State of Oklahoma
Incentive Evaluation Commission

Small Business Incubators Income Tax Exemption Draft Evaluation

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Key Findings & Recommendations

Overview

The State of Oklahoma provides a corporate income tax exemption for up to 10 years for tenants of small business incubators, from the date of occupancy. Small business incubators must be certified by the Department of Commerce. The purpose of the incentive is to promote, encourage, and advance economic prosperity and employment through the state by creating a more favorable tax climate for the tenants, particularly as they graduate from the incubators.

Recommendation: Retain, with modifications

Key Findings Related to Established Criteria for Evaluation

- **In 2023, 405 full-time jobs were provided by tenants and 1,135 full-time jobs were provided in 2022.** The number of certified incubators was 25 in 2023, down from 29 certified incubators in 2022. The number of certified incubators has decreased in recent years, thereby increasing the average number of tenants per incubator.

- **Nearly half of the incubators serve "mixed-use" tenants,** accounting for 12 of the 25 certified incubators. Of the remaining incubators, six target technology-centered businesses and five indicate they focus on manufacturing/distribution businesses.

- **For tenants generating income, their total payroll in 2023 was $25.4 million.** 114 tenants generated income in 2023 and accounted for 292 jobs.

- **In 2023, income-generating tenants produced $66.6 million in revenue,** qualifying for $3.3 million of income tax eligible for exemption.

- **Case studies or other longitudinal tracking of program recipient growth outcomes show that a business incubator's main goal is to produce successful firms** that will leave the program financially viable and freestanding, typically in two to three years.

- **The incubator managers maintain close relationships and connections among themselves to better serve their tenants.** They act as a resource hub to each other and to their tenants to help their tenants succeed.

- **The Department does not currently track the interaction or coordination with other programs or service offerings in the economic development or entrepreneurial support ecosystem**, however, the incubator managers keep their tenants aware of other state programs and opportunities.

- **The economic activity associated with eligible income from 2022 – 2023 generated 86 jobs and $12.7 million.** For every $1.00 of income eligible for the exemption, it is estimated that $1.95 of economic output was generated in the State in 2022 and $1.97 of economic output was generated in the State in 2023.

- **The economic activity associated with eligible income from 2022 – 2023 generated $0.3 million in State tax revenue.** This represents a roughly estimated state return on investment of $0.06 for every $1.00 of eligible income in 2022 and $0.04 for every $1.00 of eligible income in 2023. While the return on investment is negative, there are other qualitative benefits from the incubators themselves that should also be taken into consideration.

- **Nearly half of the incubators serve tenants in rural areas.** 11 of the 25 incubators are located in rural counties and 14 are located in urban counties. Four incubators operate in Oklahoma City and three incubators operate in Tulsa, Oklahoma's two largest cities.

- **Comparable programs were found in three other states, including the neighboring state of Missouri.** Montana and New York were also found to have similar programs, with New York having two such programs. Some differences in other programs were the taxes being exempted and the length of exemption eligibility.

Recommended Program Changes

- Update the statute language to require participation in the Department's data collection survey, including in post-program years, as a condition of continued tenancy, while applicable, and eligibility for the income tax exemption.

- Revise the OTC's tax forms to allow for disaggregation of the exempted income tax from incubator residents. The incentive evaluation statute requires the evaluation to make recommendations on ways to better evaluate the incentive when data is not available to do so. In this case, the OTC tax forms do not allow for ready disaggregation of the data, and to be able to do so, the forms should be modified. While the OTC believes that it is important to limit the lines on the tax forms, most taxpayers now use electronic tax preparation software or professional services, which negates the concern about additional form complexity.

Introduction

Incentive Evaluation Commission Overview

In 2015, HB2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The Commission has completed two cycles of qualified evaluations, from 2016-2019 and 2020 through 2023. This is now the first year of a new four-year cycle.

In 2023, the Legislature passed and Governor Stitt signed into law SB 745, which made a number of changes to the incentive evaluation process that were recommended by the Commission. Among them was the ability of the Commission to review qualified incentives within the four-year evaluation cycle. In prior cycles, incentives had to be reviewed at least once every four years, which effectively locked in place the order that incentives would be evaluated. As a result, some incentives in this cycle may be reviewed in less or more than four years.

One reason for the change in the evaluation cycle was to allow incentives with similar purposes or that are targeted to specific industries or parts of the state to be evaluated in the same year. This allows for continuity in the discussion and comparisons of effect and effectiveness. This grouping is considered an evaluation best practice.[1] For 2024, there are two broad categories of evaluated incentives:

- Financing/Venture Capital/Early Business related.
- Tourism/Film/Quality of Life related.

This evaluation of the Oklahoma Small Business Incubators Income Tax Exemption (“the Program”), administered by the Oklahoma Department of Commerce (“the Department”) and the Oklahoma Tax Commission (“OTC”), is one of 12 evaluations being conducted by the Commission in 2024 and fits within the financing/venture capital/early business-related incentives. This Program was last evaluated in 2022. Based on this evaluation and their collective judgment, the Commission will make recommendations to the Governor and the State Legislature related to this program.

Summary of 2022 Evaluation Findings and Recommendations

Overall Recommendation: Retain, with modifications

Key Findings:

- On average, incubators collectively have 149 tenants per year.
- 16 of the 36 incubators categorize themselves as “mixed use”, 16 indicate they focus on manufacturing/distribution businesses, and 7 target technology-centered businesses.
- Case studies or other longitudinal tracking of program recipient growth outcomes show that a business incubator’s main goal is to produce successful firms that will leave the program financially viable and freestanding, typically in two to three years.
- Between 2018 and 2021, employment associated with tenants nearly doubled.
- The Department does not currently track the interaction or coordination with other programs or service offerings in the economic development or entrepreneurial support ecosystem.
- The economic activity associated with program funding from 2015 – 2019 was 96 jobs and $26.3 million.

