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POLICY BRIEF

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Development Incentives: A Guide for Nevada Legislators

Executive Summary

This policy brief presents independent analysis designed to inform discussions during the upcoming special session (September 2014) of the Nevada Legislature that will consider Governor Brian Sandoval's recently proposed $1.3 billion development incentive package to Tesla Motors.

The following pages contain a description of the components of the proposed Tesla deal and the reported benefits of the business agreement to both Tesla and the Silver State. We review the current literature on the impact of development incentives, and find that a growing number of states are designing incentive packages with provisions that promote greater transparency and accountability, emphasize performance, encourage local hiring, and focus on job training.

There are a number of issues that legislators should consider as they prepare for discussions in the special session:

- Has the state identified sufficient revenue streams to respond to increased demand for infrastructure (roads, schools, services)?
- How can legislators guarantee that the proposed number of jobs will be created?
- How can legislators ensure that local Nevadans are hired?
- How can legislators strengthen the K-16 pipeline to ensure that Nevadans are well positioned to fill jobs at Tesla (or other similar companies)?
- What market signals does the Tesla $1.3 billion mega-deal send to other businesses that are seeking to operate in Nevada?
- Does Nevada's economic development plan contain clear criteria for the use and award of development incentives?

Based on our review of recent reforms and the literature on best practices, the Guinn Center proposes the following recommendations for Legislators to consider:

- ➢ Require that transferable credits (valued at $120 million) included in the Tesla tax incentive package are transferred at their original value (and not at a discount).
- ➢ Include clawback (recapture) provisions in the final agreement with Tesla.
- ➢ Include performance-based measures in the final agreement.
- ➢ Reduce sales and use tax abatements relative to property tax abatements, and lower the overall amount of sales and use tax and property tax abatements.
- ➢ Establish a government commission to monitor the contract and performance targets.
- ➢ Establish a standing committee between Tesla and Nevada System of Higher Education to build the workforce pipeline.

Development Incentives: A Guide for Nevada Legislators

Introduction

On September 4, 2014, Nevada Governor Brian Sandoval, surrounded by legislators and economic development specialists, held a press conference to announce that Tesla Motors CEO Elon Musk had decided to build his $5 billion lithium-ion battery gigafactory in Nevada (Storey County).

At the conference, Governor Sandoval announced that Nevada would extend $1.3 billion in tax credits and incentives to encourage Tesla Motors to locate the gigafactory to Nevada. Governor Sandoval indicated that he would be calling a special session of the legislature promptly to approve the proposed set of development (or tax) incentives.

Over the course of Nevada's legislative history, special sessions have only been called 27 times. Most recently, a special session was called in 2013 to address "several issues that remained unresolved when the regular session ended, including legislative approval for an increase in the Clark County Sales and Use Tax, economic development, class-size reduction, charter schools, and an appropriation for the Millennium Scholarship."[1] And five out of the last six special sessions have lasted a single day.

One has to go back even further – to 1984, in fact – to find a special session that was called for the explicit purpose of addressing a development incentive package for businesses. In 1984, then Governor Richard Bryan called the 15th Special Session to change the banking laws to allow for the establishment of a Citicorp call center (expected to result in 1,000 jobs).

What are the components of the proposed Tesla deal?

As Tesla Motors continued to visit and compare various locations in the Intermountain West in recent months, senior leadership of the company indicated that they expected the winning state to extend roughly $500 million in tax benefits (roughly 10 percent of the value of the $5 billion project). Governor Sandoval's proposed incentive package of approximately $1.3 billion over 20 years is more than twice the asking price. According to research by Good Jobs First, Nevada's Tesla package, if approved, would rank as one of the top 10 biggest mega-tax incentive deals in the country.[2]

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[1] Nevada Legislature. http://www.leg.state.nv.us/Division/Research/Publications/Factsheets/SpecialSessions_Summary.pdf

[2] Ryan Frank. "Nevada's tax deal for Tesla would be one of the largest in U.S. history." *Las Vegas Sun.* September 4, 2014. http://www.lasvegassun.com/news/2014/sep/04/nevadas-tax-deal-tesla-would-be-one-largest-us-his/

Benefits to Tesla (Direct and Indirect Costs to Nevada)

The components of the deal, which would "allow Tesla to operate in Nevada essentially tax free for 10 years," include the following:[3,4]

- $725 million in sales tax abatements for at least 20 years;
- $332 million worth of real and personal property tax abatements over 10 years;
- $195 million in credits: $120 million is in the form of transferable tax credits "which other Nevada companies will be able to buy from Tesla in order to reduce their own tax liabilities to the state"; and up to $70 million in tax credits worth $12,500 per employee for up to 6,000 jobs;
- $27 million in payroll (modified business) tax abatements over 10 years; and
- $8 million in electricity rate discounts over eight years.[5]

Table 1. Components of proposed Tesla benefit package

Incentive	Amount	Number of Years	Amount per Year
Sales Tax	$725,000,000	20	$36,250,000
Property Tax	$332,000,000	10	$33,200,000
Payroll (Modified Business Tax)	$27,000,000	10	$2,700,000
Energy Rates	$8,000,000	8	$1,000,000
Transferable Tax Credits	$120,000,000	Unknown	Unknown
Credits for Jobs	$75,000,000	Unknown	Unknown
TOTAL	**$1,287,000,000**		

While not included in the deal, there is an estimated cost of $100 million to complete the USA Parkway, linking Interstate 80 and U.S. Highway 50 through the Tahoe-Reno Industrial Park, where the Tesla 5-million square foot battery plant will be located. The right of way for USA Parkway will cost the state highway fund an estimated $43 million, and the cost of building the highway linking the two major roads could cost as much as $60-65 million, thus totaling roughly $100 million.[6,7]

[3] Charlotte McLeod. Tesla's Gigafactory Decision a "Nevada Victory." *Lithium Investing News*. September 4, 2014. http://lithiuminvestingnews.com/9454/tesla-motors-gigafactory-nevada-united-states-lithium-graphite-cobalt/

