



# **State of Oklahoma**

# **Incentive Evaluation Commission**

**Small Business Incubators Income Tax Exemption Draft Evaluation**

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# **Key Findings & Recommendations**



## Incentive Overview

Under the Oklahoma Small Business Incubators Incentives Act, tenants of certified Oklahoma small business 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. 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.

**Retain, Reconfigure or Repeal:** Retain, with modifications.

## Key Findings

- **Number of small businesses served by the program:** The number of small business tenants of Oklahoma’s certified business incubators varies from year to year, ranging from a high of 190 in 2011 to a low of 109 in 2020. On average, incubators collectively have 149 tenants per year. Because the overall number of incubators has slightly declined while the number of tenants has remained essentially unchanged, the average number of tenants per incubator has increased by a compound annual growth rate (CAGR) of 2.4 percent.
- **Types of small businesses served as a result of the program:** While more than half of incubators target a specific type of business, other incubators target multiple, limited types of businesses. As summarized in the following table, 16 of the 36 incubators categorize themselves as “mixed use” (either solely or in addition to targeted business types), 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:** 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. Incubator graduates reported the following activity to the Oklahoma Department of Commerce (Department):

**Table 1: Employment and Payroll of Incubator Graduates, 2015-2021**

	2015	2016	2017	2018	2019	2020	2021
Employment	85	89	67	85	144	171	194
Establishments	8	9	10	10	15	17	18
Payroll (\$ M)	\$3.5	\$3.7	\$3.5	\$4.3	\$5.8	\$7.1	\$8.6
Avg. Wages	\$40,615	\$41,167	\$52,684	\$50,443	\$40,451	\$41,542	\$44,222

Source: Department of Commerce

- **Employment and payroll associated with small businesses served as a result of the program:** Between 2018 and 2021, employment associated with tenants nearly doubled, growing from 827 to 1,660 over the four-year time period. In recent years, the Department has not collected consistent information regarding payroll. In 2018, it totaled \$13.9 million – equal to \$16,863 per employee.
- **Interaction or coordination with other programs or service offerings in the economic development or entrepreneurial support ecosystem:** The Department does not currently track this information, so it is presently not possible to know if incubator tenants are benefitting from additional Oklahoma (or other) services and supports.



- **Economic activity associated with program funding:** The following table summarizes the estimated economic impacts associated with small businesses' tenancy in Oklahoma's certified business incubators.

**Table 2: Economic Impacts of Incubator Tenants' Claimed Income, 2015-2019**

Type	Employment	Labor Income	Value Added	Output
Direct	48	\$3,915,248	\$5,477,772	\$18,051,868
Indirect	25	\$1,538,666	\$2,293,178	\$4,790,830
Induced	23	\$1,080,372	\$1,911,848	\$3,525,380
<b>Total</b>	<b>96</b>	<b>\$6,534,286</b>	<b>\$9,682,797</b>	<b>\$26,368,079</b>

Source: PFM; IMPLAN 2022

- **State return on investment:** When considering just the direct impacts of the incubator companies, the economic impact model estimates the net state revenue is negative at -\$34,000. When examining the total economic impacts of the income through the use of IMPLAN, net state tax revenue is estimated at \$186,400. This includes the indirect and induced economic and tax impacts of the incubator companies' output.

**Table 3: Economic Impacts of Incubator Tenants' Claimed Income, 2015-2019**

Impact Type	State Tax Revenue
Direct	(\$33,946)
Indirect	\$101,454
Induced	\$118,919
<b>Total</b>	<b>\$186,427</b>

Source: PFM; IMPLAN 2022

- **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:** While the likely cost of the exemption is 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, 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). As discussed in this evaluation, foregone revenue in 2021 could reasonably range somewhere between \$0.2 and \$1.6 million – the latter of which would be significantly higher than in prior years.

