Special Report

Arkansas Legislative Audit

Cost-Benefit Analysis of Selected Economic Incentive Projects

For the Period January 1, 2013 through December 31, 2022

INTRODUCTION

The Consolidated Incentive Act of 2003 (CIA), codified at Ark. Code Ann. §§ 15-4-2701 – 15-4-2714, combined existing economic development tax incentives primarily into four statutory and five discretionary economic incentive programs that are described in **Appendix A**. Ark. Code Ann. § 15-4-220 requires Arkansas Legislative Audit (ALA) to prepare a cost-benefit analysis of the economic incentive projects annually. ALA staff selected 72 projects for review in this report. In addition to reviewing selected projects, ALA staff determined the overall effectiveness of the CIA programs using accumulated data from past project reviews.

OBJECTIVES

The objectives of this report were as follows:

- Evaluate controls over the awarding and issuance of CIA incentives by the Arkansas Economic Development Commission (AEDC) and the Department of Finance and Administration (DFA).
- Determine the overall effectiveness of the CIA programs as well as the effectiveness of selected CIA projects.

REPORT HIGHLIGHTS

- For the 10-year period reviewed (calendar years 2013 through 2022):
  - ⇒ CIA incentives awarded and issued by the State totaled $667.1 million.
  - ⇒ CIA incentives used by companies totaled $644.4 million.
  - ⇒ Statutory incentives accounted for 77.3% of all incentives awarded and issued, while discretionary incentives accounted for the remaining 22.7%.
- ALA conclusions about the cost effectiveness of CIA programs are shown in **Exhibit VI on page 7**.
- Inadequacies with AEDC's verification process resulted in the loss of state funds, as discussed on **pages 10 and 11.**
- For the 7 non-InvestArk/non-Research and Development projects reviewed for this report, the State invested an average of $7,782 for each of the 757 new full-time, permanent jobs created. **Exhibit IX on page 9** provides a summary of these projects.

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SCOPE AND METHODOLOGY

This review was conducted primarily for the period January 1, 2013 through December 31, 2022. ALA staff interviewed representatives from AEDC and DFA and reviewed application, payment, and evaluation documents relating to the selected projects. Additionally, ALA staff utilized IMPLAN®, a widely-used economic software model, to estimate local economic impacts of specified incentive projects.

BACKGROUND

The General Assembly determined that job creation and capital investment depend on remaining competitive with other states for business locations and expansions. Enacted by the General Assembly in 2003, the CIA consists of incentive programs divided into statutory and discretionary groups. Statutory incentives are available to any qualifying business applying for funds, and discretionary incentives are awarded at the discretion of AEDC's Director in competitive situations. Companies may receive multiple incentives. Primary programs are listed and summarized in **Appendix A**.

AWARDING AND ISSUANCE OF CIA FUNDS

For the 10-year period beginning in 2013 and going through the end of calendar year 2022, CIA incentives awarded and issued by the State totaled $667.1 million. This amount is expected to rise for this period because a delay exists between when the incentive requirement is met and when the recipient may file a claim to receive the incentive. For 2013 through 2022, the amount of incentives used by companies totaled $644.4 million.

County Tier System

With the exception of the InvestArk, Payroll Tax Credit – Targeted Business, and In-House Research and Development incentives, benefits provided by the CIA are determined in relation to the tier ranking of the county in which the project is located. As shown in **Exhibit I on page 3**, the State's 75 counties are divided into four tiers, with Tier 1 representing the counties with the least need for economic development, and Tier 4 representing the counties with the greatest need of economic development. AEDC determines the tiers annually by ranking each county using four variables:

- Poverty rate.
- Population growth.
- Per capita income.
- Unemployment rate.

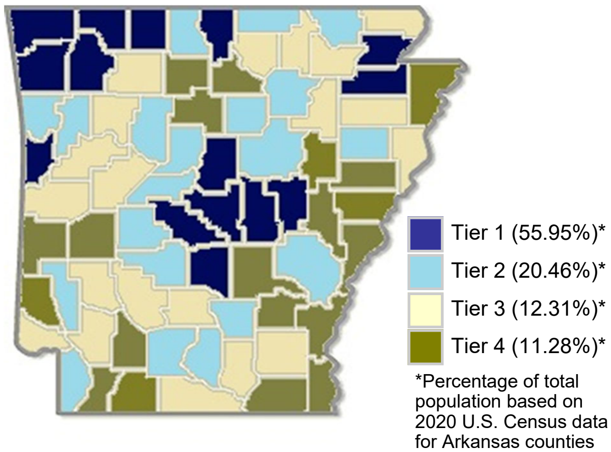
Exhibit I also shows CIA funds awarded and issued from 2013 through 2022 based on 2022-2023 county tier ratings. **Exhibit II on page 3** illustrates CIA funds awarded and issued by region, and **Exhibits III and IV on page 4** and **Exhibit V on page 5** show CIA funds awarded and issued by calendar year, industry, and incentive program, respectively.

Arkansas Economic Development Commission

AEDC is responsible for awarding CIA incentives and first determines if companies are eligible as a non-retail business engaged in commerce for profit, as defined by Ark. Code Ann. § 15-4-2703(10). Once eligibility is determined, AEDC ensures data submitted on the application meet the requirements and thresholds of the incentive requested. Requirements include average hourly wages, investment totals, and new payroll created. ALA staff reviewed the application process, illustrated in **Appendix B**, and found it to be reasonable.

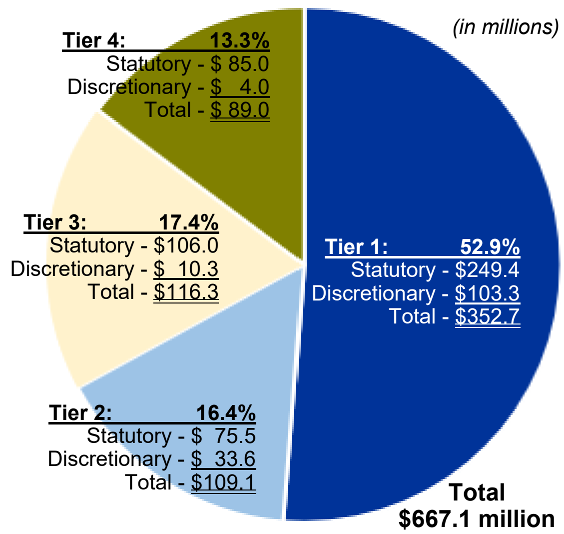
Exhibit I
Consolidated Incentive Act (CIA) Funds

County Tier Map 2022-2023



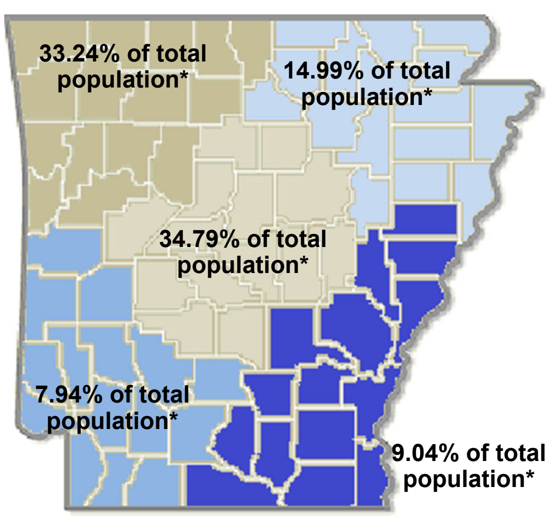
Note: County tiers are reassigned each year. The county tiers shown here were in effect for projects approved during the period July 1, 2022 through June 30, 2023. Tier 1 represents the most prosperous counties, with the least need for economic development, and Tier 4 represents the counties with the greatest need for economic development.

