thank you for providing me with an opportunity to respond to your revised draft report on the compliance audit of the Vermont Economic Advancement Incentive Program. The Department has a comment on Finding 1 of the report, which I am enclosing as a separate document. I am also enclosing the audit management letter that you have requested.

As you know, we initially had many more concerns about the report. Because of the patience and energy of your staff in working through and resolving these issues comments on issues other than Finding 1 are unnecessary.

Sincerely,

Richard Mallary  
Commissioner

Response of the Department of Taxes  
to the  
State Auditor's Compliance Audit  
of the  
Vermont Economic Advancement Tax Incentive Program

January 31, 2003

The Tax Department has reviewed and considered the substance of Finding 1. It outlines discussions with the Tax Department over a period of time and the Department's view of its role in the review and allowance of VEPC tax credits.

There is a reasonable difference of opinion with respect to the appropriate role of the Tax Department in allowing or denying credits that were awarded by VEPC prior to July 1, 2000 with the effective date of Act 159 of 2000. The clear legislative intent of Act 71 was to make available certain tax credits for entities that performed specified activities promoting economic development. The applications for these tax credits were received and processed by VEPC which then awarded credits on the basis of the representations and expectations outlined in the applications. The awards, however, provided no guidance to the Tax Department as to the criteria to be considered in determining whether the credits should be allowed either in whole or in part.

On the basis of the wording of the awards letters, it can be argued that the Tax Department could have denied any credit where the applicant did not exactly meet and conform in that year to every representation or expectation made in the application or did not comply in full with every guideline. Such a strict standard would have been devastating for the program and inconsistent with the legislative intent. Due to the nature of the VEPC applications, the Tax Department believes it would have been required to make economic judgments statutorily delegated to VEPC as opposed to performing its usual and appropriate function of verifying specific facts. Additionally, the Department believes there to be no explicit or implicit authority granted to it to exercise its judgment as to the extent of compliance or to adjust or apportion awards based on its review. This is a reasoned and defensible analysis of the law and the legislative history, and is fully consistent with concerns expressed by the Department as to its comfort with auditing some of the non-financial aspects of credit applications. It is also supported by the fact that the Legislature addressed the question in Act 159, by requiring VEPC to notify the company and the Tax Department of specific "performance expectations". This statutory revision provides the Department with a method of objectively reviewing a company's performance in the same manner that we review the calculation of the credits.

It is clear, however, that extended contention with respect to the legal nuances of the manner in which the Tax Department can allow or deny credits is unproductive. The Department shall proceed from this point forward on the basis that the language in the award letters made all awards conditional and that the inherent powers of the Department allow it to reduce or deny credits awarded by VEPC.

To that end, and without having the Tax Department intrude upon or reverse the discretion of VEPC in the granting of credits, the Department will endeavor to apply the procedures established in 32 VSA Sec. 5930a (l) (1) with respect to credits awarded prior to July 1, 2000. The Department will:

1. Request VEPC to provide it with very detailed performance expectations for all credits awarded by VEPC prior to 7/1/2000. These performance expectations, or benchmarks, which would be similar to the performance expectations the Council now specifies for awards authorized after June 2000 pursuant to 32 V.S.A. § 5930a(k), v an be used by the Department to determine whether there is full or partial compliance with the expectations and to determine what portion, if any, of the approved credit should be allowed; and
2. Review future requests for the utilization of credits pursuant to these benchmarks and allow or deny credits on that basis.

Also, the Department requests a clarification in the section of Finding 1 (pages 20 and 21), that discusses the existence of any requirement or authority for the Department to conduct performance reviews for credits authorized before July 1, 2000. The difference of opinion was limited to whether the Department should have been monitoring for conformance with statements made in the applications to VEPC. This is not clear in the discussion. A particular problem is that the discussion is illustrated by examples identifying the statutory requirements for expenditures to be eligible for the research and development credit or the small business investment credit.

There has been no difference of opinion regarding the Department's responsibility for monitoring the existence of such eligible expenditures. The Department is charged with monitoring the returns and correcting credit claims if taxpayers have, for example, misstated the amount of eligible R&D expenditures made. Its procedures for doing this are discussed elsewhere in the report. The difference of opinion is whether the Department was also required to determine whether, in addition to making qualified R&D expenditures for the year, a taxpayer also conformed to statements in its application which might have indicated, for example, an intent to create 75 new jobs, construct a new facility costing \$600,000 using local contractors, and use a local supplier for raw materials.



# Appendix B

Vermont Economic Progress Council's Response to Draft Audit



**RESPONSE TO THE 2002 STATE AUDITOR'S REVIEW OF THE ECONOMIC  
ADVANCEMENT TAX INCENTIVE PROGRAM**

*by*

**THE VERMONT ECONOMIC PROGRESS COUNCIL**

The Vermont Economic Progress Council ("the Council") hereby submits its response to the Revised Draft Report ("the Report") of the State Auditor issued January 13, 2003 concerning the internal control and compliance review of the Economic Advancement Tax Incentive (EATI) program.

**General Statement**

The Council has a fundamental disagreement with the auditor regarding the inclusion of the policy perspectives expressed in Finding and Recommendation 4 and 5 (pages 36- 44). As clearly defined in the authorizing statute and the Auditor's own Statement of Purpose (both on page 55), this audit is performed to determine compliance with statute and assess the design and implementation of internal control systems.

Finding 4 and Finding 5 and the resultant recommendations are entirely based on opinions held by the Auditor regarding the underlying policy contained in the statute rather than compliance with the statute. The Auditor's opinions regarding legislative policy are outside the scope of a compliance and performance audit as defined in 32 VSA Section 163(12) and should not be included.

**Auditor's Comment:** We respectfully disagree. The evaluation of compliance, as required by 32 VSA 163 (12), is a necessary component of a program audit, a type of performance audit that is defined by the Comptroller General of the United States in Government Auditing Standards as:

"an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action."<sup>64</sup>

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<sup>64</sup> Government Accounting Standards, 2.6, United States General Accounting Office, 1994, p. 14.

Specifically, as outlined in Government Auditing Standards, program audits may, for example:

- a. Assess whether the objectives of a new, or ongoing program are proper, suitable, or relevant;
- b. Determine the extent to which a program achieves a desired level of program results;
- c. Assess the effectiveness of the program and/or of individual program components;
- d. Identify factors inhibiting satisfactory performance;
- e. Determine whether management has considered alternatives for carrying out the program that might yield desired results more effectively or at a lower cost;
- f. Determine whether the program complements, duplicates, overlaps, or conflicts with other related programs;
- g. Identify ways of making programs work better;
- h. Assess compliance with laws and regulations applicable to the program;
- i. Assess the adequacy of the management control system for measuring, reporting and monitoring a program's effectiveness; and,
- j. Determine whether management has reported measures of program effectiveness that are valid and reliable.<sup>65</sup>

Our findings and discussions about the “but-for” test and the lack of a financial cap on this program (Findings 4 and 5) provide information, analysis and recommendations that we believe are critical to improving internal controls, performance, and accountability in a program where Vermonters have invested significant resources to promote jobs and economic development. These findings fall squarely within the Comptroller General’s defined parameters of a program audit.

### **Recommendation 1**

#### **Page 28:**

VEPC strongly opposes the second option listed in Recommendation 1 to restrict “awards of future tax credit incentives until a system of accountability is operating” at the tax department. The Council agrees that such a system is required, but the EATI program is one of the few tools available to incent economic growth in Vermont. Taking this action would unnecessarily delay potential future applicants and prevent potential job growth and investment. New authorizations do not impact tax department administration of the program for up to a year after authorization of incentives by VEPC; that is, a newly authorized company does not begin to claim credits until a year after authorization. A year should be sufficient time for the department to have the suggested internal controls in place.

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<sup>65</sup> Government Accounting Standards, 2.9, United States General Accounting Office, 1994, p.16.



## **Finding 2:**

### **Pages 29 - 32**

As stated in this finding, there are two separate employment level reviews in the program. The finding does not make it clear that the reviews are included in the statute for different reasons. The first is a performance review, measuring employment levels as reported on annual Activity Reports against employment levels projected in the application. This review, which was added as part of the statute amendments in 2000, was included to ensure review of a company's performance in relation to annual expectations. The review is done to determine if a company is eligible for credits earned in a particular year.

The second review measures employment levels against a percentage of the previous year's employment level as required by the recapture provision. This review was included to provide a trigger to recapture credits already claimed and applied, deny credits in the year the employment level fell, and deny any future credits, if a company falls below a certain employment level. The impact of the review effects all credits authorized, not just what is being claimed in a given year.

**Auditor's Comment:** Although the Council has clear employment definitions for purposes of application and review, the Council has not communicated with the Department of Taxes to insure that consistent definitions are used throughout the application, review, compliance reporting and recapture processes.

### **Page 29, paragraph 2:**

The statement in this finding that VEPC has not issued guidelines regarding the definition of "employee" is not accurate. First, the statute defines "employee" in guideline #1 (Section 5930a(b)(1)) as new and full-time. Second, as the audit report itself indicates, in Recommendation #2 (page 32), VEPC *has* issued guidelines that clarify the definitions in its adopted Procedures, EATI informational documents, and EATI application documents.

### **Page 31, paragraph 1:**

The statement in this finding regarding the potential requirement for a company to provide data for up to 16 years is not accurate. It is correct that companies have *up to* five years to *earn* the credits for which they were authorized. If a company earns the credit (e.g. increases payroll, makes investments) but cannot apply the credit, or all the credit, against their tax liability in the year it was earned, the statute allows the credit or the remainder of the credit to be carried forward and applied against a future tax liability for up to five years (Title 32, section 5930h (a)). If the earned credit is not applied, or not entirely applied, against tax liability in the year it was earned, the carry forward period starts in the year it is earned and is available for up to five years. For example, if a company earned a payroll credit in 2000, but was not able to apply it against tax liability that year, they can carry the credit forward until 2005 or until it is fully applied against their tax liability. The same is true for a credit earned in 2001 (it can be carried forward until 2006). Therefore, if a company is authorized for incentives based on activity that begins in 2000, the last possible year the company could *earn*

credits is 2004 and the latest possible year in which a carry forward could be applied against a tax liability is in 2009. The only credits that could carry forward until 2009 are those that were earned in 2004. It is important to note that what is being “carried forward” is not the company’s ability to *earn* the credit (that is, make the required investments), but the ability to *apply* the credits against a tax liability.

Since the carry forwards result when a credit has already been earned, that is, the company has already made the investment, the longest a company would have to provide employment and other data is for up to six years from the date of authorization. The company has to provide activity reports only to justify *earning and claiming* a credit, not to have a carry forward *applied* against their tax liability (Title 32, section 5930a (1)(1)(a)).

**Page 31, paragraphs 2 and 3:**

All applicants and companies authorized for tax incentives are notified that annual Activity Reports are required to be filed with VEPC *and the tax department*. After the reporting requirement was added to the statute in 2000, all companies, including those approved before July 2000 were notified of the annual reporting requirement. VEPC worked with the tax department to develop the annual Activity Report format to ensure that the reports contained the data required by both the tax department and VEPC. VEPC utilizes many staff hours and resources to ensure that companies comply with the reporting requirements and VEPC rescinded several incentive authorizations last year, as required by statute, because the companies did not comply with the reporting requirements. These Activity Reports are available to the tax department upon request if they are not receiving copies of Activity Reports from the companies, as required by law.

As mentioned above, Guideline 1 refers to the creation of full-time jobs. Therefore, VEPC has always required data on only full-time employees (defined as working 37 hours/week or more) on EATI applications and annual Activity Reports and has always collected employment data as of the end of each calendar year. The data is requested and collected in a consistent manner on both the application and annual Activity Reports.

For the employment review meant to detect a drop in employment level sufficient to trigger the recapture provision, companies answer a question on their tax return schedules relative to the EATI program if they are claiming a credit. The tax return schedule asks the question as to whether the company’s employment level dropped below 75% during the year for which the credits are being claimed. The schedule does not ask the company’s employment levels and base employment levels, but that data is available on annual Activity Reports, which are required to be filed with the tax department.

VEPC agrees that the recapture statute (5930h (c)) could be improved through further legislative amendments and VEPC intends to seek language clarifying the recapture statute during the next legislative session.

**Auditor’s Comment:** The recapture provision in 5930(h) relies upon employment information from the applicant for up to six years after an award is “utilized.” Depending upon how the term “utilized” is interpreted (as equivalent to “claimed,”

“applied” or “applied and carried forward”) the period of time required for recapture reporting could be anywhere from 6 to 16 years. The main point here is that the term “utilized” should be statutorily or administratively defined to eliminate this confusion and that under any current definition of the term, no employment reporting is currently occurring after an award has been applied. For purposes of 5930(h), it is essential.

**Recommendation 2:**

The Council believes the definition of “employee” that has been included in its Procedures, utilized in the application process, and required in annual Activity Reports is consistent with statute and provides the data needed for purposes of performance review.

The Council agrees that the “recapture” statute could be improved and will work with the tax department to propose amended “recapture” language during this legislative session.

**Finding 3:**

**Page 33, paragraph 3:**

As the program matures and credit claims are made, issues requiring additional procedures have been publicly considered and adopted by VEPC. For example, in December 2001, the Council adopted a procedure for reviewing applications from companies that are already authorized for credits but have a new project or a change to the authorized project. In December 2002, the Council formally amended this procedure to handle requests for the reassignment of credits to another entity.

The Council does not feel that a policy statement is required regarding rescissions. The requirement to disallow the incentives is contained in statute (Title 32, section 5930a (m)). Applicants are notified of the requirements contained in statute during the application and approval process. If the Council is considering rescinding an incentive authorization, the authorized company is notified of the impending action by the Council and invited to respond. Then the Council takes action on the rescission in public session.

**Auditor’s Comment:** In the final report, the discussion regarding the reassignment of tax credits is found in Finding 9.

**Pages 33 – 34:**

Staff checks consistency of information and data and the Council frequently asks questions of applicants in a manner that verifies application information. The requirement to verify data at the time of application is appropriate for programs that provide benefits up front, such as loan or grant programs. The tax incentive program is set up so that VEPC authorizes incentives based on data provided, but the credits can only be claimed after investments have actually been made and performance is verified by the tax department. Like most programs where the benefit is gained by taking a reduction in tax liability, the verification process for the EATI program takes place at the time the benefit is actually claimed. That is, when the tax department reviews the claim and verifies information and data, which is subject to audit.

Additionally, application signatories are held accountable for the contents of their original application through certification backed by the force of law. Through Title 32, section 5930a (m)(2), the incentives can be disallowed if “the applicant knowingly fails to supply any information required ...or knowingly files false or misleading information.” Applicants are signing the certification and declaring the veracity of the information in the application subject to the penalties of perjury.

### **Recommendation 3**

VEPC accepts the accuracy of the starting data and information provided by applicants subject to certification by the applicant, as provided by statute and subject to the penalties of law. Of course, every effort is taken to check all application information and data for accuracy and consistency as part of the application review.

The Council believes that relying on certification of application data and information at the time of application and verifying the baseline data at the time credits are first claimed not only complies with statute, but is also proper, appropriate and efficient. First, Title 32, section 5930a (m)(2) allows that the incentives can be disallowed if “the applicant knowingly fails to supply any information required...or knowingly files false or misleading information.” Second, requiring further verifying information to be submitted by the applicant or taking additional steps to check the veracity of the baseline data, *in addition to asking the applicant to certify the information subject to penalties of perjury*, is counter to the cultivation of customer service that is necessary to improve Vermont’s business climate. Finally, and most importantly, verifying baseline information and data at the time of application and then *again* at the time credits are first claimed is an unnecessary demand on limited resources. When the tax department verifies the data provided to claim credits for the first time, it will have to verify the baseline data that the credit claim is based upon. This is the most efficient time to verify both sets of data and is the proper time to verify the baseline data since it is the point at which the benefit is actually being allowed.

### **Finding 4**

#### **Pages 36 - 38:**

The Council disagrees with the contention that the “but for” cannot be verified and with the absolute manner with which the issue is treated in this Finding and Recommendation. Administering the “but for” is sometimes difficult, but not impossible. The Council points out that even the Auditor’s finding fluctuates between the absolute statement that the “but for” cannot be verified (page 36, paragraph 1) and the statement that the “but for” is “entirely validated by the subjective judgment of the Council” (page 36, paragraph 6), which is the standard set in statute.

**Auditor’s Comment:** Administering the “but-for” test is not impossible, verifying it is.

## Page 37, paragraph 1

As required by law, the Council takes the ‘but for’ test very seriously and goes to great lengths to verify the veracity of official statements made by company executives during Council interviews with applicants. The judgment is not entirely subjective as suggested by the Finding. The Council utilizes all of the data and information submitted in their deliberation of the ‘but for’. Further, as with application data and information, the ‘but for’ statement is certified by requiring the signature of the applicant, thereby binding the official to that statement by law. The Council is not aware of any other programs that impose a falsification risk beyond self-incrimination for the applicant. Indeed, it is hard to imagine a standard beyond self-incrimination that would be more effective. The risk of perjury is substantial.

