



## Memorandum

**To:** Oklahoma Incentive Evaluation Commission  
**From:** Randall Bauer, PFM Project Team  
**RE:** Recommended Changes to the 2022-2025 Incentive Evaluation Schedule

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As required by statute, the Oklahoma Incentive Evaluation Commission (Commission) updated the schedule for incentive evaluations in 2022 through 2025 at its December 2021 meeting. As the PFM project team has begun its work on the 2022 incentives, we have identified some incentives that we believe should be modified on that schedule. This will also, in some cases, impact on the incentives subject to evaluation for the Commission in 2022. The following identifies these issues and our recommendations to the Commission.

1. **Energy Efficient Residential Construction Tax Credit.** This credit had a June 30, 2016 sunset and has not been re-enacted. We reviewed it in 2018 because the credit can be carried forward for four years. The sunset and carry forward provision were confirmed in the Oklahoma Tax Commission's 2020 Tax Expenditure Report. Given that the credit is no longer in use, there is no reason to further evaluate it.

Parenthetically, it would probably make sense to add a third category to the spreadsheet for those incentives that have been removed from statute and thus are no longer in use. This (along with some of the oil and gas incentives and a few others) would fit into that category.

2. **Basic and Applied Research Loan/Grant Program.** This is the agriculture research loan/grant program. PFM wrote a memo to the Commission in 2018 noting that the program had hardly been used (many years no financial impact and in no year more than \$100,000), and the Commission voted at its April 26, 2018 meeting to exempt it from evaluation. In this case, we neglected to move it into the exempt category. We would again suggest that it be moved into that category, and we will, should this recommendation be adopted, update the 2022-2025 schedule to reflect that.
3. **Quality Jobs Investment Program.** This was repealed in 2019. It is notable that the Commission recommended repealing the program in the 2018 evaluation, and the Oklahoma Development Finance Authority agreed with that recommendation – no loans had been made in the program since 2007. There is really no point in re-stating those conclusions, as nothing has changed since its repeal in 2019.
4. **Small Business Incubators – Sponsors.** This was also repealed in 2019 (in the same bill that repealed the Quality Jobs Investment Program). This was also a recommendation of the Commission in 2018. The Small Business Incubators tax



exemption for tenants remains in place, and we will evaluate it. In 2018, we combined the two into a single evaluation, so that will not change, but there isn't much point in keeping the sponsor exemption on the schedule.

5. **Incentives for Inventors/New Products Development Income Tax Exemption.** These are the same program and should be combined on the spreadsheet. We will evaluate it/them, but the spreadsheet needs to be revised to combine them.



## 2022 Incentives for Evaluation

### Affordable Housing Act

Intent: To expand the supply of new and affordable rental units and rehabilitate existing rental housing for qualifying households by stimulating private investment.

Synopsis: Investors in affordable housing projects in Oklahoma counties with population less than 150,000 may qualify for income tax credits equal to 100 percent of the Federal Low-Income Housing Tax Credit.

The credit period is up to 10 years after the project is placed into service. Credits are non-refundable but may be carried forward for five years; they cannot be used to reduce a tax liability accruing prior to January 1, 2016. An insurance company may use the credits against state premium tax.

#### 2018 Criteria for Evaluation:

- Number of housing projects funded by the program
- Housing units associated with the credit
- Change qualified housing projects before/after the credit
- Comparison with other states with/without similar credits
- State return on investment

#### 2022 Proposed Criteria for Evaluation:

- Number of projects and units funded by the program
- Program-funded projects as a share of all low-income housing production
- Number and percent of low-income units in market-rate neighborhoods
- Percent of low-income population with/without access to affordable housing over time
- Percent of low-income renters served as a result of the program
- Economic activity associated with program funding
- State return on investment

### Applied Research Support Program

Intent: To increase investment in the research and development of new technologies that will ultimately bring value to the state of Oklahoma and help grow and diversify the state's economy.

Synopsis: The Oklahoma Applied Research Support Program (OARS) assists in the accelerated development of technology in the State by supporting applied research activities in existing and emerging technical areas whose results have both:

- A high probability of leading to commercially successful products, processes or services within a reasonable period of time; and
- A significant potential for stimulating economic growth within the state, encouraging and sustaining partnerships among institutions of higher education, non-profit research organization, and private enterprises by encouraging collaborative projects which are designed to promote increased knowledge and technology transfer.