[4] Anjeanette Damon. "Inside Nevada's $1.25 billion Tesla tax deal." *Reno Gazette Journal*. September 5, 2014. http://www.rgj.com/story/news/2014/09/04/nevada-strikes-billion-tax-break-deal-tesla/15096777/

[5] A brief note about the energy rates: In 2013, the Nevada Legislature passed a law proposing a new program that allows companies expanding or relocating to Nevada to be eligible for a discounted electricity rate. The Nevada Power Company and the Sierra Pacific Power Company set the discount rate for new commercial or industrial customers to be 30 percent for the first year, 20 percent in the second year, and 10 percent in the fourth year. In July 2014, the Nevada Public Utilities Commission approved the new tariff arrangement, thus implementing the Economic Development Rate Rider program (which offers discounted tariffs for up to four years). Under the deal, Tesla will be eligible for *eight* years of discounted electricity, amounting to about $8 million. In anticipation of the special session to discuss the Tesla deal, a bill draft resolution was proposed to extend the Economic Development Rate Rider program from its current cap at four years to eight years (while also revising the discount rates). If the bill passes, the Public Utilities Commission must approve the revised plan. Sources: The National Law Review. Nevada Finalizing Electric Rate Incentives to Attract New Businesses. April 8, 2014. http://www.natlawreview.com/article/nevada-finalizing-electric-rate-incentives-to-attract-new-businesses; and Nevada Public Utilities Commission. http://pucweb1.state.nv.us/PDF/AxImages/DOCKETS_2010_THRU_PRESENT/2014-3/39811.pdf; https://www.ralstonreports.com/sites/default/files/BDR-Language%202.pdf

[6] Sean Whaley. "Roads add nearly $100 million to Tesla deal." *Las Vegas Review Journal*. September 7, 2014. http://www.reviewjournal.com/news/nevada/roads-add-nearly-100-million-tesla-deal

[7] Geoff Dornan. "USA Parkway key in Tesla Deal." Nevada Appeal. September 6, 2014. http://www.nevadaappeal.com/news/local/12896707-113/deal-parkway-reno-tesla

Benefits to Nevada

Political leaders and policymakers across the Silver State have emphasized the huge gains – both direct and indirect – that the Tesla project will bring to Nevada. Among the benefits of the Tesla $5 billion lithium-ion battery gigafactory setting up shop in Nevada are:[8]

- 3,000 construction jobs in the short-term to build the gigafactory;
- 6,500 people on site once the factory is up and running;
- 16,000 indirect jobs;
- $3.5 billion investment in (purchase of) manufacturing equipment and property;
- $37.5 million contribution to Nevada's K-12 system (for five years, beginning in 2018); and
- $1.0 million donation to the University of Nevada at Las Vegas to fund advanced battery research.

The anticipated job growth is promising given that the unemployment rates in the Reno-Sparks Metropolitan area (7.9 percent) and the Carson City Metropolitan area (8.7 percent) remain well above the national average (6.1 percent).[9] If the project succeeds in creating 22,500 direct and indirect jobs, this would amount to 2 percent of the state's entire workforce and 11 percent of the region's workforce.[10] Moreover, it is anticipated that the 6,500 direct hires will earn an average wage of $27.35 per hour, significantly higher than the regional median hourly wage of $16.09.[11]

As proposed, the deal would allow Tesla to operate in Nevada tax-free for ten years, preventing the state from collecting taxes prior to 2024. After that, the state expects to collect about $400 million in tax revenue over 10 years.

Estimates suggest that the fiscal benefit (new revenues, new expenditures) of the project is projected to be $1.9 billion over 20 years, while the economic benefits (resulting from spin-off effects, greater consumer spending, etc.) could range between $40 billion to $100 billion.[12]

What do we know about the impact of development incentives?

Nevada's extension of development or tax incentives is part of a widely used economic development strategy. Cities and states frequently offer development incentives as a tool to encourage businesses to expand within and/or relocate to their jurisdictions. Roughly $50 to $70 billion in development incentives are awarded to businesses each year.[13] (During the period 1999-

[8] Anjeanette Damon. "Nevada offered $1.25 billion in tax breaks to win Tesla." *Reno Gazette Journal*. September 5, 2104. http://www.usatoday.com/story/money/cars/2014/09/04/tesla-nevada-gigafactory/15099365/
[9] Bureau of Labor Statistics and Nevada Workforce Informer 2014 annual average as of September 5, 2014. http://www.nevadaworkforce.com/cgi/dataanalysis/AreaSelection.asp?tableName=Labforce
[10] Anjeanette Damon. "Nevada offered $1.25 billion in tax breaks to win Tesla." *Reno Gazette Journal*. September 5, 2104. http://www.usatoday.com/story/money/cars/2014/09/04/tesla-nevada-gigafactory/15099365/
[11] Nevada Governor's Office of Economic Development. Summary of Economic Impact Analysis and Impact Review. September 2014. http://www.diversifynevada.com/documents/Full_Tesla_Summary_Report_Analysis_Letters.pdf
[12] Dana Hull. "Tesla to build 'gigafactory' near Reno." *San Jose Mercury News.* September 4, 2014. http://www.mercurynews.com/business/ci_26470220/reno-tesla-motors-nevada-gigafactory-battery; Anjeanette Damon. "Nevada offered $1.25 billion in tax breaks to win Tesla" *USA Today*. September 5, 2014. http://www.usatoday.com/story/money/cars/2014/09/04/tesla-nevada-gigafactory/15099365/
[13] States Smarten Up on Economic Development Incentives. New Republic. May 7, 2012.