The ‘but for’ test is designed to allow the Council to determine whether or not the overall direct activity to be undertaken on the part of the applicant is in fact incremental to the Vermont economy. While it cannot be guaranteed that the Council’s determination in this regard will be infallible, the Council has a track record of diligence on this issue. In addition, it should be pointed out that the existence of the so-called background growth rates in the fiscal cost-benefit model that are applied in each application analysis are designed to help provide a fiscal safeguard against any incorrect determinations in this regard.

**Auditor’s Comment:** A standard beyond self-incrimination is present in any attestation that can be independently verified. The use of quantifiable, verifiable standards are present in many government programs. There are no such verifiable measures associated with the ‘but-for’ test. There is no risk to perjury except self-incrimination.

The so-called ‘background growth rate’ applied in the cost-benefit model provides a 5-10 percent discount in the award calculation, depending upon the industry and time period during which the model is run. It does not offset the fiscal risk from the the ‘but-for’ test, where a false finding would eliminate all net fiscal return on investment to the State.

It should also be noted that the Council typically permits an award recipient to perform within 10 percent of a stated performance expectation level and still receive the full award. This variance could completely negate any potential benefit from the background growth rate discount.

## Page 37, paragraph 2

The Council has worked very hard to implement a very subjective test with almost no guidance in statute. The Council believes it has developed methods through the application and interview process to accurately gauge a company’s compliance with the but for ‘to the best of its judgment,’ as required by law.

The Council, businesses, economic developers and the legislature recognize that many factors are taken into consideration when a company is reviewing expansion or relocation plans. Workforce, transportation and telecommunications infrastructure all are considered. But, ultimately the decision to move forward depends on the company’s financial strength, of which

the potential incentives are a critical factor. Most state tax incentive programs are not constructed like Vermont's. The EATI program is very unique because of the strict cost-benefit modeling, the quality control guidelines, *and* the "but for" test. Eliminating the "but for" would make the Vermont program more like those in other states whose role are minimized in the academic literature cited.

### **Page 37, paragraph 3**

Inclusion in this Finding of statements made by recipients to the press over three years ago is not constructive. The Council took action against any companies that made statements contrary to their original "but for" statement if the statements reported by the press were found to be true and accurate. One company lost their incentive authorization because of it.

**Auditor's Comment:** These citations fell within the audit period of July 2000 to July 2002.

### **Page 37, paragraph 6**

The case mentioned in the finding does *not* illustrate the difficulty in verifying the "but for." The fact that an approved company has closed its Vermont operation has nothing to do with its "but for" statement. The "but for" has to do with the company's intentions at the time of application, not two years later. It does, however, illustrate the ability of VEPC and the tax department to deal with such situations under the program structure. As stated in the finding, VEPC has rescinded this company's incentive authorization and they are the subject of a recapture by the tax department.

### **Page 38, paragraph 1**

Again, the finding is stating absolutes where one cannot exist. The finding states, "no verification is possible." The "but for" is not impossible to verify, it just requires more information to increase confidence in it. The next paragraph states as an absolute that attributing economic benefit to this single factor (the but for) "is not accurate." The attribution of benefit to the "but for" carries the *risk* of not being accurate. This is a risk the State must be willing to take to incent millions of dollars in economic activity since the "but for" was codified in statute in 2000.

### **Recommendation 4:**

The Council believes that this finding and recommendation fall outside the purview of this audit. As stated in statute and in the Purpose Statement of this audit, the audit is conducted to determine compliance with statute and to review the design and implementation of internal controls of the program. This finding and recommendation takes a position on policy contained in statute rather than compliance with the statute.

The "but for" is not relied upon as the basis for asserting a theoretical positive return on investment. A positive or negative return is determined by the cost-benefit model based upon the data provided in each application. The cost-benefit model has been approved by the Joint



Fiscal Committee. The Council believes that the “but for” is difficult to administer, not impossible to administer. It also makes Vermont’s incentive program unique in the country. Eliminating the “but for” would change the program to be more like the reward programs offered in other states for *any* economic activity rather than the incentive program that it provides for Vermont businesses to create *new* economic activity.

**Auditor’s Comment:** We respectfully disagree. The cost-benefit model, as now constructed and run, always assumes a positive “but for” finding. A false “but-for” finding would, by definition, always yield a net negative fiscal benefit to the State. If the Council adheres to the above statement, we would welcome the demonstration of even one instance where in the absence of a positive “but-for” finding the cost-benefit model would yield a net positive return on investment.

### Finding 5

#### **Page 39, paragraphs 1 – 5:**

The assertion that any “net” loss in corporate income tax revenue to the state can be attributed to this program is not substantiated. The language in the discussion section that refers to the decline in corporate tax revenues is at best coincidental, and at worst needlessly pejorative. Causation between the state’s “net” revenue decline (versus simply “gross” credit claims) in the corporate tax receipts and tax credit claims under the EATI program is not shown. Further, the finding discussion speaks only of fiscal costs without mentioning the benefits derived from investments in Vermont that would not have been made “but for” this program. Based on data received through the end of 2001, over \$500 million in investments had been incited and the program has a net positive revenue impact of \$3 million. That is \$3 million in *new* revenues to the state that would not have occurred unless the incentives were offered.

**Auditor’s Comment:** As stated previously, all statements of net fiscal benefit rely on the accuracy of the unverifiable “but for” test. This is not a reliable basis for fiscal cost measurement.

#### **Page 41, paragraph 5**

The Council disagrees that the net fiscal cost of the program is “impossible to know.” The Council provided such an estimate to the Legislature last year based on the data available at the time. The statements implying that net fiscal cost can be driven by the Council’s approval rate or manufacturing sector performance are not accurate. The approval rate of applications has no bearing on the program net fiscal cost. By approving an application, VEPC authorizes a company to claim credits only if and when investments are made. If the credits are then claimed, the economic activity is occurring and the fiscal benefit will accrue to the State. The performance of the program cannot be so directly tied to the overall manufacturing performance as implied by this finding. First, only 70% of program participants are manufacturers. Second, if the manufacturers in the program are claiming credits, they are performing (making investments) and benefiting the State. Their performance could very well be at variance with the overall manufacturing sector performance cited in the finding.

**Page 42, paragraph 4:**

The Council takes exception to the utilization of one example as the basis for this part of Finding 5. To base the Council's compliance with certain guidelines on less than 1% of the applications evaluated by the Council is unfair and distorting. In fact, with respect to Guidelines 5 and 8:

- Half of the authorized projects involve expansions to, or renovation of, existing facilities;
- 10% are reutilizing existing empty facilities;
- 20% do not involve new or renovated facilities at all; and
- Only 20% involve new facilities, all of which were planned for permitted industrial or commercial parks or approved growth areas.

**Page 42, paragraph 4 - Page 43, paragraph 1:**

This portion of Finding 5 is based on the misperception that the tax credit authorizations are, or could be, targeted. The Council does not, and should not, select which applications to consider or direct applicants to certain regions of the state. VEPC markets the program throughout the state and works closely with the regional development corporations to ensure potential investors consider VEPC incentives when deciding whether or not to locate in or expand in Vermont.

The sentence from Guideline 1 included in this finding is but one element for the Council to consider as it determines the overall consistency with this guideline, the other guidelines and the overall eligibility and effectiveness of an application. Further, projects in the regions with high levels of economic activity draw employees from other regions and the companies have linkages (customer, supplier, vendor relationships) with other companies throughout the state. The projects do not impact just the county in which they are located – they create good-paying jobs for Vermonters living in neighboring counties. Finally, preference for the regions referenced by the Guideline is built into the cost-benefit model through adjusted background growth rates and discount rates utilized for applications that are to take place in those regions.

**Page 43, paragraph 5:**

The Council objects to the characterization of the “but for” as questionable. It is subjective, but can be applied. The “but for” is being applied by the Council in accordance to law. Further, the Council strongly objects to the characterization of the cost-benefit model and the Council's reliance on the model as a risk to the State's fiscal condition. The Council did not design and build the model. It was designed and built by a contracted economist and approved by the legislature's Joint Fiscal Committee (JFC). Oversight of the Council's use of the model is continued by the JFC and its appointed economic analysts.

The controls placed on the program by the legislature through the “but for” test, the guidelines, the cost-benefit model, and the caps on net negative projects provide the necessary fiscal protection. These controls are superior to the alternative of “gross” program caps, which would restrict the program and result in the denial of excellent projects once the cap is met.



## **Recommendation 5**

Again, the Council believes that this finding and recommendation fall outside the purview of this audit. As stated in statute and in the Purpose Statement of this audit, the audit is conducted to determine compliance with statute and to review the design and implementation of internal controls of the program. This finding and recommendation takes a position on policy contained in statute rather than compliance with the statute.

The Council opposes the imposition of “gross” program caps. Capping the program would be disastrous for economic development during a time when the state needs every tool for job creation. Imposition of a cap would increase the likelihood of awards having a net revenue cost to the state because all authorizations would be made without a determination of the activity being incremental and the cap would inevitably be fully utilized. Essentially, enacting recommendations 4 and 5 would transform the program to be more like the reward programs offered in other states for *any* economic activity rather than the incentive program that it provides for Vermont businesses to create *new* economic activity. Further, a cap would mean that even excellent projects are randomly denied if they apply after the cap has been met.

VEPC does support the examination of the elimination of the corporate income tax as suggested by this recommendation.

## **Finding 6**

### **Page 45, paragraph 7:**

The Council agrees that the program should not provide incentives that merely support cyclical recovery. However, this finding is inaccurate. Guideline #1 already contemplates this situation by suggesting that employment levels should exceed the applicant’s average annual employment for the two preceding years. The program application requires inclusion of this data. Further, the cost-benefit model utilizes background growth rates based on historic data so that the credits calculated by the model are only applied to growth beyond the normal business cycle. The statute and guidelines also already contemplate this situation for a company already in the program through the recapture provision. Moreover, the fact that VEPC has rescinded some credit authorizations indicates that the program works as intended.

**Auditor’s Comment:** Background growth rates have nothing to do with the cyclical variation at issue here. They measure longer term growth in an industry and simply act as a discount (usually in the range of 5-10 percent) on award levels generated by the cost-benefit model. Per Guideline #1, the Council currently considers employment history for only two years. A normal business cycle is closer to five years and should be the basis for such consideration.

## **Recommendation 6**

The Council disagrees with this recommendation and believes the guidelines and cost-benefit model already include safeguards against issues raised regarding cyclical recovery activity and implementation of the program.

## **Finding 7**

### **Page 47, paragraph 1:**

The Council is not aware of any changes to the cost-benefit model that have not been presented to the Joint Fiscal Committee (JFC) of the Legislature. The only changes made to the model are those that were required by changes made to the program by passage of Act 138 (H.239), which contained the High-Tech Growth incentives. These changes are currently in the process of review by the JFC through their contracted economist.

There have been annual updates made to the model that are required to keep the model data current with periodic revisions by the reporting agencies of government and to include data for years subsequent to the original construction of the cost-benefit model. No changes in calculation or analytical procedures have been made since the JFC's original approval. To make this statement, the council interprets the term "modification" as referred to in statute to mean changes or alterations to the model as originally approved by the JFC. Data updates to the model to keep it current and make it more accurate do not meet this standard. They are updates, not changes.

### **Page 48, paragraph 1:**

The Council is aware of the difficulties of the current REMI model data updates and emphasizes that updates and testing of the REMI portion of the VEPC model is done in conjunction with the other users of the REMI model within State government. VEPC is a secondary user, along with the Joint Fiscal Office, of a primary contract held by the Department of Public Service. The contractor utilizing the REMI economic model to input results into the VEPC fiscal model performs updates and tests of the REMI model in conjunction with these other users.

### **Page 48, paragraph 3:**

The Council has not had the opportunity to review the analysis mentioned and therefore finds it difficult to comment on what was "revealed." There are too many unknowns such as the assumptions made regarding application data, what data was input, which previous model version was utilized, or what year the application data began. Any of these variables could mean that the differences are not only "justifiable", but also positive.

**Auditor's Comment:** This information was shared with the Council at a meeting with the Auditor on January 21, 2003, and was supplied to the Auditor by the Council's subcontractor who manages and runs the cost-benefit model. As explained at this meeting and in the discussion associated with the finding, the exact same model

inputs were tested on the current and preceding cost-benefit model to generate the output presented. As noted in the discussion, these variances are large enough to merit review and further analysis.

### **Recommendation 7**

The Council is not aware of any modifications to the EATI cost/benefit model that have not been presented to the JFC. The only changes were those required by the new high-tech credits. Those changes are in the process of review by the JFC's economist as requested by the JFC. The Council is not aware of any changes that have been made in analysis procedures that would require JFC approval. Testing for consistency with updated data in the cost-benefit model is already routinely undertaken.

If the Auditor is aware of actual modifications that have been made to the model or modifications that have not been tested, they should specify them and VEPC will look into them. If the JFC would like to receive a summary of the annual data updates made to the model, VEPC will provide copies. VEPC does not consider annual model data updates to be modifications to the model, as defined by statute. They are updates, not changes or modifications.

### **Finding 8**

VEPC disputes this finding. As required by law (Title 32, section 5930a (d)), the Council applies the cost-benefit model in a uniform manner, including consideration of the passage of time and inflation on the value of multi-year fiscal benefits and costs. In fact, the credits resulting from each cost-benefit model run are always *less than* what an applicant is expecting because they are calculated to include background growth so the credits are calculated only on incremental investment.

Preliminary runs of the cost-benefit model are run occasionally. They are usually run because a company or economic development practitioners are comparing overall incentive packages and costs between two states. If a preliminary run of the model is provided, only the total credit amounts are conveyed to the applicant. No information is given to the applicant regarding changes that could be made to the data to result in a higher award. The only time the data is discussed and revised is if an inconsistency is found or data is missing.

Requiring the applicant to specify the authorization level expected or needed would weaken, rather than improve, the program. Business assesses a number of criteria when making major investment decisions relative to future growth. The success of business expansion cannot be predicted by making specific calculations of each criterion as suggested by the State Auditor. To ask applicants to project "exactly how large a state subsidy is needed to incent a given investment" is impossible to do. It is not a specific "not to exceed amount" for each criteria used by business in its decision process but rather a range of amounts for all criteria looked at in aggregate to reach major business conclusions.

**Auditor's Comment:** It is impossible to calculate the credits based on "incremental investment" only, for any individual company. The so-called "background growth rates" are broad discount factors based on long term growth rates, not company-spe-

cific information. They provide a 5-10 percent discount in the award calculation, depending upon the industry and time period during which the model is run.

As noted previously, the Council typically permits an award recipient to perform within 10 percent of a stated performance expectation level and still receive the full award. This variance could completely negate any potential fiscal benefit from the background growth rate discount.

### **Recommendation 8**

Staff makes every effort to obtain complete data to avoid multiple runs of the cost/benefit model. Preliminary runs of the cost-benefit model are done rarely. Requiring applicants to specify the credit amount needed would weaken the incentive program. Requiring businesses to be specific in a process that is based on multiple financial projections and other uncertain outcomes would be impossible. Since business cannot be specific, most applicants would shy away from such an incentive program in total and favor incentives requiring fewer specifics offered by other states.

### **Finding 9**

VEPC believes it has the statutory authority to reassign credits because the authority to amend an incentive authorization is inherent in its authority to administer the program. There have been instances where the Council has acted on a request to reassign credits to related entities. In all cases, the Council applied the same careful consideration to the requests as they did with the initial application.

There is only a limited chance that these reassignments could result in any additional cost to the state, let alone “a major additional cost to the State”. The reassignments did not alter the costs or the benefits of the project in any way and did not change the amount of credits originally authorized. The reassignments would only result in the potential utilization of the original credits authorized by VEPC for the entity actually making the investment. Therefore, there would only be utilization of the credits originally approved, if the investments are made. There would not be a “higher utilization” as stated in the finding.

None of the reassignments involved acquisitions or the sale of the original applicant company. They were all cases of the credit Certificate of Eligibility being assigned to the incorrect entity. The reassignment changed the Certificate of Eligibility to the entity actually making the investment.

From the perspective of internal controls of the program, VEPC has added safeguards to the application procedure to ensure that applicants understand and clarify which entities will be making which investments so that the credits are assigned correctly at the time of application, if the application is approved.

**Auditor’s Comment:** The final report takes into account and reflects the Council’s observations.

### **Recommendation 9**

VEPC believes its authority to amend incentive authorizations is contained in its authority to administer the program. If an error is made by the applicant or the Council during consideration of an application, the Council must have the ability to consider amendments. Further, the sale and acquisition of companies with incentives already authorized is inevitable. The Council must have the ability to consider requests from the acquiring or acquired company to determine the status of the incentives.

On December 19, 2002, the Council amended its procedures to formally put in place a procedure to consider requests to amend applications, including reassigning the Certificate of Eligibility to the proper entity. The procedure also anticipates consideration of requests to determine the status of incentives awarded to companies involved in an acquisition.