CIA Funds Awarded 2013-2022 Based on 2022-2023 County Tier Ratings

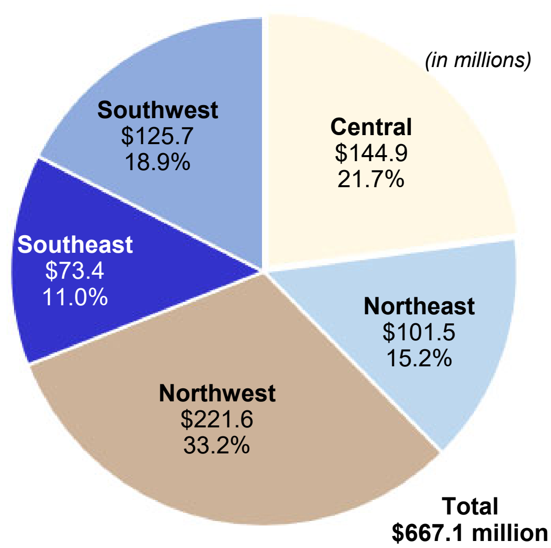


Sources: *Department of Finance and Administration, Arkansas Economic Development Commission, and Arkansas Economic Development Institute (unaudited by Arkansas Legislative Audit)*

Exhibit II
Consolidated Incentive Act (CIA) Funds Awarded by Region
January 1, 2013 - December 31, 2022



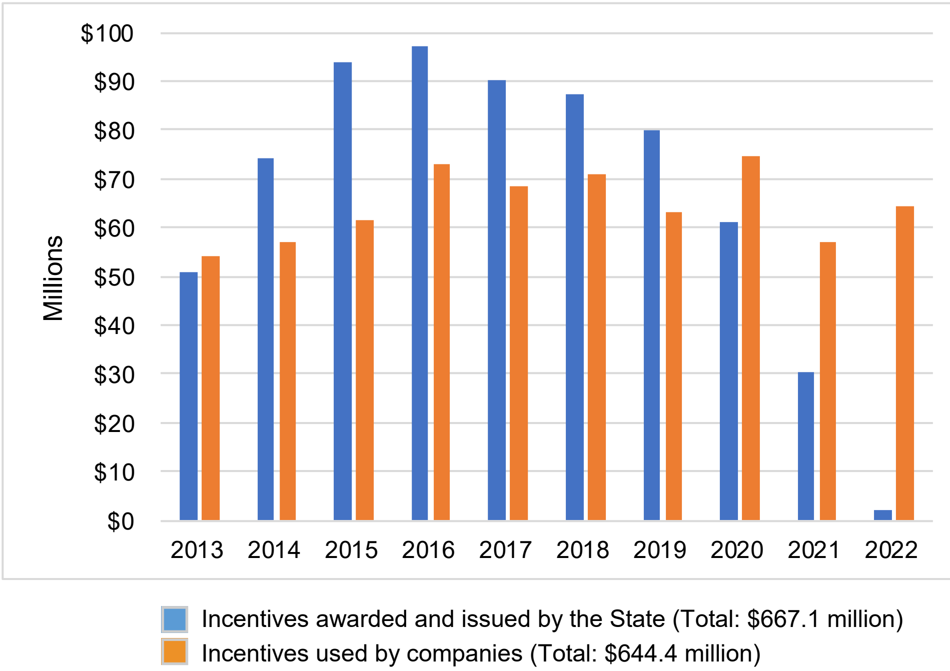
*Based on 2020 U.S. Census data for Arkansas counties



Sources: *Department of Finance and Administration, Arkansas Economic Development Commission, and Arkansas Economic Development Institute (unaudited by Arkansas Legislative Audit)*

Exhibit III

Consolidated Incentive Act (CIA) Funds Awarded and Used by Calendar Year
January 1, 2013 - December 31, 2022



Note: The amount of incentives awarded and issued for 2022 is expected to rise because a delay exists between when the incentive requirement is met and when the recipient may file a claim to receive the incentive.

Sources: *Department of Finance and Administration and Arkansas Economic Development Commission (unaudited by Arkansas Legislative Audit)*

Exhibit IV

Consolidated Incentive Act (CIA) Funds Awarded and Used by Industry
January 1, 2013 - December 31, 2022

Industry Category*	Amount	Percentage
Mining, Extraction, Utilities, and Construction	$ 6,917,689	1%
Food and Textile Manufacturing	108,617,613	16%
Wood, Paper, Petroleum, Coal, and Chemical Manufacturing	210,359,668	32%
Metal, Machinery, Electronic, and Miscellaneous Manufacturing	157,490,226	24%
Wholesale, Transportation, and Warehousing	13,209,208	1%
Professional Services (e.g., Finance, Real Estate, Scientific) and Other	170,530,699	26%
Total CIA Funds by Industry	**$ 667,125,103**	**100%**

*United States Department of Commerce, North American Industry Classification System

Sources: *Department of Finance and Administration and Arkansas Economic Development Commission (unaudited by Arkansas Legislative Audit)*

Exhibit V

Consolidated Incentive Act (CIA) Funds Awarded by Incentive Program
January 1, 2013 - December 31, 2022

Incentive	Amount	Percent
Statutory		
InvestArk	$ 387,901,892	58.1%
Advantage Arkansas	19,560,715	2.9%
Tax Back	22,051,739	3.3%
In-House Research and Development	86,356,432	12.9%
Total Statutory	515,870,778	77.3%
Discretionary		
ArkPlus	$ 23,507,703	3.5%
Create Rebate	113,220,825	17.0%
In-House Research and Development - Targeted Business	14,395,797	2.2%
Payroll Tax Credit - Targeted Business	130,000	0.0%
Total Discretionary	151,254,325	22.7%
Total Incentives	**$ 667,125,103**	**100.0%**

Sources: *Department of Finance and Administration and Arkansas Economic Development Commission (unaudited by Arkansas Legislative Audit)*

During the application process, AEDC conducts a cost-benefit analysis for each proposed project using IMPLAN®, a software program that analyzes economic impact, and an internally-developed cost-benefit spreadsheet. IMPLAN® calculates regional multipliers for Arkansas based on industry category. AEDC uses those multipliers to estimate potential direct, indirect, and induced tax benefits to the State. This process does not account for any potential local tax benefits (e.g., new property tax, local sales tax, or business license fees). AEDC analyzes each potential project over a 10-year period (or a 20-year period for large projects), regardless of the length of incentives offered, for comparison purposes among projects. ALA staff reviewed the cost-benefit analysis process and assumptions used by AEDC and determined them to be reasonable.

Statutory incentives must be approved by AEDC, regardless of the outcome of the cost-benefit analysis, if other eligibility requirements are met. Over the prior 10-year period, statutory incentives accounted for 77.3% of all incentives awarded and issued. With the exception of In-House Research and Development – Targeted Business incentives, discretionary incentives are approved only if they have a positive cost-benefit ratio and meet other criteria. Discretionary incentives accounted for 22.7% of all incentives awarded and issued in the past 10 years.