2012, the Silver State ranked only 47th in tax incentives per capita, even after including the recent $89 million development incentive package offered to Apple).[14]

However the impact of development incentives is mixed and "existing studies do not allow for clear conclusions on the cost-effectiveness of business tax credits."[15] Many economists and policy analysts acknowledge that "business tax credits do lead to new revenues for state government, but not enough to completely offset the initial costs."[16,17]

Frequently, jobs created by development incentive packages fail to exceed the value of what states give away in uncollected tax revenue. Recently, Good Jobs First, an advocacy group that monitors economic development strategies and their impacts, analyzed 240 mega-tax incentive deals (defined as state subsidies valued at $75 million or more), and found that the average cost per job created was $456,000.[18]

If the proposed Telsa Motors $1.3 billion development incentive package is approved and 6,500 workers are directly hired, the average cost would amount to $200,000 per job. (As a point of comparison, the $89 million Apple incentive package has resulted in 310 new jobs, reflecting an average cost of $287,000 per job.)[19]

What are best practices associated with development incentives?

Policymakers face a dilemma: development incentives can make a difference in the site selection process. However, they are often an inefficient use and even waste of public resources; they subsidize companies that would have relocated anyway; and they foster unfair competition and give rise to criticism that the government is picking winners and losers. Despite the challenges, development incentives remain a widely used tool of economic development that allows states to compete for jobs and capital.

The challenge then is for state and local policymakers to "find ways to make their jurisdictions attractive without giving away the tax base, and to use incentives selectively and responsibly."[20] While political leaders and decision makers recognize that development incentives are an inherent cost of doing business, a growing number of states are attempting to offer incentives more selectively, improve the transparency surrounding the deals, and employ more rigorous measures for assessing the costs (benefits) of the incentives and for evaluating their impact.

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[14] "United States of Subsidies" *New York Times New York Times*. 2012.
http://www.nytimes.com/interactive/2012/12/01/us/government-incentives.html#home

[15] Jennifer Weiner. 2009. State Business Tax Incentives: Examining Evidence of their Effectiveness. New England Public Policy Center Discussion Paper 09-3. https://www.bostonfed.org/economic/neppc/dp/2009/neppcdp0903.pdf As noted in the study, the lack of transparency in previous studies have methodological limitations.

[16] Ibid.

[17] For a review of the studies, see Alan Peters and Peter Fisher, "The Failures of Economic Development Incentives," Journal of the American Planning Association 70 (2004): 27–37.

[18] Anjeanette Damon. Is Tesla's $1.25 billion tax break worth it?" *Reno Gazette Journal*. September 8, 2014.
http://www.rgj.com/story/news/2014/09/05/teslas-billion-tax-break-worth/15160039/

[19] Commission on Economic Development. "Statement of Taxes and Fees Abatements, Exemptions and Waivers." October 1, 2012.
http://www.leg.state.nv.us/Division/Research/Library/Documents/ReportsToLeg/2013-2015/06-13.pdf

[20] Bill Schweke. 2009. Business Incentives Reform. Corporation for Enterprise Development: Washington, D.C.
http://cfed.org/assets/pdfs/business_incentives_reform.pdf

Transparent Incentives

Many state and local governments offer packages that are a combination of a number of incentives. The Nevada Tesla deal includes property tax and sales tax abatements, job creation credits, reductions in the modified business (payroll) tax, and transferable credits. In general, the tax policy goals, including development incentives, should be assessed on principles of equity, neutrality, simplicity, transparency, adequacy, and competitiveness.

Research indicates that transferable credits do not fare well when measured against principles of simplicity and transparency. Briefly, transferable credits are those that a business can sell to another firm, which can then apply the credit to its own tax liability.[21] But these credits are complicated and they are not transparent.

For instance, when the recipient company sells its credits to other taxpayers, it is difficult for policymakers to determine who receives the benefits. Because there is no requirement that the recipient company must sell his credit to a company in the same industry, transferable credits often subsidize activity that is completely unrelated to the original strategic nature of the development incentive. In Nevada, these transferable tax credits could be sold to large casino hotels, which pay gaming taxes and have an incentive to reduce their tax burden.

In addition, transferable credits may undermine the principle of adequacy. For instance, transferable credits "usually sell at a discount, meaning that the selling firm receives less than their full value. The state, however, still forgoes the entire original amount."[22]

Accountability Provisions

Many state and local governments have laws in place requiring accountability provisions in the development incentives packages. The most common of these is callled a clawback or recapture provision.[23] Clawbacks are clauses in subsidy laws that require a company to return all or part of the value of a subsidy if the company fails to meet the obligations agreed to as a condition of receiving the incentive package.

Many clawback laws are written so that different penalties apply depending on the extent to which a company fails to meet its targets. For example, if a company falls 15 percent short of its goal, it then has to pay back 15 percent of the subsidy. If a company shuts down or moves out of state, the government may require it to pay back the full amount of the subsidy. Clawbacks may be added to development subsidy programs through the legislative process at the state and/or local level.[24]

For example, in 2000, authorities from Chicago and Illinois prepared a development incentive package for the Ford Motor Company that included clawback provisions. These clawback provisions required Ford "to create a minimum of 500 full-time jobs by the end of 2006 and to maintain these jobs through 2011." If those provisions were not met, Ford was required to "pay

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[21] Jennifer Weiner, Federal Reserve Bank of Boston. "State Business Tax Incentives: Examining Evidence of their Effectiveness." https://www.bostonfed.org/economic/neppc/dp/2009/neppcdp0903.pdf

[22] Jennifer Weiner, Federal Reserve Bank of Boston. "State Business Tax Incentives: Examining Evidence of their Effectiveness." https://www.bostonfed.org/economic/neppc/dp/2009/neppcdp0903.pdf, page 12.