[1] “Best Practices for Planning Tax Incentive Evaluations: Lessons Learned from Indiana’s Evaluation Process,” Pew Charitable Trusts, August 2022, p.3. Accessed electronically at www.pewtrusts.org/-/media/assets/2022/08/best-practices_incentiveeval-planning_2022-3-24_final.pdf

- When considering the direct impacts of the incubator companies, the net state revenue is negative at -$34,000. When examining the total economic impacts (direct, indirect, and induced), the net state revenue is estimated at $186,400.
- An assessment of whether adequate protections are in place to ensure the fiscal impact of the incentive does not increase substantially beyond the state's expectations in future years.

Other recommendations:

- Establish standards for tenant occupancy to qualify for the tax exemption.
- Increase data collection requirements.
- Consider requiring participation in the survey, including in post-program years, as a condition of tenancy and/or eligibility for the exemption.

2024 Criteria for Evaluation

The provisions of HB 2182 require that criteria specific to each incentive be used for the evaluation. A key factor is evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated foals as established in state statute or legislation.

To assist in a determination of program effectiveness, the Incentive Evaluation Commission has adopted the following criteria:

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

Background

The Role of Small Business Incubators

Despite the important economic role played by small businesses, new business survival rates highlight that these companies often struggle to overcome challenges that threaten their viability. Between 1994 and 2020, an average of 67.7 percent of new employer establishments survived for at least two years. During the same period, the five-year survival rate was 48.9 percent, the ten-year survival rate was 33.7 percent, and the fifteen-year survival rate was 25.6 percent. Survival rates by owner demographic showed slight differences. The 2017 – 2019 two-year survival rate for young employer establishments (2-3-year-old firms surviving to at least 4-5 years old) was 79 percent. While Women (81 percent), Hispanic (82 percent), and Veteran-owned (84 percent) businesses had better survival rates than the national average, Black (73 percent) and Asian-led businesses (78 percent) were below the national rate.[2]

In light of these factors, business incubators have become an increasingly popular way to support young and smaller firms. Business incubators offer a combination of affordable workspace, strong community partnerships and critical business advisory services that support entrepreneurs and their businesses. Firms typically apply to join and participate in the incubator for a predetermined amount of time before moving into the community. While there is room within this definition for different incubator models with varying amounts of space dedicated to different functions, services and types of business assistance, Oklahoma broadly defines a business incubator as “a facility in which small units of space may be leased by a tenant and in which management maintains or provides access to business development services for use by tenants.”

The earliest incubator programs focused on technology companies or a combination of light industrial, technology, and service firms – today, these are referred to as mixed-use incubators. Recently, new incubators have targeted industries such as food processing, medical technologies, space and ceramics technologies, arts and crafts and software development. Incubator sponsors have also targeted programs to support microenterprise creation, the needs of women and minorities, environmental activities, and telecommunications.

A business incubator’s main goal is to produce successful firms that will leave the program financially viable and freestanding (typically in two to three years). These incubator graduates have the potential to create jobs, revitalize neighborhoods, commercialize new technologies and strengthen local and national economies.

According to estimates from the International Business Incubator Association, there are 1,400 incubators in the U.S., equal to a share of 15.3 percent of all entrepreneurship centers.[3]

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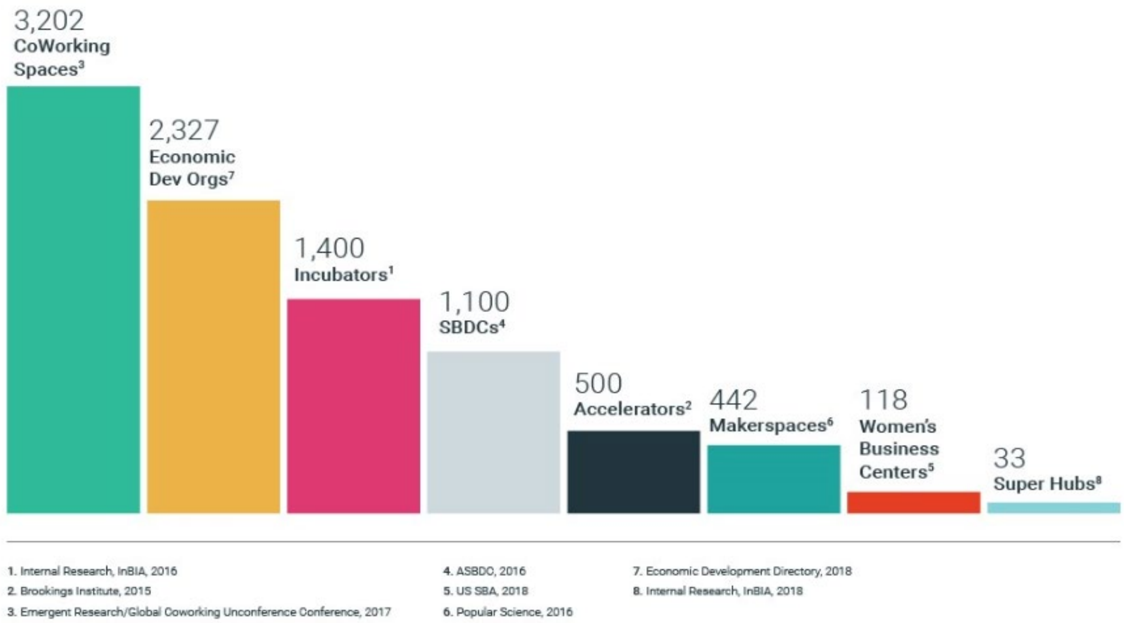
[2] SBA, “Frequently Asked Questions About Small Business, 2023.” Accessed electronically at https://advocacy.sba.gov/wp-content/uploads/2023/03/Frequently-Asked-Questions-About-Small-Business-March-2023-508c.pdf
[3] InBIA, https://inbia.org/wp-content/uploads/2018/08/NumberofECsimage.jpg?x62369