Department of Finance and Administration

DFA verifies that incentive requirements have been met and issues the payments/rebates, with two exceptions: the Create Rebate and In-House Research and Development incentives. Create Rebate payments are issued by AEDC based on authorizations provided by DFA, and AEDC determines the eligibility of research expenditures for In-House Research and Development projects prior to authorizing income tax credits.

For a company to receive an incentive, it must annually certify that it has met certain requirements. To monitor the performance-based incentives, DFA's Office of Field Audit conducts annual audits of the data that companies submit to ensure accuracy and eligibility of incentives claimed. Errors noted by DFA auditors are communicated to the companies, which make appropriate adjustments.

ALA staff noted that all audits related to projects reviewed had been completed prior to an incentive being issued, excluding InvestArk projects. To be more efficient, DFA incorporates InvestArk audits into its regularly-scheduled sales and use tax audits of direct-pay taxpayers, which occur every three years. The DFA verification process is illustrated in **Appendix B**.

REVIEW OF CIA PROGRAMS

ALA conclusions about the cost-effectiveness of entire CIA programs are shown in **Exhibit VI on page 7**. Conclusions for all of the CIA programs were derived from ALA evaluations in calendar years 2013 through 2022, with the exception of the InvestArk program. Because of its uniqueness as a "retention" incentive program, InvestArk was evaluated based on 2016 through 2023 data.

A number of factors are considered when determining whether economic incentives result in a net positive benefit to the State. For example, the primary reason to offer a business an incentive is to elicit economic activity that would otherwise not occur. However, there is no definitive way to determine the action a business would have taken if an incentive had not been offered. If a business would have created jobs or invested in a new location without receiving incentives, then any incentives offered could be considered unnecessary. Likewise, if an incentive caused a business to create jobs or invest in a new location that it would not have otherwise, the impact from the incentive could be considered positive.

Statutory incentives are awarded and issued if the company applies and meets the requirements for the incentives. Essentially, any company with knowledge of incentives available will know upfront what it is allowed to claim and will incorporate this knowledge into the decision to create jobs or build a new facility. It is likely, then, that the availability of statutory incentives will cause some companies to claim incentives for projects they would have pursued even without the incentives. However, for the purposes of this report, incentives were analyzed under the assumption that, without the incentive, the corresponding economic activity would not have occurred.

Statutory Incentives

Among statutory incentives, as shown in **Exhibit VI on page 7**, ALA staff concluded that the TaxBack and Advantage Arkansas incentive programs resulted in a net positive benefit to the State, based on review of individual projects selected from calendar years 2013 through 2022.

Exhibit VI shows that the cost effectiveness of the InvestArk incentive program is also positive; however, it should be noted that the effectiveness of this program is difficult to capture because it attempts to *retain* rather than *increase* economic activity. To reach a conclusion about the cost effectiveness of the program, ALA staff determined whether the companies that received InvestArk funds in 2011 through 2018 and were evaluated by ALA staff were continuing to operate five years later, in 2016 through 2023. If the companies were still operating, then the incentive was considered effective. Of the 240 InvestArk projects previously reviewed by ALA staff, 210 of the companies (87.5%) remained in operation five years after the incentive was awarded. The 30 companies (12.5%) no longer in operation five years after the incentive was awarded received $28.8 million (8.5%) of the $337.8 million in InvestArk funds awarded.

Exhibit VI

Effectiveness of Consolidated Incentive Act (CIA) Incentive Programs

Incentive	Number of Projects Reviewed (2013 – 2022)*	Percentage of Projects Reviewed with Positive Cost Effectiveness	ALA Conclusion about Overall Effectiveness of the Program
Statutory Incentives			
TaxBack	124	87.1%	**Positive**
InvestArk **(Note 1)**	240	87.5%	**Positive**
Advantage Arkansas	179	93.9%	**Positive**
(Pre-Act 327 of 2019) In-House Research and Development **(Note 2)**	30	36.7%	**Negative**
Discretionary Incentives			
Create Rebate	51	94.1%	**Positive**
ArkPlus **(Note 3)**	6	**(Note 3)**	**Inconclusive**
Sales and Use Tax Refund – Targeted Business **(Note 3)**	0	**(Note 3)**	**Inconclusive**
Payroll Tax Credit – Targeted Business **(Note 3)**	6	**(Note 3)**	**Inconclusive**
(Pre-Act 327 of 2019) In-House Research and Development – Targeted Business **(Note 2)**	23	0.0%	**Negative**
(Post-Act 327 of 2019) In-House Research and Development **(Note 2)**	0	**(Note 3)**	**(Note 2)**
(Post-Act 327 of 2019) In-House Research and Development – Targeted Business **(Note 2)**	0	**(Note 3)**	**(Note 2)**

ALA = Arkansas Legislative Audit

*Conclusions for all of the CIA programs were derived from ALA evaluations in calendar years 2013 through 2022, with the exception of the InvestArk program, which was evaluated based on 2016 through 2023 data.

Note 1: The methodology used to reach a conclusion about the cost effectiveness of the InvestArk program involved determining whether the companies that received InvestArk funds in 2011 through 2018 were continuing to operate five years later (in 2016 through 2023, respectively). If the companies were still operating, then the job retention incentive investment was considered effective.

Note 2: Act 327 of 2019 changed the 20% Research and Development incentive from statutory to discretionary and limited eligible expenditures to wages and benefits. The Act also requires credits to be based on the incremental amount spent that exceeds the baseline established from previous-year spending.

Note 3: More projects from these programs will have to be reviewed before conclusions can be drawn.

Sources: *Arkansas Economic Development Commission and Department of Finance and Administration (unaudited by Arkansas Legislative Audit)*

Additionally, the 20% Research and Development projects reviewed by ALA to date were statutory incentives, and as shown in **Exhibit VI**, 36.7% of the 30 projects reviewed returned positive cost-benefit ratios. It should be noted that Act 327 of 2019 changed the 20% Research and Development incentive from statutory to discretionary and limited eligible expenditures to wages and benefits. The Act also requires credits to be based on the incremental amount spent that exceeds the baseline established from previous year spending.

Discretionary Incentives

Based on review of individual projects selected from calendar years 2013 through 2022, as shown in **Exhibit VI on page 7**, ALA staff concluded that one of the five discretionary incentives awarded, Create Rebate, returned a net positive benefit to the State. Based on the data evaluated, ALA staff could not reach a definitive conclusion regarding the overall effectiveness of ArkPlus, Sales and Use Tax Refund – Targeted Business, and Payroll Tax Credit – Targeted Business. More related projects will have to be reviewed from these programs before conclusions can be drawn.

In-House Research and Development – Targeted Business projects resulted in a negative impact on the State. These projects have a high incentive cost of 33%, causing them to return negative cost-benefit ratios. However, if the primary purpose of the In-House Research and Development – Targeted Business incentives is to encourage research and assist in the growth of certain business sectors in the State, the short-term impact may be less valuable to the State than the potential long-term gains. ALA staff encourage AEDC to monitor these projects and ensure that these long-term goals are being met.

