Report 18-18
December 2018

Electronics and Information Technology Manufacturing Zone Program

Wisconsin Economic Development Corporation

State of Wisconsin



Legislative Audit Bureau

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State Auditor
Joe Chrisman

Special Assistant to the State Auditor
Anne Sappenfield

Performance Evaluation Director
Dean Swenson

Team Leader
Derek Hippler

Evaluator
Ross Ryan

Publications Designer and Editor
Susan Skowronski

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STATE OF WISCONSIN | Legislative Audit Bureau
22 East Mifflin St., Suite 500 ▪ Madison, WI 53703 ▪ (608) 266-2818 ▪ Hotline: 1-877-FRAUD-17 ▪ www.legis.wisconsin.gov/lab

Joe Chrisman
State Auditor

December 19, 2018

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Cowles and Representative Kerkman:

As required by s. 13.94 (1) (u), Wis. Stats., we have evaluated the Wisconsin Economic Development Corporation's (WEDC's) process for verifying information submitted by recipients of the tax credits allocated under the Electronics and Information Technology Manufacturing Zone program. Beginning in 2018, statutes require us to complete such an evaluation annually for five years.

In November 2017, WEDC executed a $2.85 billion tax credit contract under the program with three corporations, which are collectively referred to as "Foxconn," to create jobs and make capital investments over the 15-year period from January 2018 through December 2032.

Statutes and WEDC's contract require WEDC to award program tax credits for the wages of employees who perform services in Wisconsin. However, WEDC established written procedures that allow it to award program tax credits for certain employees who do not perform services in Wisconsin, as long as these employees are paid in the zone. In this way, these written procedures do not comply with statutes or WEDC's contract. WEDC indicated that it intends to award Foxconn program tax credits for the wages of employees who are directed from and paid in the zone. We note that employees who are directed from and paid in the zone may not necessarily perform services in Wisconsin.

Statutes require our annual evaluations to analyze whether WEDC adhered to statutory and contractual requirements when it verified the amount of program tax credits awarded to Foxconn. WEDC's contract with Foxconn stipulates that WEDC may first award program tax credits in 2019, based on the jobs Foxconn created in 2018. Thus, our second evaluation, which we will publish in 2019, will include our first analysis of WEDC's compliance with these statutory and contractual requirements.

We appreciate the courtesy and cooperation extended to us by WEDC. A response from WEDC's chief executive officer follows the report.

Respectfully submitted,

Joe Chrisman
State Auditor

JC/DS/ss

Electronics and Information Technology Manufacturing Zone Program ▪

2017 Wisconsin Act 58, which was enacted in September 2017, created the Electronics and Information Technology Manufacturing Zone program. The Wisconsin Economic Development Corporation (WEDC) administers the program. Statutes allow WEDC to designate not more than one electronics and information technology manufacturing zone that shall remain in effect for no more than 15 years. Statutes stipulate that WEDC may award no more than $2.85 billion in tax credits under the program, including $1.5 billion for creating jobs and $1.35 billion for making capital investments. These tax credits are refundable, meaning that if a recipient's tax credits exceed its Wisconsin income tax liability, a recipient receives a payment from the Department of Revenue (DOR).

In November 2017, WEDC executed a $2.85 billion contract with Foxconn.

In November 2017, WEDC executed a $2.85 billion contract with three corporations that agreed to build a facility to fabricate thin-film transistor liquid-crystal displays, which are used in electronic appliances such as televisions and computer monitors. If these three corporations, which are collectively referred to as "Foxconn," create contractually specified jobs and make contractually specified capital investments, WEDC will award them up to $2.85 billion in program tax credits over the 15-year period of the contract and will inform DOR that they may claim these tax credits.

Beginning in 2018, statutes require the Legislative Audit Bureau to annually evaluate for five years:

- WEDC's process for verifying information that was submitted by recipients of program tax credits and that indicates the extent to which these recipients created contractually specified jobs and made contractually specified capital investments; and

- whether WEDC adhered to statutory and contractual requirements when it verified the amount of program tax credits to award recipients as a result of their efforts to create jobs and make capital investments.