Figure 1: Number of U.S. Entrepreneurship Centers by Type



Source: InBIA, Numbers of U.S. Entrepreneurship Centers by Type

More than half (54 percent) are mixed-use incubators that work with clients from many industries. An additional 37 percent cater to technology-based tenants, and the remaining 9 percent focus on manufacturing, service, and other industries. Among U.S. incubators, 32 percent are affiliated with academic institutions, 25 percent are sponsored by local or regional economic development organizations, 16 percent are sponsored by governments, 15 percent have no sponsoring entity, 4 percent are for-profit, and the remaining 8 percent are hybrids. InBIA estimates that the 1,400 U.S. incubators have assisted nearly 50,000 companies, which have provided nearly 200,000 full-time jobs and generated $15 billion in revenue annually.

Oklahoma's Certified Business Incubators

According to the 2023 Small Business Incubator Annual Report prepared by the Department, 25 certified small business incubators are operating in Oklahoma (details regarding the incubator certification process are provided in the "Incentive Usage & Administration" chapter of this evaluation).[4] Oklahoma's current certified incubator locations are detailed in the following figure. 14 of the certified incubators serve urban areas while 11 serve rural counties.[5]

[4] Oklahoma Department of Commerce, "Small Business Incubator Certification Program: 2023 Annual Report." Accessed electronically at https://okcommerce.gov/wp-content/uploads/Incubator-Report-2023.pdf

[5] Urban areas are those located within a Metropolitan Statistical Area as defined by the Federal Office of Management and Budget.

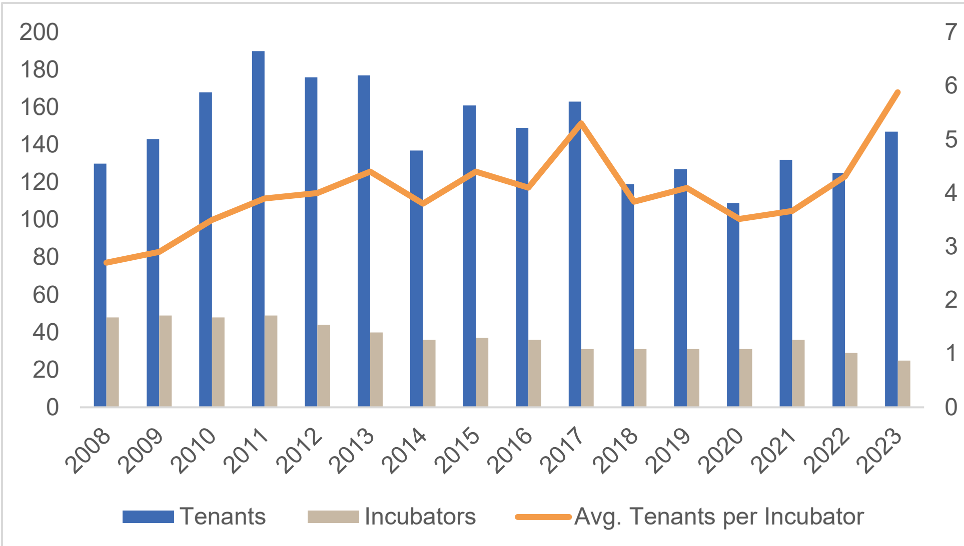
Figure 2: Certified Small Business Incubator Locations, 2023

Source: Department of Commerce 2023 Small Business Incubator Certification Program Annual Report

The certified incubators in the state can vary throughout the year. This is due to new incubators opening or others that close for various reasons. After maintaining a stable number of incubators of either 48 or 49 through 2011, a series of declines left only 31 in operation by 2017. These 31 incubators remained in operation through 2020. There was an increase to 36 in 2021 and then a decrease to 29 in 2022. As of 2023, there are 25 operating state certified incubators.

The number of tenants the incubators host also varies each year as new businesses are formed, and others graduate out of the incubator or go out of business. Since 2019, the number of tenants has been an average of 128 with 147 current as of 2023. In recent years, because the number of incubators have declined and the number of tenants has increased, the average number of tenants per incubator has also steadily increased, from 3.5 in 2020 to 5.9 in 2023.

Figure 3: Certified Incubators and Tenants, 2008-2023



Source: Department of Commerce Small Business Incubator Certification Program Annual Reports

In 2023, 405 full-time jobs were provided by the 132 tenants of Oklahoma's 25 certified incubators. This is down from a high of 1,660 jobs in 2021. The average number of jobs per incubator in 2023 was 16.2. The number of jobs per incubator from 2008 – 2023 was on average 25.1. The average number of jobs provided per tenant in 2023 was 2.8, reflecting that many tenants had few employees. When accounting for the 1,080 jobs provided in 2023 by graduated businesses still located in-state and the 405 jobs associated with current incubator tenants, Oklahoma's small business incubators were responsible for nearly 1,500 jobs in 2023.

