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To: Honorable Members of the Joint Legislative Committee on the Budget

From: Greg Albrecht, Chief Economist, Legislative Fiscal Office GVA
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Subject: Pool Corp. Tax Equalization Renewal Request
Act 704 of 2014 and Act 389 of 2007

Act 704 of the 2014 Regular Session requires a standard set of economic and financial information be submitted to the Joint Legislative Committee on the Budget (JLCB) for projects that involve a state commitment in excess of $10 million over the term of a project. The Act requires the Legislative Fiscal Office to provide an evaluation of the submitted project assessment.

The Department of Economic Development (LED) is submitting such information for JLCB approval of a five-year renewal of a tax equalization benefit for various business entities collectively referred to as POOL. Based on the information provided by LED, the renewal does not actually meet the state commitment threshold of Act 704, in that the commitment totals an estimated $8.1 million over the 2014 – 2018 term. However, LED has indicated that out of an abundance of caution and as a trial run of the new reporting process it is submitting the renewal under the requirements of Act 704.

In addition, Act 389 of 2007 requires third and subsequent renewals of tax equalization exemptions be approved by the JLCB under the provisions of R.S. 47:3204. This renewal would be the third one for POOL. The analysis of the renewal under both requirements is discussed below.

Act 704 of 2014 Provisions

a) State Commitment: The estimated benefits to POOL over the five-year renewal period (2014 – 2018) are $8.1 million in reduced corporate income and franchise tax liabilities. This commitment of state resources is less than the $10 million threshold required for consideration under Act 704.
b) Analytical Model: Estimates of the economic impact in Louisiana of the operations of POOL were provided by Paul S. Nelson and Robert C. Eisenstadt; professors of economics at the University of Louisiana at Monroe. They utilized the RIMS I and RIMS II multipliers for the wholesale trade industry of Louisiana, generated by the Bureau of Economic Analysis of the U.S. Department of Commerce. These are standard input/output multipliers commonly utilized for economic impact analysis. Economic impacts were generated from POOL's direct employment of 340 full-time equivalent employees and payroll of $26 million.
c) Economic Impacts: The estimates of economic impact do not entirely conform to the requirements of Act 704. However, the authors of the analysis were not aware that the analysis was commissioned for Act 704 purposes (or for the requirements of Act 389).
    i) Value Added was estimated for fourteen industries for a single initial year, and totaled $90.1 million. This is the industry level and state level equivalent of gross domestic product, and is a broad measure of total economic activity, although it includes components that do not necessarily reflect economic impacts on the households of the state economy.
    ii) Household Earnings were estimated for an initial single year and for a ten-year present value. For the single year, total earnings in the economy were estimated

at $43.9 million; 76% of which are attributable to the operations of POOL (it's purchases and the purchases of it's suppliers) and 24% of which are attributable to the induced effects in the economy (purchases by employees and consumers).

iii) Employment was estimated for a single initial period. POOL is estimated to directly employ 340 full-time equivalent employees; 327 full-time and 27 part-time employees, where 2 part-time employees are assumed to be 1 full-time employee. Total economy-wide employment is estimated at 730, with indirect employment by supplier firms estimated at 146 (20%), and employment induced in other industries estimated at 244 (33%).

d) Impacts By Industry: Value added was estimated for fourteen industry groups. Of the $90.1 million total estimate, $58.5 million or 65% was attributable to the wholesale trade industry. A large portion of impact obviously occurs in the industry within which the subject firm operates. Effects step down sharply across the remaining industries with the next largest effect in real estate, rentals, and leasing at $6.3 million or 7% of the total, and the smallest effects in food services and utilities, at $1.1 million or 1.2% of the total each.

e) Fiscal Costs: Tax Equalization credits extended to POOL over the life of the five-year renewal period are reported by the Department of Economic Development to total $8.1 million. Credits start at $1.3 million for 2014 and increase to $1.9 million by 2018. These credits are taken against corporate income and franchise tax liabilities.

f) Incentive Significance: According to the Department of Economic Development, factors such as transportation, energy, and infrastructure are not critical for the POOL headquarters location, and that the primary factor contributing to a Louisiana location is the comparative tax liabilities between Louisiana and Florida or Nevada. In addition, according to the Department, POOL has indicated that if the Tax Equalization renewal is not provided, the company will strongly consider relocating the corporate headquarters to another state.