[23] Bill Schweke. 2009. Business Incentives Reform. Corporation for Enterprise Development: Washington, D.C. http://cfed.org/assets/pdfs/business_incentives_reform.pdf

[24] Good Jobs First. Key Reforms: Clawbacks. http://www.goodjobsfirst.org/accountable-development/key-reforms-clawbacks

back a percentage of the financing proportionate to the percentage of promised jobs the company failed to create, and it must repay the city for infrastructure and road improvements."[25]

Performance-Based Contracts

A growing number of incentive programs are "performance-based," which means that the recipient company does not receive agreed upon benefits until it has satisfied program requirements.[26] In Florida, the state is protecting "the taxpayers' investment by structuring incentive deals so that the company has to perform, wholly or partly, with performance verified by the State, before all or a pro-rata portion of the incentive value is realized." In 2013, more than 85 percent of the state's development incentive packages were 'pay after performance.'[27] Also, in Florida and North Carolina, states hold incentive grants in an escrow account until performance goals are met by the company.

To illustrate the value of performance based contracts, when Dell opened a computer manufacturing plant in North Carolina in 2004, officials extended a $279 million package of tax breaks and other incentives. The incentives were paid out over time once the company met certain employment (1,500 jobs) and capital investment ($100 million) performance targets.[28] When Dell unexpectedly closed its operations four years later and laid off more than 600 workers, officials were able to recover all the money the city provided to the company in upfront costs and annual incentive payments.[29]

Staying local

States that extend development incentives to businesses have an expectation that these businesses will hire local workers and goods from local manufacturers/suppliers. While some states and city governments have legislation in place requiring businesses to hire locally, the question of whether development incentive programs can require assisted firms to favor in-state suppliers and employees over others (i.e., "buy or hire local") is legally complex.[30] As such, policymakers should avoid including explicit requirements that companies receiving incentives should hire locally.

However, there are a few ways that local and state governments can improve the likelihood that businesses receiving tax incentives will hire locally. The first type of provision sets a threshold job creation requirement as a condition for receiving public assistance, which is also an example of performance-based contracting. The second provision offers a specific amount of incentive on a per-job basis, and does not provide any funds to the company until the job has been created. For

[25] Good Jobs First. "The Ideal Deal: How Local Governments Can Get More for their Economic Development Dollar" March 2007. http://www.goodjobsfirst.org/sites/default/files/docs/pdf/idealdeal.pdf

[26] Good Jobs First. Key Reforms: Clawbacks. http://www.goodjobsfirst.org/accountable-development/key-reforms-clawbacks

[27] Florida Department of Economic Opportunity, Division of Strategic Business Development. 2013 Annual Incentives Report. December 20, 2013. http://www.floridajobs.org/business/EDP/EconomicDevelopmentIncentivesReport.pdf

[28] Jonathan Q. Morgan. "Using Economic Development Incentives for Better or For Worse." *Popular Government.* Winter 2009. http://www.matthewsnc.gov/Portals/0/Repository/2/0112SOG_Incentives_article.pdf

[29] WRAL "Dell to Close N.C Plant, eliminate 905 jobs." October 7, 2009. http://www.wral.com/business/story/6156112/

[30] Good Jobs First. "The Ideal Deal: How Local Governments Can Get More for their Economic Development Dollar" March 2007. http://www.goodjobsfirst.org/sites/default/files/docs/pdf/idealdeal.pdf For example, in 2013, Baltimore's City Council passed a law requiring the businesses receiving a government contract or incentive package guarantee that they hire 51 percent of their new workers were from Baltimore. However, the city's own legal department opposed the law, arguing that it violated the Constitution. See: Luke Broadwater. "Council approves local hiring mandate: GBC sought to kill bill requiring contractors to hire city residents." *The Baltimore Sun*. June 3, 2013. http://articles.baltimoresun.com/2013-06-03/news/bs-md-ci-local-hiring-vote-20130603_1_large-city-contracts-council-president-bernard-c-jack-young

example, an incentive package offered by North Dakota to Coventry Healthcare contained a provision that gave Coventry incrementally larger payments as the company expanded its workforce.[31] The advantage of "back-loading" incentives and linking them to job creation is that it provides a degree of protection to governments in the event that the company fails or falls behind in its hiring schedule.

Several states have included guidelines in their incentive packages that require businesses that receive subsidies to make "good faith efforts" to hire workers from within city (state) limits. Unfortunately, because these clauses lack hard targets or metrics, there is no guarantee that the company will hire local workers. That said, there are a number of "first source" provisions that states can include in the incentive contracts. For instance, officials can specify job marketing, solicitation, and training provisions in the contracts, including a requirement that the subsidized business advertise jobs through particular agencies.

Contracts can also require a business to interview candidates referred from a specific source, such as a network of placement and training community agencies and to post job vacancies to the network's database. Governments can also obligate businesses to provide periodic hiring reports, and to retain a specific level of new hires over the life span of the incentive, and can then impose penalties for failing to achieve agreed upon hiring targets. Development incentive contracts can also require firms to work with employment and training agencies that have been been pre-qualified by the state and local decision makers.

Non-tax incentives

Increasingly, policymakers are including non-tax incentives, particularly employment-based incentives. Some governments offer job creation or employee training/retraining tax credits, and/or provide employment screening and customized training. The advantage of focusing on employee-based incentives is that even if a business fails or relocates to another state, the government has invested in building a skilled workforce and knowledge base.

Improved Accountability, Monitoring and Evaluation

State and local political leaders understand that development incentives are a critical component of an effective economic development strategy. But, "the recession has forced states to rethink current practices and deploy these tools more strategically."[32] As such, policymakers are introducing measures that improve accountability and evaluations of deals (with the goal of measuring cost and impact). Among the policies to improve accountability are:

- Provide and publish information on incentive packages and conduct assessments;
- Use rigorous and standardized approaches for calculating the costs of each job created or retained;
- Establish a strategic and ongoing schedule to review ("sunset review") and assess the appropriateness, effectiveness, and efficiency of tax and non-tax incentives; and
- Establish benchmark "return on investment" targets.