To complete this evaluation, we interviewed WEDC staff, examined WEDC's contract with Foxconn, and analyzed the policies and written procedures WEDC established to verify information submitted by recipients of program tax credits. As separately required by statutes, our biennial financial audit of WEDC and program evaluation audit of WEDC's economic development programs will analyze WEDC's overall management of its finances and administration of its programs. We anticipate completing this biennial audit in spring 2019.

WEDC established written procedures that allow it to award program tax credits for certain employees who do not perform services in Wisconsin, as long as these employees are paid in the zone.

Statutes and WEDC's contract require WEDC to award program tax credits to recipients for the wages of employees who perform services in Wisconsin. However, WEDC established written procedures that allow it to award program tax credits for certain employees who do not perform services in Wisconsin, as long as these employees are paid in the zone. In this way, these written procedures do not comply with statutes or WEDC's contract. WEDC will not award any program tax credits in 2018 because its contract stipulates that it may first award program tax credits in 2019, based on the jobs Foxconn created in 2018.

Contractual Provisions

WEDC's contract establishes annual minimum numbers of jobs that Foxconn must create in order to be awarded program tax credits for job creation in that year.

WEDC's contract establishes annual minimum numbers of jobs that Foxconn must create in order to be awarded program tax credits for job creation in that year. For example, Foxconn must create at least 260 jobs in 2018 in order to be awarded any program tax credits in 2019. Foxconn may be awarded program tax credits for creating jobs in each year of the 15-year contract, but program tax credits for capital investments may be awarded only during the seven-year period from 2019 through 2025. After Foxconn creates jobs or makes capital investments in a given year, WEDC will award it program tax credits in subsequent years.

WEDC's contract stipulates the annual amounts of program tax credits that WEDC may award Foxconn for creating jobs and making capital investments. However, if Foxconn is not awarded all available program tax credits in a given year, some or all of these unawarded tax credits will carry forward and may be awarded in future years. The precise amounts of program tax credits that carry forward varies by year, and Foxconn must create a contractually specified minimum number of jobs in a given year in order for capital investment tax credits to carry forward.

WEDC may award Foxconn up to $9.5 million in program tax credits for creating jobs in 2018.

The table below shows the contractually specified annual amounts of program tax credits that WEDC may award to Foxconn, although the actual amounts awarded may vary because certain tax credits that were not awarded in prior years may be carried forward. In 2018, WEDC may award Foxconn up to $9.5 million in program tax credits for creating jobs, but it cannot award Foxconn any tax credits for making capital investments. If Foxconn does not create at least 260 contractually specified jobs in 2018, all $9.5 million in program tax credits will carry forward and may be awarded in future years.

Amounts of Program Tax Credits WEDC May Award Foxconn[1]
(in millions)

Calendar Year	Minimum Number of Jobs[2]	Job Creation	Capital Investment	Total
2018	260	$ 9.5	–	$ 9.5
2019	520	19.1	$ 192.9	212.0
2020	1,820	47.8	192.9	240.7
2021	3,640	84.0	192.9	276.9
2022	5,200	120.3	192.9	313.2
2023	7,150	120.6	192.9	313.5
2024	7,800	120.9	192.9	313.8
2025	8,450	121.1	192.9	314.0
2026	9,100	121.5	–	121.5
2027	10,400	121.7	–	121.7
2028	10,400	122.0	–	122.0
2029	10,400	122.3	–	122.3
2030	10,400	122.7	–	122.7
2031	10,400	123.0	–	123.0
2032	10,400	123.5	–	123.5
Total		**$1,500.0**	**$1,350.0**	**$2,850.0**

[1] Contractually specified amounts of program tax credits that are not awarded in a given year may be carried forward and awarded in future years.

[2] Foxconn must create a minimum number of jobs in order to be awarded tax credits for job creation in a given year.

Job Creation

Statutes and WEDC's contract stipulate that Foxconn is to be awarded program tax credits for creating jobs filled by employees paid at least $30,000 annually and offered retirement, health, and other benefits that are equivalent to such benefits offered to employees required to work at least 2,080 hours annually. Statutes and WEDC's contract stipulate that Foxconn is to be awarded program tax credits equal to 17.0 percent of the wages of such employees, but it cannot be awarded tax credits for any wages exceeding $100,000.

