



# **State of Oklahoma**

# **Incentive Evaluation Commission**

## **Construction Materials Tax Exemption Evaluation**

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# Key Findings and Recommendations



## Overview

The Construction Materials Tax Exemption offers a full exemption from sales tax on purchases of tangible personal property by a qualified manufacturer that is used in the expansion or construction of a new manufacturing facility meeting new jobs and investment requirements. According to the Oklahoma Tax Commission, the incentive has not been used over the last five fiscal years.

### **Recommendation: The project team recommends repealing the program.**

The project team recommends repealing the program as it is no longer useful to the state. The intent of this incentive is now being fulfilled by the Quality Jobs Program. At each level of qualification for the exemption, the Quality Jobs Program offers a greater benefit to the manufacturer.

### *Key Findings*

- **The exemption has not been claimed in the last five fiscal years.**
  - Eligible businesses are likely choosing the state's Quality Jobs Program instead of the Construction Materials Sales Tax Exemption;
  - The Quality Jobs Program statute prohibits the use of both programs simultaneously. At each level of qualification for the exemption, the Quality Jobs Program offers a more generous benefit in present value terms.
  
- **Documentation required to submit claims may be burdensome.** Statute requires that the following information be included in each refund claim:
  - Invoices indicating the amount of state and local tax billed;
  - Affidavit of each vendor that sales tax charged has been collected by the vendor and remitted to the Tax Commission;
  - Affidavit from the contractor or subcontractor making purchases stating that the sales tax refund claimed by the qualified manufacturer is based on state and local sales tax paid by the contractor or subcontractor on qualified purchases;
  - Additional data required by the Tax Commission.



# Introduction



## **Incentive Evaluation Commission Overview**

In 2015, HB2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The first set of 11 evaluations were conducted in 2016, 12 were conducted in 2017 and an additional 11 were conducted in 2018.

The Construction Materials Tax Exemption Evaluation is one of 10 incentives scheduled for review by the Commission in 2019. Based on this evaluation and their collective judgment, the Commission will make recommendations to the Governor and the State Legislature related to this incentive.

## **Incentive Background**

The program offers a full exemption from sales tax on purchases of tangible personal property by a qualified manufacturer that is used in the expansion or construction of a new manufacturing facility meeting new jobs and investment requirements. According to the Tax Commission, the incentive has not been used over the last five fiscal years.

## **Criteria for Evaluation**

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In the case of this credit, the specific goal of the incentive is not listed in legislation. However, the goal of the incentive can be interpreted to be to encourage the construction of manufacturing or distributor facilities or expansions in the state.

Additionally, to assist in a determination of program effectiveness, the Incentive Evaluation Commission has adopted the following criteria:

- Changes to industry measures – size sector GDP, employment compared to other sectors;
- Comparisons of changes in sector versus states with/without similar exemptions;
- Changes in Oklahoma industry employment
- Changes in Oklahoma industry capital investment;
- State return on investment.



# Incentive Usage and Administration



## Historic Use of the Credit

According to the Oklahoma Tax Commission (OTC), this incentive has not been used over the last five fiscal years. Two likely reasons for this include the availability of more generous incentives and the potentially burdensome documentation associated with claiming the exemption.

## Incentive Administration

The State offers a full exemption from sales tax on purchases of tangible personal property by a qualified manufacturer that is used in the expansion or construction of a new manufacturing facility. The following table outlines the requirements for a qualified manufacturer's construction:

**Table 1: Construction Materials Exemption Qualification Levels**

<b>Construction Cost</b>	<b>New Jobs</b>	<b>Combined Cost of Construction, material, machinery, equipment and other tangible personal property</b>
<b>\$5 million</b>	100	No requirement
<b>\$10 million</b>	75	\$50 million
<b>\$300 million</b>	1,750 <sup>1</sup>	No requirement

The program's statute was modified in 2005 to allow qualified general wholesale distributors of groceries to benefit from the exemption. In order to qualify for the exemption as a distributor, the facility had to have been constructed between July 1 2005 and December 31 2005 and have a total cost of construction exceeding \$40 million with 50 new employees. Aside from this brief window, only manufacturers have been eligible to claim the exemption. It is likely that this modification was made to benefit one specific project.