### **Finding and Recommendation 10**

The Council agrees with the finding, except that there *is* currently follow-up with both the company and municipality through the requirement of annual activity reports, as required by statute. VEPC has already begun providing Performance Expectation Documents to both the company and municipality following municipal awards. VEPC will implement procedures, coordinated with the tax department, to make adjustments to the incentives if performance does not occur.



# Appendix C

Audit Team





# Audit Team

**Susan R. Watson, CPA, of Newport, is Director of Statewide Audits for the Office of the State Auditor.** She was Finance Director at GPC International's U.S. Division in Boston, Massachusetts, where she oversaw all the company's financial functions and controls, and led a team responsible for developing consolidated financial reporting software for the company's international network of divisions. As director of statewide audits, she oversees and manages the federal Single Audit as well as the state's annual General Purpose Financial Statement audit, which includes significant testing of the State's internal controls and financial information systems.

**Thomas E. Kavet, of Williamstown, is with Economic and Information Systems Consulting.** He is consulting economist for the Vermont State Legislature, and has an extensive background in regional economics, public policy analysis, economic forecasting, and business economics. Since 1996, as economist to the Legislature, he has provided economic and tax revenue analysis and forecasts, research and analysis on tax issues and other public policies, and expert advice and testimony on a wide range of economic and policy issues. Previous to his establishing a consulting company in Vermont, he worked for 10 years as senior economist, director, general manager, and vice president at DRI/McGraw-Hill, Inc. (now Global Insights), the nation's largest economic consulting and forecasting firm, in New York City and Lexington, Massachusetts, where he initiated, developed and led a wide range of economic research, forecasting and consulting services.

**Mitchell L. Pearl, of Middlebury, is an Attorney with the firm of Langrock Sperry & Wool.** His practice focuses on a broad variety of litigation and commercial matters, land use and real estate issues, and civil rights cases. He is a graduate of Colgate University and New York University School of Law, where he was Managing Editor of the Law Review. He clerked for the Hon. Franklin S. Billings, Jr., Chief Judge, U.S. District Court, District of Vermont before entering private practice. He was awarded the David W. Curtis Civil Liberties Award in 1999 by the Vermont Chapter of the American Civil Liberties Union and is a member of the Vermont Supreme Court's Advisory Committee on Public Access to Court Records.

**Michael J. Clasen, of Montpelier, is the Deputy State Auditor.** He assisted with audit planning, research, review and supervision. He formerly held the position of Chief, Statewide Internal Control and Compliance Audits, for the State Auditor's Office. A graduate of the University of Iowa, Clasen also served in state government as a budget and management analyst with the Vermont Department of Finance and Management as well as a supervisor for policy and program development with the Vermont Department of Aging and Disabilities.

**George Thabault, of Colchester, is the Chief of Special Audits and Reviews for the Office of the State Auditor.** He assisted the team with research, writing, audit planning and coordination. He is a graduate of St. Michael's College and has a background in public policy, municipal operations, research, and journalism.



# Appendix D

Active Authorizations (as of December 2002)



**ALL APPLICATIONS AS OF DECEMBER 19, 2002 - IN CHRONOLOGICAL ORDER**

Entity <sup>1</sup>	Month/Year Authorized	Total Authorized <sup>2</sup>	Years Authorization Expected to be Exercised <sup>3</sup>	Status	Explanation	Location of Project	County
Hubbardton Forge	Oct-98	\$232,000	1998-2002	Active		Castleton	Rutland
Town of Castleton/Hubbarton Forge	Oct-98	\$47,400	1999-2003	Active		Castleton	Rutland
City of South Burlington/IDX	Nov-98	\$2,693,000	1998-2008	Active		So. Burlington	Chittenden
IDX Systems	Nov-98	\$7,271,514	1998-2002	Active		Burlington	Chittenden
Stratton Corporation	Nov-98	\$100,000	N/A	Inactive	Incentive revoked by legislature.	Stratton	Windham
Town of Milton/Husky	Nov-98	\$6,808,500	2000-2009	Active		Milton	Chittenden
Town of Randolph/Quickpull	Nov-98	\$25,600	1999-2004	Active		Randolph	Orange
Business Air, Inc.	Dec-98	\$375,700	1998-2002	Active		Bennington	Bennington
Husky Injection Molding Systems, Inc.	Dec-98	\$10,598,100	August 1998-July 2003	Active		Burlington	Chittenden
Mack Molding Co., Inc.	Dec-98	\$6,418,100	July 1998 - June 2003	Active		Arlington	Bennington
Plastic Technologies of Vermont, Inc.	Dec-98	\$168,700	1998-2001	Active	Carryforward remains.	So. Burlington	Chittenden
Speciality Filaments, Inc.	Dec-98	\$518,200	1998-2002	Active		Middlebury	Addison
Tri-Tech USA, Inc.	Dec-98	\$263,900	1998-2002	Active		So. Burlington	Chittenden
Vermont Furniture Designs	Dec-98	\$119,390	1998-2002	Active		Burlington	Chittenden
Vertek Corporation	Dec-98	\$949,200	1998-2002	Active		Williston	Chittenden
Clifford of Vermont, Inc. / Quickpull	Jan-99	\$259,200	1998-2002	Active		Bethel	Orange
Earth Brothers dba Black River Produce	Jan-99	\$194,100	1998-2002	Active		Proctorsville	Windsor
G.W. Plastics, Inc.	Jan-99	\$627,800	1998-2002	Active		Bethel	Windsor
Kalow Technologies, Inc.	Jan-99	\$187,700	1998-2002	Active		No. Clarendon	Rutland
Leahy Press, Inc.	Jan-99	\$139,400	1998-2002	Active		Montpelier	Washington
MacDermid Equipment Inc	Jan-99	\$121,000	N/A	Inactive	Failed to file activity report. Authorization rescinded 8/21/02.	Springfield	Windsor
New England Precision	Jan-99	\$196,700	1998-2002	Active		Randolph	Orange
Town of Cavendish/Black River Produce	Jan-99	\$120,000	2000-2009	Active		Cavendish	Windsor
Twincraft, Inc.	Jan-99	\$544,300	1998-2002	Active		Winooski	Chittenden
Abacus Automation	Feb-99	\$155,679	1998-2002	Active		Bennington	Bennington
Champlain Chocolate Company	Feb-99	\$65,952	July 1998 - June 2003	Active		Burlington	Chittenden
Concepts ETI, Inc.	Feb-99	\$507,183	1998-2002	Active		White River Jct.	Windsor
Controlled Energy Corporation	Feb-99	\$135,285	1999-2003	Active		Waitsfield	Washington
K-2 Construction dba North Woods Joinery	Feb-99	\$129,928	July 1998 - June 2003	Active		Cambridge	Lamolle
Oak Knoll Assisted Living, L.P.	Feb-99	\$355,406	N/A	Inactive	Facility closed.	Manchester Ctr	Bennington
Town of Bennington/Abacus Automation	Feb-99	\$77,963	1999-2003	Active		Bennington	Bennington
Town of White River Junction/Juvenile Furniture	Feb-99	\$186,389	1998-2002	Denied			
Vermont Precision Woodworks	Feb-99	\$233,173	1999-2003	Active		Morrisville	Lamolle
WICOR Americas - EHV-Weidmann	Feb-99	\$233,173	1999-2003	Active		St. Johnsbury	Caledonia
CHEMFAB Corporation	Mar-99	\$239,021	N/A	Inactive	Facility closed.	No. Bennington	Bennington
Country Home Products, Inc.	Mar-99	\$629,624	1998-2002	Active	Authorization rescinded 8/21/02.	Vergennes	Addison
IVEK Corporation	Mar-99	\$194,075	July 1998 - June 2003	Active		No. Springfield	Windsor
Precision Valley Communications Corp	Mar-99	\$256,503	1998-2002	Active		Springfield	Windsor
Rhino Foods, Inc.	Mar-99	\$92,067	1998-2002	Active		Burlington	Chittenden
Vermont Fastener Sales Corp.	Mar-99	\$157,009	1998-2002	Inactive	Failed to file activity report. Authorization rescinded 8/21/02.	Swanton	Franklin

**ALL APPLICATIONS AS OF DECEMBER 19, 2002 - IN CHRONOLOGICAL ORDER**

Entity <sup>1</sup>	Month/Year Authorized	Total Authorized <sup>2</sup>	Years Authorization Expected to be Exercised <sup>3</sup>	Status	Explanation	Location of Project	County
Stoweflake	Mar-99			Denied			
Advanced Illumination	Apr-99	\$49,362	1999-2003	Active		Stockbridge	Windsor
Burton Snowboards	Apr-99	\$1,870,742	1999-2003	Active		Burlington	Chittenden
Charles E. Tuttle Co., Inc.	Apr-99	\$208,651	1999-2003	Active		No. Clarendon	Rutland
Competitive Computing	Apr-99	\$576,428	1998-2002	Active		Colchester	Chittenden
H.A. Manosh	Apr-99	\$190,251	1999-2003	Active		Morrisville	Lamoille
King Arthur Flour Company	Apr-99	\$481,500	1998-2002	Active		Norwich	Windsor
Northeast Cooperatives	Apr-99	\$804,135	1999-2003	Active		Brattleboro	Windham
Northern Lights Cable	Apr-99	\$94,118	1998-2002	Active		Bennington	Bennington
PKC Corporation	Apr-99	\$440,938	1999-2003	Active		Burlington	Chittenden
Village of Essex Junction/Stewart Construction	Apr-99	\$16,926	N/A	Inactive	Unable to use incentive. Declined credits.	Essex Junction	Chittenden
Knight Industries	May-99	\$238,852	N/A	Inactive	Authorization rescinded 8/21/02.	No. Clarendon	Rutland
Mylan Technologies	May-99	\$539,229	1999-2003	Active		St. Albans	Franklin
RSD Transportation	May-99	\$124,940	1998-2002	Active		White River Jct.	Windsor
Wild Apple Graphics	May-99	\$74,308	1999-2003	Active		Woodstock	Windsor
Sugarbush	May-99			Denied	Incentive revoked by legislature		
Killington	May-99			Denied	Incentive revoked by legislature		
Mount Snow	May-99			Denied	Incentive revoked by legislature		
Okemo	May-99			Denied	Incentive revoked by legislature		
Town of Arlington/Keelan Co*	May-99			Denied			
Agrimark	Jun-99	\$213,915	1999-2003	Active		Middlebury	Addison
Barry Callebaut	Jun-99	\$180,251	1999-2003	Active		St. Albans	Franklin
C & S Wholesale Grocers, Inc.	Jun-99	\$1,945,642	1999-2003	Active		Brattleboro	Windham
Eveready Battery	Jun-99	\$542,718	1999-2003	Active		St. Albans	Franklin
WCFR Polaris	Jun-99			Denied			
Fab-Tech, Inc.	Jul-99	\$311,558	1999-2003	Active		Colchester	Chittenden
B.F. Goodrich	Aug-99	\$2,006,991	1999-2003	Active		Vergennes	Addison
Bennington Iron Works	Aug-99	\$53,921	1999-2003	Active		Bennington	Bennington
CRMI, Inc.	Aug-99	\$485,810	1999-2003	Active		Newport	Orleans
Lydall Westex	Aug-99	\$119,251	1999-2003	Active		St. Johnsbury	Caledonia
Resolution, Inc.	Aug-99	\$1,325,177	1999-2003	Active		So. Burlington	Chittenden
Town of Bennington/Bennington Iron Works	Aug-99	\$15,657	2000-2004	Active		Bennington	Bennington
Town of St. Johnsbury/Lydall Westex	Aug-99	\$301,490	2000-2009	Active		St. Johnsbury	Caledonia
Bond Auto Parts	Sep-99			Denied			
City of Barre/Bond Auto Parts	Sep-99			Denied			
First Fiber Corp	Sep-99	\$1,604,248	N/A	Inactive	Did not purchase plant.	Gilman	Essex
Madhouse Munchies	Sep-99	\$93,675	N/A	Inactive	Moved out-of-state.	Hartford	Windsor
Medical Associates	Sep-99	\$121,024	1999-2003	Active		St. Albans	Franklin
Town of Randolph/VT Pure*	Sep-99	\$101,289	2000-2006	Active		Randolph	Orange
Vermont Pure	Sep-99	\$99,199	1999-2003	Active		Randolph	Orange
Barry Chouinard	Oct-99	\$107,853	1999-2000	Active	All credits claimed.	Northfield	Washington
Gardner Supply Co.	Oct-99	\$1,268,818	1999-2003	Active		Burlington	Chittenden

**ALL APPLICATIONS AS OF DECEMBER 19, 2002 - IN CHRONOLOGICAL ORDER**

Entity <sup>1</sup>	Month/Year Authorized	Total Authorized <sup>2</sup>	Years Authorized Expected <sup>3</sup> to be Exercised <sup>3</sup>	Status	Explanation	Location of Project	County
Murphy Realty	Oct-99			Denied			
Northern Power Systems	Oct-99	\$623,003	1999-2003	Active		Waitsfield	Washington
Superior Technical Ceramics	Oct-99	\$55,228	N/A	Inactive	Contradicted but for in press. Authorization rescinded 12/21/00.	St Albans	Franklin
Food Science Corp	Nov-99			Denied			
Sam's Department Store	Nov-99			Denied			
American Tissue	Dec-99	\$1,730,483	N/A	Inactive	Facility closed. Credits rescinded 8/21/02.	Gilman	Essex
Autumn Harp	Dec-99	\$336,479	2000-2004	Active		Bristol	Addison
Blodgett Corporation	Dec-99	\$3,066,923	N/A	Inactive	Replaced by April 2001 authorization.	Burlington	Chittenden
Select Design	Dec-99	\$387,496	2000-2004	Active		Burlington	Chittenden
Asten Johnson Filaments	Jan-00	\$362,189	2000-2004	Active		Williston	Chittenden
Cornell Trading, Inc.	Jan-00	\$581,672	2000-2004	Active		Williston	Chittenden
Sheffex U.S.A., Inc.	Jan-00	\$275,336	N/A	Inactive	Facility closed. Authorization rescinded 8/21/02.	St. Johnsbury	Caledonia
Tansitor Electronics, Inc.	Jan-00	\$679,515	2000-2004	Active		Bennington	Bennington
Town of St. Johnsbury/Sheffex	Jan-00			Denied			
U.S. Tsubaki, Inc.	Jan-00	\$146,815	1999-2003	Active		Bennington	Bennington
Vermont Fasteners Manufacturing Corp.	Feb-00	\$364,128	2000-2004	Inactive	Failed to file activity report. Authorization rescinded 8/21/02.	Swanton	Franklin
Tuttle Law Print, Inc.	Mar-00	\$157,071	2000-2004	Active		Rutland	Rutland
City of Montpelier/Connor Construction/Cabot	Apr-00	\$43,700	2001-2006	Active		Montpelier	Washington
City of Newport/NPAM*	Apr-00	\$15,158	2001-2007	Active		Newport	Orleans
Vermont Precision Tools	Apr-00	\$434,000	2000-2004	Active		Swanton	Franklin
National Hanger Company	May-00	\$271,216	2000-2004	Active		No. Bennington	Bennington
Town of Hartford/Madhouse Munchies*	May-00			Denied			
Mass Bay Brewing	Jun-00	\$170,973	2000-2004	Active		Windsor	Windsor
Riser Management Systems	Jun-00	\$1,293,490	2000-2004	Active		Burlington	Chittenden
Northeast Cooperatives	Jul-00	\$311,602	2000-2004	Active		Brattleboro	Windham
Allan's Vending	Aug-00			Denied			
Huber & Suhner	Aug-00	\$2,441,602	2000-2004	Active		Colchester	Chittenden
T. Copeland & Sons	Aug-00	\$372,453	2000-2004	Active		Bradford	Orange
Town of Hartford/Allan's Vending*	Aug-00	\$14,906	2001-2005	Active		White River Jct.	Windsor
Hanover Capital Management	Sep-00	\$1,339,220	2000-2004	Active		Hartford	Windsor
North East Precision	Sep-00	\$324,345	2000-2004	Inactive	Declined credits. Authorization rescinded 8/21/02.	St. Johnsbury	Caledonia
Town of Hartford/ Hanover Capital Manager	Sep-00	\$91,700	2001-2006	Active		Hartford	Windsor
Northern Lights Cable	Oct-00	\$1,820,243	2000-2004	Active		Bennington	Bennington
H. Hirschmann, LTD	Nov-00	\$83,774	2001-2005	Active		Pittsford	Rutland
Preci Manufacturing	Nov-00			Denied			
City of Burlington/ Gilbane*	Dec-00	\$1,461,700	N/A	Inactive	Replaced by April 2001 authorization.	Burlington	Chittenden
Stratford Publishing	Dec-00	\$314,101	2001-2005	Active		Brattleboro	Windham
Town of Stowe/Stowe/Flake*	Jan-01			Denied			
Blodgett Corporation	Apr-01	\$1,069,093	N/A	Inactive	Project cancelled. Authorization rescinded 8/21/02.	Burlington	Chittenden