## Recommendations

- **Establish standards for tenant occupancy to qualify for the tax exemption.** The program statute does not require businesses to be tenants in an incubator for a designated amount of time prior to becoming eligible for the exemption. A business could theoretically establish tenancy then immediately depart the incubator while becoming eligible for the exemption for 10 years. There are also no performance standards associated with eligibility for the incentive. Incorporating expectations and/or requirements regarding a tenant's investment of time and resources would likely strengthen the program.
- **Increase data collection requirements.** Data collection for any incentive program is indisputably a best practice, and this process is undoubtedly beneficial to a wide variety of interested internal and external stakeholders across the state. However, certain modifications are likely to improve the quality of the analysis that the data is able to facilitate. These 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
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- Additionally, the Department should consider requiring participation in the survey (including in post-program years) as a condition of tenancy in a certified incubator and/or eligibility for the exemption. Alternatively, the Department could require that incubators include these provisions in their service agreements with tenants.



# Introduction



## Oklahoma Incentive Evaluation Commission Overview

The Oklahoma Incentive Evaluation Commission (Commission) was created by House Bill (HB) 2182 of 2015 to produce objective evaluations of the State of Oklahoma’s wide array of economic development incentives. The Commission is made up of five members appointed by the Governor, President Pro Tempore of the Senate and Speaker of the House of Representatives, along with representatives of the Department of Commerce, Office of Management and Enterprise Services and the Tax Commission.

Under the enabling legislation, each of the State’s economic incentives must be evaluated once every four years according to a formal set of general criteria, including (but not limited to) economic output, fiscal impact, return on incentive and effectiveness of administration, as well as criteria specific to each incentive.

Since the Commission’s inception, it has contracted with PFM Group Consulting LLC (PFM) to serve as the independent evaluator of each incentive scheduled for review in that year. PFM issues a final draft evaluation on each incentive with recommendations as to how Oklahoma can most effectively achieve the incentive’s goals, including recommendations on whether the incentive should be retained, reconfigured or repealed. The evaluations are also to make recommendations, where needed, for any changes to State policy, rules or statutes that would allow the incentive to be more easily or conclusively evaluated in the future.

The Commission is charged with considering the independent evaluator’s facts and findings – as well as all public comments – before voting to retain, repeal or modify each incentive under review. It then submits a final report to the Governor and Legislature. This incentive was last evaluated in 2018.

## Summary of 2018 Evaluation Findings and Recommendations

Based on the preceding framework, significant findings and recommendations from the 2018 evaluation of the Small Business Incubators Income Tax Exemption are summarized in the following table:

**Table 4: Summary of 2018 Evaluation Findings and Recommendations**

<b>Evaluation Category</b>	<b>KeyFinding(s)</b>
Overall Findings	<ul style="list-style-type: none"> <li>- The number of certified incubators operating in the State has declined since 2008; however, the number of small businesses located in OK has increased</li> <li>- Incubators have aided in the creation of more than 3,000 OK jobs, and payroll of incubator tenants has increased over time</li> </ul>
Fiscal and Economic Impact	<ul style="list-style-type: none"> <li>- It is likely the return on investment to the State is breakeven or positive; however, given the data limitations associated with the program, it is difficult to document the annual economic and tax impacts</li> </ul>
Administrative Effectiveness	<ul style="list-style-type: none"> <li>- Some degree of taxpayer confusion exists regarding how to accurately claim the income tax exemption for incubator tenants</li> <li>- It is difficult to estimate the tax expenditure amounts of the individual components of the tax form used to claim the exemption</li> </ul>
Retain, Reconfigure or Repeal	<ul style="list-style-type: none"> <li>- Retain income tax exemption for tenants; repeal income tax exemption for sponsors</li> </ul>
Recommendations	<ul style="list-style-type: none"> <li>- Improve the exemptions claims process</li> <li>- Eliminate the requirement that tenants make at least 75 percent of gross sales out of state in order to qualify for years 6 to 10 of the tax exemption</li> </ul>

*Source: State of Oklahoma Incentive Evaluation Commission, Tax Incentive Evaluation Report 2018*

Based on PFM’s analysis and consideration of other factors, the Commission voted 4-0 to retain the tax exemption for tenants and 4-0 to repeal the tax exemption for sponsors.