There are two funding categories:



- Proof of concept funding supports early stage applied research and development. Yearly awards are up to \$45,000 and 1-2 years of funding are provided.
- Accelerated funding supports later stage applied research and development. Total awards are up to \$300,000 over 1-3 years.

OARS awards provide a maximum of one state dollar of funding for each non-state dollar of matching funds.

2018 Criteria for Evaluation:

- Commercially successful products developed as a result of program funding
- Economic activity associated with program funding
- Number/types of collaborative projects associated with funding
- Comparison of collaborative projects before/after the program
- Return on investment

2022 Proposed Criteria for Evaluation:

- Value and number of awards made over time
- Value of additional funding leveraged as a result of program funding
- Number and value of commercially successful products, processes or services developed as a result of program funding
- Interaction or coordination with other programs or service offerings in the economic development or entrepreneurial support ecosystem
- Case studies or other longitudinal tracking of program recipient growth outcomes
- Economic activity associated with program funding
- State return on investment

## **Health Research Program**

Intent: The Health Research Program addresses OCAST's statutory mandate of supporting basic human health-related research by allocating resources according to scientific merit and the potential to leverage private and federal resources while fostering public and private sector collaboration.

Synopsis: The Oklahoma Health Research Program funds basic research projects related to human health for one to three years at a maximum level of \$45,000 per year. All proposals are reviewed and ranked for funding by experienced health researchers who reside outside the state of Oklahoma. Peer reviewers evaluate applications for scientific merit based on the quality of the proposed research, qualifications of the principal investigator and appropriateness of the institutional facilities and budget.

2018 Criteria for Evaluation:

- Number of health research scientists recruited/retained through the program
- National research funding obtained as a result of the program
- Comparison of national research funding before/after the program initiated
- Comparison of national research funding for states without this type of program
- Health care products and services developed as a result of funding
- State return on investment



### 2022 Proposed Criteria for Evaluation:

- Value and number of awards made over time
- Value of additional funding leveraged as a result of program funding
- Number and value of health care products and services developed as a result of program funding
- Interaction or coordination with other programs or service offerings in the economic development or entrepreneurial support ecosystem
- Case studies or other longitudinal tracking of program recipient growth outcomes
- Economic activity associated with program funding
- State return on investment

### **Investment/New Jobs Tax Credits**

Intent: To incentivize capital investment and job creation

Synopsis: Aircraft maintenance, or web search portal facilities may qualify for the following tax credits:

- 1 percent of qualified property cost
  - Requirements: at least \$50,000 in depreciable property for use in a manufacturing operation (with manufacturer exemption permit), qualified aircraft maintenance or manufacturing facility, or a qualified web search portal
  - The capital investment cannot be the direct cause of a decline in FTEs.
- \$500 per new employee
  - Requirements: A net increase in the number of FTEs in a manufacturing operation (with manufacturer exemption permit), qualified aircraft maintenance or manufacturing facility, or a qualified web search portal
  - Each employee must be paid at least \$7,000 per year to be counted toward calculation

Manufacturers may qualify for the following tax credits:

- 2 percent of qualified property cost
  - Requirements: at least \$40 million of depreciable property within 3 years
  - The capital investment cannot be the direct cause of a decline in FTEs.
- \$1,000 per new employee
  - Requirements: net increase in the number of FTEs engaged in manufacturing and \$40 million of depreciable property investment within 3 years
  - Each employee must be paid at least \$7,000 per year to be counted toward calculation

Qualified property includes machinery, fixtures, equipment, buildings, and substantial improvements thereto.

The tax credit may be taken for a total of 5 tax years. Tax credits for job creation may be carried forward for an additional 15 years.

### 2018 Criteria for Evaluation:

- Change in employment and payroll from qualified facilities
- Change in employment and payroll from qualified industries before/after program
- Change in employment and payroll in qualified industries in other states
- Return on investment analysis



#### 2022 Proposed Criteria:

- Change in employment, payroll, and capital investment from qualified facilities
- Change in employment, payroll, and capital investment from qualified industries before/after program
- Change in employment, payroll and capital investment in qualified industries in other states
- State return on investment

### **Technology Transfer Income Tax Exemption**

Intent: To incentivize the transfer of technology from corporations to small businesses in the state

Synopsis: Corporations may exclude up to 10 percent of the gross proceeds from transfers of technology to qualified small businesses located in Oklahoma. The exemption is allowed for up to 10 years following the first royalty payment from the transfer.