REVIEW OF SELECTED CIA PROJECTS

In addition to drawing conclusions regarding the overall effectiveness of CIA incentive programs, ALA staff reviewed 72 individual CIA projects with eligible project investments of approximately $2.1 billion that were awarded incentives totaling $165 million in tax credits, refunds, and rebates. Projects reviewed received seven of the different available incentives. These incentives were offered for tax years 2013 through 2022, and the projects were distributed among tier rankings as follows:

- 37 projects in Tier 1 counties.
- 16 projects in Tier 2 counties.
- 9 projects in Tier 3 counties.
- 10 projects in Tier 4 counties.

To estimate the effectiveness of the projects, ALA staff compared estimated project costs from application data obtained from AEDC to actual DFA audited costs. The ALA analysis is divided between InvestArk and Non-InvestArk incentives, and each is discussed in the sections that follow.

InvestArk Incentives

InvestArk is primarily a “retention” incentive available to existing businesses that have been in the State for at least two years and invest $5 million in new construction and equipment. Of the 72 projects reviewed in this report, 57 received only InvestArk incentives, and 1 received a combination of InvestArk and other incentives. ALA staff did not calculate a cost-benefit ratio on InvestArk projects or the InvestArk portion of projects because, due to the nature of the incentive, job creation is not required. As a result, the cost-benefit calculation is not as accurately measured by the IMPLAN® software, which relies heavily on job creation in its calculations.

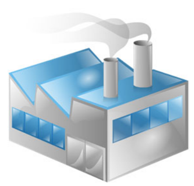
InvestArk projects may or may not result in a positive net tax benefit to the State. The intended result of an InvestArk project is to retain businesses that may otherwise choose to leave the State by incentivizing new development within the State. InvestArk projects result in new or updated facilities or equipment, which could lead to increased jobs and productivity or could lead to decreased jobs if the improvements reduce the workforce (e.g., through enhanced automation).

Act 362 of 2017 began the process of phasing out the InvestArk program. Beginning July 1, 2017, no new InvestArk projects were approved. Using the savings from the phase-out of InvestArk, an increased amount of sales tax refund for partial replacement and repair of certain machinery and equipment allowed under Ark. Code Ann. § 26-52-447(b) is being phased-in. With this year's review of 58 projects, as outlined in **Schedule 1 on pages 12 and 13**, ALA's review of the InvestArk program is complete. ALA will continue to work with DFA as the program concludes and will report any issues that may arise; however, this is the final report with extended discussion of the InvestARk program.

Non-InvestArk Incentives

For the 7 non-InvestArk/non-Research and Development projects reviewed, the State invested an average of $7,782 for each of the 757 new full-time, permanent jobs created, assuming all credits are used. The 757 new employees received payroll totaling $35.9 million in the final year of their respective projects. **Exhibit IX** provides a summary of the 15 Research and Development and other non-InvestArk projects, and **Schedule 2 on pages 14 and 15** provides detailed data on projects reviewed.

Exhibit IX
Cost-Benefit Analysis of Non-InvestArk Incentives Reviewed
Summary of Data from Schedule 2



Cost-Benefit Ratio ≥ 1:2.00 | Cost-Benefit Ratio between 1:1.00 to 1:1.99 | Cost-Benefit Ratio < 1:1.00

		Arkansas Companies				State of Arkansas		
		Eligible Expenses Claimed				Project Costs	Project Revenues	Cost-Benefit Ratio
	Economic Incentive Project Time Period	Actual Project Costs	New Full-Time, Permanent Employees in Final Year of the Project	New Actual Annual Wages in Final Year of the Project	Actual Average Hourly Rate in Final Year of the Project	Total Incentives Paid	Estimated Direct, Indirect, and Induced Income and Sales and Use Tax as a Result of Incentives over the Life of the Project	Calculated by ALA Using IMPLAN® Software
1	2013-2018, 2020	$ 0	87	$ 5,757,368	$ 19.12	$ 1,517,492	$ 4,705,831	1:3.11
2	2015-2019	0	183	9,690,347	27.41	2,500,000	12,272,579	1:4.90
3	2015-2017	0	277	9,590,603	16.88	765,361	3,700,619	1:4.83
4	2016-2019	0	86	5,145,378	28.95	550,000	2,399,486	1:4.29
5	2017-2019	1,831,532	68	3,851,593	28.36	518,767	1,594,509	1:3.05
6	2018	232,345	6	175,899	14.86	14,902	41,064	1:2.76
7	2017-2019	0	50	1,663,188	16.90	24,458	437,699	1:17.92
8	2014-2018	4,109,632	Note 1	Note 1	Note 1	2,188,650	312,279	1:0.14
9	2017-2021	19,227,853	Note 1	Note 1	Note 1	4,217,244	1,304,172	1:0.31
10	2016-2019	85,141	Note 1	Note 1	Note 1	145,714	156,870	1:1.05
11	2016-2020	354,683	Note 1	Note 1	Note 1	850,008	263,300	1:0.31
12	2016-2019	0	Note 1	Note 1	Note 1	2,391,586	5,042,438	1:2.08
13	2016-2020	14,721	Note 1	Note 1	Note 1	206,709	105,476	1:0.51
14	2017-2021	1,814,948	Note 1	Note 1	Note 1	454,961	387,767	1:0.86
15	2017-2021	238,349	Note 1	Note 1	Note 1	607,295	239,946	1:0.39
Totals		$ 27,909,204	757	$ 35,874,376		$ 16,953,147	$ 32,964,035	

ALA = Arkansas Legislative Audit

Note: Additional detail is provided in **Schedule 2 on pages 14 and 15.**

Note 1: Employment, annual wage, and hourly rate data are not included for Research and Development projects since, in some cases, these are not new full-time, permanent employees.

Sources: *Department of Finance and Administration and Arkansas Economic Development Commission (unaudited by Arkansas Legislative Audit)*

Of the 15 non-InvestArk projects reviewed, 6 had unfavorable cost-benefit ratios calculated by ALA, as described below and reflected in **Schedule 2**:

> **In-House Research and Development:** Two companies (Companies #9 and #14) received the In-House Research and Development incentive and four companies (Companies #8, #11, #13, and #15) received the In-House Research and Development – Targeted Business incentive. IMPLAN® calculated an unfavorable cost-benefit ratio for these projects, primarily because of the significant amount of the incentive being awarded up front compared to the anticipated future economic effect of the projects' activities. The primary purpose of this incentive is to encourage growth of the targeted businesses and research and development. Therefore, it may take years before the State receives the economic benefit, if any, from these incentive projects. These projects predate the changes made with Act 327 of 2019, so the large amount of supply expenses allowed under the previous guidelines contributed to some of the low benefit ratios returned.

All 9 remaining projects reviewed had a favorable cost-benefit ratio. Two of these projects received the In-House Research and Development incentive; however, one had very little supply expense, and the other had no supply expenditures. Before Act 327, much higher incentives were typically awarded due to large amounts of supply expenses.

The remaining 7 projects received a payroll incentive (Create Rebate or Advantage Arkansas), and some also received a sales and use tax refund (TaxBack). The design of payroll incentives helps to ensure projects return positive tax benefits to the State. For new, taxable payroll, Advantage Arkansas allows a maximum 4% income tax credit, and Create Rebate allows a maximum 5% rebate. Advantage Arkansas requires a minimum hourly wage exceeding the lowest county average hourly wage in Arkansas, and Create Rebate requires a minimum amount of new wages depending on the tier in which the business locates. Companies applying for the TaxBack incentive are required to also apply for a payroll incentive. These safeguards in incentive design help to ensure that new jobs created will at least pay enough individual sales and use tax and income tax to recover a significant portion of incentive cost. When combined with other potential positive aspects of the projects (e.g., corporate sales and use tax and income tax) as well as any indirect and induced job and tax benefits due to increased economic activity, these incentives mostly result in a net positive gain to the State.