Table 1: Certified Incubator Employment Statistics, 2008-2023

	FT Jobs Provided by Incubator Tenants	Avg. Jobs Provided per Incubator	Avg. Jobs Provided per Incubator Tenant	Jobs Provided by Graduated Businesses Remaining in OK
2008	853	17.8	6.6	1,864
2009	618	12.6	4.3	1,331
2010	715	14.9	4.3	1,294
2011	883	18.0	4.6	1,551
2012	1,029	23.4	5.8	1,845
2013	946	23.7	5.3	1,553
2014	979	27.2	7.1	1,805
2015	741	20.0	4.6	1,944
2016	726	20.2	4.9	1,931
2017	862	27.8	5.3	2,147
2018	827	26.7	6.9	2,122
2019	946	30.5	7.4	2,246
2020	1,165	37.6	10.7	1,373
2021	1,660	46.1	12.6	1,692
2022	1,135	39.1	9.1	1,255
2023	405	16.2	2.8	1,080
Average	**925**	**24.7**	**6.5**	**1,765**

Source: Department of Commerce Small Business Incubator Certification Program Annual Reports

Notably, businesses that graduate from an incubator and remain in operation can – and often do – continue to employ and pay workers. The Department collects data from incubator managers on past tenant's current operations, but getting this information is often difficult and incomplete. As part of the 2023 survey results, 13 incubators reported past tenants that were still in operation in Oklahoma. Of the incubators that reported any past tenants, nine of them reported payroll information. Some incubators did not have payroll data for any past tenants; payroll data was reported for 23 total tenants. Of the incubators the reported any past tenants, 10 reported employment data.

Though this data is incomplete and does not include payroll or employment information for all past tenants, it is still informative. For 2023, in the aggregate, 98 total businesses were still operation in Oklahoma with 500 full-time employees.

The Department noted that some tenants did list "$0" in payroll but may have been a sole-proprietor or owner and thus did not consider themselves to be a part of payroll. This indicates that the payroll reported for past tenants may be an undercount.[6]

[6] The Department did not provide aggregate payroll data for past tenants due to its incomplete nature.

Incentive Usage & Administration

Incentive Characteristics

In 1988, the Oklahoma Legislature passed the Oklahoma Small Business Incubators Incentives Act (the Act) to “promote, encourage and advance economic prosperity and employment throughout the state by creating a more favorable tax climate for tenants of small business incubators” in Oklahoma.[7]

Under the Act, tenants of certified incubators are exempt from state tax liability on income earned as a result of activities conducted as an occupant in an incubator for up to 10 years from the occupancy date in an incubator site in accordance with rules of the OTC. The exemption remains in effect after the date the tenant is no longer an occupant in an incubator, but not to exceed a total of 10 years.

According to Oklahoma Statutes, incubators are defined as “facilities in which small units of space may be leased by a tenant and in which management maintains or provides access to business development services for use by tenants” and the term tenant refers to a “sole proprietorship, business partnership or corporation operating a business for profit and leasing or otherwise occupying space in an incubator.”

Historic Use of the Tax Exemption

In attempting to compile and analyze exemption claims associated with this incentive, the process for claiming the income tax exemption makes it very difficult to determine its actual financial impact. In fact, the OTC regularly reports in its Tax Expenditure Reports the following: “Estimate is not available. This exemption is commingled with several others on the Oklahoma income tax form 511; and therefore, the amount of income exempted under this expenditure item cannot be estimated.”[8]

The primary reason for this complication is that taxpayers claim this exemption by reporting associated income on the “Miscellaneous: Other Subtractions” line of Schedule 511-A. This single line item on the Form is used to claim various allowed subtractions that are not specifically enumerated on other lines of the Schedule, including (on the 2023 Form):[9]

- Royalty income: Enter “1”
- Manufacturer’s exclusion: Enter “2”
- Payments received as a result of a military member being killed in a combat zone: Enter “3”
- Income earned by an individual whose military spouse was killed in a combat zone: Enter “4”
- Small Business Incubator exclusion: Enter “5”
- Allowable deductions not included in items 1-5: Enter “99”

The OTC does not have a process in place to easily disaggregate the information collected on the forms in order to be able to attribute claims activity to any of the subtractions described in the preceding.

In addition, there appear to be reporting problems associated with the indication of which type of “miscellaneous other subtraction” a taxpayer is claiming. According to OTC staff, it is not unusual for a taxpayer to enter the wrong number or record an entry on the line item that could (and perhaps should) have been claimed on one of the other lines on the Form. As a result, aggregating the returns that use the numeric

[7] O.S. §74-5072. Note: With the elimination of the income tax exemption for sponsors, this section was amended as follows: Section 5072. The purpose of the Small Business Incubators Incentives Act shall be to promote, encourage and advance economic prosperity and employment throughout the state by creating a more favorable tax climate for tenants of small business incubators in this state.

[8] Oklahoma Tax Commission, “Tax Expenditure Report, 2021 – 2022.” Accessed electronically at https://oklahoma.gov/content/dam/ok/en/tax/documents/resources/reports/tax-expenditure/TaxExpenditureReport-2021-2022.pdf

[9] Oklahoma Tax Commission, “2021 Oklahoma Resident Individual Income Tax Forms and Instructions.” Accessed electronically at https://oklahoma.gov/content/dam/ok/en/tax/documents/forms/individuals/current/511-Pkt.pdf

code for the small business incubator subtraction is unlikely to accurately reflect the number of returns and the amount being claimed.