## ALL APPLICATIONS AS OF DECEMBER 19, 2002 - IN CHRONOLOGICAL ORDER

Entity <sup>1</sup>	Month/Year Authorized	Total Authorized <sup>2</sup>	Years Authorization Expected <sup>3</sup>	Status	Explanation	Location of Project	County
City of Burlington/ Gilbane	Apr-01	\$1,551,709	2002-2011	Active		Burlington	Chittenden
Global Z International	Apr-01	\$50,266	2001-2005	Active		Bennington	Bennington
Integrated Vision	Apr-01	\$973,411	2001-2005	Active		St. Johnsbury	Caledonia
Town of Bennington/ Global Z Intl	Apr-01	\$19,520	2002-2005	Active		Bennington	Bennington
Vermont Slate and Copper	Apr-01	\$28,900	2001-2005	Active		Stowe	Lamoille
American Flatbread	Jun-01	\$67,367	N/A	Inactive	Project canceled. Authorization rescinded 8/21/02	Waitsfield	Washington
Mobile Medical International Corp.	Jun-01	\$1,103,466	2001-2005	Active		St. Johnsbury	Caledonia
New England Precision	Jun-01	\$82,148	2001-2005	Active		Randolph	Orange
Town of Northfield/Paine Consulting*	Jun-01			Denied			
Hancor, Inc.	Nov-01	\$44,354	2002-2006	Active		North Springfield	Windsor
Ascension Technology	Jan-02	\$367,848	2002-2006	Active		Milton	Chittenden
Homebound Mortgage	Jan-02	\$1,860,261	2002-2006	Active		Colchester	Chittenden
Vermont Composites	Mar-02	\$452,320	2002-2006	Active		Bennington	Bennington
GSP Coatings	Mar-02			Denied			
GSP Coatings	Apr-02	\$108,435	2002-2006	Active		Brattleboro	Windham
Town of Berlin/Connor Group*	Apr-02	\$93,300	2003-2012	Inactive	Replaced by 6/27/2002 authorization.	Berlin	Washington
BF Acquisitions	May-02	\$967,427	2002-2006	Inactive	Condition not met. Authorization rescinded 9/26/02	Springfield	Windsor
Dubois & King	May-02	\$268,046	2002-2006	Active		Randolph	Orange
Town of Randolph/Dubois & King*	May-02	\$108,700	2004-2013	Active		Randolph	Orange
Vermont Machine Tool Corp.	May-02	\$1,461,282	N/A	Inactive	Condition not met. Authorization rescinded 8/21/02.	Springfield	Windsor
NASTECH	Jun-02	\$811,588	2002-2006	Active		Bennington	Bennington
Town of Berlin/Connor Group*	Jun-02	\$142,428	2002-2011	Active		Berlin	Washington
Vermont Machine Tool Corp.	Jun-02	\$316,408	2002-2006	Active		Springfield	Windsor
Bourne & Koch	Jul-02	\$118,643	2002-2006	Active		Springfield	Windsor
Mary Meyer	Jul-02	\$73,857	2002-2006	Active		Townshend	Windham
Preci Manufacturing	Jul-02	\$223,080	2002-2006	Active		Springfield	Windsor
Speciality Filaments, Inc.	Jul-02	\$769,456	2002-2006	Active		Middlebury	Addison
Tivoly, Inc.	Aug-02	\$465,918	2002-2006	Active		Derby Line	Orleans
Town of Waterbury/Green Mtn Coffee	Sep-02	\$200,127	2003-2012	Active		Waterbury	Washington
Town of Waitsfield/Northern Power Sys	Sep-02	\$151,900	2003-2012	Active		Waitsfield	Washington
North Hartland LLC	Oct-02			Denied		North Hartland	Windsor
Sonnax/Neil Joseph	Nov-02	\$725,332	2002-2006	Active		Rockingham	Windham
Ellsworth Icecream	Dec-02	\$408,550	2003-2007	Active		North Springfield	Windsor
Hampton Direct	Dec-02	\$365,508	2003-2007	Active		Williston	Chittenden
<b>GRAND TOTAL INCENTIVES AUTHORIZED 10/98 - 12/02</b>		<b>\$94,024,797</b>					
<b>TOTAL ACTIVE INCENTIVES AS OF 12/19/02</b>		<b>\$80,162,048</b>					

(1) Entity name at time of award

(2) Property tax stabilization, Reallocation TIF awards are estimates

\* Property Tax applicant

(3) Unless otherwise noted, period begins January 1 and expires December 31



# Appendix E

Descriptions of Businesses Awarded Tax Incentives



# **Business Descriptions**

October 1998 through December 2002

## **ABACUS AUTOMATION**

Abacus Automation manufactures assembly machines and robotic and test systems for industries worldwide.

## **ADVANCED ILLUMINATION**

Advanced Illumination produces specialized high tech lighting equipment for the machine vision industry.

## **ADVANCED INTERNET RECRUITMENT STRATEGIES**

AIRS, founded in 1997, is the largest provider of internet recruitment training services worldwide. They teach recruiters and human resource professionals to find passive employee candidates on the internet utilizing advanced search techniques.

## **AGRI-MARK**

Agri-Mark is a dairy cooperative owned by dairy farmers whose milk is used to produce a number of dairy products.

## **ASCENSION TECHNOLOGY**

Ascension is an ISO 9001 certified, high-technology manufacturer of precision motion and position tracking equipment.

## **ASTENJOHNSON**

AstenJohnson manufactures and markets technically advanced custom polymer extrusions. Their principle market is internal, but they also pursue other global markets when resources permit.

## **AUTUMN-HARP**

Autumn-Harp is a contract manufacturer of natural skin care products including lip balms, healing salves, body lotions and baby products.

## **BF GOODRICH**

Manufactures equipment and systems for a variety of aircraft including commercial liners, military transports, bombers, fighters and helicopters. They also provide systems for the space shuttle and unmanned space flights.

## **BARRY CALLEBAUT**

Barry Callebaut is a world leader in manufacturing cocoa liquor, cocoa butter, cocoa powder, and processed chocolate products, including industrial chocolate and compounds. The company has three U.S. locations Jersey City and Pennsauken, New Jersey and St. Albans, Vermont.

**BARRY T. CHOUINARD**

Barry T. Chouinard is a garment dying company focused on the activewear market.

**BENNINGTON IRON WORKS**

Bennington Iron Works is a structural steel fabricator serving the northeastern market. They provide steel for schools, medical facilities, office buildings, warehouse and industrial buildings.

**BLACK RIVER PRODUCE**

Black River Produce is a wholesale distributor of produce, seafood and other Vermont products. They distribute product throughout Vermont, Massachusetts and New Hampshire.

**BOURNE & KOCH**

Bourne & Koch is a machine tool company located in Rockford, Illinois. They are considering a facility in Springfield, Vermont to provide support, service, sales, training and research and development for Fellows and Jones and Lamson products.

**BURTON SNOWBOARDS**

Burton Snowboards is a 20-year old Vermont company, which leads the world in the manufacture and marketing of snowboards. The company's corporate headquarters is located in Burlington with additional facilities in South Burlington, Canada and Austria.

**BUSINESS AIR**

Business Air provides aviation services to businesses throughout North America. Located at the Bennington Airport, the company offers charter flights and scheduled service with 20 small aircraft, stationed in Vermont, New York, Tennessee and Ohio. The company is also responsible for managing the Bennington Airport, providing such services as fuels sales, aircraft maintenance, etc.

**C&S WHOLESALE**

C&S Wholesale is the leading distributor of wholesale products and produce on the eastern seaboard. With corporate headquarters located in Vermont, C&S employs approximately 4,000 people company wide in 12 facilities.

**CATALOG RETAIL MARKETING INTERNATIONAL**

CRMI is proposing to develop a customer contact service bureau (call center) in Newport, VT.

**CHAMPLAIN CHOCOLATE**

Champlain Chocolate is an award winning manufacturer of specialty chocolates.

**CHARLES E. TUTTLE**

Charles E. Tuttle is an independent publisher and distributor of books. Started in the 1830's, they currently publish 120 titles per year and support two other Vermont publishers by offering fulfillment services.

### **COMPETITIVE COMPUTING**

Competitive Computing provides networking, software development, and electronic commerce solutions to a wide range of professional organizations.

### **CONCEPTS ETI**

Concepts ETI is an engineering design and development organization for turbomachinery. Their services include engineering design software, turbomachinery design and development, laboratory performance testing, advanced technology development, design audit, educational courses, and publications.

### **CONTROLLED ENERGY CORPORATION**

Controlled Energy Corporation is an importer of water heating and space heating appliances from Europe and South America. They distribute these products through building product retailers nation wide.

### **CORNELL TRADING**

Cornell Trading is a retail/wholesale distributor of women and children's clothing, household linens, furniture and accessories principally imported from India and Hong Kong.

### **COUNTRY HOME PRODUCTS**

Country Home Products is a manufacturer and mail order sales company of outdoor power equipment.

### **DUBOIS & KING**

Dubois & King is a 40-year old multi-discipline professional services firm providing engineering, planning, and environmental services to clients throughout New England and New York.

### **ELLSWORTH ICE CREAM**

Ellsworth Ice Cream is a manufacturer and distributor of frozen ice cream novelties.

### **EHV-WEIDMANN**

EHV-Weidmann, which is a division of WICOR Americas Inc., manufactures and fabricates transformer boards. They serve the electrical high voltage transmission and distribution industry with this very specialized product. The company is located in St. Johnsbury and has a leased facility in Tennessee.

### **EVEREADY BATTERY**

Eveready Battery is the world's largest manufacturer of dry cell batteries and flashlights. Their products, primary batteries, miniature batteries, rechargeable batteries and lighting products, are distributed in more than 160 countries.

**FAB-TECH**

Fab-Tech was established in 1987 as a manufacturer of sheet metal components. Seeing opportunities in the microprocessor industry, the company developed PermaShield Pipe. PSP is a Teflon coated stainless steel corrosive fume exhaust system.

**GARDENER SUPPLY**

Gardener Supply is a direct consumer marketer of innovative gardening solutions and equipment for gardeners throughout the U.S.

**GLOBAL-Z INTERNATIONAL**

Global-Z operates a computer service bureau, providing marketing database management services to international marketing companies such as L.L. Bean, MCI WorldCom, Apple Computer and Orvis.

**GW PLASTICS**

GW Plastics is a custom plastic injection molder and mold maker located in Bethel, VT. The company also has production facilities in Texas and Arizona.

**GSP COATINGS**

GSP Coatings is a new company that will do anodizing - the process of affixing metal coatings and metal surface treatments to metal parts - for GS Precision and other companies in the Brattleboro region.

**H.A. MANOSH**

H.A. Manosh is a wood products manufacturer, and a well drilling and construction company.

**H. HIRSCHMANN**

H. Hirschmann LTD., which began in 1982, is a custom manufacturer of specialty doors and windows. Markets include residential construction, historic restoration projects and institutional construction projects.

**HAMPTON DIRECT**

Hampton Direct imports and distributes consumer non-durable goods to national mail order and direct response companies.

**HANCOR**

Hancor is a manufacturer of high-density polyethylene pipe (HDPE) for a variety of field drainage applications.

**HOMEBOUND MORTGAGE**

Homebound Mortgage is a family-owned residential mortgage company, incorporated in Vermont in 1998. They offer their services directly through an Internet site and through traditional methods such as the newspaper and yellow pages.

## **HUBER + SUHNER**

Huber + Suhner is a Swiss based company which manufactures electrical interconnect products. Product lines include specialty battery cables, high temperature wire, high frequency connectors, cable, and various interconnect solutions, as well as wireless communications components and antenna systems.

## **HUBBARDTON FORGE**

Hubbardton Forge is a manufacturer of hand forged lighting products.

## **HUSKY INJECTION MOLDING**

Husky Injection Molding is one of the worlds leading manufacturers of injection molding systems that produce everything from bottle closures to car bumpers. Products include a range of injection molding machines, part handling robots, molds for PET preforms, and hot runner systems.

## **IDX**

IDX Systems Corporation is a leader in providing complete healthcare information solutions for integrated delivery networks including group practices, MSOs, health plans, and hospitals. To connect systems and sites, IDX offers the IDXtendR@ the Site Series, products and services designed to align physicians and hospitals, streamline patient flow, enhance quality, and reduce costs. IDX serves more than 1,600 sites nationwide.

## **INTEGRATED VISION**

Integrated Vision is a design and engineering firm that will incorporate a start-up business called Radmont which will design, develop, assemble, and market a off-road vehicle for persons with disabilities.

## **IVEK**

IVEK, located in Springfield, is a manufacturer of precision liquid metering and dispensing pumps. These products are used in high-tech manufacturing operations related to pharmaceutical, medical diagnostic and semiconductor industries

## **KALOW TECHNOLOGIES**

Kalow is an engineering company that custom designs and manufactures the hardware and software for electrical, electronic, fluid power and mechanical control systems.

## **KING ARTHUR**

King Arthur has been providing bakers with the highest quality products for over 200 years. Their catalogue includes the very best tools, ingredients and information possible. The Bakers store in Norwich had over 50,000 visitors last year, from all over the United States and several from overseas.

## **LEAHY PRESS**

Leahy Press is a full service printing operation.

**LYDALL WESTEX**

Lydall Westex manufactures thermal and acoustical shielding for the automotive industry.

**MACK MOLDING**

Mack Molding is a custom injection molder specializing in large part, contract manufacturing and electronics assembly. They have the capability to offer painting and decorating of plastic parts and are involved with the design and procurement of custom injection molds. Mack Molding has three operating divisions with facilities located in the Carolinas, Massachusetts, Scotland, and Vermont.

**MARY MEYER**

Mary Meyer Corp. is a stuffed toy importer and wholesaler located in Townshend.

**MASS BAY BREWING**

Mass Bay Brewing began operations in 1986 and is now New England's largest craft brewer of beer.

**MED ASSOCIATES**

MED Associates designs and sells instrumentation and software for research pharmaceutical companies, laboratories, university teaching and research centers.

**MOBILE MEDICAL INTERNATIONAL. INC.**

Mobile Medical develops, manufactures, markets and operates Mobile Surgery Units. The units are expandable tractor-trailer shells that are specially outfitted for various medical uses.

**MYLAN TECHNOLOGIES**

Mylan Technologies is a wholly owned subsidiary of Mylan Laboratories located in Pittsburgh, PA. The company also has a manufacturing and distribution presence in eight other states including Puerto Rico. Their primary business is the development and manufacture of transdermal patches. The transdermal delivery system is a very reliable way of delivering a drug to a patient at the desired dosage level.

**NASTECH**

NASTECH makes steering columns for Ford, Toyota, Nissan, and Honda.

**NATIONAL HANGER COMPANY, INC.**

National Hanger Company located in North Bennington is a manufacturer of plastic garment hangers as well as a distributor of store fixtures and supplies. The company recently established a new division, which offers products specific to the dry cleaning and tailoring industry.

**NEW ENGLAND PRECISION**

New England Precision is a metal stamping business that principally serves the sprinkler, architectural hardware and security hardware industries.



### **NORTH WOODS JOINERY**

North Woods Joinery is a manufacturer of handcrafted post & beam homes, churches, light commercial space, bridges, towers, barns, and outbuildings. The company sells not only to Vermont clients, but also several other states in the mid west and southwest. North Woods is able to provide a complete line of services from developing the architectural drawings, to manufacturing and construction on-site.

### **NORTHEAST COOPERATIVES**

Northeast Cooperatives is a distributor of natural and organic products including produce, refrigerated and frozen foods, groceries, supplements, and health and beauty aids.

### **NORTHERN LIGHTS CABLE**

Northern Lights Cable is a manufacturer of fiber optic cable. In 1997, Prestolite Wire Corp., headquartered in Southfield, Michigan acquired Northern Lights. Prestolite manufactures copper wire products for the automotive, industrial and telecommunications fields.

### **NORTHERN POWER SYSTEMS**

Northern Power Systems specializes in the integration of renewable energy technologies with conventional fossil fuel power systems. The systems utilize solar, wind, battery and diesel energy.

### **PRECI MANUFACTURING**

Preci Manufacturing is a family-owned subcontract machining facility specializing in the production of aerospace and defense related precision parts.

### **PROBLEM KNOWLEDGE COUPLERS**

Established in 1982, PKC builds and licenses medical guidance software products known as problem knowledge couplers. The software takes patient information and couples it with clinical information built into the coupler derived from leading medical treatises and periodicals. The result is an extensive list of potentially relevant options for diagnosis treatment or risk management.

### **PLASTIC TECHNOLOGIES OF VERMONT**

Plastic Technologies of Vermont is a manufacturer of a complete line of High Density Polyethylene and Polyethylene Terephthalate bottles used for packaging milk, juices, and other related food and household products.

### **PRECISION VALLEY COMMUNICATIONS**

Precision Valley is a mapping, engineering and design contractor for the broadband industry. They provide design information technology, which enables video, telephony and Internet services to be provided to their customers.

**QUICK-PULL**

Quik-Pull, Inc. which has been in business since 1979, fabricates wire and cable assemblies otherwise known as bundling.

**RESOLUTION**

Resolution manages order processing, media manufacturing and inventories, whole-sale distribution and consumer fulfillment, revenue accounting and information for video, audio, interactive and printing publishing clients. They integrate e-commerce; video duplication and distribution/fulfillment services into one seamless outsource for their clients.