Four states—Arizona, Iowa, Oregon, and Washington—have integrated evaluation of their major development incentives into the policy process, ensuring that those investments are regularly

[31] Good Jobs First. "The Ideal Deal: How Local Governments Can Get More for their Economic Development Dollar" March 2007. http://www.goodjobsfirst.org/sites/default/files/docs/pdf/idealdeal.pdf
[32] Kenan Fikri. "States Smarten Up on Economic Development Incentives." *New Republic*. May 7, 2012.

reviewed. In Oregon, new legislation has tax credits automatically expiring after six years unless legislators vote to extend them. In Washington, policymakers began a 10 year process to review every tax incentive the state offers. There, nonpartisan analysts work with a citizen commission and legislative auditor to annually review and evaluate the state's incentives.[33] In 2010, Missouri created a Tax Credit Review Commission, comprised of business, community, and legislative leaders, whose sole charge is to critically analyze the return on investment of tax incentives.

What are some of the issues that Nevada's legislators need to consider?

Below we outline a number of questions that Nevada's legislators should be exploring as they head into the special session in September to discuss the Tesla mega-deal.

A. Demands on Existing Infrastructure

- Has the state identified sufficient revenue streams to respond to increased demand for infrastructure (roads, schools, services)?

One way of asesssing the fairness of policies, particularly tax and regulatory policies, is to explore how the costs and benefits of a policy are distributed. With respect to the proposed $1.3 billion Tesla deal, it is widely believed that the new gigafactory will have tremendous fiscal and economic benefits for the entire state. But there are also costs.[34] As such, legislators need to look at the distribution of costs and benefits across the state. The state also needs to evaluate whether the economic growth spurred by Tesla's presence will generate sufficient tax revenue to cover the increased need for public services in the counties most affected by the proposal.

The biggest components of the deal are sales and use tax abatements and property tax abatements. Under the current tax abatement program, businesses are eligible for a 50 percent break on property and modified business taxes and a partial abatement on sales and use taxes for equipment purchases for a limited time.[35] However, the proposed Tesla deal abates 100 percent of sales and property taxes for an extended period of time (20 years and 10 years respectively).[36]

Here we briefly sketch the potential distributional impact of these development incentives. School districts and local governments rely on sales and property tax revenue for a substantial part of their budgets. Tables 2a and 2b shows the breakdown of revenue for the county governments and school districts in Storey County and Washoe County.

Sales and Use Tax Abatements

The sales and use tax subsidy for Tesla is estimated to be worth $725 million over 20 years, *which is equal to about 80 percent of the total sales tax revenue the state government receives*

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[33] Pew Center on the States. Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth." April 2012. http://www.pewstates.org/research/reports/evidence-counts-85899378806. ITEP. "Five Steps Toward a Better Tax Expenditure Debate." October 1, 2012. http://itep.org/itep_reports/2012/10/five-steps-toward-a-better-tax-expenditure-debate.php

[34] Here we acknowledge that several large renewable energy projects have been located in southern Nevada in recent years; however, we note that these projects are financed largely with federal tax incentives (credits) and loan guarantees.

[35] Nevada Governor's Office of Economic Development Incentives. http://www.diversifynevada.com/programs-resources/incentives

[36] Anjeanette Damon. "Nevada taxpayers, here's how the Tesla deal affects you." *Reno Gazette Journal.* September 9, 2014. http://www.rgj.com/story/news/2014/09/08/nevada-taxpayers-tesla-deal-affects/15303711/

in a year.[37] As Tables 2a and 2b show, the mix of taxes differs for each governmental entity, which means that each entity will be affected differently by the Tesla deal.

Table 2a. Sources of Revenue in Storey and Washoe Counties[38]

2012-13 County Revenue				
Revenue	**Storey County**	**% of Total**	**Washoe County**	**% of Total**
Property Taxes	7,942,480	72%	136,079,617	50%
Sales Taxes*	787,383	7%	62,615,710	23%
Other Taxes	21,086	0%	325,000	0%
Licenses and Permits	648,379	6%	8,066,347	3%
Intergovernmental Revenue	541,906	5%	31,775,763	12%
Charges for Services	773,045	7%	22,463,887	8%
Fines	14,877	0%	8,249,132	3%
Miscellaneous	199,835	2%	2,776,486	1%
Other Finance Sources	49,291	0%	2,336,865	1%
Total Revenue	**10,978,282**	**100%**	**274,688,807**	**100%**

*Sales taxes are part of Intergovernmental Revenue but are broken out here for illustrative purposes.
Washoe County sales taxes are an estimate based on Consolidated Tax Distribution 2013.

Table 2b. Sources of School District Revenue, Storey and Washoe Counties[39]

2012-13 School District Revenue						
Revenue	**Storey**	**% of Total**	**Washoe**	**% of Total**	**Statewide**	**% of Total**
Property Taxes	3,531,481	66%	90,605,814	22%	580,720,255	19%
Sales & Use Taxes	1,610,924	30%	143,443,676	35%	1,062,791,994	35%
Governmental Services Tax	127,410	2%	11,468,837	3%	60,681,476	2%
Other Local Revenue	39,667	1%	7,043,087	2%	59,861,997	2%
State Revenue	-	0%	141,413,298	35%	1,173,119,013	39%
Federal Revenue	-	0%	644,920	0%	4,107,107	0%
Other Sources	1,028	0%	8,694,696	2%	72,316,977	2%
Reserves	-	0%	3,205,640	1%	1,454,240	0%
Total Revenue	**5,310,510**	**100%**	**406,519,968**	**100%**	**3,015,053,059**	**100%**

The abatements on sales and use tax revenue (resulting in foregone revenue) could have a statewide impact. Tesla will likely make purchases throughout the state and could have significant purchases outside the state. As discussed in more detail below, some portions of the sales and use tax are distributed to government agencies in the county where the tax was collected while other parts of the tax are distributed statewide.