SB 485 of 2019 made two significant changes to the program, effective January 1, 2020: (1) the income tax exemption for sponsors was repealed; and (2) the requirement that tenants make at least 75 percent of gross sales out of state in order to qualify for the income tax exemption in years 6 to 10 was eliminated.<sup>1</sup>

## **2022 Criteria and Evaluation Approach**

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

In the case of the Small Business Incubators Income Tax Exemption for Tenants, the stated goals are “to promote, encourage and advance economic prosperity and employment through the state by creating a more favorable tax climate for tenants of small business incubators in Oklahoma.”

In addition to this goal and the general evaluation factors previously described, the Commission has adopted the following criteria to assist in a determination of program effectiveness:

- 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

To conduct its 2022 review of the Small Business Incubators Income Tax Exemption for Tenants, the PFM project team conducted the following activities:

- Submitted data requests to the Oklahoma Department of Commerce (Department) and Oklahoma Tax Commission (OTC)
- Reviewed and analyzed data from internal and external sources
- Completed subject matter expert/internal stakeholder interviews with representatives from the Department and OTC
- In collaboration with the Oklahoma City, Tulsa and Oklahoma State Chambers of Commerce, conducted external stakeholder interviews with industry representatives
- Conducted site visits of two representative certified business incubators
- Benchmarked Oklahoma to other states

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<sup>1</sup> SB 485 of 2019 is provided in Appendix C.



# Background



## U.S. Small Business Statistics

Small businesses – defined by the U.S. Small Business Administration (SBA) as “firms with fewer than 500 employees”<sup>2</sup> – represent the majority of all businesses in the U.S. and play a significant role in job creation nationwide. According to the SBA’s 2021 State Small Business Profile, the nation’s 32.5 million small businesses (inclusive of nonemployer firms<sup>3</sup>) collectively comprise 99.9 percent of all U.S. businesses and employ 61.2 million workers (46.8 percent of the U.S. total) with annual payroll of \$2,819.1 billion.<sup>4</sup>

While Oklahoma’s more than 360,000 small businesses represent a similar share of all businesses in the state (99.4 percent), they employ a higher share of the state’s workers (715,000 employees, or 51.7 percent) and supply a higher share of Oklahoma annual payroll (\$28.3 billion, or 44.9 percent).

Compared to neighboring states, Oklahoma small businesses represent the highest share of total businesses in the state, and the second highest shares of employment and payroll, second only to New Mexico (54.4 percent and 49.2 percent, respectively).

**Table 5: Small Business Statistics, Select States**

	Establishments		Employment		Payroll (Billions)	
	Small Businesses	% of All Businesses	Small Businesses	% of All Businesses	Small Businesses	% of All Businesses
Oklahoma	362,364	99.4%	715,603	51.7%	\$28.3	44.9%
Arkansas	258,552	99.3%	491,383	47.1%	\$17.8	40.2%
Colorado	139,442	97.6%	1,163,586	48.0%	\$55.5	41.5%
Kansas	55,623	96.1%	601,550	50.0%	\$24.0	43.6%
Missouri	115,604	97.4%	1,160,657	45.8%	\$46.3	38.4%
New Mexico	32,919	95.3%	343,648	54.4%	\$13.3	49.2%
Texas	445,838	98.6%	4,870,825	45.1%	\$224.7	38.9%
<b>United States</b>	<b>32,540,953</b>	<b>99.9%</b>	<b>61,244,031</b>	<b>46.8%</b>	<b>\$2,819.1</b>	<b>39.7%</b>

Source: SBA 2021 State Small Business Profiles

Small businesses are often significant sources of innovation. One SBA analysis found that small businesses make up a substantial majority of firms in patent-intensive industries, which rely relatively heavily on intellectual property. Overall, approximately 96 percent of all firms in patent-intensive industries are considered small businesses. Further, these small businesses tend to employ more people on a per-firm basis than the national average: U.S. small businesses have an average of 10 employees per firm, while small firms in “super heavy” patent intensive industries (e.g., those receiving over nine percent of all corporate patents issued) have an average of 24 employees.<sup>5</sup>

<sup>2</sup> According to the SBA, a business is defined as “small” based primarily on either the number of employees over the past 12 months or the average annual receipts over the past three years. The two most widely-used standards to qualify a business as small are 500 employees for most manufacturing and mining industries or \$7.5 million in average annual receipts for many nonmanufacturing industries. In addition to size standards, a business must meet the following criteria to qualify as small: (1) is organized for profit; (2) has a place of business in the U.S.; (3) operates primarily within the U.S. or makes a significant contribution to the U.S. economy through payment of taxes or use of American products, materials or labor; (4) is independently owned and operated; and (5) is not dominant in its field on a national basis.