The exemption applies to sales directly to the qualified manufacturer and also to contractors or sub-contractors associated with the construction. Recipients of the exemption must file applications with the OTC. Upon approval, a qualified manufacturer receives a permit serving as proof of eligibility for the exemption. In order for a purchase to qualify for the tax exemption, the manufacturer must provide this proof of eligibility to vendors when making purchases. Both state and local sales taxes are exempt for qualified manufacturers, so an approval by the governing body of the municipality in which the firm is located must approve a resolution in support of the construction project before any exemption is granted.

The exemption is administered as a refund of sales taxes on qualified purchases. The qualified manufacturer may file claims for a refund monthly, quarterly, semi-annually, or annually with the OTC. Claims must be filed within 36 months of the date of the first purchase.

The following information is required to be provided to the OTC as part of all claims:

- Invoices indicating the amount of state and local tax billed;
- Affidavit of each vendor that sales tax charged has been collected by the vendor and remitted to the OTC;
- Affidavit from the contractor or subcontractor making purchases stating that the sales tax refund claimed by the qualified manufacturer is based on state and local sales tax paid by the contractor or subcontractor on qualified purchases.

When claims are presented, each month, the OTC estimates the amount necessary to make refund payments and transfers that amount from sales tax collections into a separate account. All refunds are funded by this separate account. Approved claims allow for a full refund of sales and use tax paid on qualified purchases.

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<sup>1</sup> For this construction cost level, statute requires that 1,750 jobs be maintained at the facility, but does not specifically require that they are new jobs



Claimants also receive accrued interest associated with the principal refund amount, as determined by the amount earned as invested by the State Treasurer's Office. If at any time within 36 months of certification by the Oklahoma Employment Security Commission new jobs decline below the required amount, any sales and use tax and interest refunded to the taxpayer will be assessed against the taxpayer.

State statute prohibits the simultaneous use of the exemption and Oklahoma's Quality Jobs Program. When faced with a choice between the two programs, firms will likely choose the Quality Jobs Program based on the more generous benefits it offers. At each construction cost level, the Quality Jobs Program appears to offer a more generous benefit in present value terms. The benefit comparison is detailed in the following table.

**Table 2: Construction Materials Tax Exemption and Quality Jobs Program Estimated Benefits**

	Scenario 1	Scenario 2	Scenario 3
Total Construction Cost	\$5,000,000	\$50,000,000	\$300,000,000
Median Total Sales Tax Rate <sup>2</sup>	8.75%	8.75%	8.75%
<b>Sales tax exemption savings</b>	<b>\$437,500</b>	<b>\$4,375,000</b>	<b>\$26,250,000</b>
Potential Quality Jobs Benefit Rate	5.00%	5.00%	5.00%
New Jobs	100	75	1,750 <sup>3</sup>
Wage of New Jobs <sup>4</sup>	\$38,133	\$38,133	\$38,133
Total New Payroll	\$3,813,300	\$2,859,975	\$66,732,750
<b>Potential Quality Jobs Annual Benefit</b>	<b>\$190,665</b>	<b>\$142,999</b>	<b>\$3,336,638</b>
Investment Tax Credit %		2.00%	2.00%
<b>Annual Investment Tax Credit<sup>5</sup></b>		<b>\$1,000,000</b>	<b>\$6,000,000</b>
<b>Present Value of 10 Years of QJ Annual Benefit</b>	<b>\$1,077,300</b>	<b>\$807,975</b>	<b>\$18,852,746</b>
<b>Present Value of 5 Year Investment Tax Credit</b>	<b>N/A</b>	<b>\$3,604,776</b>	<b>\$21,628,657</b>
<b>Total Present Value of QJ+ITC</b>	<b>\$1,077,300</b>	<b>\$4,412,751</b>	<b>\$40,481,403</b>
<b>State Sales Tax Exemption Savings</b>	<b>\$437,500</b>	<b>\$4,375,000</b>	<b>\$26,250,000</b>

This assumes a business discount rate of 12 percent, that the company pays the median average county wage (as of 2017) and received the Quality Jobs Program full benefit of 5 percent of new payroll. This analysis assumes the median total sales tax rate as of September 2019 in each scenario, but total sales tax rates range from 4.5 percent to 11.5 percent. Under the second and third scenarios, the manufacturer would qualify to combine the Quality Jobs Program with the Investment Tax Credit. Combining these incentives results in a greater benefit than the sales tax exemption for the manufacturer.

Another factor potentially discouraging participation in the program is the documentation required in order to claim the exemption. State statute requires that the invoices of all state and local tax billed, affidavits from each vendor associated with purchases, as well as the contractors that make purchases on behalf of manufacturers.