[37] Nevada Economic Forum General Fund Revenue Status Report, August 2014. http://www.leg.state.nv.us/interim/77th2013/Committee/NonLeg/EcForum/Other/FY2014/FY2014_GF_Revenue_Status_Report_August_2014.pdf & Anjeanette Damon. "Nevada offered $1.25 billion in tax breaks to win Tesla" *USA Today*. September 5, 2014. http://www.usatoday.com/story/money/cars/2014/09/04/tesla-nevada-gigafactory/15099365/
[38] Storey County 2014-15 Budget: http://www.storeycounty.org/FTPFiles/Budget/general_001.pdf
Washoe County 2012-13 CAFR: http://www.washoecounty.us/repository/files/33/07general2013.pdf
Consolidated Tax Distribution 2013: http://tax.nv.gov/Publications/Consolidated_Tax_Distribution_(CTX)/
[39] FY 2013 NRS 387-303 Report, http://www.doe.nv.gov/Business_Support_Svc_Reports/

The largest category of sales and use tax is the Local School Support Tax (LSST), which is distributed to school districts where the funds are collected (see Table 3). Use taxes collected for purchases outside the state are deposited in the Distributive School Account and are allocated to school districts statewide. School districts rely heavily on the LSST, which represents 35 percent of school district general fund revenue statewide as shown in Table 2b.

Table 3: Statewide Sales and Use Tax

ITEM	Local School Support Tax (LSST)	State Sales Tax	Supplemental City-County Relief Tax (SCCRT)	Basic City-County Relief Tax (BCCRT)	TOTAL
Tax Rate	2.60%	2.0%	1.75%	0.5%	6.85%
Percent (%) of Sales Tax	38%	29%	26%	7%	100%

As the number of students increases, the amount of funding needed for schools also increases. Schools are funded by several sources, including the General Fund, LSST, and property taxes under a funding formula known as the Nevada Plan. If the amount of LSST and property tax revenue are insufficient to cover the increased costs, the General Fund would need to make up the difference.

The second largest category is the 2 percent state sales tax. The state sales tax goes into the state General Fund and is used statewide. Since Southern Nevada is the largest population center, the largest impact of the foregone tax revenue could be felt in Southern Nevada.[40]

The Supplemental City-County Relief Tax (SCCRT) is the next largest category at 1.75 percent. These funds go to counties to be distributed to local governments and other special districts. Certain counties, including Storey County, receive a guaranteed level of funding under the SCCRT. Guaranteed counties receive the amount of funding in the prior year, adjusted by the lesser of the revenue growth rate or the county's change in population and inflation in the prior fiscal year.

The smallest statewide sales tax category is the Basic City-County Relief Tax (BCCRT) at 0.5 percent. Taxes collected within the county are distributed to the county while use taxes collected for purchases made outside the county are distributed statewide based on each county's share of the population. Given that Tesla is building a large manufacturing facility, many of its purchases will likely come from out of state and would be subject normally to use taxes. Approximately 73 percent of these use taxes would go to Clark County.[41]

Property Tax Abatements

While sales have a statewide impact, property taxes are largely treated as local revenue. In Storey County, where the proposed Tesla plant would be located, 95 percent of property taxes levied stay within the geographic area and are distributed to local governments. Five percent of the revenue goes to the state Consolidated Bond Interest and Redemption Fund. The real and personal property tax exemption for Tesla is estimated to be $332 million over 10 years, an

[40] David Damore. Southern Nevada's Fair Share, *Las Vegas Sun*, September 4, 2011. http://www.lasvegassun.com/news/2011/sep/04/southern-nevadas-fair-share/

[41] Nevada Revised Statutes 377.055 and US Census 2013 Population Estimates. Available: http://factfinder2.census.gov/faces/nav/jsf/pages/community_facts.xhtml#none and http://factfinder2.census.gov/faces/nav/jsf/pages/community_facts.xhtml

amount nearly 35 times the amount of property tax revenue Storey County is estimated to receive in 2014-15.[42]

Table 4 presents the tax rates in Storey County in 2014-15 for each government entity that receives property tax revenue and the percentage of total property tax revenue that each entity receives.

Table 4: Property Tax Rates in Storey County

ITEM	Schools	Counties	Total Combined Special Districts	State	Total
Property tax rate	0.8947	1.8514	0.5446	0.1700	3.4607
Percent (%) of Property Tax	26%	53%	16%	5%	100%

Under state law, the maximum combined property tax rate is $3.64 per $100 in assessed value. However, the Legislature may authorize additional rates outside of the $3.64 statutory limit. In Storey County, the total tax rate is $3.46 per $100.

Most of the property tax revenue goes to the Storey County government and no direct funding is provided to towns. As shown in Table 2a, in 2012-13, property taxes were 72 percent of Storey County's general fund revenue.[43] Without additional revenue, Storey County could likely have limited ability to provide additional services demanded by Tesla's presence in the county.[44]

The property tax rate for each school district in Nevada is $0.75 per $100 in assessed value. The Storey County School District also has a tax rate for debt of $0.1447 per $100, which results in a total school district tax rate of $0.8947 per $100 in assessed value.

The Storey County School District is small, with only 397 students (2013-14) and a budget of $5.3 million, 66 percent of which comes from property taxes ($3.5 million) (See Table 2b). The influx of Tesla workers and their families would likely increase the need for education services, although many Tesla workers are likely to live in surrounding counties, such as Washoe, Carson City, and Douglas. If property taxes and LSST taxes do not increase sufficiently where the Tesla workers choose to live, the state General Fund would be required to make up any difference in funding required by the Nevada Plan. The cost of building school facilities could also be significant. Given the recent lack of success statewide in approving tax initiatives for school construction and renovation, the Legislature may want to look into options such as creating voter-approved assessment districts to create a dedicated funding source for school facilities.

Taking Distributional Impacts into Consideration

While Tesla's presence will spur economic growth and increase tax revenues, it is not yet known whether this anticipated revenue will be sufficient to cover the increased need for public services in the counties most affected by the proposal in a timely manner.