<sup>3</sup> The SBA defines a nonemployer firm as one that has no paid employees, has annual business receipts of \$1,000 or more and is subject to federal income taxes. Nonemployers account for about three percent of business receipts but make up an estimated 75 percent of all businesses.

<sup>4</sup> SBA, “2021 Small Business Profile: United States.” Accessed electronically at <https://cdn.advocacy.sba.gov/wp-content/uploads/2021/08/30143723/Small-Business-Economic-Profile-US.pdf>

<sup>5</sup> SBA, “Understanding the Small Business Presence in Patent-Intensive Industries,” (June 9, 2015). Accessed electronically at <https://advocacy.sba.gov/2015/06/09/4572/>



## 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 2019, an average of 67.6 percent of new employer establishments survived at least two years. During the same period, the five-year survival rate was 48.9 percent, the ten-year survival rate was 33.6 percent, and the fifteen-year survival rate was 25.7 percent. Survival rates by owner demographic showed slight differences. The 2016-2018 two-year survival rate for young employer establishments (2-3-year-old firms surviving to at least 4-5 years old) was 71 percent. Women (67 percent), Black (65 percent), Hispanic (64 percent) and Asian-led firms (70 percent) were below the national rate. Veteran-owned businesses (63 percent) were also below the national rate.<sup>6</sup>

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.

Research has indicated that business incubators do have a positive effect on businesses. As examples:

- Firms in incubators receive more business services than firms not associated with an incubator, thereby increasing their chances for survival.<sup>7</sup>
- According to the International Business Incubators Association (InBIA), 87 percent of all businesses that graduate from incubators are still in business after five years. Most businesses started outside of an incubator fail within the first four years.
- Of companies graduating from technology incubators, 70 to 80 percent are still operating three years post-graduation. An SBA study found a survival rate of less than 50 percent for non-incubated startups after three years.
- Every 50 jobs created by an incubator client generate approximately 25 more jobs in the same community.
- Incubators create jobs at a cost of approximately \$1,100 each, whereas other publicly supported job creation mechanisms cost more than \$10,000 per job created.

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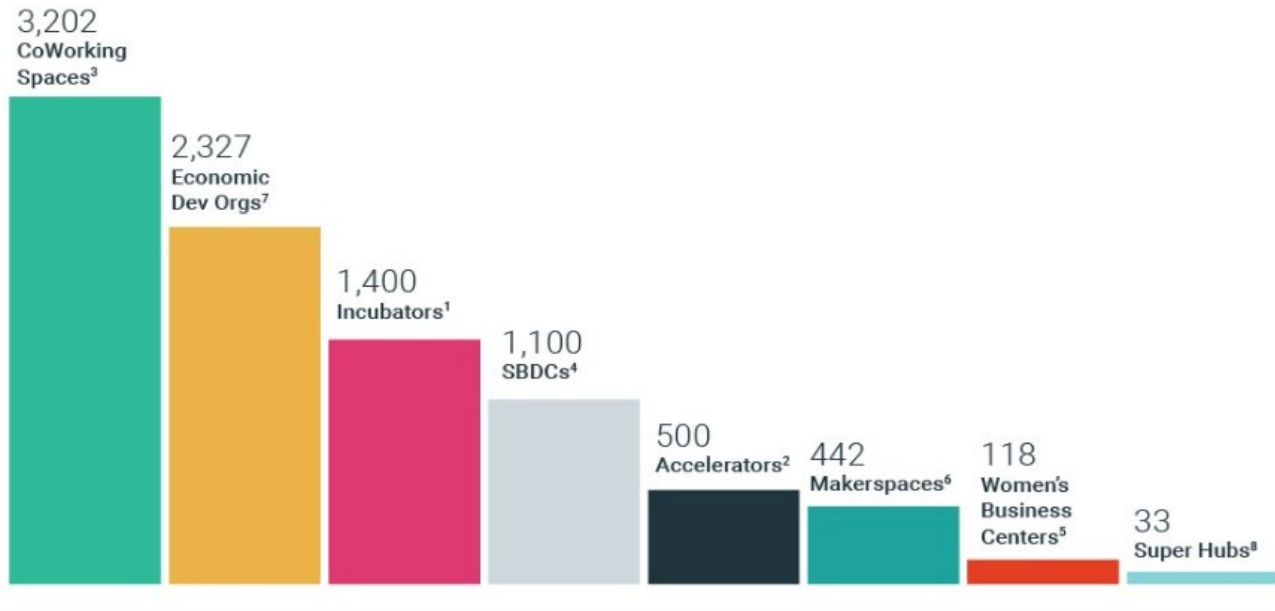
<sup>6</sup> SBA, “Frequently Asked Questions About Small Business, 2021.” Accessed electronically at <https://cdn.advocacy.sba.gov/wp-content/uploads/2021/12/06095731/Small-Business-FAQ-Revised-December-2021.pdf>