Despite these limitations, the OTC estimates that the small business incubator exemption comprises the following activity among entries on the Miscellaneous: Other Subtractions" line of Schedule 511-A:

Importantly, not all incubator tenants have income subject to taxation and therefore, the exemption is not used by all tenants of certified incubators. According to aggregated information collected for use in the Department's annual incubator reports, no more than 44 percent of incubators had eligible tenants in 2023. Prior to that, only 33 percent of incubators had qualified tenants in 2022 and less than 20 percent in each year prior to that.

Table 2: Activity Associated with Incubators with Tenants Generating Income, 2018-2023

	Incubators	Total Tenants	Jobs	Payroll	Sales	Income Eligible for Exemption
2018	5/31 (16%)	58	550	$9,618,676	$22,529,735	$2,309,826
2019	5/31 (16%)	58	634	$1,992,553	$4,516,500	$4,876,904
2020	6/31 (19%)	54	675	$0	$0	$1,082,156
2021	7/36 (19%)	69	1,174	$0	$0	$32,153,540*
2022	9/27 (33%)	76	1,005	$43,952,753	$79,516,422	$3,029,962
2023	11/25 (44%)	114	292	$25,386,843	$66,561,153	$3,436,200

Source: Oklahoma Department of Commerce
** In 2021, a new incubator – 36 Degrees North – accounted for the vast majority (approximately 75 percent) of all income eligible for the exemption.*

Because the tenant information displayed in the preceding table is collected and reported to the Department by incubator operators, the validity of the information cannot be confirmed. However, it does provide an estimate for understanding the potential state revenue impacts of the program.

While the likely cost of the exemption is likely relatively minimal to the state (in terms of foregone revenue), it is notable that adequate protections are not in place to ensure the fiscal impact of the incentive does not increase substantially beyond the state's expectations in future years. For example, as shown in

Table 2, the amount of tenant income reported by incubators in 2021 was more than $32 million, vastly higher than what was reported in prior years (approximately 75 percent of the total was attributable to a new incubator). Foregone revenue in 2021 could reasonably range somewhere between $160,000 and $1.6 million, based on the tax rates, – the latter of which would be significantly higher than in prior years.

Incentive Administration

The Department is responsible for the implementation and administration of the Small Business Incubators Incentives Act, including certification of all incubators. The following are the primary tasks associated with program administration:

- **Certification and Recertification:** To become certified, a small business incubator must file an application with the Department and be able to demonstrate:
    - That a facility exists that can be transformed into an incubator at a specified cost;
    - The ability to directly provide, or arrange for the provision of, business development services for tenants of the incubator, including (but not limited to) financial consulting assistance, management and marketing assistance and physical services;

- A potential for sustained use of the incubator facility by eligible tenants, through a market study and other means; and
- The ability to manage and operate the incubator facility in accordance with State law.

In its evaluation of applicants, the Department considers the ability of the sponsor to carry out these provisions. In addition, the Department evaluates the potential economic impact of the incubator in the community; the incubator's conformance with state, area-wide and local economic development plans (if such exist); and the location of the incubator in order to encourage geographic distribution of incubators across the state. The Department also conducts a site visit of the proposed incubator.

Once an incubator is certified, the Department may perform periodic reviews to ensure the facility maintains compliance. Failure to maintain compliance may result in revocation of certification. Incubator certification is valid for 10 years unless 1) there is a change in incubator ownership, 2) tenants occupying the space exceed "small business" size standards for their industry as defined by the SBA or 3) the OTC deems the sponsor ineligible for tax incentives under the program, resulting in a request for incubator de-certification.

The Department is also responsible for the recertification of incubators every 10 years. The Department tracks the recertification dates of each incubator and provides sufficient notice and a recertification form to the incubator; reviews the recertification submission; and visits the incubator to recertify.

▪ **Program Reporting:** As part of its oversight of the Small Business Incubators Incentives Act, the Department must provide a report to both the Speaker of the House of Representatives and the President Pro Tempore of the Senate. The report, which must be submitted on or before December 31 of each year, is required to contain the following information:

- Number of new incubator tenants by industry for current reporting period
- Cumulative total of incubator tenants by industry
- Total new jobs created by tenants for the reporting year
- Cumulative total of jobs created by tenants
- Total financial value of initial investment by tenants for the reporting year
- Total financial value of cumulative investment by tenants
- Number of firms still operating in Oklahoma after ending their tenancy in the incubator
- The number of jobs provided by these firms for the reporting year

To compile this information, the Department requires that incubators file annual reports each calendar year regarding incubator tenants and their associated activities. The following information has historically been requested as part of that process:

- Name of tenant company
- Number of employees
- Type of business or NAICS code
- Date of occupancy
- Tenants graduated
- Tenants lost
- Type(s) of business targeted
- Tenant usage of/eligibility for exemption
- Support services offered to tenants
- Number of companies in incubator to date
- Number of companies operating in the State after graduation
- Total employment of graduate companies in the State
- Optional tenant success story

Prior to 2020, the Department also requested information related to annual payroll and annual sales of tenants. In 2020, it began requesting the total square footage/size of incubators. The Department has considered collecting (or, in some instances, recollecting) additional data points to facilitate deeper analysis of the impacts and activities of incubators and their tenants, including:

- FEIN of each tenant
- New incubator tenants this (current) year to date
- Total number of jobs created by new tenants this (current) year to date
- Annual payroll of each tenant this (current) year to date
- Annual sales of each tenant this (current) year to date
- Financial investments made by tenants this (current) year to date

Since the last time the incentive was evaluated in 2022, the Department has implemented additional data collection practices to better understand how each incubator is operating and supporting its tenants. The additional data collected include:

- Full-time versus part-time employees
- Interns employed
- Use of and payments to subcontractors
- Estimated annual gross revenue
- Estimated annual cost of goods/services
- Sources and amounts of other revenue and financial assistance

The Small Business Incubators Incentive incorporates multiple best practices in its program design.[10] The incentive is targeted towards small start-up businesses that have gone through the rigorous acceptance process of their respective state-certified incubator. This discretionary design allows the state to support specific businesses without having the additional administrative burden of finding and accepting applicants. The incentive has a limited duration of ten years, though most companies do not use the incentive for a full ten years due to many not having income to be eligible for exemption. The design of the incentive also allows for incubator managers to communicate the guidelines clearly and simply to tenants.

Economic & Fiscal Impact

[10] A full list and explanation of incentive best practices can be found in Appendix B.

Economic and Fiscal Impact

A detailed explanation of the IMPLAN economic impact methodology can be found in Appendix C.

The economic impacts for this incentive are calculated based on available survey data from incubator participants that is collected by incubator managers and reported to the Department. In this survey, respondents reported the amount of income eligible for the tax exemption. In 2022, the amount of eligible income was $3.0 million and in 2023, the amount of eligible income was $3.4 million.

Based on the survey results, this income is generally associated with technology firms, manufacturing, and professional services, with several other smaller industries represented as well. It is reasonable that these economic and fiscal impacts are an underestimate since not all companies who had eligible income responded to the Department's survey.

The economic impact generated from the reported income eligible for the tax exemption generated an additional 40 jobs in 2022 and 46 jobs in 2023. The economic output generated was $5.9 million in 2022 and $6.8 million in 2023. As a result of this tax incentive, for the 2023 economic impact, $1.97 of economic activity was generated for every $1.00 of eligible income. For the 2022 economic impact, $1.95 of economic activity was generated for every $1.00 of eligible income. It should be noted that these are rough estimates due to the data limitations of not all eligible companies responding to the Department's survey.

The added economic impact also contributed to $178,625 of state tax revenue in 2022 and $153,120 of state tax revenue in 2023, offsetting the direct income that was eligible for exemption. This represents a state return on investment of $0.06 for every $1.00 of eligible income in 2022 and $0.04 for every $1.00 of eligible income in 2023.

Table 3: Economic Impacts of Eligible Income, 2022

Impact	Employment	Labor Income	Value Added	Output	Est. OK Tax Revenue
Direct	22	$1,798,871	$1,910,632	$3,029,962	$88,319
Indirect	8	$418,243	$565,211	$1,131,406	$25,855
Induced	10	$493,337	$932,293	$1,733,579	$64,451
Total	**40**	**$2,710,451**	**$3,408,136**	**$5,894,947**	**$178,625**

Table 4: Economic Impacts of Eligible Income, 2023

Impact	Employment	Labor Income	Value Added	Output	Est. OK Tax Revenue
Direct	26	$2,055,109	$2,208,671	$3,436,201	$74,756
Indirect	9	$490,123	$663,910	$1,329,242	$22,248
Induced	11	$566,610	$1,070,767	$1,991,062	$56,116
Total	**46**	**$3,111,842**	**$3,943,348**	**$6,756,505**	**$153,120**

While the quantitative ROI is negative, there are qualitative benefits from the growth of nascent small businesses that should also be taken into consideration.

Incentive Benchmarking

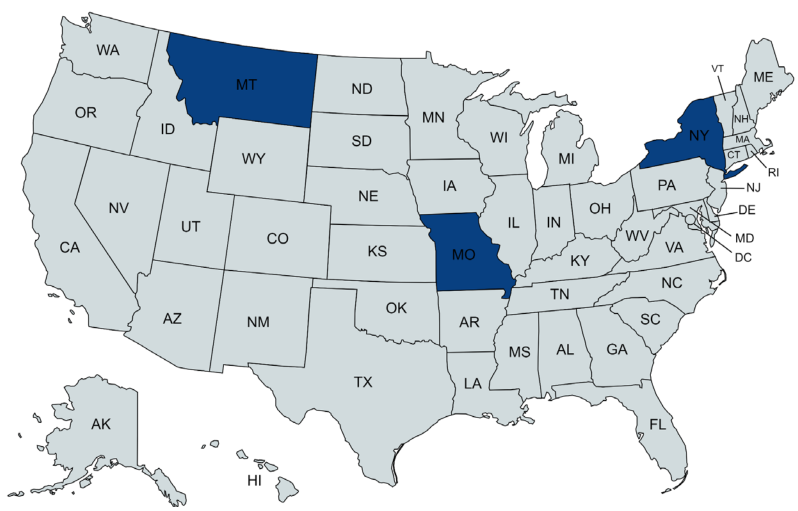
Benchmarking

For evaluation purposes, benchmarking provides information related to how peer states use and evaluate similar incentives. At the outset, it should be understood that no states are 'perfect peers' – there will be multiple differences in economic, demographic and political factors that will have to be considered in any analysis; likewise, it is exceedingly rare that any two state incentive programs will be exactly the same.[11] These benchmarking realities must be taken into consideration when making comparisons – and, for the sake of brevity, the report will not continually re-make this point throughout the discussion.