g) Fiscal Cost/Benefits: The impact analysis estimated the amount of state sales tax and personal income tax associated with the operations of POOL in the state. Effectively 1.6% of the total household earnings estimate was assumed subject to the state's 4% sales tax rate (40% of earnings assumed spent on goods & services taxed at 4%). The average compensation for POOL employees ($76,657 and 340 employees) and the average Louisiana labor income for the indirect and induced employment in the economy ($39,230 and 390 employees) were used to estimate personal income tax liabilities assuming two-person joint returns with only federal income tax deductions claimed. These assumptions resulted in a combined state tax receipt estimate of $1.576 million for 2014. Non-discounted tax receipts were provided for ten years, with the estimates for 2015 – 2018 growing by 3.6% per year to $1.8 million in 2018. This growth rate is a combination of a 4% annual growth projected by POOL for its expenses, and an assumed growth in wages for indirect and induced employees of 1.72%, the projected inflation rate in the analysis. These fiscal benefit estimates are compared to the fiscal cost estimates of the tax exemption ranging from $1.3 million in 2014 to $1.9 million in 2018. By these estimates, fiscal benefits exceed fiscal costs in each of the first three years of the renewal period; 2014 by $300,000, 2015 by $100,000, 2016 by $100,000. By 2017 costs and benefits are the same, and by 2018 costs exceed benefits by $100,000. Over the entire five-year period benefits exceed costs by a total of $400,000.

General Evaluation

The absolute levels of economic impacts estimated from input/output multipliers should be taken with considerable caution. These multipliers are based on dated relationships between industries, in this case as far back as 2002 for detailed industries and only as recent as 2010 for aggregated industries. In addition, multiplier analysis is static and linear, and tends to overstate economic impacts and, consequently, fiscal benefits.

It is notable that the estimated net fiscal benefits are quite small; $300,000 in the first year, falling to $100,000, then $0, and finally ending at -$100,000 in the fifth year. While the fiscal benefits include only sales tax and personal income tax, and can be considered conservative in that sense, those two taxes already make up about 70% of all taxes associated with household earnings, the basis of the estimated fiscal benefits. Adding other taxes to the estimated total benefits results in net benefits over costs that do not exceed $1 million in any year. This is still a slim margin of net benefit. If the firm receives other state tax benefits this margin is even slimmer.

It is also notable that the relatively slim margin of net fiscal benefit that falls out of the analysis occurs largely because the fiscal costs of the tax benefits extended to the firm are reported to be significantly smaller over the next five-year renewal period than they are reported to have been in the prior ten years (discussed below). The estimated state fiscal benefits going forward are projected on the basis of the firm's current size and activity, and are likely to be larger than in the past. If fiscal costs in the future turn out to be closer to their historical levels, the state will experience net fiscal losses in the future renewal period.

The analysis also does not account for the state's balanced budget requirement. This omission is common in impact analysis, but means that the $8.1 million total fiscal cost of the exemption, that have to be paid for elsewhere in the state budget, is not considered in the analysis. Lower government expenditures are a negative spending change that has its own multiplier effects that work to dampen the positive effect of the presence of POOL in the economy. Thus, total economic and fiscal benefits are overstated and, consequently, net fiscal benefits are, as well. Given the narrow margin of net benefits resulting from the analysis, it is possible that a more complete analysis would result in net fiscal costs to the state.

Finally, LED asserts that no other business costs or conditions (such as transportation, energy, and infrastructure) other than comparative tax liabilities are instrumental in the location of POOL in Louisiana. This is a strong assertion and would seem unlikely to be the case for any enterprise. However, according to LED, the company has indicated that it will strongly consider relocating to another state if the tax equalization renewal is not provided. If that is true, at best the fiscal costs of the renewal result in a small net benefit to the state fisc, but possibly a small net cost. If not true, the renewal results in absolute costs to the state fisc.

Act 389 of 2007 Provisions

Without regard to Act 704 of 2014, the renewal of the tax equalization exemption for POOL has to be approved by the JLCB under the provisions of R.S. 47:3204, the tax equalization program, as amended by Act 389 of the 2007 Regular Session. Act 389 of 2007 removed the then current ten-year maximum number of years of tax exemption, and allowed unlimited five-year renewals of tax exemption if the applicant can demonstrate that it's activities generate economic benefits to the state economy that exceed twenty times the tax exemption benefit to the applicant. Economic benefits to the state are to be determined by the use of the appropriate nationally recognized multipliers published by the U.S. Department of Commerce.