**RHINO FOODS**

Rhino Foods is a manufacturer and distributor of specialty desserts, ice cream novelties and ice cream add-ins for ice cream manufacturers.

**RISER MANAGEMENT**

Riser Management designs, engineers and manages new building wiring systems, they design rooftop communications and broadcast centers and assist clients with strategic portfolio development and negotiations with telecommunication service providers.

**RSD TRANSPORTATION**

RSD is a transportation and warehouse firm offering services for handling and storing of products on a square foot pallet, weight, piece and hourly basis. The company has a complete inventory control system with real time stock status. They offer pick up and delivery in the local and regional area, and are serviced by New England Central Railroad.

**SELECT DESIGN**

Select Design specializes in innovative marketing services, focusing on building brands and identities through the creation of customized promotional products and apparel.

**SONNAX INDUSTRIES/NEIL JOSEPH LLC**

Sonnax is a designer, manufacturer and distributor of automatic transmission and torque converter components for the automotive aftermarket.

**SPECIALTY FILAMENTS**

Specialty Filaments is a manufacturer and distributor of monofilaments, primarily serving the brush industry. They manufacture toothbrushes, cosmetic brushes, paint-brushes, and structured foam and injection molded brush backs.

**STRATFORD PUBLISHING**

Stratford Publishing is a full service company offering services such as copy editing, design to art rendering, scanning, composition and indexing. The company also provides internet publishing. Web site design and short run printing.

## **T. COPELAND & SONS**

T. Copeland & Sons, located in Bradford, Vermont is a manufacturer of transitional and contemporary hardwood furniture. Their product lines include bedroom furniture consisting of beds, nightstands, dressers and mirrors; two lines of home office furniture and two lines of dining room furniture.

## **TANSITOR**

Tansitor manufactures solid Tantalum capacitors for hearing aids. Their product line also includes Tantalum foil and wet Tantalum capacitors for the defense and aerospace industries.

## **TIVOLY**

Tivoly is a wholly owned subsidiary of Tivoly SA (Albertville, France). Located on the Vermont, Canada border, the company designs, manufactures and sells cutting tools for metalworking industries.

## **TRI-TECH**

Is a specialty machine shop.

## **TUTTLE LAW PRINT**

Tuttle Law Print is a printing and engraving firm specializing in products for professional offices, primarily law offices throughout the U.S.

## **TWINCRAFT**

Located in Winooski, Twincraft, Inc. is a private label bar soap manufacturer.

## **U.S.TSUBAKI**

U.S. Tsubaki is part of a larger manufacturer that produces roller chain and sprockets for large agricultural and construction equipment.

## **VERMONT COMPOSITES**

Vermont Composites is a designer and fabricator of advanced composite structures for markets in medical equipment (mainly x-ray tables), aerospace, aircraft, military communications, recreational, electronics, and the automotive industry.

## **VERMONT FURNITURE DESIGN**

Vermont Furniture Design is a manufacturer of high quality cherry furniture. They supply some of the top national and regional furniture chains in the U.S. and export some product to Europe.

## **VERMONT MACHINE TOOL**

Vermont Machine Tool is a machine tool builder, specializing in the remanufacturing of grinders, gear cutters, and turning machines, along with engineering design to customize or redesign equipment.

**VERMONT PRECISION TOOLS, INC.**

Vermont Precision Tool, located in Swanton, is a manufacturer of high-speed knockout pins, ejector pins, perforators and special punches and blanks for the automotive, aircraft and medical industries.

**VERMONT PRECISION WOODWORKS**

Vermont Precision Woodworks is a manufacturer of bedroom furnishings and specialty wood parts for pianos.

**VERMONT PURE**

Vermont Pure is a natural spring water bottling company.

**VERMONT SLATE AND COPPER SERVICES, INC.**

Vermont Slate and Copper Services, Inc. manufactures, sells and distributes a roofing product called a "snow guard" under the trade name Alpine SnowGuards.

**VERTEK**

Vertek specializes in the development and implementation of practical information technology strategies designed to improve business performance. Services offered include assessment of needs, process engineering and the development and testing of solutions.

**WILD APPLE GRAPHICS**

Wild Apple Graphics publishes and licenses artwork on a domestic and international basis.

# Appendix F

Statutes Authorizing Tax Credit Incentive Program (current)



# Revised Statute (as of 2002)

## **Title 32: Taxation and Finance**

### **Chapter 151: Income Taxes**

#### **§ 5930A. VERMONT ECONOMIC PROGRESS COUNCIL**

(a) There is created a Vermont economic progress council which shall be attached to the department of economic development for administrative support, including an executive director who shall be appointed by the council, knowledgeable in subject areas of the council's jurisdiction, and hold the status of an exempt state employee, and a staff assistant who shall be an employee in the state classified service, whose positions shall both come from currently vacant state employee positions and not add any new positions to the state. The council shall consist of nine citizens of the state appointed by the governor. The governor shall appoint citizens to the council who are knowledgeable and experienced in the subjects of community development and planning, education funding requirements, economic development, state fiscal affairs, property taxation, or entrepreneurial ventures, and shall make appointments to the council insofar as possible as to provide representation to the various geographical areas of the state and municipalities of various sizes. Members of the council shall serve initial staggered terms with three members serving three-year terms, three members serving two-year terms, and three members serving one-year terms. All council members' terms shall be three-year terms upon the expiration of their initial terms and council members may be reappointed to serve successive terms. The governor shall select a chair from among the council's members. In addition to the nine members appointed by the governor, there shall also be two regional members from each region of the state; one shall be designated by the regional development corporation of the region and one shall be designated by the regional planning commission of the region. Regional members shall be nonvoting members and shall serve during consideration by the council of applications from their respective regions. For attendance at meetings and for other official duties all members, including regional members, shall be entitled to compensation for services and reimbursement of expenses as provided in section 1010 of this title.

(b) The Vermont economic progress council, within 45 days of receipt of a complete application, shall approve or deny the following economic incentives:

(1) tax stabilization agreements and exemptions under subdivision 5404a (a)(2) of this title;

(2) the economic advancement tax incentives set forth in this subchapter;

(3) sales and use tax exemptions provided in section 9741 of this title that require the approval of the Vermont economic progress council;

(4) property tax exemptions that require the approval of the Vermont economic progress council under subdivision 5404a(c)(1) of this title; and

(5) applications for allocation to municipalities of a portion of education grand list value and municipal liability from new economic development under subsections 5404a(e) and (f) of this title.

(c) The council shall first review each application under subsection (b) of this section and ascertain, to the best of its judgment, that but for the economic incentive to be offered, the proposed economic development would not occur or would occur in a significantly different and significantly less desirable manner. Applications that do not meet the “but for” test are not eligible for economic incentives, and shall not be considered further by the council. If the “but for” test is answered in the affirmative, then prior to approving any application for an economic incentive under subsection (b) of this section, the council shall evaluate the overall consistency of each application with the following guidelines:

(1) The enterprise should create new, full-time jobs to be filled by individuals who are Vermont residents. The new jobs shall not include jobs or employees transferred from an existing business in the state, or replacements for vacant or terminated positions in the applicant’s business. The new jobs include those that exceed the applicant’s average annual employment level in Vermont during the two preceding fiscal years. The enterprise should provide opportunities that increase income, reduce unemployment, and reduce vacancy rates. Preference should be given to projects that enhance economic activity in areas of the state with the highest levels of unemployment and the lowest levels of economic activity.

(2) The new jobs should make a net positive contribution to employment in the area, and meet or exceed the prevailing compensation level, including wages and benefits, for the particular employment sector. The new jobs should offer opportunities for advancement and professional growth consistent with the employment sector.

(3) The enterprise should create positive fiscal impacts on the state, the host municipality, and the region as projected by the cost-benefit model applied by the council under subsection (d) of this section.

(4) The enterprise should be welcomed by the host municipality, and should conform to all appropriate town and regional plans and to all permit and approval requirements.

(5) The enterprise should protect or improve Vermont’s natural, historical, and cultural resources, and enhance Vermont’s historic settlement patterns.

(6) It is desirable for the enterprise to make use of Vermont resources.

(7) It is desirable for the enterprise to strengthen the quality of life in the host municipality, and to foster cooperation within the region.



(8) It is desirable for the enterprise to use existing infrastructure or to locate in an existing downtown redevelopment project.

(9) If the enterprise proposes to expand within a limited local market, then the enterprise should not be given an unfair competitive advantage over other Vermont businesses in the same or similar line of business and in the same limited local market as a result of the economic incentive granted.

(d) In reviewing the application of a business or municipality under subdivision (c)(3) of this section to determine whether the applicant is eligible for the economic incentives under subsection (b) of this section, the council shall apply a cost-benefit model to determine the return on investment to the state, relative to other applicants, and to assist in establishing appropriate award levels for individual applicants. The cost-benefit model shall be a uniform and comprehensive methodology for assessing and measuring the projected net fiscal benefit to the state of proposed economic development activities. Any modification of the cost-benefit model shall be subject to the approval of the joint fiscal committee. The council shall perform cost-benefit analysis in consultation with the commissioner of economic development. The cost-benefit analysis may include consideration of the effect of the passage of time and inflation on the value of multi-year fiscal benefits and costs.

(1) In determining the projected net fiscal benefit or cost of the incentives considered under subdivisions (b)(1), (4), and (5) of this section, the council shall calculate the net present value of the enhanced or forgone statewide education tax revenues, reflecting both direct and indirect economic activity. If the council approves an incentive pursuant to this section, the fiscal costs, if any, to the state shall be counted as if all those costs occurred in the year in which the council first approved the incentive and that cost shall reduce the amount of the annual authorization for such approvals established by the legislature for the applicable fiscal year.

(2) In determining the projected net fiscal benefit or cost of the incentives considered under subdivisions (b)(2) and (3) of this section, the council shall calculate the net present value of the enhanced or forgone state tax revenues attributable to the incentives, reflecting both direct and indirect economic activity. If the council approves an incentive, the fiscal costs, if any, to the state shall be counted as if all of those costs occurred in the year in which the council first approved the incentive and that cost shall reduce the amount of the council's annual authorization for approval of economic incentives as established by the legislature for the applicable fiscal year.

(e) A business or municipality may apply to the economic progress council to receive the economic incentives available under subsection (b) of this section, except that only a municipality may apply for approval of a tax stabilization agreement as allowed under 32 V.S.A. § 5404a(a)(2) and (e) and for education fund revenue sharing under 32 V.S.A. § 5404a(a)(2).

(f) The economic progress council shall have the authority to adopt rules under chapter 25 of Title 3 to provide streamlined and efficient procedures for processing and deciding applications.

(g) Decisions of the economic progress council shall be administrative decisions that are not subject to the contested case hearing requirements of chapter 25 of Title 3. The council's decisions shall be final and not subject to judicial review.

(h) Information and materials submitted by a business concerning its income taxes and other confidential financial information shall not be subject to public disclosure under the state's public records law in Title 1, chapter 5, but shall be available to the joint fiscal office or its agent upon authorization of the joint fiscal committee or a standing committee of the general assembly, and shall also be available to the auditor of accounts in connection with the performance of duties under section 163 of this title; provided, however, that the joint fiscal office or its agent, and the auditor of accounts, shall not disclose, directly or indirectly, to any person any proprietary business information or any information which would identify a business except in accordance with a judicial order or as otherwise specifically provided by law. Nothing in this subsection shall be construed to prohibit the publication of statistical information, rulings, determinations, reports, opinions, policies, or other information so long as the data is disclosed in a form that cannot identify or be associated with a particular business.

(i) The governor shall recommend to the general assembly, and the general assembly shall thereafter establish by law,

(1) an annual authorization for the total net fiscal cost of incentives the council may approve in the authorized year under subdivisions (b)(1), (4), and (5) of this section for projects that are net negative under the cost-benefit model;

(2) an annual authorization for the total net fiscal cost of incentives the council may approve in the authorized year under subdivisions (b)(2) and (3) of this section for projects that are net negative under the cost-benefit model.

(j) By February 15 of each year, the council, in consultation with the commissioner of economic development, shall report to the house committee on ways and means, the house committee on commerce, the senate committee on finance, the house and senate committees on appropriations, and the joint fiscal committee of the general assembly on the gross and net value of incentives granted pursuant to subdivisions (b)(1),(4) and (5) of this section and pursuant to subdivisions (b)(2) and (3) of this section during the preceding year. The report shall include an account of each incentive granted under subsection (b) of this section, from inception of the program to the date of the report, including the date and amount of the award, the expected calendar year or years in which the award will be exercised, whether the award is currently available, the date the award will expire, and the amount and date of all incentives exercised. The council's report shall also describe the extent to which the tax credits allowed by the department of taxes in the previous calendar year supported econom-

ic activity that complied with the performance expectations in the written notification of approval under subsection (k) of this section. The report shall also address the council's conformance with subsection (i) of this section.

The council may use measures to protect confidential financial information, such as reporting information in an aggregate form or masking the identity of the tax award recipient.

(k) The council shall provide written notification to the applicant of its approval of economic incentives under subsection (b) of this section. The written notification shall include both an assessment of the probability that the economic development activity would not occur or would occur in a significantly different and significantly less desirable manner but for the approval of incentives under this section, and an assessment of the application's consistency with the guidelines set forth in subsection (c) of this section. The written notification shall also specify performance expectations on which continuing approval shall be conditioned. The council shall forward a copy of the written notification, including its assessment and the performance expectations, with the certificate of eligibility that it provides to the department of taxes.

(l)(1)(A) To claim an incentive under subdivisions (b)(2) and (3) of this section, an award recipient shall file a report with the department of taxes and with the council within 60 days of the close of the applicant's fiscal year in which the economic activity occurred. The report shall respond directly to the performance expectations in the written notification of approval issued under subsection (k) of this section, and shall include a description of the economic activity, including the total number of jobs created, the number of new jobs filled by Vermont residents, the wages for the new jobs, investments made according to the categories of incentives awarded, the nature and extent to which the economic activity was consistent with the guidelines in subsection (c) of this section, and any other information required by the council or the department of taxes to assess the performance of the award recipient.

(B) The department of taxes shall compare the award recipient's report with the performance expectations in the written notification of approval. Upon determining that an award recipient has met all of the performance expectations, the department of taxes shall allow the tax credit and shall provide the council with a report of the credit amount allowed and the basis for allowing the credit. If the department of taxes is unable to determine compliance with the performance expectations, the department shall request that the council conduct a more detailed review. At the conclusion of its review, the council shall submit a written report to the commissioner of taxes, recommending that the credit be approved, in full or in part, or disallowed. Upon receiving the recommendation, the commissioner of taxes shall decide whether the credit shall be approved, in full or in part, or disallowed.

(C) In assessing the performance of an award recipient, the department of taxes shall have the authority to obtain from the council all records and information necessary to determine whether the award recipient has complied with the performance expectations in the written notice of approval.

(D) In any one year, an economic incentive awarded under subdivision (b)(2) of this section shall not be applied to reduce the award recipient's income tax liability by more than 80 percent of its income tax liability in that year.

(E) Nothing in this subsection shall preclude the department of taxes from adjusting the tax liability of any award recipient whose credit was incorrectly calculated.

(2) By December 31 of each year following the approval of an economic incentive, until the December 31 following the taxable year in which the approved incentive expires, an award recipient that has obtained the council's approval under subdivisions (b)(1), (4), or (5) of this section shall file a report with the council, stating the amount of any incentives used during the preceding taxable year, and detailing compliance with all performance expectations upon which the award was conditioned.

(m) The value of any economic incentives taken by an applicant that has obtained the council's approval under this section shall be refunded to the state, and any economic incentives remaining to be exercised shall be disallowed in the event that:

(1) the applicant fails to comply with all performance expectations upon which the award was conditioned;

(2) the applicant knowingly fails to supply any information required under this section or knowingly files false or misleading information; or

(3) the applicant fails to file the report required in subsection (l) of this section.

(Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998; amended 1999, No. 159 (Adj. Sess.), § 4, eff. May 29, 2000; No. 159 (Adj. Sess.), §§ 5-12.)

### **§ 5930B. ECONOMIC ADVANCEMENT TAX INCENTIVES**

A business may request approval of not more than three of the five economic incentives provided in sections 5930c, 5930d, 5930e, 5930f and 5930g of this subchapter. A high-tech business may, in the alternative, request approval of not more than three of the five economic incentives as provided in section 5930k of this subchapter. Approval of the Vermont economic progress council pursuant to this subchapter may be for up to five years. (Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998.)

### **§ 5930C. ECONOMIC ADVANCEMENT PAYROLL TAX CREDIT**

A person, upon obtaining the approval of the Vermont economic progress council pursuant to section 5930a of this title, may receive a credit against income tax liability imposed under this chapter equal to a percentage of its increased payroll costs, defined as salaries and wages, within the state of Vermont in the tax year for which the credit is claimed above its costs of salaries and wages from the preceding tax year according to the following schedule:

(1) A person reporting less than \$10 million in annual sales in the tax year that the credit is claimed may receive a credit against its income tax liability equal to ten percent of its increased costs of salaries and wages costs in the applicable tax year.