The process of creating a comparison group for incentives typically begins with bordering states. This is generally the starting point, because proximity often leads states to compete for the same regional businesses or business/industry investments. Second, neighboring states often (but not always) have similar economic, demographic, or political structures that lend themselves to comparison.

For purposes of benchmarking Oklahoma's Small Business Incubators Income Tax Exemption, the only neighboring state with a directly comparable program was Missouri. In expanding the benchmarking to any state, two additional states nationwide were found to have comparable programs, New York and Montana, with New York having two similar programs.

Figure 4: Program Comparison Group



[11] The primary instances of exactly alike state incentive programs occur when states choose to 'piggyback' onto federal programs.

Table 5: Benchmark Programs

State Program	Purpose	Eligibility Requirements	Program Details
Oklahoma Small Business Incubator Tenants Tax Exemption	To promote, encourage, and advance economic prosperity by creating a more favorable tax climate for tenants of small business incubators in Oklahoma.	▪ Member of an approved small business incubator	10-year income tax exemption
New York State Certified Business Incubators and Innovation Hot Spots[12]	To provide a network of support and create a culture of innovation and success across the state.	▪ Enrolled in and in good standing with one of 20 state-certified business incubators ▪ In first five years of operation ▪ In the formative stages of development	5-year tax exemption from state corporate income tax and state sales tax on purchases
New York START-UP NY[13]	Helps new and expanding businesses through tax-based incentives and innovative academic partnerships.	▪ Be a new business in the state or an existing business relocating or expanding within the state ▪ Partner with a state college or university ▪ Create new jobs and contribute to the economic development of the local community	10-year tax exemption from state corporate income and state sales tax and new employees are exempt from state income tax on income earned from the company
Montana Business Incubator Tax Exemption[14]	Support the development and growth of local businesses.	▪ A business owned or leased and operated by a local economic development organization	Property tax exemption

[12] https://esd.ny.gov/certified-business-incubator
[13] https://esd.ny.gov/startup-ny-program#eligibility
[14] https://leg.mt.gov/bills/mca/title_0150/chapter_0240/part_0180/section_0020/0150-0240-0180-0020.html

State Program	Purpose	Eligibility Requirements	Program Details

Missouri Small Business Incubator Tax Credit[15]	Helps small business incubators leverage funds to use for working capital and other non-operating expenditures that support new business creation in communities.	▪ Missouri taxpayer who makes a contribution to an approved incubator sponsor in Missouri	▪ 50% tax credit that can be applied to:
			  ▪ Income tax
			  ▪ Corporate franchise tax
			  ▪ Bank Tax
			  ▪ Insurance Premium Tax
			  ▪ Other Financial Institution Tax
			▪ Carry forward 5 years
			▪ Sellable or transferable
			▪ Maximum amount of $500,000 per calendar year

[15] https://ded.mo.gov/programs/business/small-business-incubator-tax-credit

Appendices

Appendix A

Oklahoma Statute Title 74. State Government
§74-5078. State income tax exemption for tenant

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

B. For tax years ending before January 1, 2020, in order to qualify for the income tax exemption for the sixth through tenth year as authorized by this section, the tenant must make at least seventy-five percent (75%) of its gross sales constituting the principal business activity of the business to buyers located outside the state or to buyers whose principal business activity is conducted outside the state or to the federal government or to buyers located within the state if the product or service is resold to an out-of-state customer or buyer for ultimate use. Provided, if a tenant does not achieve the qualifying percentage for any one of the above tax years, the tenant shall not be disqualified for subsequent tax years in which the qualifying percentage is achieved.

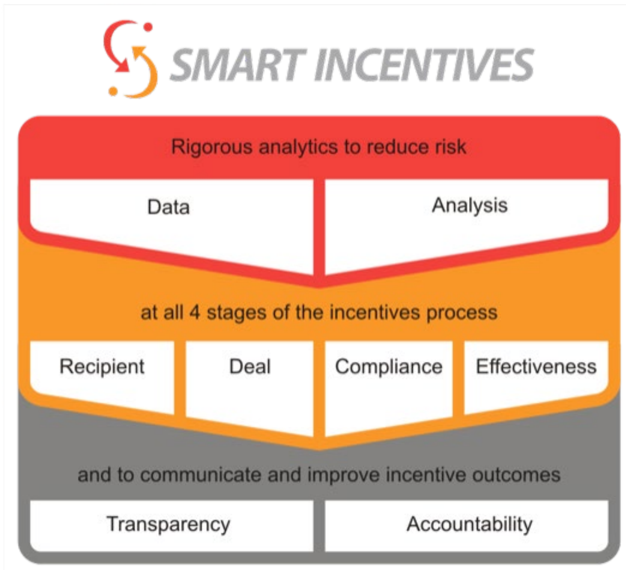
The Oklahoma Tax Commission shall promulgate rules to implement the provisions of this section.

Added by Laws 1987, c. 228, § 8, eff. Jan. 1, 1988. Amended by Laws 1997, c. 230, § 2, eff. Nov. 1, 1997; Laws 2001, c. 187, § 1, eff. Nov. 1, 2001; Laws 2002, c. 486, § 11, eff. Jan. 1, 2003; Laws 2019, c. 320, § 3.

Appendix B: Business Incentives Best Practices

There has been extensive writing around what constitute business incentives best practices. From the project team's review of many sources,[16] it has identified 10 important best practices and sought to incorporate them into the analysis and discussion of this incentive.

