Issue Brief

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Cracking the Cracker Bill

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Last week, Governor Earl Ray Tomblin signed into law H.B. 4086, a major tax incentive designed to attract a new chemical plant, known as a cracker, into West Virginia. The cracker facility would convert by-products of West Virginia's Marcellus Shale gas wells into useful chemicals. West Virginia's significant Marcellus Shale reserves and drilling activity have made it a target for companies looking to invest in a cracker facility. According to the official fiscal note for H.B. 4086, prepared by the state tax department, the tax incentive has no fiscal impact. However, there are several problems with the reasoning behind the $0 fiscal impact, and it is likely that there will be a significant fiscal impact if a facility is built, and takes advantage of the tax incentive.

While legislators debated and ultimately passed H.B. 4086, the fiscal note, which informed them that there would be no fiscal impact, did not include:

- An estimate of the revenue forgone
- An estimate of the costs of increases in demand for government services
- A model to estimate the economic impact and corresponding increases in revenue
- An explanation for how state revenue increases offset forgone local revenue

The fiscal note also assumes that a cracker facility would not locate in West Virginia without the tax incentive, due to the state's uncompetitive property taxes. This assumption relies on misconception about the state's property tax system and ignores many factors more influential to business location decisions.

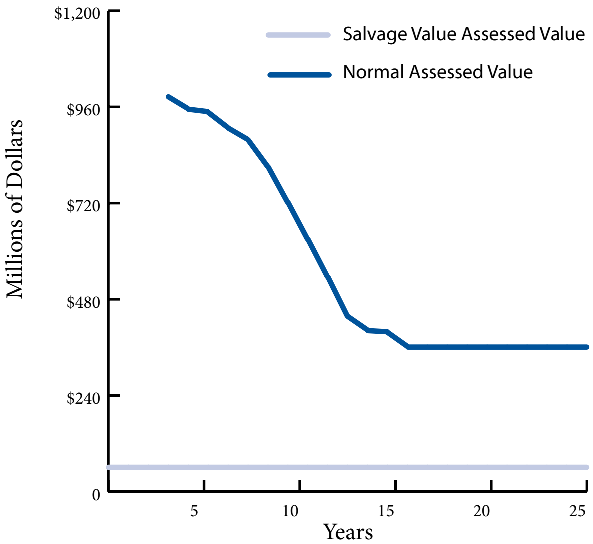
Fiscal Note Does Not Estimate Revenue Forgone or Local Impact

H.B. 4086 contains a 25-year property tax break for any company that invests at least $2 billion in West Virginia to build a cracker plant. Property taxes in West Virginia are levied against a property's assessed value. Normally all property in the state is assessed at 60 percent of its market value, which is determined through an appraisal process.[1] For a manufacturing property, like a cracker facility, the market value depreciates over time. The tax incentive would allow the cracker facility to be assessed at 60 percent of its salvage value. Salvage value is defined as five percent of a property's original cost.[2] The cracker facility would enjoy the special tax treatment for 25 years.

The special assessment valuation for the cracker facility would dramatically lower its assessed value, greatly reducing its property tax burden. Under a normal assessment and State Tax Department depreciation guidelines, the assessed value of a $2 billion cracker facility would fall from $1.14 billion to $362 million over the course of 25 years, as the value of the facility depreciates.[3] Under salvage value treatment, the facility would be assessed at $60 million for the entire 25 year period, between $1 billion and $300 million below a normal assessment (**Figure 1**).

According to H.B. 4086's fiscal note, the tax incentive "will have little or no direct effect on Property Tax revenue because manufacturing capital investments exceeding $2 billion in

Figure 1
Special Tax Treatment Greatly Reduces Assessed Value



Source: Source: WVCBP Analysis of H.B. 4086, WV Code §11-6F and WV State Tax Department Data.

a single facility rarely, if ever, occur in West Virginia."[4] The fiscal note does note that some property tax revenue will be forgone, but does not attempt to quantify that amount, stating, "the special method of appraisal would not reduce any tax derived from current sources."[5]

In fact, the amount of revenue forgone due to the incentive is substantial. Under a normal assessment, a $2 billion facility would owe approximately $24.7 million in its first year using state average property tax rates. With the special salvage value treatment, the facility would owe approximately one-twentieth that amount, or about $1.3 million (**Figure 2**). Over the course of 25 years the facility will have paid $32.6 million with the tax incentive in place, compared to $335.8 million under a normal assessment.[6] The amount of revenue forgone over 25 years totals $303.9 million, an average of approximately $12.1 million per year (**Figure 3**).

The substantial amount of revenue forgone could have significant implications for local governments and schools, which rely heavily on property tax revenue, another aspect missing from the fiscal note's analysis.