Statutes and WEDC's contract require WEDC to award program tax credits for the wages of employees who perform services in Wisconsin.

Statutes and WEDC's contract require WEDC to award program tax credits for the wages of employees who perform services in Wisconsin. Section 238.396 (3s) (c), Wis. Stats., stipulates that WEDC may not certify Foxconn to claim program tax credits for the wages of employees who perform services outside of Wisconsin. In addition, ss. 71.07 (3wm) and 71.28 (3wm), Wis. Stats., require WEDC to award program tax credits based on a tax credit recipient's zone payroll, which is statutorily defined to be the wages of employees who perform services in Wisconsin. The text of each of these statutory provisions is shown in the Appendix.

In November 2017, WEDC established program policies that were approved by its governing board. Although these policies contain information about how WEDC will award program tax credits, they do not specify how WEDC will ensure that program tax credits are awarded only for the wages of employees who perform services in Wisconsin. WEDC established written procedures that specify in greater detail how it will award program tax credits. WEDC's governing board does not approve written procedures. These written procedures allow WEDC to award program tax credits for "any employee that does not live in Wisconsin and is designated as 'remote', 'working at home', or 'sales'" as long as these employees are paid in the zone. These written procedures do not comply with statutes or WEDC's contract because they allow WEDC to award program tax credits for the wages of employees who do not perform services in Wisconsin.

WEDC indicated that it intends to award Foxconn program tax credits for the wages of employees who are directed from and paid in the zone. It indicated that it plans to do so based on s. 71.25 (8) (b), Wis. Stats., which pertains to the determination of corporate income taxes and indicates that a corporation's state payroll includes certain employees who are not residents of Wisconsin and do not perform services in Wisconsin. However, ss. 71.07 (3wm) and 71.28 (3wm), Wis. Stats., and WEDC's contract require WEDC to award program tax credits based on the zone payroll, which is a subset of the state payroll and includes only the wages of those employees who perform services in Wisconsin. We note that employees who are directed from and paid in the zone may not necessarily perform services in Wisconsin.

When awarding program tax credits, WEDC should ensure that it will comply with statutes and its contract, which require that program tax credits be awarded for the wages of employees who perform services in Wisconsin. WEDC should also modify its written procedures to require it to award program tax credits only for the wages of employees who perform services in Wisconsin. Doing so will ensure that its written procedures comply with statutes and its contract. Given the amount of tax credits that may be awarded through this program, WEDC should provide its modified written procedures to its governing board, which may review them and ensure that they comply with statutes and its contract. WEDC should then follow its modified written procedures when it awards program tax credits.

☑ Recommendation

We recommend the Wisconsin Economic Development Corporation:

- *ensure that it will comply with statutes and its contract, which require that Electronics and Information Technology Manufacturing Zone program tax credits be awarded for the wages of employees who perform services in Wisconsin;*

- *modify its written procedures to require it to award tax credits under the Electronics and Information Technology Manufacturing Zone program only for the wages of employees who perform services in Wisconsin;*

- *provide these modified written procedures to its governing board; and*

- *report to the Joint Legislative Audit Committee by January 31, 2019, on the status of its efforts to implement these recommendations.*

We noted three other job creation-related provisions in WEDC's contract with Foxconn. First, statutes indicate that WEDC may require a recipient of program tax credits to repay any tax credits that a recipient claimed for a year in which the recipient failed to maintain contractually specified employment levels. WEDC's policies require a recipient to maintain all created jobs for which it received program tax credits for the duration of its contract with WEDC. However, WEDC's contract does not require Foxconn to repay any program tax credits if it does not maintain all created jobs during the first five years of the contract.

Second, WEDC's policies indicate that if award recipients do not create at least a contractually specified minimum number of jobs annually, the program tax credits that could have been awarded for these jobs cannot be carried forward and awarded in future years. However, WEDC's contract allows unawarded program tax credits for creating jobs to be carried forward, even if Foxconn does not create a contractually specified minimum number of jobs annually. After we identified this discrepancy between the policies and the contract, WEDC indicated that it plans to modify its policies so that they comply with the contract.