(2) A person that reports annual sales of \$10 million or more, but less than \$20 million, in the tax year that the credit is claimed may receive a credit against its income tax liability of six to nine percent of its increased costs of salaries and wages in the applicable tax year based on the following proportional, graduated scale:

(A) a nine percent tax credit for reported sales of \$10 million through \$12,500,000.00;

(B) an eight percent tax credit for reported sales of more than \$12,500,000.00 through \$15 million;

(C) a seven percent tax credit for reported sales of more than \$15 million through \$17,500,000.00; and

(D) a six percent tax credit for reported sales of more than \$17,500,000.00 through \$20 million.

(3) A person reporting more than \$20 million in annual sales in the tax year that the credit is claimed may receive a credit against its income tax equal to five percent of its increased costs of salaries and wages in the applicable tax year.

(4) For a person in its first year of operation, its costs of salaries and wages in the preceding tax year shall be deemed to have been zero. (Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998.)

#### **§ 5930D. ECONOMIC ADVANCEMENT RESEARCH AND DEVELOPMENT TAX CREDIT**

(a) A person, upon obtaining the approval of the Vermont economic progress council pursuant to section 5930a of this title, may receive a credit against its income tax liability imposed by this chapter in the amount of ten percent of qualified research and development expenditures undertaken within the state of Vermont in the tax year for which the credit is claimed.

(b) "Qualified research and development expenditures" shall have the same meaning as provided for the term "qualified research expenses" included in the Internal Revenue Code at 26 U.S.C. § 41(b). (Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998.)

## **§ 5930E. WORKFORCE DEVELOPMENT INCENTIVE TAX CREDIT**

(a) A person, upon obtaining the approval of the Vermont economic progress council pursuant to section 5930a of this title, may receive a credit against its income tax imposed by this chapter in the amount of ten percent of its qualified training, education and workforce development expenditures within the state of Vermont in the tax year that such expenditures were made.

(b) Qualified training, education and workforce development expenditures under this section shall mean:

(1) expenditures eligible for financial assistance under the Vermont training programs administered by the department of economic development;

(2) expenditures defined in subdivision 127(c)(1) of Title 26 of the United States Code concerning the employee educational assistance initiative; or

(3) expenditures for employer-provided child care and transportation subsidies that allow for training and educational activities for welfare-to-work participants.

(c) A person that has obtained the approval of the Vermont economic progress council, may receive a credit against its income tax imposed by this chapter in the amount of twenty percent of its qualified training, education and workforce development expenditures for the benefit of welfare-to-work participants in the tax year for which the credit is claimed. (Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998.)

## **§ 5930F. VERMONT EXPORT TAX INCENTIVE**

A person doing business in Vermont and one or more other states, upon obtaining the approval of the Vermont economic progress council pursuant to section 5930a of this title, may receive a credit against its income taxes imposed by this chapter.

(1) For a C corporation, the credit is in an amount equal to the difference between a calculation of its income tax under the formula for apportionment provided in section 5833 of this title and a calculation of its income tax under the formula for apportionment provided in section 5833, except that such calculation shall be determined (i) without regard to that portion of subdivision 5833(a)(3) which provides that sales of property shipped from this state are sales of tangible personal property made in this state; and (ii) by doubling the sales factor in subdivision 5833(a)(3).

(2) For persons other than C corporations, the credit is equal to the difference between the amount computed by applying the corporate income tax rates provided in section 5832 of this chapter to the income attributable to Vermont determined using the two apportionment methods set out in subdivision (1) of this section as if the income attributable to Vermont were taxed at the entity level. (Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998; amended 1999, No. 49, § 72, eff. June 2, 1999.)



## § 5930G. SMALL BUSINESS INVESTMENT TAX CREDIT

A person, upon obtaining the approval of the Vermont economic progress council under section 5930a of this title, may receive a credit against its income taxes imposed by this chapter in an amount equal to five to ten percent of its total investments within the state of Vermont in plants or facilities and machinery and equipment in the applicable tax year, but only if those investments exceed \$150,000.00, according to the following:

(1) A person employing fewer than 150 full-time employees that has obtained the approval of the Vermont economic progress council may receive an income tax credit equal to ten percent of its investments in plants or facilities and machinery and equipment in the applicable tax year.

(2) A person employing between 150 and 250 full-time employees that has obtained the approval of the Vermont economic progress council may receive an income tax credit of six to nine percent of its investments in plants or facilities and machinery and equipment in the applicable tax year based on the following proportional sliding scale:

(A) a nine percent tax credit for 150-174 full-time employees;

(B) a eight percent tax credit for 175-199 full-time employees;

(C) a seven percent tax credit for 200-224 full-time employees: and

(D) a six percent tax credit for 225-250 full-time employees.

(3) A person employing more than 250 full-time employees that has obtained the approval of the Vermont economic progress council may receive an income tax credit equal to five percent of its investments in plants or facilities and machinery and equipment in the applicable tax year.

(4) A person is not required to acquire an ownership interest with its investment to be eligible to receive an income tax credit under this section, provided the Vermont Economic Progress Council has approved a long-term capital lease as an investment eligible to receive an income tax credit, and the person's investment has been made in the form of a long-term capital lease that meets the lease accounting criteria established by Financial Accounting Standard No. 13 as promulgated by the Financial Accounting Standards Board. The person's investment shall be the present value, at the time the lease is executed, of the minimum lease payments over the period of the lease, excluding executory costs, as outlined in the Financial Accounting Standard No. 13. Any credit based upon a long-term capital lease shall be disallowed or, if used, then repaid, if the taxpayer terminates the lease prior to the end of the lease term originally approved by the Vermont Economic Progress Council. (Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998; amended 1999, No. 159 (Adj. Sess.), § 13, eff. May 29, 2000.)

## **§ 5930H. CARRY-FORWARD, CARRY-BACK AND RECAPTURE**

(a) A five-year carry-forward is allowed for each economic incentive under this subchapter. The carry-forward period shall run for no more than five years after the last year of the term approved by the council for the receipt of incentives.

(b) Carry-backs are not allowed for the economic incentives under this subchapter.

(c) In the event a person that has obtained the approval of the Vermont economic progress council under section 5930a of this title ceases to employ in Vermont, for a period of 120 consecutive days, at least 75 percent of the number of employees it employed in Vermont as of the year in which a credit was utilized under this subchapter, then for any such year and all succeeding years, any unused credit shall be disallowed. Furthermore, there shall be imposed upon each such employer a recapture penalty equal to a percentage of the total credit used, computed in accordance with the following table:

Years between close of tax year when credit became available and year when business became ineligible	Percent of credit recaptured
Two or less	100%
More than 2, up to 4	50%
More than 4, up to 6	25%

The recapture shall be reported on the taxpayer's income tax return for the tax year in which the 120 consecutive-day threshold occurred. (Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998; amended 1999, No. 159 (Adj. Sess.), § 14.)

## **§ 5930I. CREDIT ALLOCATION**

Credit as calculated in this subchapter to a person who is a partnership, limited liability company, subchapter S corporation, or trust, shall be available to a partner, member, shareholder, or beneficiary required to pay Vermont income tax in the same proportion as the income of the person is distributed to the shareholder, partner, member or beneficiary. (Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998.)

## **§ 5930J. VERMONT ECONOMIC PROGRESS COUNCIL; LONG-TERM ECONOMIC DEVELOPMENT PLANNING**

(a) The general assembly finds that long-term economic development planning is needed to build a diverse and sustainable economy, and to increase the well-being of Vermonters and their communities, without compromising the quality of our environment. This section is intended to enable Vermont to create and continually revise a long-term economic planning process. The general assembly further finds that the views of people from the public and the private sector, including Vermonters from business, education and government, are essential in order to develop a process for



long-range economic planning and job creation. The Vermont economic progress council will be a forum for government and the private sector to work together in the public interest to create economic development plans for a diverse, sustainable economy for Vermont.

(b) The economic progress council shall advise the governor and the general assembly on long-term economic development planning.

(1) In fulfilling its economic development planning responsibilities, the council may:

(A) solicit the assistance of individuals and groups with interests or expertise in the particular subject before the council;

(B) request the assistance and cooperation of any state or local agency or governmental unit in collecting economic development information and conducting economic development planning. Such state and local agencies and governmental units shall provide reasonable assistance to, and cooperate with the council in the discharge of its responsibilities. The council shall consult and cooperate with the telecommunications technology council of Vermont, and any other council or committee established by law or executive action relating to economic development;

(C) appoint one or more task forces, composed of individuals from the public and private sectors, to assist the council in its economic development planning;

(D) perform such other activities as are necessary to carry out the purposes of this chapter;

(E) subject to the provisions of section 5 of this title, accept grants, gifts, donations or other things of value from a donor which is a qualified nonprofit organization under Section 501(c)(3) of the federal Internal Revenue Code for sums up to \$200,000.00 to assist in defraying the costs of fulfilling the purposes of this chapter;

(F) execute contracts or provide grants, regarding professional or administrative services, to fulfill the purposes of this chapter;

(G) establish and administer a special fund, as provided under subchapter 5 of chapter 7 of this title, to be known as the Vermont economic progress council study fund for the purposes of fulfilling subdivisions (E) and (F) of this subdivision (1). Revenues to the fund shall be those funds collected pursuant to subdivision (E) of this subdivision (1); and

(H) before January 15 of each year, report to the general assembly the names of each donor and the amount donated under subdivision (E) of this subdivision (1), the names of the contractors and grantees and the amounts contracted for or granted under subdivision (F) of this subdivision (1), which list shall include the donations made during the fiscal year to date, as well as all donations made during the previous fiscal year.

(2) The council shall report to the governor and the general assembly on or before December 15 of each year with its recommendations for implementing the state's long-term economic development planning agenda. Such recommendations shall contain goals, anticipated budgets, evaluation mechanisms, and proposals for legislation where necessary. (Added 1997, No. 147 (Adj. Sess.), § 214.)

### **§ 5930K. HIGH-TECH GROWTH INCENTIVES**

(a) For purposes of this section, "high-tech business" means a business whose activity in Vermont is certified by the commissioner of economic development to be exclusively in design, development and manufacture of:

(1) Computer hardware or software, and information and communication technologies, such as high-level software languages, graphics hardware and software, speech and optical character recognition, high-volume information storage and retrieval, and data compression.

(2) Electronic devices involving microelectronics, semiconductors, electronic equipment and instrumentation; radio frequency, microwave and millimeter electronics; optical and optic-electrical devices; and data and digital communication and imaging devices.

(3) Medical devices, including medical, surgical or dental equipment, and excluding pharmaceutical products.

(4) Energy technology involving sources other than fossil fuels.

(5) Electric vehicles which draw propulsion energy only from an on-board source of electrical energy, alternative fuel vehicles, or hybrid vehicles which draw propulsion energy from both a consumable fuel and a rechargeable energy storage system.

(b) A high-tech business may request approval of not more than three of the following incentives provided in this chapter: sections 5930c (payroll tax), 5930d (research and development), 5930f (export incentive), 5930g (investment tax credit, but limited to investments in plants or facilities), and 5930k(c) (high-tech credit growth incentives).

(c) A high-tech business, upon obtaining the approval of the Vermont Economic Progress Council pursuant to section 5930a of this title, shall be entitled to the following set of tax benefits as one of its three incentives:

(1) Machinery and equipment. A credit of up to \$100,000.00 per year against the income tax liability imposed under this chapter in an amount up to six percent (as determined under the cost-benefit analysis for the applicant) of its total investments within the state of Vermont during the period approved by the Vermont Economic Progress Council, in machinery and equipment, excluding expenditures for renovation of existing facilities to provide cable, fiber or telecommunications access.

(2) Technology infrastructure. A credit against the income tax liability imposed under this chapter in an amount up to six percent (as determined under the cost-benefit analysis for the applicant) of its total investments within the state of Vermont during the period approved by the Vermont Economic Progress Council, in renovation of existing facilities to provide cable, fiber or telecommunications access.

(3) Workforce development. A credit against the income tax liability imposed under this chapter in an amount equal to that allowed under section 5930e of this chapter, except that award of a credit under this subdivision shall not be limited to industrial manufacturing entities.

(4) Sales and use tax exemption for approved personal computers and software under subdivision 9741(47) of this title.

(d) Incentives under this section shall be subject to provisions of this subchapter, including authorization limits, reporting requirements, and application, cost-benefit analysis and approval requirements under section 5930a of this chapter.



# Appendix G

Statutes Authorizing Tax Credit Incentive Program (former)



**Retroactive effective date—1995 amendment.** 1995, No. 46, § 57, provided that section 54 of the act, which added subsec. (f) of this section, was to take effect on April 20, 1995, and apply to credits claimed on tax returns filed on and after July 1, 1993.

*Subchapter 11D. Manufacturer's Investment Tax Credit*

**§ 5930. Manufacturer's investment tax credit**

(a) **Definitions.**

\* \* \*

(3) "Qualified capital expenditures" mean expenditures properly chargeable to capital account by a manufacturer between July 1, 1993 and June 30, 1995, totaling at least \$4 million for plant, equipment and machinery to be located and used in Vermont for creating, producing, or processing tangible personal property for sale, except that in the case of an application for credit under this section filed on or before July 1, 1995 such expenditures shall be properly chargeable to capital account between July 1, 1993 and June 30, 1996.

\* \* \*

(5) "Secretary" means the secretary of commerce and community development.

\* \* \*

(g) **Disclosure of tax return and other information.**

(1) Notwithstanding the provisions of section 3102 of this title, the commissioner shall disclose to the secretary the amounts of credits claimed under this section by a qualified manufacturer on such manufacturer's Vermont income tax returns, and such information shall be available to the public from the secretary.

(2) The secretary also shall make available to the public, for each qualified manufacturer that has been certified for credits under this section, an analysis of the job impact of the credits certified under this section, including information on the number of jobs created or retained, changes in wage and benefit levels of employees, and impact on tax revenues. The analysis shall be conducted and the information disclosed at the time the credits are certified, and at annual intervals thereafter.—Amended 1995, No. 46, §§ 55, 56; 1995, No. 190 (Adj. Sess.), § 1(f).

HISTORY

**Amendments—1995 (Adj. Sess.).** Subdivision (a)(5): Substituted "secretary of commerce and community development" for "secretary of development and community affairs".

—1995, Subdivision (a)(3); Act No. 46, § 55 added "except that in the case of an application for credit under this section filed on or before July 1, 1995 such expenditures shall be properly chargeable to capital account between July 1, 1993 and June 30, 1996" following "sale".  
Subsection (g): Added by Act No. 46, § 56.

**Retroactive effective date—1995 amendment.** 1995, No. 46, § 57, provided that section 56 of the act, which added subsec. (g) of this section, was to take effect on April 20, 1995, and apply to credits claimed on tax returns filed on and after July 1, 1993.

*Subchapter 11E. Economic Advancement Tax Incentives*

HISTORY

**Applicability.** 1997, No. 71 (Adj. Sess.), § 81(a) provides: "Sec. 48 [which enacted this subchapter] (tax credits) shall apply to tax years beginning on or after September 1, 1998."

Section 123(f) of the act provides: "The economic advancement incentives provided in Sec. 48 of this act, establishing subchapter 11E of chapter 151 of Title 32, shall take effect for tax years beginning on and after January 1, 1998, except that those provisions of 32 V.S.A. § 5930a, providing additional functions to the Vermont economic progress council, shall take effect from passage."

**§ 5930a. Vermont economic progress council**

(a) There is created a Vermont economic progress council which shall be attached to the department of economic development for administrative support, including an executive director who shall be appointed by the council, knowledgeable in subject areas of the council's jurisdiction, and hold the status of an exempt state employee, and a staff assistant who shall be an employee in the state classified service, whose positions shall both come from currently vacant state employee positions and not add any new positions to the state. The council shall consist of nine citizens of the state appointed by the governor. The governor shall appoint citizens to the council who are knowledgeable and experienced in the subjects of community development and planning, education funding requirements, economic development, state fiscal affairs, property taxation, or entrepreneurial ventures, and shall make appointments to the council insofar as possible as to provide representation to the various geographical areas of the state and municipalities of various sizes. Members of the council shall serve initial staggered terms with three members serving three-year terms, three members serving two-year terms, and three members serving one-year terms. All council members' terms shall be three-year terms upon the expiration of their initial terms and council members may be reappointed to serve successive terms. The governor shall select a chair from among the council's members. In addition to the nine members appointed by the governor, there shall also be two regional members from each region of the state; one shall be designated by the regional development corporation of

the region and one shall be designated by the regional planning commission of the region. Regional members shall be nonvoting members and shall serve during consideration by the council of applications from their respective regions. For attendance at meetings and for other official duties all members, including regional members, shall be entitled to compensation for services and reimbursement of expenses as provided in section 1010 of this title.