Figure 3
Amount of Revenue Forgone Tops $300 Million

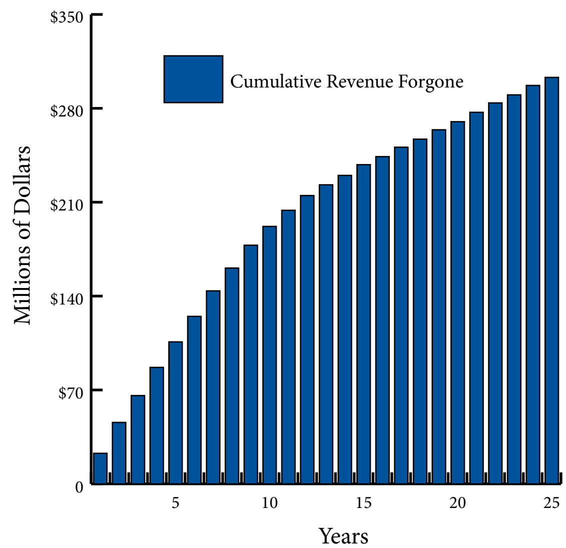


Figure 2
Salvage Value Reduces Property Taxes Owed by More Than $12 Million Per Year

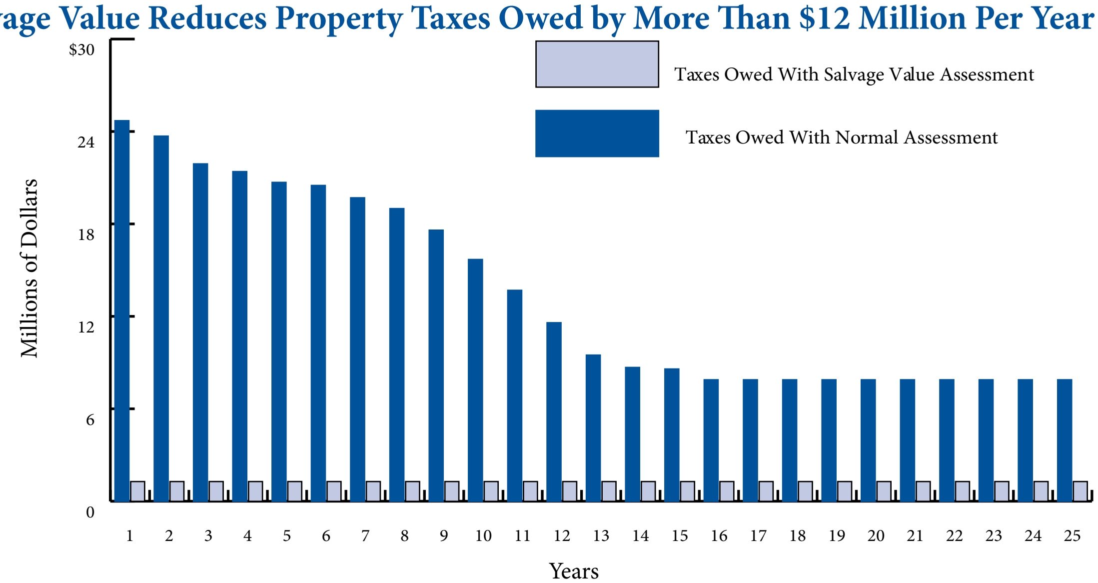


Table 1 contains estimates for the amount of property tax revenue forgone (at current levy rates), for three potential counties that may become home to a cracker facility, under the tax incentive.

Table 1

Potential Forgone Revenue for Host Counties and School Districts

	Revenue Forgone	
	Total (25 Years)	**Average Per Year**
Kanawha County		
County Regular	$79,945,694	$3,197,828
County Excess	$34,046,803	$1,361,872
School Regular	$108,457,795	$4,338,312
School Excess	$94,816,712	$3,792,668
Total	**$317,267,004**	**$12,690,680**
Marshall County		
County Regular	$72,677,904	$2,907,116
School Regular	$108,457,795	$4,338,312
School Bond	$25,660,981	$1,026,436
School Excess	$125,732,774	$5,029,311
Total	**$332,529,364**	**$13,301,175**
Wetzel County		
County Regular	$79,945,694	$3,197,828
School Regular	$108,457,795	$4,338,312
School Excess	$128,304,454	$5,132,178
Total	**$316,707,943**	**$12,668,318**

Source: WVCBP Analysis of H.B. 4086, WV Code §11-6F, and WV State Tax Department Data.

Each county examined could potentially miss out on approximately $3-4 million per year from county levies, while the school districts could forgo between $8 million and $10 million per year due to the tax incentive.