<sup>7</sup> Kenan Institute of Private Enterprise, “Business Incubators: If You Build It, Will Entrepreneurs Succeed?” (September 2, 2020). Accessed electronically at <https://kenaninstitute.unc.edu/kenan-insight/business-incubators-if-you-build-it-will-entrepreneurs-succeed/#:~:text=Business%20incubators%20support%20young%20businesses,business%20services%20help%20offset%20costs.>



According to InBIA estimates, there are 1,400 incubators in the U.S., equal to a share of 15.3 percent of all entrepreneurship centers.<sup>8</sup>

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



1. Internal Research, InBIA, 2016

2. Brookings Institute, 2015

3. Emergent Research/Global Coworking Unconference Conference, 2017

4. ASBDC, 2016

5. US SBA, 2018

6. Popular Science, 2016

7. Economic Development Directory, 2018

8. Internal Research, InBIA, 2018

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 2021 Small Business Incubator Annual Report prepared by the Department, 36 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).<sup>9</sup> The locations of Oklahoma's current certified incubator locations are detailed in the following figure. Notably, these locations largely align with the state's population centers, often home to institutions of higher education and hubs of economic activity.

<sup>8</sup> InBIA, <https://inbia.org/wp-content/uploads/2018/08/NumberofECsimage.jpg?x62369>

<sup>9</sup> Oklahoma Department of Commerce, "Small Business Incubator Certification Program: 2021 Annual Report." Accessed electronically at [https://www.okbia.org/files/ugd/c07624\\_a99db2586fe64eb391268681fc40b721.pdf](https://www.okbia.org/files/ugd/c07624_a99db2586fe64eb391268681fc40b721.pdf)



**Figure 2: Certified Small Business Incubator Locations, 2021**



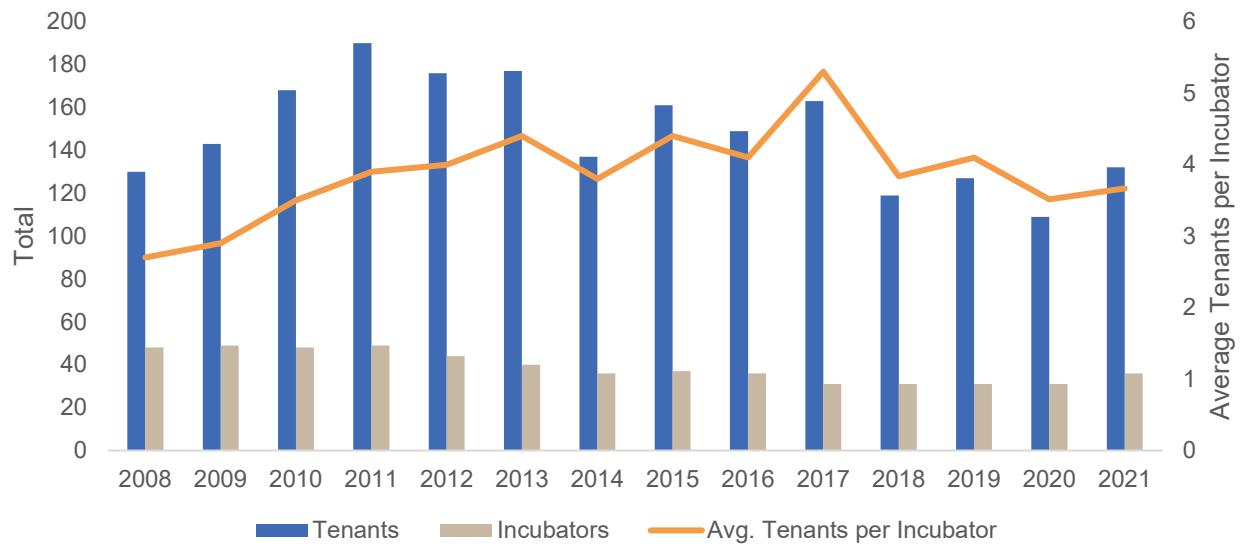
Source: Department of Commerce 2021 Small Business Incubator Certification Program Annual Report