Third, WEDC's contract stipulates that Foxconn must create a minimum of 10,400 jobs over the 15-year period of the contract, but it indicates that Foxconn may create up to 13,000 jobs. Foxconn does not need to create 13,000 jobs in order to be awarded all program tax credits for job creation. Contractual provisions pertaining to job creation indicate that Foxconn could be awarded all available program tax credits in the final year of the contract if, for example, Foxconn created:

- 10,400 jobs and paid each of the employees in these jobs an average of $69,900; or

- 13,000 jobs and paid each of the employees in these jobs an average of $55,900.

Capital Investments

Statutes allow WEDC to award Foxconn program tax credits over a seven-year period if WEDC determines that Foxconn made a significant capital investment in the electronics and information technology manufacturing zone, which is contractually defined to be Foxconn's business facilities within contractually specified geographic boundaries in Racine County. These program tax credits must not exceed 15.0 percent of Foxconn's capital expenditures. As required by statutes, WEDC adopted policies and procedures for defining a significant capital investment.

WEDC's contract indicates that Foxconn will make up to $10.0 billion in capital investments to complete the fabrication facility. However, contractual provisions related to how the tax credits will be calculated allow Foxconn to be awarded all

$1.35 billion in program tax credits that are available for capital investment if it makes at least $9.0 billion in capital investments.

Reporting Requirements

Foxconn is contractually required to report to WEDC by April 1 of each year on the numbers of jobs it created and capital investments it made in the prior calendar year.

Foxconn is contractually required to report to WEDC by April 1 of each year on the numbers of jobs it created and capital investments it made in the prior calendar year. Its first report is due by April 1, 2019, and will include information on the jobs created from January 2018 through December 2018. WEDC's contract further stipulates that Foxconn must hire and pay for a nationally recognized certified public accountant (CPA) to perform an attestation of the job creation and capital investment information submitted by Foxconn. WEDC's contract stipulates that this CPA must report to WEDC on the results of this attestation within 45 days after April 1.

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Appendix

Appendix

Statutory Requirements for Awarding Program Tax Credits

Statutes indicate how WEDC is required to award program tax credits. Statutes refer to WEDC as “the corporation” and a tax credit recipient as a “claimant.”

Section 238.396 (3s) (c), Wis. Stats., states that “The corporation may not certify a business to claim tax benefits under ss. 71.07 (3wm) (b) and 71.28 (3wm) (b) for services performed outside this state.”

Sections 71.07 (3wm) (b) and 71.28 (3wm) (b), Wis. Stats., require WEDC to award program tax credits based on the “zone payroll” of a tax credit recipient. Sections 71.07 (3wm) (a) 6. and 71.28 (3wm) (a) 6., Wis. Stats., define zone payroll as “the amount of state payroll that is attributable to wages paid by the claimant to full-time employees for services that are performed in the zone or that are performed outside the zone, but within the state, and for the benefit of the operations within the zone, as determined by the Wisconsin Economic Development Corporation.”

Response ■

Mark R. Hogan
Secretary and CEO

December 18, 2018

Mr. Joseph Chrisman
State Auditor
Legislative Audit Bureau
22 E. Mifflin Street, Suite 500
Madison, WI 53703

Dear Mr. Chrisman:

Thank you for the opportunity to respond to the Legislative Audit Bureau's (LAB's) evaluation of the Wisconsin Economic Development Corporation's (WEDC's) process for verifying information submitted by recipients (collectively referred to as "Foxconn") under the Electronics and Information Technology Manufacturing Zone (EITMZ) program.

Enacted in September 2017, Wisconsin Act 58 created the EITMZ and provided the statutory guidelines for WEDC's contract with Foxconn. WEDC signed a contract with Foxconn on November 10, 2017 which outlines the terms, conditions, and requirements for Foxconn to receive up to $2.85 billion in tax credits over a 15-year period in exchange for Foxconn investing up to $10 billion and creating up to 13,000 jobs. WEDC created Program Guidelines for the EITMZ program which were approved by WEDC's Board of Directors in November 2017. WEDC also created internal procedures to address the verification process specific to the EITMZ program. Both actions are standard practice for all WEDC's programs.