ISSUES WITH AEDC'S VERIFICATION PROCESS

Finding 1: Research and Development (R&D) programs are the two CIA programs for which AEDC is solely responsible for awarding state income tax credits, based on verification of data submitted by participating companies. AEDC should verify the existence, accuracy, and program eligibility of expenses claimed by participating companies. DFA's Office of Field Audit audits the data companies submit for all other CIA programs.

During testing, ALA staff noted inadequacies with AEDC's verification process that resulted in the loss of state funds. Specifically, ineligible or undocumented company expenses were allowed to count toward income tax credits awarded. Examples below highlight issues noted:

- $1.2 million in state income tax credits were awarded by AEDC to a company in 2013 and 2014 based on $3.5 million in stock awards and stock options.[1] Documentation available does not establish that the stock transactions are an actual expense to the company or how these and other approved expenses (e.g., gym memberships, Apple iTunes purchases, and office parties) are direct R&D expenses, as required by the program. Furthermore, Arkansas Secretary of State documents as well as company-submitted documents indicate the company operated as a Limited Liability Corporation (LLC), which has neither stocks nor stockholders.

[1] The 33% Targeted Business R&D Program allows participants to sell state income tax credits awarded for immediate cash. Credits are typically purchased by third-party individuals or businesses at a discount for full face value. In this instance, the company sold over $2 million in credits tied to the stock fringe benefits outlined above as well as additional expenses approved by AEDC.

- $2.3 million in state income tax credits were awarded by AEDC from 2014-2018 to two companies with no itemized expense listing available. Instead, category descriptions were used, such as "leased infrastructure," "cost of supplies," and "wages for qualified services." The lack of itemized expenses precludes AEDC from performing a sufficient review of submitted expenses.
- $325,155 in state income tax credits were awarded by AEDC to a company from 2016-2018 for wage expenses (e.g., for sales, legal, marketing, and administrative staff) totaling $1.6 million without adequate supporting documentation to verify the wage expenses were directly related to R&D activity. According to AEDC rules, "qualified wages" are for employees who directly engage, supervise, or support research.
- $438,592 in state income tax credits were awarded by AEDC to five companies in 2019 and 2020 without any supporting documentation.

Recommendation: *ALA staff recommend AEDC reevaluate the process used to award tax credits to ensure expenses are valid, accurate, and allowable. Company expense submissions should be substantiated by supporting documents, including invoices, organizational charts, Internal Revenue Service W-2 Forms, or job descriptions to establish a direct tie to R&D. AEDC may also consider a second review of previously approved tax credits to ensure submitted expenses were incurred, were properly documented, and met program eligibility requirements so that erroneously awarded tax credits may be recovered.*

Finding 2: Due to a calculation error, AEDC awarded a company $88,883 in state income tax credits above the amount allowed. The incremental increase in expenses from the third to fourth year were not used to calculate the incentive based on program requirements. Instead, the full amount of fourth-year expenses was incorrectly used to calculate the incentive, resulting in the overpayment.

Recommendation: *ALA staff recommend AEDC notify DFA of this error so that proper action can be taken to recover any loss to the State.*

CONCLUSION

Based on analysis of CIA projects, ALA staff concluded that the TaxBack, Advantage Arkansas, Create Rebate, and InvestArk programs have an overall positive cost effectiveness, while the In-House Research and Development and In-House Research and Development – Targeted Business programs have a negative cost effectiveness.

Due to the low number of projects completed, ALA staff have not yet evaluated sufficient data to reach a conclusion regarding the effectiveness of the ArkPlus, Sales and Use Tax Refund – Targeted Business, and Payroll Tax Credit – Targeted Business, as well as the Research and Development programs subsequent to Act 327 of 2019.

Additionally, AEDC's review of annual expenses submitted for review and approval for the two Research and Development programs was inadequate, as discussed on **pages 10 and 11**.

MANAGEMENT RESPONSE

Management response is provided in its entirety in **Appendix C**.

Schedule 1

Consolidated Incentive Act (CIA)
InvestArk Projects Selected for Review

Company	Years Incentives Awarded	Tier	InvestArk Incentives Awarded	Actual Project Cost Submitted by Company	Met Minimum Investment Requirements for Incentive	DFA Audits Completed (Note 1)
1	2015-2019	1	$ 1,837,692	$ 26,252,735	Yes	Note 1
2	2015-2019	1	999,019	14,271,689	Yes	Note 1
3	2015-2019	4	986,073	14,086,752	Yes	Note 1
4	2016-2018	2	9,614,991	137,357,014	Yes	Yes
5	2016-2019	1	990,273	14,147,173	Yes	Note 1
6	2016-2017, 2019	3	719,613	10,280,909	Yes	Note 1
7	2016-2020	2	1,049,999	15,514,007	Yes	Note 1
8	2016-2020	1	972,476	13,892,520	Yes	Note 1
9	2016-2019	1	1,613,563	23,050,915	Yes	Note 1
10	2016-2017, 2019-2020	1	4,301,088	61,444,098	Yes	Note 1
11	2016-2019	2	685,765	9,796,630	Yes	Note 1
12	2016-2020	2	957,483	13,678,320	Yes	Note 1
13	2017-2021	1	1,406,716	20,095,954	Yes	Note 1
14	2017-2019	2	553,260	7,903,701	Yes	Note 1
15	2019-2020	2	427,300	6,104,284	Yes	Yes
16	2017-2020	2	3,290,000	47,000,000	Yes	Note 1
17	2017-2020	4	443,495	6,335,621	Yes	Yes
18	2017-2019	1	2,230,788	31,868,406	Yes	Yes
19	2016-2020	2	1,608,779	22,982,548	Yes	Note 1
20	2017-2021	2	2,425,558	34,650,822	Yes	Note 1
21	2017-2021	2	578,513	8,288,375	Yes	Note 1
22	2017-2020	2	693,649	9,999,995	Yes	Note 1
23	2017-2019	1	1,440,337	20,889,747	Yes	Note 1
24	2017-2020	2	607,918	8,684,546	Yes	Note 1
25	2017-2020	3	1,309,253	18,750,000	Yes	Note 1
26	2017-2021	1	901,233	13,021,039	Yes	Note 1
27	2017-2021	2	501,395	7,162,807	Yes	Note 1
28	2017-2019, 2021	1	535,222	7,646,035	Yes	Note 1
29	2017-2019, 2021	1	594,594	8,494,202	Yes	Note 1
30	2017-2021	1	9,581,248	136,875,000	Yes	Yes
31	2017-2018, 2021	4	665,000	9,500,000	Yes	Note 1
32	2017-2018	3	558,048	7,972,105	Yes	Note 1
33	2020-2021	4	616,499	8,807,130	Yes	Yes
34	2017-2019	4	355,624	5,080,348	Yes	Yes
35	2017-2018	1	740,687	10,581,250	Yes	Note 1
36	2018-2019	1	919,289	13,132,705	Yes	Note 1