The local impact is important to analyze as property taxes are the primary source of tax revenue for local governments, funding many important services. The forgone revenue for the counties means any increased costs incurred due to the development of the cracker facility, like increased infrastructure demand, fire and police protection, new roads and water services, among others, may not be to offset due to the reduced revenue. This could lead to higher property taxes on other business and homeowners in order to reduce the fiscal strain, and should have been included in a fiscal impact analysis.

Each county would also miss out on a total of $108 million in revenue from their regular school levies, as well as over $100 million from their school excess levies. If the cracker facility was to locate in one of these counties, and attract an influx of workers and their families, enrollment in the local schools would likely increase, driving up education costs. Without the offsetting increase in property tax revenue, the state would be forced to pay out more through the school aid formula, another factor not considered in the fiscal note. Meanwhile, school costs covered by excess levies would also likely increase. Since these costs are not covered by the school aid formula, the forgone revenue would likely be replaced by higher excess levy rates paid by other businesses and homeowners.

The $8 to $10 million per year in forgone school property tax revenue for each county would be enough to pay for an additional 770 to 1,000 new students, according to 2009 per pupil spending levels.[7]

In the case of Marshall County, the forgone revenue would have also been used to pay down the school district's bonds much more quickly. Instead, the bond levy will remain in effect longer, keeping property taxes higher on other businesses and homeowners.

Fiscal Note Does Not Use Any Model to Measure Impact

The fiscal note for H.B. 4086 states, "…there will likely be other direct or indirect increases in tax revenue attributable to the new or expanded facility that would result in the creation of thousands of new jobs that may offset the tax revenue foregone."[8] But, as noted above, the fiscal note does not estimate the amount of revenue forgone needed to be offset, nor does it provide an estimate of the amount of the other indirect and direct revenue increases. In order to determine how much revenue could be created, an econometric model would be needed to assess the full economic impact. An econometric model also could be used to assess the costs of increasing demand on government services in order to determine if these additional costs are also offset. A model could also be used to determine how much of the economic impact would actually occur in West Virginia, offsetting forgone revenue here, and not in neighboring states, a factor not considered in the fiscal note.

An econometric model could also account for other tax incentives that the cracker facility and its "downstream" economic activities could take advantage of. The assumption in the fiscal note that the economic activity generated by the cracker facility could replace lost revenue does not account for all of the other tax incentives available. For example, many of these downstream developments could be eligible for salvage value assessments for 10 years[9] and other special tax treatment. According to state officials, other existing state laws could cut the cracker's state taxes by 60 to 100 percent.[10]

Without accounting for increased demands on government services, the impact shared between states, and existing tax incentives that drastically lower potential revenue, and without any estimate of the amount of revenue forgone, the fiscal note's assumption that indirect economic activity around the cracker facility will generate offsetting revenue has no value.

State Revenue Increases Do Not Offset Forgone Property Tax Revenue

The fiscal note for H.B. 4086 states that the creation of new jobs may offset forgone revenue. However, if revenue increases from new job creation occur, it would mainly increase for state revenues, like personal income, corporate income, and sales tax revenue. The forgone revenue from the tax incentive is all property tax revenue, which is the main source of tax revenue for local governments. The amount of property tax revenue collected by the state is insignificant. If the assumption is true, increases in state revenue do not offset forgone local revenues, with the limited exception of the school aid formula. Reductions in revenues collected through school excess and bond levies have no state revenue replacement. The assumption in the fiscal note did not account for these differing revenue streams.

The Fiscal Note Assumes the Tax Incentive Will Be Reason For Cracker's Location

The underlying assumption behind the fiscal note analysis of H.B. 4086 is that a cracker facility would not locate in West Virginia without the tax incentive. A $0 fiscal impact only makes sense in that context. The driving force behind this assumption is the fact that West Virginia levies property taxes on both real and personal property. This fiscal note itself notes that the two states in competition with West Virginia, Ohio and Pennsylvania, do not levy property taxes on personal property. This difference in taxation has long been considered a deterrent to investment in the state by members of the business community and by state officials, who claim that the property tax system makes West Virginia uncompetitive.[11] The tax incentive therefore was designed to "counteract" the business personal property tax.[12]

However, there is very little evidence to suggest that West Virginia's property taxes are a deterrent, or that the tax incentive will be the reason why West Virginia would be chosen. While West Virginia does have a higher tax rate on business personal property, its rate on real property is far below both Pennsylvania and Ohio, according to the Council on State Taxation. Taken together, West Virginia's business property tax rates are close to the national average. On average over the past three years, business property taxes nationally have totaled 1.8 percent of private sector GDP. In West Virginia, businesses have paid 2.1 percent in private GDP, while in Ohio and Pennsylvania, businesses have paid 1.9 and 1.7 percent respectively.[13] The difference between the three states is small enough to be offset by any number of other business taxes or costs.