<sup>2</sup> Includes State, County and City tax rates as of September 2019

<sup>3</sup> For this construction cost level, statute requires that 1,750 jobs be maintained at the facility, but does not specifically require that they are new jobs. The combination of Quality Jobs with the Investment Tax Credit provides a greater benefit to the company at our assumed wage level as long as 430 of the total jobs are new

<sup>4</sup> Median average county wage according to the Bureau of Economic Analysis is used in these scenarios, which may be a conservative estimate of manufacturing wages. Average annual pay in Oklahoma for manufacturing (NAICS code 31 through 33) was \$58,770 in 2018 according to the US Bureau of Labor Statistics. Assuming a higher wage would increase the benefit provided by Quality Jobs.

<sup>5</sup> Companies qualify to combine an investment tax credit of 2% with the Quality Jobs Program if \$40 million of qualified depreciable property is invested. Qualified depreciable property includes machinery, fixtures, equipment, buildings, or substantial improvements thereto.



# **Economic and Fiscal Impact**



### **Economic and Fiscal Impact**

According to the OTC, this exemption has not been used in the last five fiscal years and therefore has had no economic or fiscal impact.



# Incentive Benchmarking



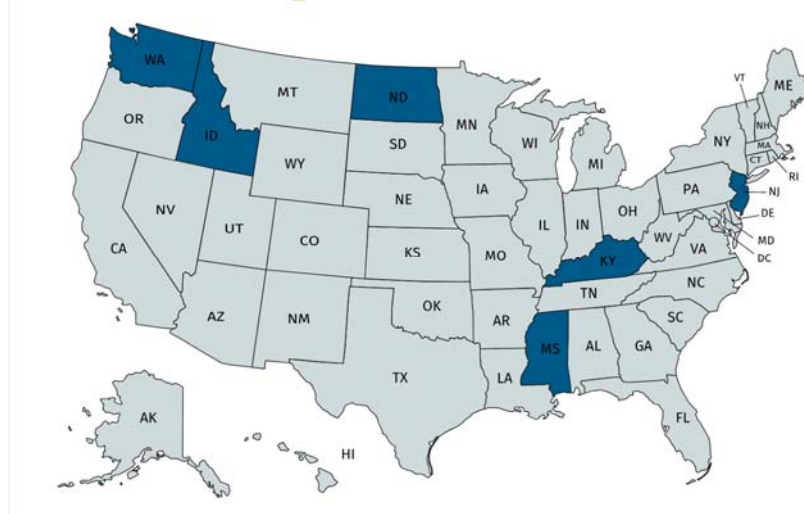
## Benchmarking

A detailed description of comparable state programs can be found in **Appendix A**.

For evaluation purposes, benchmarking provides information related to how peer states use and evaluate similar incentives. At the outset, it should be understood that no states are ‘perfect peers’ – there will be multiple differences in economic, demographic and political factors that will have to be considered in any analysis; likewise, it is exceedingly rare that any two state incentive programs will be exactly the same.<sup>6</sup> These benchmarking realities must be taken into consideration when making comparisons – and, for the sake of brevity, the report will not continually re-make this point throughout the discussion.

The process of creating a comparison group for incentives typically begins with bordering states. This is generally the starting point, because proximity often leads states to compete for the same regional businesses or business/industry investments. Second, neighboring states often (but not always) have similar economic, demographic or political structures that lend themselves to comparison. In the case of the Construction Materials Tax Exemption, no bordering states were found to have a comparable program. However, after expanding the search, six states were found to have comparable programs.

**Figure 1: States with Comparable Programs**



Comparable programs are differentiated by target recipients, qualifying purchases, and the level of exemption or refund provided. Of the six comparable state programs, two were more narrowly targeted than Oklahoma’s. North Dakota is specifically targeted toward agricultural commodity processing plants, and Washington’s program is aimed toward commercial plane and plane parts manufacturers. Programs in Mississippi and New Jersey allow machinery and equipment to be exempt from sales tax in addition to construction materials, while Oklahoma’s program does not. While Oklahoma and four comparable programs offer a full exemption, Idaho offers a rebate of 25 percent and Mississippi offers a 50 percent exemption for most applicants.

Among other states, with Washington’s program reduced revenue by \$22.7 million in FY 2019, New Jersey’s by \$10.9 million and Kentucky’s by \$6.0 million.