Schedule 1 (Continued)

Company		Years Incentives Awarded	Tier	InvestArk Incentives Awarded	Actual Project Cost Submitted by Company	Met Minimum Investment Requirements for Incentive	DFA Audits Completed (Note 1)
37		2017-2019, 2021	1	$ 1,260,355	$ 18,005,063	Yes	Note 1
38		2017, 2019	1	836,643	11,952,036	Yes	Note 1
39		2017-2020	1	1,761,995	25,171,341	Yes	Yes
40		2017-2019	4	425,606	6,080,102	Yes	Yes
41		2017-2020	4	3,776,176	53,945,363	Yes	Yes
42		2017-2019	4	980,972	14,013,904	Yes	Yes
43		2017-2020	3	3,211,931	45,929,054	Yes	Note 1
44		2018-2021	1	941,500	13,450,000	Yes	Note 1
45		2018, 2020-2021	3	466,414	6,663,052	Yes	Note 1
46		2017-2021	3	2,274,559	32,493,712	Yes	Note 1
47		2018-2021	3	1,245,848	17,797,819	Yes	Note 1
48		2017-2020	3	668,627	9,551,790	Yes	Yes
49		2018-2022	4	4,856,498	69,378,534	Yes	Note 1
50		2017-2021	1	51,578,750	736,839,281	Yes	Note 1
51		2019-2020	1	4,337,658	61,966,551	Yes	Yes
52		2018-2019	2	505,307	7,218,664	Yes	Note 1
53		2018-2019	2	723,680	10,338,285	Yes	Note 1
54		2017-2018	1	1,022,000	14,600,000	Yes	Note 1
55		2017-2020	4	3,920,000	55,999,999	Yes	Note 1
56		2018-2020	1	1,277,247	18,246,394	Yes	Note 1
57	**(Note 2)**	2017-2019	1	2,614,158	37,345,118	Yes	Note 1
58		2017-2018	1	1,297,833	18,540,471	Yes	Note 1
Total				**$ 147,696,197**	**$ 2,111,125,915**		

DFA = Department of Finance and Administration

Note 1: Some years had not been audited by DFA at time of our review. Therefore, some expenditures may be disallowed, and credits will be adjusted by DFA accordingly.

Note 2: Project received additional non-InvestArk incentives that are evaluated in **Schedule 2.**

Sources: *DFA and Arkansas Economic Development Commission (unaudited by Arkansas Legislative Audit)*

Schedule 2

Consolidated Incentive Act (CIA)
Non-InvestArk Projects Selected for Review

Company	1	2	3	4	5	6	7	8	9	10	11	12
Years Incentives Awarded	2013-2018, 2020	2015-2019	2015-2017	2016-2019	2017-2019	2018	2017-2019	2014-2018	2017-2021	2016-2019	2016-2020	2016-2019
Tier	2	3	1	1	1	1	1	1	1	1	1	1
CIA Incentives Awarded: *(Note 1)*												
Statutory Incentives:												
AA - Advantage Arkansas	$0	$0	$0	$0	$0	$1,759	$24,458	$0	$0	$0	$0	$0
TB - Tax Back	$0	$0	$0	$0	$107,494	$13,143	$0	$0	$0	$0	$0	$0
IHR - In-House Research and Development	$0	$0	$0	$0	$0	$0	$0	$0	$4,217,244	$145,714	$0	$2,391,586
Discretionary Incentives:	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
AP - ArkPlus	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
CR - Create Rebate	$1,517,492	$2,500,000	$765,361	$550,000	$411,273	$0	$0	$0	$0	$0	$0	$0
IHR-TB - In-House Research - Targeted Business	$0	$0	$0	$0	$0	$0	$0	$2,188,650	$0	$0	$850,008	$0
PTC-TB - Payroll Tax Credit - Targeted Business												
Total	$1,517,492	$2,500,000	$765,361	$550,000	$518,767	$14,902	$24,458	$2,188,650	$4,217,244	$145,714	$850,008	$2,391,586
Estimated Direct, Indirect, and Induced State Tax Benefits *(Note 1)*	$4,705,831	$12,272,579	$3,700,619	$2,399,486	$1,594,509	$41,064	$437,699	$312,279	$1,304,172	$156,870	$263,300	$5,042,438
Actual Eligible Project Costs: *(Notes 1 and 2)*	$0	$0	$0	$0	$1,831,532	$232,345	$0	$4,109,632	$19,227,853	$85,141	$354,683	$0
New Full-Time, Permanent Employees (positions):												
Projected	90	170	237	64	88	60	94	**Note 3**				
Actual (average of years available)	87	223	183	74	69	n/a	30					
Actual (final year total)	87	183	277	86	68	6	50					
New Annual Wages (years receiving payroll incentive):												
Projected	$5,101,200	$7,340,736	$9,400,000	$3,293,162	$3,900,000	$125,000	$2,975,814					
Actual (average over life of project)	$5,231,912	$12,273,361	$6,541,546	$4,727,071	$3,515,154	n/a	$956,004					
Actual (final year total)	$5,757,368	$9,690,347	$9,590,603	$5,145,378	$3,851,593	$175,899	$1,663,188					
Average Hourly Rate:												
Projected	$27.25	$20.76	$17.67	$24.36	$21.76	$32.00	$15.22					
Actual (average over years data available)	$23.85	$25.35	$17.70	$30.75	$25.97	n/a	$16.45					
Actual (final year total)	$19.12	$27.41	$16.88	$28.95	$28.36	$14.86	$16.90					
Initial AEDC Cost-Benefit Ratio Calculation Outcome	positive	positive	positive	positive	positive	positive	positive	N/A	N/A	N/A	N/A	N/A
ALA Cost Benefit Ratio	1:3.11	1:4.90	1:4.83	1:4.29	1:3.05	1:2.76	1:17.92	1:0.14	1:0.31	1:1.05	1:0.31	1:2.08
Met Minimum Requirements for Incentive	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
DFA Audits Completed	Yes	Yes	Yes	Yes	Yes	Yes	Yes	*Note 5*	*Note 5*	*Note 5*	*Note 5*	*Note 5*
							Note 4					

Schedule 2 (continued)

Company	13	14	15	Total Non-InvestArk Projects Reviewed
Years Incentives Awarded	2016-2020	2017-2021	2017-2021	
Tier	1	1	1	
CIA Incentives Awarded: *(Note 1)*				
Statutory Incentives:				
AA - Advantage Arkansas	$0	$0	$0	$26,217
TB - Tax Back	$0	$0	$0	$120,637
IHR - In-House Research and Development	$0	$454,961	$0	$7,209,505
Discretionary Incentives:	$0	$0	$0	
AP - ArkPlus	$0	$0	$0	$0
CR - Create Rebate	$0	$0	$0	$5,744,126
IHR-TB - In-House Research - Targeted Business	$206,709	$0	$607,295	$3,852,662
PTC-TB - Payroll Tax Credit - Targeted Business				$0
Total	$206,709	$454,961	$607,295	$16,953,147
Estimated Direct, Indirect, and Induced State Tax Benefits *(Note 1)*	$105,476	$387,767	$239,946	$32,964,035
Actual Eligible Project Costs: *(Notes 1 and 2)*	$14,721	$1,814,948	$238,349	$27,909,204
New Full-Time, Permanent Employees (positions):				
Projected	**Note 3**			803
Actual (average of years available)				
Actual (final year total)				757
New Annual Wages (years receiving payroll incentive):				
Projected				$32,135,912
Actual (average over life of project)				
Actual (final year total)				$35,874,376
Average Hourly Rate:				
Projected				
Actual (average over years data available)				
Actual (final year total)				
Initial AEDC Cost-Benefit Ratio Calculation Outcome	N/A	N/A	N/A	
ALA Cost Benefit Ratio	1:0.51	1:0.86	1:0.39	
Met Minimum Requirements for Incentive	Yes	Yes	Yes	
DFA Audits Completed	*Note 5*	*Note 5*	*Note 5*	

AA - Advantage Arkansas (statutory) - income tax credits for job creation of new, full-time, permanent employees.