Qualified small business requirements:

- Capitalization of not more than \$250,000
- At least 50 percent of its employees and assets located in Oklahoma at the time of transfer
- Not a subsidiary or affiliate of the transferor corporation

Technology transferred may be a proprietary process, formula, pattern, device or compilation of scientific or technical information which is not in the public domain. Corporations must be the exclusive and undisputed owner of the technology at the time the transfer is made.

#### 2018 Criteria for Evaluation:

- Comparison of Oklahoma incentive to other states
- Number and amount of technology transfers
- Dollar value of the benefit
- Employment and payroll associated with the technology transfer

#### 2022 Proposed Criteria for Evaluation:

- Comparison of Oklahoma incentive to other states
- Number and amount of technology transfers
- Employment and payroll associated with the technology transfer
- Interaction or coordination with other programs or service offerings in the economic development or entrepreneurial support ecosystem
- State return on investment
- Case studies or other longitudinal tracking of program recipient growth outcomes
- State return on investment

### **New Products Development Income Tax Exemption**

Intent: To encourage the development and manufacturing of products in the state

Synopsis: Royalty earned by an inventor from a product developed and manufactured in Oklahoma may be exempt from state income tax for a period of 7 years from January 1 of the first year in which such royalty is received as long as the manufacturer remains in the state.



In-state manufacturers of a product developed in Oklahoma may exclude 65% of the cost of depreciable property purchased and utilized directly in manufacturing the product, up to \$500,000. If the exclusion exceeds tax liability, the exclusion may be carried forward for up to 4 years. The manufacturer may also be eligible for Investment/New Jobs Tax Credit.

2018 Criteria for Evaluation:

- Use of the program
- Comparison of Oklahoma incentive to other states
- Determination of the amount of layering with Investment/New Jobs Tax Credit

2022 Proposed Criteria for Evaluation:

- Use of the program
- Comparison of Oklahoma incentive to other states
- Determination of the amount of layering with Investment/New Jobs Tax Credit
- Interaction or coordination with other programs or service offerings in the economic development or entrepreneurial support ecosystem State return on investment
- Case studies or other longitudinal tracking of program recipient growth outcomes
- State return on investment

## **Technology Business Finance Program**

Intent: To support the formation of new private sector startups and enhance their ability to advance to the next stage of investment

Synopsis: Provides Oklahoma tech start-up companies with pre-seed financing and early-stage risk capital to stimulate investments from private sources. TBFP is administered through a contract with i2E Inc. with awards ranging up to \$100,000

OCAST's guidelines require that the company is a small business (500 employees or less) with at least 50 percent of its employees and assets located in Oklahoma. Matching capital from private sources is required to be between at least 5% and 50% of state investment, depending on the project.

Funding provided must be repaid within 5 years, according to the following schedule:

- 1.25x if repaid within 1 year
- 1.75x if repaid within 3 years
- 2x if repaid beyond 3 years

Royalties are also shared as part of the program, according to the following schedule:

- 5% of gross revenue at the earlier of 1 year after funding, or when gross revenue exceeds \$25,000 per quarter
- 7% of gross revenue at earlier of 2 years after funding or when gross revenue exceeds \$50,000 per quarter
- 10% of gross revenue at earlier of 3 years after funding or when gross revenue exceeds \$100,000



#### 2018 Criteria for Evaluation:

- Jobs/payroll associated with the program
- Use of the program over time
- Comparison of participant success rates to tech start-ups, generally
- Return on investment from an equity standpoint

#### 2022 Proposed Criteria for Evaluation:

- Jobs/payroll associated with the program
- Use of the program over time
- Comparison of participant success rates to tech start-ups, generally
- Interaction or coordination with other programs or service offerings in the economic development or entrepreneurial support ecosystem
- State return on investment
- Case studies or other longitudinal tracking of program recipient growth outcomes
- Return on investment from an equity standpoint

### **Quick Action Closing Fund**

Intent: None provided in statute

Synopsis: The Quick Action Fund is to be used for economic development and related infrastructure development when expenditure of funds is likely a determining factor in locating a high-impact business.