<sup>6</sup> The primary instances of exactly alike state incentive programs occur when states choose to ‘piggyback’ onto federal programs.



# Appendices



## Appendix A: Comparable State Programs

Construction Materials Sales and Use Tax Exemption			
State	Program Name	Incentive Details	Eligibility
Oklahoma	Construction Materials Sales and Use Tax Exemption	Refunds sales taxes paid on construction materials for new or expanding manufacturing facilities.	<p>Eligible manufacturing facilities include:</p> <ul style="list-style-type: none"> <li>• Facilities with construction costs exceeding \$5 million which create 100 new manufacturing jobs and are maintained for a minimum of 36 months. Construction costs include building and construction costs, and engineering and architectural fees, but not legal fees.</li> <li>• Facilities with construction costs exceeding \$10 million, and with combined total costs of material, construction, and machinery exceeding \$50 million, which add 75 new employees who are retained for 36 months.</li> <li>• Facilities with construction costs exceeding Three Hundred Million Dollars (\$300,000,000) which maintain an employment level of a least 1,750 full time equivalent employees.</li> </ul>
Idaho	25 Percent Sales and Use Tax Rebate	A 25% rebate is available on all sales and use tax that the taxpayer or its contractors actually paid for any property constructed, located, or installed within the project site during the project period.	<ul style="list-style-type: none"> <li>• The business must create at least 10 new jobs paying on average \$40,000/year (\$19.23/hour) plus benefits.</li> <li>• The average wage of any additional new employee during project period must be \$15.50/hour plus benefits</li> <li>• The business must invest \$500,000 in new facilities</li> </ul>
Kentucky	Enterprise Initiative Act	Provides a refund of Kentucky sales and use tax paid by approved companies for building and construction materials permanently incorporated as an improvement to real property. It is also available for Kentucky sales and use tax refunds for eligible equipment used for research and development and data processing equipment.	<p>Company must make a minimum investment of \$500,000 in an economic development project. Investment costs include expenditures for:</p> <ul style="list-style-type: none"> <li>• Building and construction materials</li> <li>• Research and development equipment</li> <li>• Acquisition of real property</li> <li>• Electronic processing equipment (minimum \$50,000 investment)</li> </ul> <p>Labor costs are not considered eligible investment costs.</p>
Mississippi	Sales and Use Tax Exemption for Construction or Expansion	Tax exemption is for component building materials, machinery, and equipment. The amount of the exemption depends on the location of the new facility. A full exemption from sales tax is available for those in less developed counties (as outlined by the Mississippi Dept. of Revenue); all other areas of the state are eligible for a one-half exemption.	Businesses constructing a new facility or expanding an existing facility in Mississippi



State	Program Name	Incentive Details	Eligibility
New Jersey	Sales and Use Tax Exemption (STX) Program	A company with 1,000 or more employees may be eligible for a sales tax exemption for purchases of machinery, equipment, furniture, and building materials for the construction or renovation of a new business location.	<ul style="list-style-type: none"> <li>• A company must have 1,000 or more employees and relocate at least 500 workers to a new or substantially rehabilitated facility.</li> <li>• Life sciences or manufacturing companies relocating 250 or more employees may be eligible.</li> <li>• Companies must maintain the retained full-time jobs for five years.</li> <li>• Qualifying companies must demonstrate that receiving the Sales and Use Tax Exemption benefit is a material factor in the company's decision not to relocate outside of New Jersey,</li> <li>• Companies must provide health care benefits to employees</li> <li>• The company or a predecessor entity must have operated in New Jersey for at least 10 years (point-of-purchase/retail facilities are excluded).</li> </ul>
North Dakota	Agricultural Commodity Processing Plant Construction Materials Sales Tax Exemption	Construction materials used to construct an agricultural commodity processing facility are exempt from sales and use taxes	Tangible personal property must be incorporated in the structure of the facility or used in the construction process to the point of having no residual economic value.
Washington	Retail Sales/Use Tax Exemption	Tax exemption available to manufacturers who construct new buildings and/or new parts of buildings that will be used primarily to manufacture commercial airplanes, commercial airplane fuselages, and commercial airplane wings.	The buildings must be used primarily to manufacture commercial airplanes, commercial airplane fuselages and commercial airplane wings. It is also available to port districts, political subdivisions, or municipal corporations when they construct new facilities to lease to these manufacturers.