AP - ArkPlus (discretionary) - income tax credits for investment in a new location or expansion project; also requires job creation.

CR - Create Rebate (discretionary) - cash payments for job creation of new, full-time, permanent employees.

TB - Tax Back (statutory) - refund of sales and use taxes for building materials and taxable equipment.

IHR - In-House Research and Development (statutory) - income tax credits of 20% of research and development expenditures.

IHR-TB - In-House Research and Development - Targeted Business (discretionary) - income tax credits of 33% of research and development expenditures in targeted sectors.

PTC-TB - Payroll Tax Credit - Targeted Business (discretionary) - income tax credits of 10% of payroll for new businesses in targeted sectors.

Note 1: For the life of the project.

Note 2: A company may incur non-taxable expenditures that count toward the minimum threshold for Tax Back.

Note 3: Employment, annual wage, and hourly rate data are not included for Research and Development projects since, in some cases, these are not new full-time, permanent employees.

Note 4: Project also received InvestArk incentives.

Note 5: Research and Development expenditures are reviewed by the AEDC Division of Science and Technology prior to payment.

N/A = Not Available

AEDC = Arkansas Economic Development Commission

ALA = Arkansas Legislative Audit

DFA = Department of Finance and Administration

Sources: *AEDC and DFA (unaudited by Arkansas Legislative Audit)*

Appendix A

Consolidated Incentive Act (CIA)
Statutory and Discretionary Incentives

Statutory Incentives

TaxBack (Sales and Use Tax Refund): Refund of sales and use taxes for purchases of building materials and taxable machinery and equipment. All project costs must be incurred within four years and must exceed $100,000.

InvestArk (Sales and Use Tax Credit): Sales and use tax credit for existing businesses investing at least $5 million in plant or equipment for new construction, expansion, or modernization within a four-year period. The credit is equal to 1/2% above the state sales and use tax rate. Additionally, any incentives earned can only be used to offset up to 50% of the company's sales and use tax liability in a given year. Any unused credits may be carried forward for a period of up to five years.

Advantage Arkansas (Income Tax Credit): Income tax credits for job creation based on the payroll of new full-time, permanent employees (i.e., an individual working at least 30 hours per week for 26 consecutive weeks). The credits may be earned for five years, range from 1% to 4%, and require minimum new payroll of $50,000 to $125,000, depending on the tier ranking of the county. Credits can be used to offset up to 50% of the company's income tax liability in a given year. Unused credits may be carried forward for nine years beyond the year in which the credit was first earned.

In-House Research and Development: Income tax credits based on qualified research and development expenditures within a five-year period. Credits may be used to offset 100% of the business' income tax liability in a given year. The incentive is equal to 20% of eligible research expenditures. Unused credits may be carried forward for nine years beyond the year in which the credit was first earned. Act 327 of 2019:

- Changed this program from a statutory to a discretionary incentive.
- Changed the amount of the incentive from a flat 20% to a maximum of 20%.
- Limited eligible expenditures to wages and benefits.
- Required credits to be based on the incremental amount spent that exceeds the baseline established from previous year spending.

Projects reviewed in reports to date were prior to this change.

Discretionary Incentives

Create Rebate (Payroll Rebate): Annual cash payments based on the annual payroll for new full-time, permanent employees (i.e., an individual working at least 30 hours per week for 26 consecutive weeks). To receive this credit, the company must create a minimum of $1.25 million to $2 million in new payroll, depending on the tier ranking of the county. The incentive period, determined at the time of the agreement, may last up to 10 years. The rebate is equal to 3.9% to 5% of new, eligible payroll, depending on the tier ranking of the county.

ArkPlus (Investment Income Tax Credit): Income tax credits equal to 10% of the total investment in a new location or expansion project. To receive this credit, the business must invest $2 million to $5 million and have new payroll of $800,000 to $2 million, depending on the tier ranking of the county. Credits can be used to offset up to 50% of the company's income tax liability in a given year. Unused credits may be carried forward for nine years beyond the year in which the credit was first earned.

Sales and Use Tax Refund – Targeted Business: Refund of sales and use taxes paid on the purchases of building materials and taxable machinery and equipment for businesses in targeted sectors. All project costs must be incurred within four years.

Payroll Tax Credit – Targeted Business: Income tax credits equal to 10% of payroll to assist with the start-up of businesses in targeted sectors that pay significantly more than the state or county average wage. The business must have payroll between $100,000 and $1 million to earn the credit. The incentive may be offered for a period not to exceed five years. Unused credits may be carried forward for nine years beyond the year in which the credit was first earned.

In-House Research and Development – Targeted Business: Income tax credits based on qualified research and development expenditures in targeted sectors within a five-year period. Credits may be used to offset 100% of the business' income tax liability in a given year. The incentive is equal to 33% of eligible research expenditures. Unused credits may be carried forward for nine years beyond the year in which the credit was first earned.

Incentive	Sales and Use Tax Refund or Credit	Income Tax Credit	Cash Payment	DFA Audit Required
Statutory Incentives				
TaxBack	✓			✓
InvestArk	✓			✓ **(Note 1)**
Advantage Arkansas		✓		✓
In-House Research and Development (pre-Act 327 of 2019) **(Note 2)**		✓		**(Note 3)**
Discretionary Incentives				
Create Rebate			✓	✓
ArkPlus		✓		✓
Sales and Use Tax Refund – Targeted Business	✓			✓
Payroll Tax Credit – Targeted Business		✓		✓
In-House Research and Development – Targeted Business		✓		**(Note 3)**

DFA - Department of Finance and Administration

Note 1: InvestArk audits are performed by DFA after incentives are issued.

Note 2: Act 327 of 2019 changed the 20% Research and Development incentive from statutory to discretionary and limited eligible expenditures to wages and benefits. The Act also requires credits to be based on the incremental amount spent that exceeds the baseline established from previous year spending.