Act 58 required LAB to annually evaluate for five years WEDC's process for verifying information submitted by Foxconn and whether WEDC adhered to statutory and contractual requirements when verifying the tax credits. This report represents LAB's initial review of WEDC's process. As noted in LAB's report, Foxconn is first eligible to receive performance-based tax credits in 2019 at which time the company may receive up to $9.5 million in tax credits for creating jobs in 2018.

Since tax credits cannot be issued until 2019, LAB's report focuses on a review of WEDC's Program Guidelines and procedures. This provides WEDC the unique opportunity to consider LAB's observations and recommendations, and to research and implement, if necessary, changes to our Program Guidelines and/or procedures well in advance of when the first tax credits might be issued in 2019.

<u>LAB's Recommendations</u>

LAB's report mentions WEDC's written procedures allow WEDC to award program tax credits for "any employee that does not live in Wisconsin" as long as these employees are paid in the zone. LAB has indicated these written procedures "do not comply with (the Act 58) statutes or WEDC's Foxconn contract because they allow WEDC to award program tax credits for the wages of employees who do not perform services in Wisconsin."

Specifically, both Act 58 [Wis. Stat. 238.396 (3wm) (6)] and WEDC's contract with Foxconn [Section 1(w)] indicate:

- "Zone Payroll means the amount of State Payroll that is attributable to wages paid by the claimant (Foxconn) to full-time employees for services that are performed in the zone (EITMZ), or that are performed outside the zone, but within the state, and for the benefit of the operations within the zone, as determined by WEDC."
- Note: In both the statutes and contract, "State Payroll" is determined by Wis. Stat. 71.25 (8).

In addition, given the uniqueness of the Foxconn contract, and acknowledging WEDC's procedures do not normally require Board approval, LAB recommended for WEDC to provide its governing Board its modified procedures for the EITMZ program.

Background

To provide context, the primary purpose of the "Zone Payroll" definition, which was created by WEDC during the Foxconn contract negotiations, was to limit Foxconn's ability to earn capital investment tax credits to only those expenditures which were made in the geographic zone located in Mount Pleasant, Racine County, Wisconsin. At the same time, the definition was meant to encourage Foxconn to expand its employment opportunities throughout the entire state of Wisconsin by offering tax credits for wages of full-time employees (as defined in the contract) whose services were for the benefit of Foxconn's operations in the geographic zone.

For example, Foxconn's investment in the corporate headquarters in Milwaukee and the innovation centers it has purchased in Green Bay, Eau Claire and Racine would not qualify for capital expenditure tax credits. However, the wages of the related full-time employees would qualify for jobs tax credits if their services are for the benefit of, and directed by, Foxconn's operation in the Mount Pleasant zone.

As further background, and during public hearings around the Act 58 legislation, questions arose as to whether the wages of Foxconn employees who are not Wisconsin residents would qualify for tax credits. In response to these questions, it was indicated WEDC's intent was for these non-resident wages to qualify if they met the Wisconsin Department of Revenue's definition for compensation that is subject to Wisconsin state income taxes [Wis. Stat 71.25 (8)(b)]. In addition, it was indicated the wages earned by residents of states having reciprocity agreements with the state of Wisconsin would also be eligible for tax credits. These provided the basis for WEDC including these wages as those eligible to receive tax credits in its procedures.

Summary

LAB concludes the portion of WEDC's procedures covering these non-resident wages do not comply with statutes or WEDC's contract because they allow WEDC to award program tax credits for the wages of employees who do not perform services in Wisconsin. WEDC believes these services are being performed in Wisconsin because they are being directed by Foxconn's operation in the EITMZ, resulting in the related wages being subject to Wisconsin income taxes per Wisconsin's Department of Revenue.

WEDC is researching LAB's specific recommendation regarding the eligibility of non-resident wages and will modify its procedures, if necessary, to comply with statutes and its contract. WEDC will also provide its Board a copy of these procedures prior to any tax credits being awarded to Foxconn. Finally, WEDC will report to the Joint Legislative Audit Committee by January 31, 2019, on the status of its efforts to implement these recommendations.

Thank you again to you and the LAB staff for the constructive discussions and recommendations that resulted in the issuance of this report.

Sincerely,

Mark A. Hogan