The Department of Commerce reviews the impact of projects based on the following:

- Creation of new jobs with healthcare requirements of Quality Jobs
- Maintenance of existing jobs which are at risk for termination
- Investment in new property plant or equipment or in the improvement or retooling of existing plant or equipment
- Additional revenues in ad valorem, income or sales and use taxes

#### 2018 Criteria for Evaluation:

- History of use of the program
- Layering of the program with other incentives
- Comparison of job and payroll growth with/without use of this incentive
- State return on investment

#### 2022 Proposed Criteria for Evaluation:

- History of use of the program
- Layering of the program with other incentives
- Total investment per project
- Actual vs. projected jobs, payroll, investment
- Comparison of job and payroll growth with/without use of this incentive
- State return on investment



## Small Business Incubator Tenants

Intent: The goal of the Oklahoma Small Business Incubators Incentives Act is to produce successful firms that will leave the program financially viable and freestanding.

Synopsis: For a period of up to 10 years from the date of tenant's occupancy in an incubator, income earned by the tenant as a result of activities conducted as an occupant in an incubator, including income distributed to partners, shareholders of a corporation for which a Subchapter S election is in effect and to the members of a limited liability company, shall be exempt from state income tax. The exemption provided by this section shall remain in effect for such activities by such tenant after the date the tenant is no longer an occupant in an incubator, but not to exceed a total duration of 10 years for any tenant.

To qualify for the exemption in the 6<sup>th</sup> through 10<sup>th</sup> year, 75 percent of sales must be to:

- out-of-state buyers
- buyers whose principal business activity is conducted outside the state
- federal government
- buyers located in the state if the product or service is resold to an out-of-state customer or buyer for ultimate use

### 2018 Criteria for Evaluation:

- Employment and payroll associated with qualified small businesses
- Change in small business employment before/after incentive
- Change in small business employment for Oklahoma versus surrounding states
- State return on investment

### 2022 Proposed Criteria for Evaluation:

- Number and type of small businesses served as a result of the program
- Graduation/success rate of small business served as a result of the program
- Employment and payroll associated with small businesses served as a result of the program
- Case studies or other longitudinal tracking of program recipient growth outcomes
- Interaction or coordination with other programs or service offerings in the economic development or entrepreneurial support ecosystem
- Economic activity associated with program funding
- State return on investment

## Seed Capital Fund

Intent: To provide seed investments to innovative Oklahoma businesses.

Synopsis: The Oklahoma Seed Capital Fund provides concept, seed and start-up equity investments to Oklahoma's innovative businesses. Investments are focused on industry sectors with technologies and proprietary products, processes, and/or know-how that provide high growth opportunities in addressable markets (e.g. advanced materials, aerospace, agri-sciences, biotechnology, communications technologies, energy, software/information technology, medical devices, nanotechnology, robotics, etc.). The Fund focuses on opportunities that show promise of rapid growth in terms of revenue, increased employment and increased private investment capital.

To be eligible for the Seed Fund, an entrepreneur must be a small business located in Oklahoma. The use of funds depends on each company's business plan. This may include such activities as developing



intellectual property, completing market assessments, implementing business operations, recruiting key members of the management team and expanding into new products or markets. Investments typically range from \$100,000 to \$1,000,000 and require participating co-investors. Investment terms are typically convertible debt or preferred equity.

2019 Criteria for Evaluation:

- Program use
- Amount of capital investment
- Comparison of capital investment in general to capital investment in eligible projects
- Oklahoma jobs created by firms receiving incentive
- Financial performance of the fund
- State return on investment

2022 Proposed Criteria for Evaluation

- Program use
- Amount of capital investment
- Comparison of capital investment in general to capital investment in eligible projects
- Oklahoma jobs created by firms receiving incentive
- Financial performance of the fund
- Interaction or coordination with other programs or service offerings in the economic development or entrepreneurial support ecosystem
- Case studies or other longitudinal tracking of program recipient growth outcomes
- State return on investment