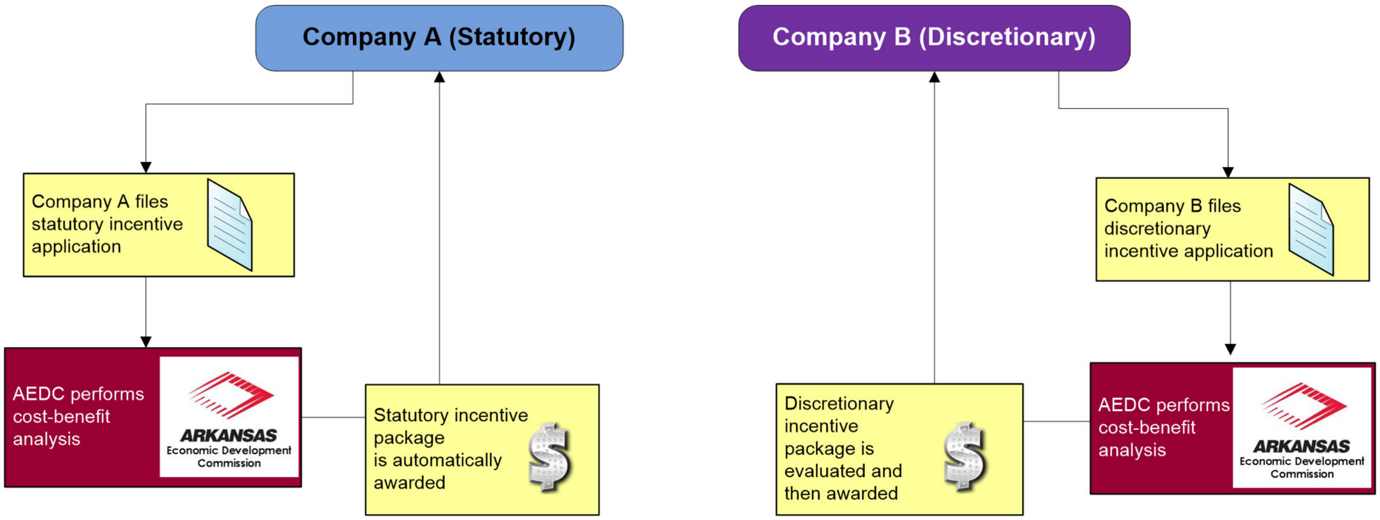
Note 3: Research and Development expenditures are reviewed by the Arkansas Economic Development Commission (AEDC) Division of Science and Technology prior to payment.

Source: *Consolidated Incentive Act of 2003, codified at Ark. Code Ann. §§ 15-4-2701 – 15-4-2714*

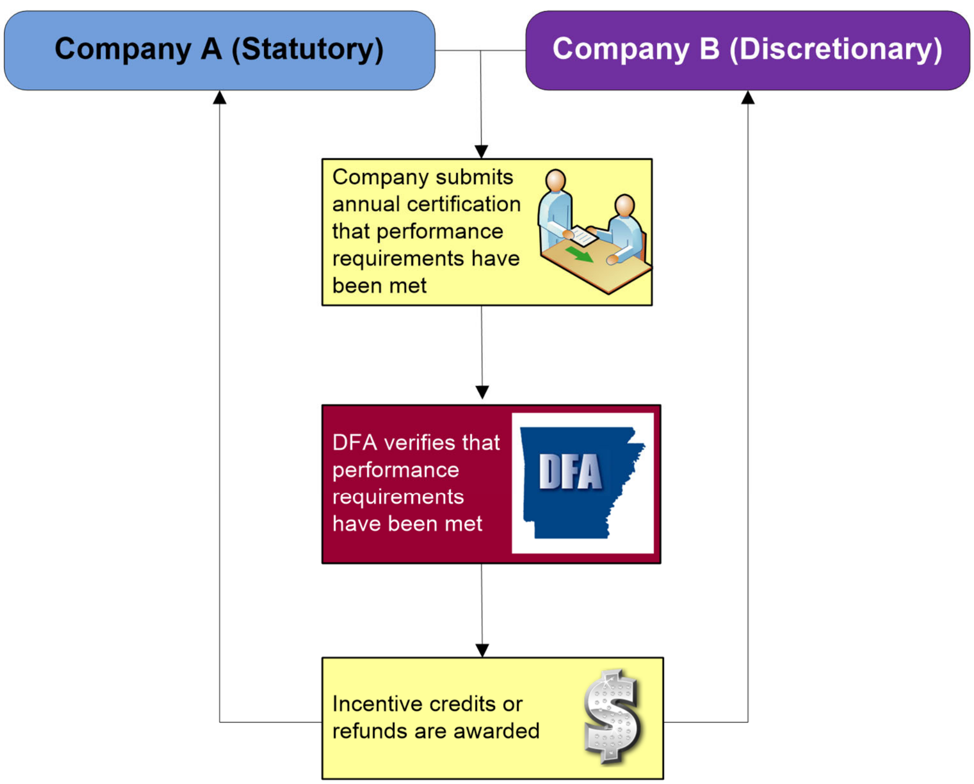
Appendix B

Consolidated Incentive Act (CIA)
Application and Verification Processes

Application Process for Statutory and Discretionary Incentives



Verification Process for Statutory and Discretionary Incentives (Note)



Note: The Department of Finance and Administration verifies that incentive requirements have been met and issues the payments/rebates, with the exception of In-House Research and Development incentives.

Source: *Consolidated Incentive Act of 2003, codified at Ark. Code Ann. §§ 15-4-2701 – 15-4-2714*

Appendix C

Management Response

ARKANSAS INC

Hugh McDonald
SECRETARY OF COMMERCE
Clint O'Neal
EXECUTIVE DIRECTOR,
ARKANSAS ECONOMIC
DEVELOPMENT COMMISSION

November 17, 2023

Mr. Justin Meatte
Arkansas Legislative Audit
State Capitol, Room 172
Little Rock, AR 72201

Re: Cost Benefit Analysis of Selected Economic Incentive Projects Special Report
January 1, 2013 through December 31, 2022

Dear Mr. Meatte,

Thank you for the opportunity to review the draft Cost Benefit Analysis of Selected Economic Incentive Projects Special Report prepared by your office. After review of the report on the selected projects and conclusion statement, we would like to present the following comments for inclusion with your report.

The first issue from the report addresses inadequacies with AEDC's verification process that resulted in a loss of state funds due to ineligible or undocumented company expenses counted towards tax credits. Our office recognized these inadequacies in 2021 and implemented more stringent controls at that time to correct for inadequacies like this one moving forward. We recognize that we must do more than just get this right in the future. We do not believe that any tax credits were issued without proper documentation being submitted, as that would have violated our internal protocols based on how the R&D program is structured. However, proper records were not retained by AEDC staff for future reference, putting us in this predicament. To remedy the lack of acceptable documentation on these projects, AEDC has contacted the tax credit recipients that do not have a complete file and have requested submission or resubmission of all missing documents. If we are unable to remedy the deficiencies through this outreach directly to tax credit recipients, we will submit project specific information to DFA for charge back procedures as authorized in the Tax Procedures Act.

The second issue from the report addresses a calculation error in which AEDC issued a 2020 tax credit for $88,883 above the proper amount. The calculation was erroneously based on the year one baseline instead of the year three to year four incremental increase. AEDC admits this was an accidental calculation error. Due to the steps taken in 2021 to create better internal controls and oversight of the program, we are confident that an error such as this will not happen in the future. We recognize that this error is unacceptable, and we are working with DFA to initiate charge back procedures as authorized by the Tax Procedures Act.

We appreciate the opportunity to respond to ALA's review of AEDC's incentive programs. We welcome further review of our programs by ALA and will continue to consider recommendations made by ALA and by the Legislature.

Sincerely,

Clint O'Neal
Executive Director
Arkansas Economic Development Commission

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LEGISLATIVE AUDIT

ARKANSAS