As a starting point, business incentives should be viewed as a process, not an event. The award of an incentive and the incentive features are part of that process, and many of the identified best practices reflect that. The process itself should take into consideration each of these factors, which PFM's subcontractor, Smart Incentives, demonstrates in the following illustration:



While the project team believes this is a strong set of best practices, there may well be others that are as (or more applicable) in specific situations. It is also likely that some of the best practices will come into conflict in some situations. For example, application and reporting requirements may reduce the simplicity of business compliance. As a result, these will always be subject to analysis on a case-by-case basis.

The 10 best practices are:

1. **For maximum impact, incentives should be targeted.** Examples of useful targeting include companies or industries that export their goods or services out-of-state; high economic impact companies or industries – such as those with higher wages and benefits, significant job creation, or significant capital investment.

2. **Incentives should be discretionary.** In most instances, an application process enables the state government to require company disclosure of information related to eligibility criteria and enables

[16] Three resources in particular were relied upon on putting together the list of best practices. They are "What Factors Influence the Effectiveness of Business Incentives?" The Pew Charitable Trusts, April 4, 2019, accessed electronically at https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2019/04/what-factors-influence-the-effectiveness-of-business-incentives; "Improving Economic Development Incentives," Timothy J. Bartik, W.E. Upjohn Institute for Employment Research, 2018, accessed electronically at https://research.upjohn.org/cgi/viewcontent.cgi?article=1000&context=up_policybriefs; "Best Practices for the Design and Evaluation of State Tax Incentives Programs for Economic Development," Matthew N. Murray and Donald J. Bruce, January 2017, included within another evaluation at https://media.al.com/news_mobile_impact/other/AL%20ENTERTAIN%20NEWMKTS%203%209%2017.pdf

the state to reject applications that do not meet its standards.

3. **Incentives should leverage significant private capital.** Ideally, the incentive should leverage private investment that is at least several multiples of the state investment.

4. **Incentives should provide most of the benefit within 1-3 years and have a limited duration.** Company discount rates are much higher than for the state, and businesses will significantly devalue incentive payments in later years.

5. **Incentives should take into consideration state and/or local as well as industry economic conditions.** Incentives that are provided in high performing areas or for stable and profitable businesses or industries will likely fail the 'but for test' – meaning the activity would likely occur without the state incentive.

6. **'Smart' incentives help businesses overcome practical barriers to growth.** In particular, customized assistance for locally owned, small and medium-sized businesses can have significant impact.

7. **Incentives should be transparent.** The incentive purpose should be clearly articulated, as are eligibility requirements, and regular, detailed reporting should be required from all program recipients.

8. **Incentives should require accountability.** When upfront financial incentives are offered in return for job creation, retention, or capital investment, there should be contract language in place that allows the state to 'claw back' state resources should the company not meet performance requirements.

9. **Incentives should have caps.** To ensure the state's financial health, program dollar caps or limits should be in place. Incentive programs should also have a limited duration, with sunsets in place to require regular review of incentive performance.

10. **Incentives should be simple and understandable.** The state should be able to easily and effectively administer the incentive, and users should be able to readily comply with its requirements.

Appendix C: IMPLAN Economic Impact Methodology

The economic impact methodology utilized to determine the multiplier effects is IMPLAN (Impact Analysis for PLANning), a proprietary model; PFM has obtained a license for use of the IMPLAN model for these evaluations.

IMPLAN's Social Accounting Matrices (SAMs) capture the actual dollar amounts of all business transactions taking place in a regional economy as reported each year by businesses and governmental agencies. SAM accounts are a better measure of economic flow than traditional input-output accounts because they include "non-market" transactions. Examples of these transactions would be taxes and unemployment benefits.

Multipliers

SAMs can be constructed to show the effects of a given change on the economy of interest. These are called Multiplier Models. Multiplier Models study the impacts of a user-specified change in the chosen economy for 440 different industries. Because the Multiplier Models are built directly from the region-specific SAMs, they will reflect the region's unique structure and trade situation.

Multiplier Models are the framework for building impact analysis questions. Derived mathematically, these models estimate the magnitude and distribution of economic impacts, and measure three types of effects which are displayed in the final report. These are the direct, indirect, and induced changes within the economy.

- **Direct** effects are determined by the Event as defined by the user (i.e., a $10 million order is a $10 million direct effect).
- The **indirect** effects are determined by the amount of the direct effect spent within the study region on supplies, services, labor, and taxes.
- Finally, the **induced** effect measures the money that is re-spent in the study area as a result of spending from the indirect effect.

Each of these steps recognizes an important leakage from the economic study region spent on purchases outside of the defined area. Eventually, these leakages will stop the cycle.

Fiscal Impacts

The IMPLAN tax report captures all tax revenue in the study area, across all levels of government that exist in that study area, for the specific industries and institutions affected by an event or group of events. Tax Impact results are based on the collected and reported taxes within the region for the given data year. IMPLAN taxes shown (and collected) are industry and geographically specific. The IMPLAN tax impact report splits the tax impacts into the various tax categories based on the picture of that region's economy. But, there is no industry-specific profile for taxes paid by tax category, so the distribution across tax categories is an all-industry average. While this is a limitation of the IMPLAN fiscal reporting, the IMPLAN tax report serves as an appropriate measure of jurisdictional tax results in the aggregate. Tax results cannot be added to any summary or detailed results as they are already included as a portion of Output. State taxes do not include taxes or district assessments levied by Federal, county, sub-county, city or township governments.