(b) The Vermont economic progress council, within 45 days of receipt of a complete application, shall approve or deny the following economic incentives:

- (1) tax stabilization agreements and exemptions under subdivision 5404a (a)(2) of this title;
- (2) the economic advancement tax incentives set forth in this subchapter;
- (3) sales and use tax exemptions provided in section 9741 of this title that require the approval of the Vermont economic progress council;
- (4) property tax exemptions that require the approval of the Vermont economic progress council under subdivisions 5404a(d)(1) and (2) of this title; and
- (5) applications for allocation to municipalities for a portion of education grant list value and municipal liability from new economic development under section 5404a(e) of this title.

(c) The council shall review each application under subsection (b) of this section by evaluating its overall consistency with the following guidelines:

(1) The degree to which the enterprise creates new full-time jobs that are filled by Vermont residents, not including those jobs or employees transferred from an existing business in the state or replacements for vacated or terminated positions with the applicant business, and provides opportunities that increase income, reduce unemployment, and reduce vacancy rates. New jobs include those which exceed the average annual employment level in Vermont for the applicant business in the preceding two fiscal years;

(2) The degree to which the new jobs pay more than the prevailing regional wage, provide employee benefits, and offer opportunities for advancement and professional growth;

(3) The creation of positive fiscal impacts on the state, the host municipality and region as projected by the cost-benefit model applied by the council under subsection (d) of this section;

(4) The degree to which the enterprise uses Vermont's resources;

(5) The degree to which the enterprise is welcomed by the host municipality, including conformance with appropriate duly adopted town

and regional plans, and conformance with all permit and approval requirements;

(6) The degree to which the enterprise strengthens the quality of life in the host municipality and fosters cooperation within the host municipality's region;

(7) The degree to which the enterprise uses existing infrastructure or is a downtown redevelopment project;

(8) The degree to which the enterprise protects or improves Vermont's natural, historical, and cultural resources, and enhances Vermont's historic settlement patterns.

(d) In reviewing the application of a business or municipality which the council pursuant to subsection (c) of this section has determined to be eligible for the economic incentives under subsection (b) of this section, the council shall apply a cost-benefit model that provides a uniform and comprehensive methodology for assessing and measuring the fiscal benefit to the state and region of the state of proposed economic development activities. The council shall develop the cost-benefit model subject to the approval of the joint fiscal committee and shall perform cost-benefit analysis in consultation with the commissioner of economic development. The cost-benefit model shall measure the present value of the anticipated direct and indirect fiscal benefits that will inure to the state against the anticipated direct and indirect fiscal costs associated with a proposed tax stabilization agreement under subdivision (b)(1) of this section and economic advancement incentive under subdivision (b)(2) of this section. The present value calculation may include consideration of: (i) the passage of time on the multi-year fiscal benefits and costs; (ii) inflation on the value of multi-year fiscal benefits and costs; and (iii) other cost and benefit factors as determined by the council.

(1) In determining the fiscal benefit or cost of the incentives approved under subdivisions (b)(1), (4) and (5) of this section, the council shall calculate the net present value of the enhanced or forgone statewide education tax revenues. If the council approves an incentive pursuant to this section, the fiscal costs, if any, to the state shall be counted as if all those costs occurred in the year in which the council first approved the incentive and that cost shall reduce the amount of the annual authorization for such approvals established by the legislature for the applicable fiscal year.

(2) In determining the fiscal benefit or cost of the incentives approved under subdivision (b)(2) of this section, the council shall calculate the present value of the enhanced or forgone state tax revenues attributable to the approved incentives, reflecting both direct and indirect economic



activity. If the council approves an incentive, the fiscal costs, if any, to the state shall be counted as if all of those costs occurred in the year in which the council first approved the incentive and that cost shall reduce the amount of the council's annual authorization for approval of economic incentives as established by the legislature for the applicable fiscal year.

(e) A business or municipality may apply to the economic progress council to receive the economic incentives available under subsection (b) of this section, except that only a municipality may apply for approval of a tax stabilization agreement as allowed under 32 V.S.A. § 5404a(a)(2) and (e) and for education fund revenue sharing under 32 V.S.A. § 5404a(a)(2).

(f) The economic progress council shall have the authority to adopt rules under chapter 25 of Title 3 to provide streamlined and efficient procedures for processing and deciding applications.

(g) Decisions of the economic progress council shall be administrative decisions that are not subject to the contested case hearing requirements of chapter 25 of Title 3. The council's decisions shall be final and not subject to judicial review.

(h) Information and materials submitted by a business applicant concerning its income taxes and other confidential financial information shall not be subject to public disclosure under the state's public records law in Title 1, chapter 5.

(i) By January 10 of each year the governor shall recommend to the general assembly, and the general assembly shall thereafter establish by law, an annual authorization for a gross maximum amount of value for incentives the council may approve under subdivisions (b)(1), (4) and (5) of this section and an annual authorization for a net amount of value of incentives which the council may approve under subdivisions (b)(2) and (3) of this section. Any unused balance of either of the council's annual authorizations may be carried forward and granted by the board in the following year.

(j) By January 10 of each year, the council, in consultation with the commissioner of economic development, shall report to the joint fiscal committee of the legislature on the gross value of incentives granted pursuant to subdivisions (b)(1), (4) and (5) of this section and the gross and net values of the incentives granted pursuant to subdivisions (b)(2) and (3) of this section during the preceding year and the cumulative impact of the credits issued. The report shall include an evaluation of past credits, and if there is a net loss, the current year's authorization shall be adjusted to account for it accordingly. The report of the council in January 1999 shall also include review of other successful state development programs dedicated to higher value jobs, opportunities to create new economic

activity not addressed by tax credits, and recommendations for economic development tools for fiscal year 2000.—Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998.

#### HISTORY

**Effective date of enactment.** See second paragraph of applicability note under subchapter 11E heading.

**Repeal and merger.** 1997, No. 71 (Adj. Sess.), § 48a provides: "10 V.S.A. § 603a (creating the Vermont Economic Progress Council) is repealed effective from date of passage of this act, and all provisions relating to findings and purposes and powers and duties of the Vermont Economic Progress Council set out at 10 V.S.A. §§ 609 and 606b shall apply to the Vermont Economic Progress Council as created in 32 V.S.A. § 5930a(a) as added by Sec. 48 of this act."

#### § 5930b. Economic advancement tax incentives

A person who operates a business may request approval of not more than three of the five economic incentives provided in this subchapter. Approval of the Vermont economic progress council pursuant to this subchapter may be for up to five years.—Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998.

#### HISTORY

**Effective date of enactment.** See second paragraph of applicability note under subchapter 11E heading.

#### § 5930c. Economic advancement payroll tax credit

(a) A person, upon obtaining the approval of the Vermont economic progress council pursuant to section 5930a of this title, may receive a credit against income tax liability imposed under this chapter equal to a percentage of its increased payroll costs, defined as salaries and wages, within the state of Vermont in the tax year for which the credit is claimed above its costs of salaries and wages from the preceding tax year according to the following schedule:

(1) A person reporting less than \$10 million in annual sales in the tax year that the credit is claimed may receive a credit against its income tax liability equal to ten percent of its increased costs of salaries and wages costs in the applicable tax year.

(2) A person that reports annual sales of \$10 million or more, but less than \$20 million, in the tax year that the credit is claimed may receive a credit against its income tax liability of six to nine percent of its increased costs of salaries and wages in the applicable tax year based on the following proportional, graduated scale:

(A) a nine percent tax credit for reported sales of \$10 million through \$12,500,000.00;

(B) an eight percent tax credit for reported sales of more than \$12,500,000.00 through \$15 million;  
 (C) a seven percent tax credit for reported sales of more than \$15 million through \$17,500,000.00; and  
 (D) a six percent tax credit for reported sales of more than \$17,500,000.00 through \$20 million.

(3) A person reporting more than \$20 million in annual sales in the tax year that the credit is claimed may receive a credit against its income tax equal to five percent of its increased costs of salaries and wages in the applicable tax year.

(4) For a person in its first year of operation, its costs of salaries and wages in the preceding tax year shall be deemed to have been zero.—Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998.

## HISTORY

**Effective date of enactment.** See second paragraph of applicability note under subchapter 11E heading.

## § 5930d. Economic advancement research and development tax credit

(a) A person, upon obtaining the approval of the Vermont economic progress council pursuant to section 5930a of this title, may receive a credit against its income tax liability imposed by this chapter in the amount of ten percent of qualified research and development expenditures undertaken within the state of Vermont in the tax year for which the credit is claimed.

(b) "Qualified research and development expenditures" shall have the same meaning as provided for the term "qualified research expenses" included in the Internal Revenue Code at 26 U.S.C. § 41(b).—Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998.

## HISTORY

**Effective date of enactment.** See second paragraph of applicability note under subchapter 11E heading.

## § 5930e. Workforce development incentive tax credit

(a) A person, upon obtaining the approval of the Vermont economic progress council pursuant to section 5930a of this title, may receive a credit against its income tax imposed by this chapter in the amount of ten percent of its qualified training, education and workforce development expenditures within the state of Vermont in the tax year that such expenditures were made.

(1) Qualified training, education and workforce development expenditures under this section shall mean:

(1) expenditures eligible for financial assistance under the Vermont training programs administered by the department of economic development;

(2) expenditures defined in subdivision 127(c)(1) of Title 26 of the United States Code concerning the employee educational assistance initiative; or

(3) expenditures for employer-provided child care and transportation subsidies that allow for training and educational activities for welfare-to-work participants.

(c) A person that has obtained the approval of the Vermont economic progress council, may receive a credit against its income tax imposed by this chapter in the amount of twenty percent of its qualified training, education and workforce development expenditures for the benefit of welfare-to-work participants in the tax year for which the credit is claimed.—Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998.

## HISTORY

**Effective date of enactment.** See second paragraph of applicability note under subchapter 11E heading.

## § 5930f. Vermont export tax incentive

An entity doing business in Vermont and one or more other states, upon obtaining the approval of the Vermont economic progress council pursuant to section 5930a of this title, may receive a credit against its income taxes imposed by this chapter in an amount equal to the difference between a calculation of its income tax under the formula for apportionment provided in section 5833 of this title and a calculation of its income tax under the formula for apportionment provided in section 5833, except that such calculation shall be determined (i) without regard to that portion of section 5833(a)(3) which provides that sales of property shipped from this state are sales of tangible personal property made in this state; and (ii) by doubling the sales factor in section 5833(a)(3).—Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998; amended 1999, No. 49, § 72, eff. June 2, 1999.

## HISTORY

**Amendments—1999.** Inserted "that portion of" preceding "section 5833(a)(3)" and "which provides that sales of property shipped from this state are sales of tangible personal property made in this state" thereafter.

**Effective date of enactment.** See second paragraph of applicability note under subchapter 11E heading.

## § 5930g. Small business investment tax credit

A person, upon obtaining the approval of the Vermont economic progress council under section 5930a of this title, may receive a credit against its

income taxes imposed by this chapter in an amount equal to five to ten percent of its investments within the state of Vermont in excess of \$150,000.00 in plants or facilities and machinery and equipment in the applicable tax year according to the following:

(1) A person employing fewer than 150 full-time employees that has obtained the approval of the Vermont economic progress council may receive an income tax credit equal to ten percent of its investments in plants or facilities and machinery and equipment in the applicable tax year.

(2) A person employing between 150 and 250 full-time employees that has obtained the approval of the Vermont economic progress council may receive an income tax credit of six to nine percent of its investments in plants or facilities and machinery and equipment in the applicable tax year based on the following proportional sliding scale:

(A) a nine percent tax credit for 150-174 full-time employees;

(B) a eight percent tax credit for 175-199 full-time employees;

(C) a seven percent tax credit for 200-224 full-time employees; and  
(D) a six percent tax credit for 225-250 full-time employees.

(3) A person employing more than 250 full-time employees that has obtained the approval of the Vermont economic progress council may receive an income tax credit equal to five percent of its investments in plants or facilities and machinery and equipment in the applicable tax year.—Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998.

#### HISTORY

**Revision note.** Deleted subsec. (a) designation at the beginning of the section for conformity with general V.S.A. style.

**Effective date of enactment.** See second paragraph of applicability note under subchapter 11E heading.

#### § 5930h. Carry-forward, carry-back and recapture

(a) A five-year carry-forward is allowed for each economic incentive under this subchapter. The carry-forward period shall run for no more than five years after the last year of the term approved by the council for the receipt of incentives.

(b) Carry-backs are not allowed for the economic incentives under this subchapter.

(c) In the event a person that has obtained the approval of the Vermont economic progress council under section 5930a of this title ceases to employ in Vermont, for a period of 120 consecutive days, at least 75 percent of the number of employees it employed in Vermont as of the year in which a credit was received under this subchapter, then for any such year and all

succeeding years, carry-forward of any unused credit shall be disallowed. Furthermore, there shall be imposed upon each such employer a recapture penalty equal to a percentage of the total credit used, computed in accordance with the following table:

Years between close of tax year when credit became available and year when business became ineligible	Percent of credit recaptured
Two or less	100%
More than 2, up to 4	50%
More than 4, up to 6	25%

The recapture shall be reported on the taxpayer's income tax return for the tax year in which the 120 consecutive-day threshold occurred.—Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998.

#### HISTORY

**Effective date of enactment.** See second paragraph of applicability note under subchapter 11E heading.

#### § 5930i. Credit allocation

Credit as calculated in this subchapter to a person who is a partnership, limited liability company, subchapter S corporation, or trust, shall be available to a partner, member, shareholder, or beneficiary required to pay Vermont income tax in the same proportion as the income of the person is distributed to the shareholder, partner, member or beneficiary.—Added 1997, No. 71 (Adj. Sess.), § 48, eff. March 11, 1998.

#### HISTORY

**Effective date of enactment.** See second paragraph of applicability note under subchapter 11E heading.

#### § 5930j. Vermont economic progress council; long-term economic development planning

(a) The general assembly finds that long-term economic development planning is needed to build a diverse and sustainable economy, and to increase the well-being of Vermonters and their communities, without compromising the quality of our environment. This section is intended to enable Vermont to create and continually revise a long-term economic planning process. The general assembly further finds that the views of people from the public and the private sector, including Vermonters from

business, education and government, are essential in order to develop a process for long-range economic planning and job creation. The Vermont economic progress council will be a forum for government and the private sector to work together in the public interest to create economic development plans for a diverse, sustainable economy for Vermont.

(b) The economic progress council shall advise the governor and the general assembly on long-term economic development planning.

(1) In fulfilling its economic development planning responsibilities, the council may:

(A) solicit the assistance of individuals and groups with interests or expertise in the particular subject before the council;

(B) request the assistance and cooperation of any state or local agency or governmental unit in collecting economic development information and conducting economic development planning. Such state and local agencies and governmental units shall provide reasonable assistance to, and cooperate with the council in the discharge of its responsibilities. The council shall consult and cooperate with the telecommunications technology council of Vermont, and any other council or committee established by law or executive action relating to economic development;

(C) appoint one or more task forces, composed of individuals from the public and private sectors, to assist the council in its economic development planning;

(D) perform such other activities as are necessary to carry out the purposes of this chapter;

(E) subject to the provisions of section 5 of this title, accept grants, gifts, donations or other things of value from a donor which is a qualified nonprofit organization under Section 501(c)(3) of the federal Internal Revenue Code for sums up to \$200,000.00 to assist in defraying the costs of fulfilling the purposes of this chapter;

(F) execute contracts or provide grants, regarding professional or administrative services, to fulfill the purposes of this chapter;

(G) establish and administer a special fund, as provided under subchapter 5 of chapter 7 of this title, to be known as the Vermont economic progress council study fund for the purposes of fulfilling subdivisions (E) and (F) of this subdivision (1). Revenues to the fund shall be those funds collected pursuant to subdivision (E) of this subdivision (1); and

(H) before January 15 of each year, report to the general assembly the names of each donor and the amount donated under subdivision (E) of this subdivision (1), the names of the contractors and grantees and the

amounts contracted for or granted under subdivision (F) of this subdivision (1), which list shall include the donations made during the fiscal year to date, as well as all donations made during the previous fiscal year.

(2) The council shall report to the governor and the general assembly on or before December 15 of each year with its recommendations for implementing the state's long-term economic development planning agenda. Such recommendations shall contain goals, anticipated budgets, evaluation mechanisms, and proposals for legislation where necessary.— Added 1997, No. 147 (Adj. Sess.), § 214.

#### HISTORY

References in text. Section 591(c)(3) of the federal Internal Revenue Code, cited in subdivision (b)(1)(E), is classified to 26 U.S.C. § 501(c)(3).

#### Subchapter 11F. Tax Credit for Rehabilitation of Historic Buildings

§ 5930n. Tax credit for substantial rehabilitation of historic buildings also claiming federal rehabilitation tax credit

##### (a) Definitions.

(1) "Adjusted basis" means the original cost of the property plus the cost of capital improvements minus any depreciation allowed or allowable under the federal Internal Revenue Code, minus the value of the land.

(2) "Affordable housing" means housing for households whose income is at or below 80 percent of median income, as established by a U.S. Department of Housing and Urban Development median that is identified by the applicant for a tax credit under this section.

(3) "Certified rehabilitation" means a certified rehabilitation as defined in the federal Internal Revenue Code at 26 U.S.C. § 47(c)(2). This definition does not apply to subchapter 11G of chapter 151 of this title.