In its current form, sales and use tax abatements comprise the biggest share of the incentive package. While abatements do not have a direct impact to the state's bottom line (they are simply

[42] Nevada Department of Taxation. 2014 LGC Redbook. http://tax.nv.gov/LocalGovt/PolicyPub/ArchiveFiles/Redbook/
[43] Storey County 2014-15 budget, including 2012-13 Actuals: http://www.storeycounty.org/FTPFiles/Budget/general_001.pdf
[44] To illustrate, much of the infrastructure development (water, sewer) of the Tahoe-Reno Industrial Center has been paid for by the developer not by Storey County.

foregone revenue), they should be factored into the distributional impact of the development incentive package. Legislators may want to consider revisiting the balance between sales and property tax abatements, as well as opportunities to lower the sales and use tax abatements.

B. Job Creation

- How can legislators guarantee that the proposed number of jobs will be realized?
- How can legislators ensure that local Nevadans are hired?
- How can legislators strengthen the K-16 pipeline to ensure that Nevadans are well positioned to fill jobs at Tesla (or other similar companies)?

Many state and local governments are beginning to design 'performance-based' contracts, which means that the recipient (subsidized) company (e.g. Tesla Motors) would not receive some portion of the benefits until targets – such as employment and capital – had been met. As recently reported, to be eligible for the sales and use tax and property abatements, Tesla must invest at least $3.5 billion in Nevada, although it is not yet clear what counts toward the investment (i.e. purchase of land and equipment, etc.).[45]

Regardless, it is highly likely that Nevada, at least in the short-term, will not have the pipeline of adequate highly skilled workers to fill the anticipated jobs at Tesla.[46] For example, National Security Technologies (NSTec), a science and technology firm engaged in security and defense applications and located in southern Nevada, reported earlier this year that only 15 percent of its workforce "live in the state before they're hired."[47] Even smaller, rural firms, such as Minden-based Burns Manufacturing, has had to hire some of its highly skilled workers from out of state.[48]

In order to maximize the opportunity for Nevadans to fill the jobs brought by Tesla Motors (and other high tech companies like Ashima), stakeholders at Nevada System of Higher Education, the Nevada Department of Education, Training and Rehabilitation (DETR), and the Governor's Office on Economic Development (GOED) need to meet with Tesla executives to ensure that appropriate training programs and curriculums are in place to train Nevadans.

C. Development Incentives and Market Signals

- What signals does the Tesla $1.3 billion mega-deal send to other businesses seeking to operate in Nevada?
- Does Nevada's economic development plan contain clear criteria for the use and award of development incentives?

One of the frequent criticisms of development or tax incentives is that they only help a few businesses and often put governments in the position of choosing winners and losers, as opposed to letting market forces determine efficient investment. Moreover, existing businesses end up subsidizing these new businesses, which are often times their competitors. Scott Drenkard, an

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[45] Anjeanette Damon. "Nevada taxpayers, here's how the Tesla deal affects you." *Reno Gazette Journal.* September 9, 2014. http://www.rgj.com/story/news/2014/09/08/nevada-taxpayers-tesla-deal-affects/15303711/

[46] For more about the workforce pipeline, see Guinn Center for Policy Priorities blog. "Are Nevada Colleges Meeting Future Workforce Needs?" August 28, 2014. http://guinncenter.org/labor-day-musings-nevada-colleges-meeting-future-workforce-needs/

[47] Kristy Totten. "Nevada National Security Site Management company looks to grow its own scientists." *Las Vegas Review Journal.* March 26, 2014. http://www.reviewjournal.com/news/nevada-national-security-site-management-company-looks-grow-its-own-scientists

[48] Remarks given by Ray Bacon, Chair of the Nevada Manufacturing Sector Council, before the STEM Advisory Council (July 31, 2014).

economist with the Tax Foundation, testified last year in front of the Indiana Commission on State Tax and Financing Policy stating, "Even though credits lower the tax burden of a particular tax filer, in most cases we see them as poor tax policy. Some businesses might get the benefit of a preference, but other businesses that aren't engaging in whatever activity is deemed "favorable" are stuck paying the full sticker rate of the tax."[49]

With respect to the proposed Tesla deal, it was reported that funds to finance the Tesla deal will come, in part, from reducing a film tax credit program from $80 million to $10 million and reducing a $27 million tax credit for insurance companies that "locate their home office in Nevada." Governor Sandoval signed the Film Tax Credit Initiative (Senate Bill 165) in June 2013 with much fanfare by stakeholders (readers may recall testimony given by Nicholas Cage) and others who argued that the "lack of incentives hurt [the] Nevada film industry."[50] But the program only began providing credit on January 1, 2014, making it too early to assess its effectiveness.

To address concerns of those who may 'lose' under Nevada's tax incentives, Nevada's political leaders should develop a strategic economic development framework that can articulate the benefits of the various development incentives. Legislators will need to set criteria for offering these subsidies and then restrict the incentive packages to projects that meet these criteria, thereby improving the likelihood that the benefits of the project will exceed the costs.[51]

Recommendations

Based on a review of best practices, the Guinn Center for Policy Priorities offers the following recommendations for Nevada legislators as they head into the special session this September.

A. Short term

These recommendations address the specific $1.3 billion development incentive package that Governor Sandoval has proposed to extend to Tesla.

- Require that transferable credits (valued at $120 million) included in the Tesla tax incentive package are transferred at their original value (and not at a discount).
  As discussed previously, transferable credits violate the tax policy principles of simplicity, transparency and even adequacy. Quite often, transferable credits sell at a discount, meaning that the selling firm receives less than their full value. The state, however, still forgoes the entire original amount. Lawmakers should require that these credits are transferred at their original face value.