The economic impact analysis discussed above is utilized by LED to test whether the activities of POOL generate economic benefits to the state economy that exceed twenty times the tax exemption benefit for the year preceding the request for renewal. LED selected the estimate of total aggregate transactions as the measure of economic benefits to the state economy. That figure is $107.8 million and encompasses all purchases made by POOL (direct effect) plus all purchases made by supplier firms (indirect effect), and all purchases made by the employees of POOL and supplier firms as well as all other consumers in the economy (induced effect). This amount is then divided by the latest year of tax exemption benefits, reportedly $998,500 in 2012. The resulting multiple is 107.962, far exceeding the 20-times threshold required in law.

While the aggregate transactions concept is the typical headline number of economic impact analysis, it significantly overstates economic impact. It includes substantial double counting of spending as gross purchases at each stage of production are added together rather than the net purchases after production costs such as costs of goods sold are deducted at each stage. This double counting is further evidenced by the fact that estimated total household earnings (labor being the largest production input in the economy) in the analysis is $43.9 million, only 41% of the aggregate transactions estimate.

The most appropriate concept in impact analysis reflecting economic benefit to a state is the household earnings concept, in this case totaling some $43.9 million; itself likely to be overstated by the nature of input/output analysis and the omission of a balanced budget requirement. This concept reflects the earnings benefits received by the residents of the state employed by POOL, its suppliers, and all other firms receiving induced purchases. Dividing that amount by $998,500 results in a multiple of 43.996, still well above the 20-times threshold.

A tax exemption benefit amount of $998,500 is used in these calculations; reportedly the benefit received by the firm in 2012. The statute requires the use of the benefit for the year preceding the request for renewal; presumably the benefit for the 2013 year. However, LED indicates that the 2013 benefit amount is not available. Thus, the amount for the latest year available was utilized. This tax benefit amount looks low in the context of the total amount of benefit LED reports the firm has received; $44.998 million over nine years, composed of $28.447 million in the original five-year period and $16.550 million in the first four years of the second five-year renewal period. These totals imply annual average benefit amounts of $5 million, $5.689 million, and $4.138 million, respectively. The figure of $998,500 for 2012 implies an average benefit of $5.184 million for the first three years of the second five-year renewal period. The 2012 figure utilized obviously seems low in comparison to these averages. If any of these average benefit amounts are divided into the household earnings estimate of economic benefits to the state, the resulting multiples all fall well below the 20-times threshold required in law (ranging from 7.717 to 10.609). These considerations suggest it is uncertain whether the 20-times threshold is met. It is not readily clear why the tax benefits expected in the future will be materially lower than those extended in the past. LED has indicated that a representative of POOL will be available at the JLCB meeting to address any questions as needed.

Regardless of the appropriate firm tax benefit utilized in the calculation of the test multiple, if the aggregate transactions concept is utilized to reflect economic benefit to the state, then for all practical purposes, it is impossible for the 20-times threshold to not be met. Calculated with the lower tax benefit figure from 2012 simply assures that the threshold is exceeded by an even greater amount.

Finally, R.S. 47:3204.B.(1)(b)(ii) requires that the application for subsequent renewal include an attestation by an independent public accounting firm of the calculation of the economic benefit to the state. An attestation was provided but attests only to the payroll calculations in the impact analysis. The payroll calculations are not what LED utilized as reflecting the economic benefits to the state. As discussed above, gross purchases in the economy (referred to as aggregate transactions in the impact analysis), inclusive of the double counting also discussed above, are utilized to reflect economic benefits in the 20-times multiple test.

Addendum

Testimony was provided to the JLCB from a representative of POOL as well as LED concerning the significant difference between the reported tax benefit the firm received over the nine years 2004 – 2012 of the original and first renewal period of the tax equalization program. The firm indicated that for the first nine years of participation in the program it had mistakenly included multi-state income in the tax benefit calculations reported to LED, rather than just income apportioned to Louisiana. This significantly overstated the true dollar amount of tax benefit extended to the firm. Starting with 2013 and the years of the third, and presumably subsequent, five-year renewal periods, the firm will report tax benefits on the basis of only its Louisiana apportioned income. This basis results in an estimated a dollar amount of state tax benefit ranging from $1.3 million to $1.9 million per year over the 2014 – 2018 period, for a total $8.1 million. LED has indicated that the program effectively eliminates all of the firm's state corporate income and franchise tax liability.