(4) "Commissioner" means the commissioner of taxes.

(5) "Division" means the division for historic preservation.

(6) "Qualified rehabilitation expenditure" means a qualified rehabilitation expenditure as defined in the Internal Revenue Code, 26 U.S.C. § 47(c) properly chargeable to the certified rehabilitation after July 1, 1998. This definition does not apply to subchapter 11G of chapter 151 of this title.

(7) "Qualified rehabilitation project" means a rehabilitation project located within a downtown community development district designated under the provisions of chapter 76A of Title 24, that is a certified rehabilitation with respect to this subchapter and meets the requirements of subdivisions (b)(2) and (3) of section 5930p of this title.

(8) "State board" means the Vermont downtown development board established pursuant to chapter 76A of Title 24.

# Appendix H

Department of Taxes' Glossary of Terms



## **Terms used by the Department of Taxes in tracking Vermont Economic Progress Council Credits**

<b><i>AUTHORIZED</i></b>	The amount approved by the Council. This is the amount shown on the Certificate of Eligibility. The amount of an award will usually cover more than one year. This is the maximum amount which can be Earned. (In certain cases, the maximum amount of approved expenditure will be reached before total Authorized credit can be Earned.)
<b><i>EARNED</i></b>	The amount of Authorized credit which is available for the year without regard to the tax liability. For each year this is the amount of payroll increase, qualified R&D expenditures, qualified expenditures for workforce development, or investments in plant and equipment multiplied by the applicable rate, or the difference between double-weighted and single-weighted apportionment.
<b><i>DISALLOWED</i></b>	The amount of credit which would otherwise be Earned but is unavailable to the taxpayer because Performance Expectations were not met.
<b><i>ALLOWED</i></b>	The amount of credit Earned and not Disallowed where the authorization is conditioned on the meeting of Performance Expectations. The term is applicable only to credits authorized after June 2000.
<b><i>APPLIED</i></b>	The amount of Earned credit used to reduce tax liability. This may be an amount Carried Forward from an earlier year or an amount Earned in same year. By state, the maximum amount which may be Applied in any year is 80% of the pre-credit tax liability (100% before July 2000).
<b><i>AVAILABLE CARRIED FORWARD</i></b>	The amount of Earned not yet Applied and available to be Applied. The amount Carried Forward is available to be Applied for 5 years after the year the credit Earned, unless the recapture of § 5930h(c) or the repayment provisions of § 5930a(m) have been triggered.
<b><i>EXPIRED CARRYFORWARD</i></b>	The amount carried forward no longer available to be Applied because it is not used during the five years following the year in which it was Earned.
<b><i>RECAPTURED CARRYFORWARD</i></b>	The amount not yet Applied and no longer available because recapture provisions of § 5930h(c) have been triggered.
<b><i>REPAID CARRYFORWARD</i></b>	The amount not yet Applied and no longer available because the repayment provisions of § 5930a(m) have been triggered.



<b><i>LOST CARRYFORWARD</i></b>	The total of Expired, Recaptured, and Repaid Carryforward. The amount Earned which will never be available to a tax liability.
<b><i>RECAPTURED</i></b>	Amount payable as liabilities of a current year because of the recapture provisions of § 5930h(c). This would be all or a portion of credits Applied in earlier years.
<b><i>REPAID</i></b>	The amount of Applied credit required to be repaid pursuant to § 5930a(m).
<b><i>ADJUSTED/AS FILED</i></b>	These terms distinguish between the amount of credits Earned, Applied.

*Source: Vermont Department of Taxes, 2002.*



# Appendix I

Letter to Tax Incentive Applicants (June 21, 2000)



# State of Vermont

## *Vermont Economic Progress Council*

National Life Building, Drawer 20  
Montpelier, Vermont 05620-0501  
Tel.: (802) 828-5256 Fax: (802) 828-3258

June 21, 2000

Dear Approved Applicant,

During the 2000 legislative session, the House and Senate considered several changes to the Economic Advancement Incentive Program. Those changes were incorporated into Act 159 (H.67 1), which passed during the final hours of the session.

There are several important features of Act 159 that will have a direct impact on all projects that have been approved by the Council. The effective date for the legislation is July 1, 2000.

### **1. Confidentiality:**

Information and materials submitted by a business concerning its income taxes and other confidential financial information shall not be subject to public disclosure under the state's public records law in Title 1, chapter 5, but shall be available to the joint fiscal office or its agent upon authorization of the joint fiscal committee or a standing committee of the general assembly, and shall also be available to the auditor of accounts in connection with the performance of duties; provided, however, that the joint fiscal office or its agent, and the auditor of accounts, shall not disclose, directly or indirectly, to any person any proprietary business information or any information which would identify a business except in accordance with a judicial order or as otherwise specifically provided by law. Nothing in this subsection shall be construed to prohibit the publication of statistical information, rulings, determinations, reports, opinions, policies, or other information so long as the data is disclosed in a form that cannot identify or be associated with a particular business.

### **2. Claiming Credits:**

To claim an income tax credit, an award recipient shall file a report with the Department of Taxes and with the Council within 60 days of the close of the applicant's fiscal year in which the economic activity occurred. The report shall respond directly to the performance expectations in the written notification of approval issued by the Council, and shall include a description of the economic activity, including the total number of jobs created, the number of new jobs filled by Vermont residents, the wages for the new jobs, investments made according to the categories of incentives awarded, the nature and extent to which the economic activity was consistent with the guidelines, and any other information required by the Council or the Department of Taxes to assess the performance of the award recipient.

The Department of Taxes shall compare the award recipient's report with the performance expectations in the written notification of approval. Upon determining that an award recipient has met all of the performance expectations, the Department of Taxes shall allow the tax credit and shall provide the Council with a report of the credit amount allowed and the basis for allowing the credit. If the Department of Taxes is unable to determine compliance with the performance expectations, the Department shall request that the Council conduct a more detailed review. At the conclusion of its review, the Council shall submit a written report to the Commissioner of Taxes, recommending that the credit be approved, in full or in part, or disallowed. Upon receiving the recommendation, the Commissioner of Taxes shall decide whether the credit shall be approved, in full or in part, or disallowed.

**NOTE: ALL PROJECTS APPROVED PRIOR TO JULY 1, 2000 WILL NOT HAVE A PERFORMANCE DOCUMENT ASSOCIATED WITH THEM. HOWEVER, THE APPROVED APPLICANT IS RESPONSIBLE FOR FILING A REPORT AS OUTLINED ABOVE.**

In assessing the performance of an award recipient, the Department of Taxes shall have the authority to obtain from the Council all records and information necessary to determine whether the award recipient has complied with the performance expectations in the written notice of approval.

In any one year, an economic incentive awarded under the income tax categories, shall not be applied to reduce the award recipient's income tax liability by more than 80 percent of its income tax liability in that year.

The Department of Taxes has the authority to adjust the tax liability of any award recipient whose credit was incorrectly calculated as part of their tax filing.

Applicants that are approved for incentives other than tax credits shall be required on or before December 31 of each year, to file a report with the Council. The report shall include the amount of any incentives used during the preceding taxable year, and a detailed description of compliance with all performance expectations upon which the approval was conditioned.

### **3. Tax Department Authority:**

The value of any economic incentives taken by an applicant that has obtained the Council's approval shall be refunded to the state, and any economic incentives remaining to be exercised shall be disallowed in the event that:

- (1) the applicant fails to comply with all performance expectations upon which the award was conditioned;
- (2) the applicant knowingly fails to supply any information required under this section or knowingly files false or misleading information; or
- (3) the applicant fails to file the required report.

#### **4. Small Business Investment Tax Credit:**

A person, upon obtaining the approval of the Vermont Economic Progress Council, may receive a credit against its income taxes in an amount equal to five to ten percent of its total investments within the state of Vermont in plants or facilities and machinery and equipment in the applicable tax year. but only if those investments exceed \$150,000.00 per year. If you believe you are entitle to an adjustment on your small business tax credit, please contact John Menard at the Department of Taxes 828-5723.

#### **5. Recapture Provision:**

In the event a person that has obtained the approval of the Vermont Economic Progress Council for income tax credits ceases to employ in Vermont, for a period of 120 consecutive days, at least 75 percent of the number of employees it employed in Vermont as of the year in which a credit was utilized, then for any such year and all succeeding years, any unused credit shall be disallowed. Furthermore, there shall be imposed upon each such employer a recapture penalty equal to a percentage of the total credit used, computed in accordance with the following table:

1. Two years or less, 100%
2. More than 2, up to 4.5%
3. More than 4, up to 6.25%

Please feel free to contact our office if you have any questions concerning the legislative changes to the program. Within the next month we will be sending you a form to use when filing your year-end report with the Council and the Tax Department

Sincerely,

Christopher D'Elia  
Executive Director



# Appendix J

Documents Related to the Program's Cost/Benefit Model





**THEORETICAL COST/BENEFIT ANALYSIS 1998-2011**

The information presented in this table is a compilation of the yearly revenue benefits and costs for all active VEPC authorizations. The numbers were derived from the cost/benefit model calculations for each project.

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Benefit <sup>2</sup>	\$4,210,012	\$11,750,812	\$19,698,912	\$28,824,212	\$39,200,412	\$52,465,312	\$59,990,512	\$38,607,300	\$25,926,900	\$14,592,900	\$12,706,200
Cost <sup>3</sup>	(10,495,640)	(13,810,266)	(19,561,439)	(26,672,633)	(33,681,033)	(38,189,533)	(43,289,333)	(28,816,526)	(15,312,700)	(7,848,100)	(7,637,600)
Difference <sup>4</sup>	(\$6,285,628)	(\$2,059,454)	\$137,473	\$2,151,379	\$5,519,379	\$14,275,779	\$16,701,179	\$9,790,774	\$10,614,200	\$6,744,800	\$5,068,600

1: The benefits and costs are theoretical because the companies have yet to engage in or are currently engaged in the economic activity represented in their applications. After the companies perform and make the investments, they are then eligible to claim the credits. At that time, Vermont begins to realize the actual revenue benefits and costs for each project.

2: Benefits are direct and indirect.

Direct:	Indirect:
Personal income and consumption	Personal income tax, sales and use tax, corporate income tax, sales and use tax, meals and rooms tax, general fund fees and other revenues.
Direct investment in facilities and equipment	Gasoline tax, motor vehicle purchase and use tax, and other trans fund revenues
Incremental business income	Statewide Education Fund revenue, Corporate Income Tax, Sales & Use on
Increased property value of business entity	Telecommunications, Gas Tax Revenues, Motor Vehicle Purchase & Use Tax

3: Costs are direct and indirect.

Direct:	Indirect:
Cost of credits	Block grant/special education payments, state general fund costs, state transportation fund costs.

4: The revenue benefits of the economic activity continue to the state after the five-year credit period has expired and are not reflected in the numbers above.

### Cost Elements

**Direct Cost:**

**Direct Cost of Credit:** Based on theoretical cost of credit and assuming the maximum level for which the applicant is eligible to actually earn.

**Indirect Cost:**

**Block Grant/Special Ed Payments:** Based on the change in school age population.

**State General Fund Costs:** Based on per-capita costs of those services and change in population.

**State Transportation Fund Costs:** Based on per-capita costs of those services and change in population.

### Benefit Elements

**Direct Benefits:**

**Personal Income and Consumption** Based on applicant's estimate of expenditures.

**Direct Investment in Facilities and Equipment** " "

**Incremental Business Income** " "

**Increased Property Value of Business Entity** " "

**Indirect Benefits:**

**General Fund Revenues:**

**Personal Income Tax** Based on the incremental change in personal income.

**Sales and Use Tax** Based on the incremental change in personal consumption.

**Corporate Income** Based on changes in the number of private employer workers.

**General Fund Fees & Other Revenues** Based on per-capita revenues and change in population.

**Transportation Fund Revenues:**

**Gasoline Tax** Based on the incremental change in personal consumption, specifically, gasoline.

**Motor Vehicle Purchase & Use Tax** Based on the incremental change in personal consumption.

**Transportation Fund Fees & Other** Based on effective per-capita revenues and changes in population.

**Education Fund Revenues:**

**Telecommunications Tax** Based on incremental change in personal consumption.

**Property Tax** Based on estimated direct impact on grand list of applicant's proposed facilities capital spending; and, indirect and induced portion based on incremental construction spending including new homes, commercial and industrial development.

**Education Fund Fees & Other Revenues** Based on incremental change in personal consumption and includes Lottery, Bank Franchise, Securities Registration, Meals & Rooms (Ed Fund portion), and Corporate (Ed Fund portion)

# Appendix K

Department of Taxes' Suggestions to Streamline the Handling  
of Tax Credits



January 22, 2003

Elizabeth M. Ready  
State Auditor  
132 State Street  
Montpelier, VT 05633-5101

Dear Ms. Ready:

During your compliance audit of the Vermont Economic Advancement Tax Incentives Program the audit team solicited suggestions for streamlining the handling of the tax credits. I am writing in response to the request from your office for a written summary of suggestions offered during the review. I understand that it is your intent to show these suggestions in the appendix to the final report of the audit.

Suggestions:

1. Performance Expectations Documents required by § 5930a(k) should list only specific, precise benchmarks for each year and should avoid extraneous remarks and minor items. The document is intended to be a tool for tax examiners reviewing a return. Documents that include discussions of guidelines, that speak only generally of expectations, or that fail to identify expectations for each year leave the taxpayer and the examiner in doubt. Time will be expended determining what the “real” expectations are, and there is a risk of disagreements over whether the expectations are met. Such disagreements have a cost both in time and goodwill.

Documents that simply repeat the pro forma projections from the application, in addition to wasting time with the required verification of minor items, guarantee that a large number of taxpayers will be found noncompliant. It is unrealistic to expect that business growth will be exactly as predicted for each of five years. For the review of Performance Expectations to be efficient, the Expectations have to be limited, precisely stated, and carefully selected.

2. The use of Expectation Documents to assign an alternate rate for a credit should be discontinued. The Council frequently includes in the expectation document a statement that the credit is to be computed at a rate other than the statutory rate. For example, § 5930d provides a credit of 10% of qualified research and development expenses. The Council may issue a certificate of eligibility for the R&D credit but include a statement in the expectation document that the credit is to be computed at the rate of 7%. This has been explained as a device to avoid having a credit earned from R&D expenditures that the Council believes would occur notwithstanding the credit. A more direct path to that end would be for the certificate of eligibility to state that only R&D expenditures in excess of the threshold amount each year could be used as qualifying expenditures for the credit. That is, if the taxpayer anticipates \$1,000,000 of R&D expenditures and the Council believes that there would be \$300,000 of expenditures even if no credit were available, the certificate of eligibility could require that the credit only accrue on expenditures after the first \$300,000. If

the company made the anticipated \$1,000,000 it would earn a credit of 10% of \$700,000, or \$70,000.

Although the alternative rate method of allowing credit of 7% of the full \$1,000,000 produces the same credit in this example, it is much more difficult to administer and it will not produce the anticipated credit in many situations. It is more difficult to administer because the Department's printed schedules and computer programming are designed to follow the statutory calculation. Tax practitioners, of course, refer to the statute to determine the calculation of credits. The fact that limitations, which are not expectations, are not stated in the certificates of eligibility creates a possibility that the limitations are overlooked or challenged as being inconsistent with the law. More seriously, the alternate rate method does not prevent accrual of a credit on the expenditures that would happen anyway. If the taxpayer in the example above spent only \$300,000 on R&D, it would accrue a credit of \$21,000. If the intent is to exclude the first \$300,000 from credit, this can be done simply and clearly by doing so directly.

3. The cost-benefit model should be adjusted to correspond to the taxpayer's fiscal year. Currently the taxpayer's annual report requires very detailed information because the information is used in relation to tax returns and the cost-benefit projections, which often corresponds to a different year. The additional detail creates more work for both the taxpayers and the Department and serves no purpose other than to allow the data to be sorted for different twelve-month periods.

4. The dates for the filing of annual reports by the taxpayers should be changed. Currently, a credit recipient is required to file with the Council and with the Department within 60 days following the close of its fiscal year. § 5930a(l)(1)(A). The Department has no need for this report until the tax return is filed, a minimum of two weeks later - probably longer depending on the entity type and the use of filing extensions. Having the report submitted separately from the return only creates additional work for both the taxpayer and the Department. While it is true that the Council can use the information sooner for purposes such as their February 15th report to the Legislature (see § 5930a(j)), data provided by companies before they have computed their tax returns is suspect.

Thank you for including these suggestions in the report appendix.

Sincerely,

George H. Phillips  
Policy Analyst

cc: Richard Mallary, Commissioner of Taxes  
Susan R. Watson, Director of Statewide Audits  
Thomas Kavet, Contract Economist for SAO

To obtain additional copies of this report contact:

Elizabeth M. Ready  
State Auditor

Office of the State Auditor  
132 State Street  
Montpelier, VT 05633-5101  
(802) 828-2281  
1-877-290-1400 (toll-free in Vermont)  
[auditor@sao.state.vt.us](mailto:auditor@sao.state.vt.us)

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