- Include clawback (recapture) provisions in the final contract with Tesla.
  Nevada legislators should include clawback provisions in the contract that would require Tesla to pay back some or all of the value of the tax incentives if Tesla fails to meet the obligations of the contract. Currently, Nevada does have a general clawback provision (NRS 360.750)

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[49] Winners and Losers: The Impact of Government Incentives. MacIver Institute: Wisconsin. January 16, 2014. http://www.maciverinstitute.com/2014/01/winners-and-losers-the-impact-of-government-incentives/

[50] Laura Carrollas. "Lack of Incentives Hurt Nevada Film Industry." *Las Vegas Review Journal*. June 3, 2012. http://www.reviewjournal.com/business/economy/lack-incentives-hurt-nevada-film-industry

[51] For example, as the special session neared, it was reported that Switch Communications wants an incentive bill that would include sales tax abatements in order to build a $750 million Southern Nevada facility and a $250 million Northern Nevada project. In the absence of criteria and a framework, it makes it difficult to justify extension of some companies and not others.

that allows the state to recapture the credit, plus interest, if a company fails to meet its obligations.[52] Legislators should review current legislation and assess whether additional and more specific provisions are needed in the Tesla contract.

- Include performance-based measures in the approved contract.
  Legislators in Nevada should include specific employee (hiring) and capital investment targets in the Tesla agreement. Legislators should consider extending credits (e.g. energy rates, payroll taxes) to Tesla only after employee and capital investment targets have been met.

- Reduce sales and use tax abatements relative to property tax abatements, and lower the overall amount of sales and use tax and property tax abatements.
  Sales and use tax abatements are the biggest item in the Tesla incentive package. While Tesla's presence will likely spur economic growth and increase tax revenues, it is not yet known whether this anticipated revenue will be sufficient to cover the increased need for public services in the counties most affected by the proposal in the short-term.

- Establish a government commission to monitor the contract and performance targets.
  This commission (comprised of citizens, nonprofits, legislative auditors, and tax policy experts) would be charged with monitoring the progress of Tesla, tracking the incentives and abatements schedule, ensuring that performance targets are met, evaluating Tesla's local and state economic and fiscal impacts, asssessing the cost-effectiveness of the incentive program, and measuring actual versus expected performance. The committee would be required to report to the Governor and Nevada Legislature once a year.

- Establish a standing committee between Tesla and NSHE to build the workforce pipeline.
  Given the existing shortages of highly skilled labor in some parts of the state, the Legislature should establish a standing committee comprised of representatives of Tesla and NSHE's 2- and 4 year institutions. This committee would design and implement the relevant academic curriculum programs, and training and certificate programs to adequately prepare Nevadans for working at Tesla.

B. Looking ahead

Beyond the proposed $1.3 billion Tesla deal, the Nevada Legislature should consider broader reforms that could improve the cost-effectiveness of development incentives and the state's overall economic development strategy. Below are general recommendations for consideration during the 2105 Legislative session.

- Establish a formal, strategic and ongoing process to review all of Nevada's tax incentives.
  Many states have laws and policies in place that require a formal review of the state's entire portfolio of development incentives. This policy measure can help formalize a process of determining which incentives are meeting the state's strategic economic development goals.

- Establish criteria for development incentives.
  Limiting development incentives (subsidies) to projects that meet certain standards may improve the cost-effectiveness of the incentives. Establishing criteria (e.g. job creation, rural

[52] NRS Title 32. Revenue and Taxation. Chapter 360 General Provisions. https://www.leg.state.nv.us/NRS/NRS-360.html#NRS360Sec750

development, under-served areas, disadvantaged populations) also helps mute the criticism that governments are choosing winners and losers.

- Consider legislation that would sunset all incentives after a period of time.
  A number of states (e.g. Arizona and Oregon) retire (or 'sunset') certain development incentives after a specified period of time, unless legislators act to extend them.[53]

- Explore the feasibility of placing limits on the number or total dollar value of incentives.
  The widespread use and popularity of development incentives owes, in part, to the fact that they are unlike direct expenditures, which are subject to annual appropriations. Also, abatements equate to foregone revenues, as opposed to direct grants. Placing limits on the number or total dollar value of incentives could constrain policymakers to more rigorously assess the cost-effectiveness of the development incentives. In 2011, Oregon's legislative leaders set a spending cap on the expiring incentives, which forced policymakers to rely on rigorous evaluations to decide which incentives should remain in place.[54]

- Strengthen alternatives that focus on building the workforce.
  State and local policymakers are including employment-based incentives in their incentive packages. Employment-based incentives are often less costly, but more importantly, provide an opportunity to invest over the long term in the local workforce. Policymakers can target specific skills training and/or populations. Employment-based incentives may include job creation credits and customized training programs. Nevada's legislators should consider reducing capital investment incentives and expanding employment-based incentives.

- Strengthen accountability and disclosure.
  State and local policymakers must adopt policies that strengthen accountability and disclosure of all development incentive packages. Reporting requirements that take into account the full range of costs and benefits wil enable policy analysts to more accurately measure the cost-effectiveness of each development incentive.

[53] Pew Center on the States. Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth." April 2012. http://www.pewstates.org/research/reports/evidence-counts-85899378806
[54] Pew Center on the States. Evidence Counts: Evaluating State Tax Incentives for Jobs and Growth." April 2012. http://www.pewstates.org/research/reports/evidence-counts-85899378806; Daphne A. Kenyon, Adam Langley, and Bethany Paquin. 2012. Rethinking Property Tax Incentives for Business. Lincoln Institute of Land Policy: Massachusetts. http://community-wealth.org/sites/clone.community-wealth.org/files/downloads/paper-kenyon-et-al.pdf

About the Kenny C. Guinn Center for Policy Priorities

The Kenny C. Guinn Center for Policy Priorities (Guinn Center) is a nonprofit, 501(c3), bipartisan, think-do tank focused on independent, fact-based, relevant, and well-reasoned analysis of critical policy issues facing the State of Nevada and the Intermountain West region. The Guinn Center engages policy-makers, experts, and the public with innovative, fact-based research, ideas, and analysis to advance policy solutions, inform the public debate, and expand public engagement. The Guinn Center does not take institutional positions on policy issues.

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