Not only are West Virginia's property taxes not excessively higher than Ohio or Pennsylvania, even with a tax on personal property, West Virginia's property taxes have been rated as better for business than Ohio's and Pennsylvania's. According to the libertarian Tax Foundation's 2012 State Business Tax Climate Index, West Virginia's property tax system ranks 25th, while Ohio ranks 33rd, and Pennsylvania ranks 42nd, suggesting that from even a libertarian, pro-business point of view, West Virginia's property tax system does not create a disadvantage compared to neighboring states.

And even if West Virginia's property taxes are more favorable to businesses according to business advocates like the Tax

Foundation, there is little to suggest that property taxes are an influential factor in the cracker's location. The media and state officials have cited the American Chemistry Council's (ACC) economic analysis of a cracker's potential impact in West Virginia.[14] According to the ACC's analysis, the reasons that West Virginia is a potential site include: major rail systems, considerable shale gas deposits, access to the Ohio River, excellent universities, and it is within 500 miles of the U.S. industrial base.[15] Property taxes or taxes of any kind are not mentioned. Nor are property taxes or tax incentives cited in the analysis prepared for Ohio and Pennsylvania. After H.B. 4086 was fast-tracked through the Legislature, potential investors where non-committal, so further tax incentives may be proposed.[16]

If West Virginia's property taxes are not actually a deterrent and there are reasons other than tax incentives for a cracker to locate in West Virginia, then it cannot be assumed that the fiscal impact is $0. A company will rarely turn down free money, but location decisions are rarely made solely on tax incentives. It is possible that the facility would have made its decision with or without tax incentives offered by any state.

Conclusion

While the location of a new cracker facility in West Virginia would be a great asset for the state, generating hundreds of jobs and boosting manufacturing, it is imperative that state and local officials understand the fiscal impact of tax incentives contained in H.B. 4086.

In this regard, the fiscal note prepared for H.B. 4086 failed. The fiscal note provided no estimate of the tax revenue forgone, had no analysis to justify the assumption that forgone revenue would be offset by economic activity, did not address the infrastructure and other costs created by a cracker facility, did not account for the differences between state and local tax revenue, did not account for existing tax incentives, and assumed that a cracker facility's location decision is driven by property taxes. The $0 price tag attached to H.B. 4086 was based on an incomplete analysis. As it stands, the fiscal impact of H.B. 4086 is undetermined, but to say it is $0 is highly misleading.

Endnotes

1 West Virginia Constitution, Article X, Section 1b, Subsection A.

2 West Virginia Code §11-6F-3.

3 The depreciated value of the facility was determined using the Trend Table No. 34 and Depreciation Table No. 6, the designated tables for a NAICS code 211112 facility, in the State Tax Department's 2011 Trend and Percent Good Tables for Tax Year 2012 used by all county assessors in the state of West Virginia – http://www.state.wv.us/taxrev/publications/propertyTax/trendAndPercentGoodTables.2012.pdf.

4 State Tax Department, Fiscal Note Summary, H.B. 4086 - http://www.legis.state.wv.us/Fiscalnotes/FN(2)/fnsubmit_recordview1.cfm?RecordID=20055680.

5 Ibid.

6 The current statewide average property tax rate for a Class III business property (all real and personal property situated outside a municipality) is 2.17%. Historically, property tax levy rates in West Virginia have been on the decline. In the past decade, the class III levy rate has fallen from 2.25% to 2.17%. For the estimates in this brief, levy rates are assumed to remain at the current level of 2.17%.

7 2009 Annual Survey of Local Government Finances - School Systems.

8 State Tax Department, Fiscal Note Summary, H.B. 4086 - http://www.legis.state.wv.us/Fiscalnotes/FN(2)/fnsubmit_recordview1.cfm?RecordID=20055680.

9 WV Code §11-6F.

10 Timothy Puko, "Pennsylvania, two neighbors vie to procure 'cracker,'" Pittsburgh Tribune-Review, January 29, 2012.

11 Lawrence Messina, "Bill offers 25-year property-tax breaks for gas cracker," The Charleston Gazette, January 17, 2012, and Lawrence Messina, "Lawmakers seek edge in 'cracker' plant competition," The Charleston Gazette, January 22, 2012.

12 Staff and Wire Reports, "State looks at incentive to lure cracker plant," Parkersburg News and Sentinel, December 20, 2011.

13 Council on State Taxation, "Total State and Local Business Taxes," 2009, 2010, 2011.

14 http://blogs.wvgazette.com/watchdog/2012/01/12/how-many-jobs-would-a-cracker-plant-create/

15 http://www.americanchemistry.com/Policy/Energy/Shale-Gas/ACC-State-Shale-Fact-Sheet-West-Virginia.pdf.

16 Lawrence Messina, "State still in running for cracker, Tomblin says," The Charleston Gazette, January 29, 2012.