The total number of certified incubators in the state can fluctuate throughout the course of a year, depending on activity related to incubator establishments, recertifications and/or closures in a given year. After maintaining a stable total of 48 or 49 incubators through 2011, a series of declines left 31 in operation by 2017. While maintaining this total through 2020, 2021 saw an increase to 36, in line with levels in 2014-2016. Overall, Oklahoma averaged 39 certified incubators between 2008 and 2021; the total has declined by a CAGR of -2.2 percent.

The number of small businesses located inside the incubators also varies (ranging from a high of 190 in 2011 to a low of 109 in 2020), though it has effectively remained flat with a CAGR of 0.1 percent between 2008 and 2021. On average, incubators collectively have 149 tenants per year. Because the overall number of incubators has slightly declined while the number of tenants has remained essentially unchanged, the average number of tenants per incubator has increased by a CAGR of 2.4 percent; this average has ranged from 2.7 to 5.3 tenants and is 3.9 tenants over the full time period.



**Figure 3: Certified Incubators and Tenants, 2008-2021**



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

While more than half of incubators target a specific type of business, other incubators target two, three or four types of businesses. As summarized in the following table, 16 of the 36 incubators categorize themselves as “mixed use” (either solely or in addition to targeted business types); 16 indicate they focus on manufacturing/distribution businesses; and 7 target technology-centered businesses.

**Table 6: Types of Businesses Targeted by Incubators**

Type of Business Targeted	# of Incubators Targeting	% of Incubators Targeting
Mixed Use	16	44.4%
Manufacturing/Distribution	16	44.4%
Technology	7	19.4%
Food/Food Production	4	11.1%
Aerospace/Aviation	3	8.3%
General Office	3	8.3%
Product/Service/Supply	3	8.3%
Health/Life Sciences	2	5.6%
Intelligence/Defense	2	5.6%
Education/Learning	2	5.6%
Startups	2	5.6%
High Growth/Scalable	2	5.6%
Disadvantaged Businesses	2	5.6%
Artists	1	2.8%
Industrial	1	2.8%
Weather/Radar	1	2.8%
Wholesale	1	2.8%

Source: Department of Commerce 2021 Small Business Incubator Certification Program Annual Report



In 2021, 1,660 full-time jobs were provided by the 132 tenants of Oklahoma's 36 certified incubators. At 5.3 percent, annual job growth is strong. The average number of jobs per incubator has also increased meaningfully over the same time frame, with a CAGR of 7.6 percent, and growth in the average number of jobs per tenant is meaningful at 5.1 percent. When accounting for the 1,692 jobs provided in 2021 by graduated businesses still located in Oklahoma and the 1,660 jobs associated with current incubator tenants, Oklahoma's small business incubators are responsible for providing more than 3,300 jobs in 2021.

**Table 7: Certified Incubator Employment Statistics, 2008-2021**

	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
<b>Average</b>	<b>925</b>	<b>24.7</b>	<b>6.5</b>	<b>1,765</b>
<b>CAGR</b>	<b>5.3%</b>	<b>7.6%</b>	<b>5.1%</b>	<b>-0.7%</b>

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. Incubator graduates reported the following activity to the Department:

**Table 8: Employment and Payroll of Incubator Graduates, 2015-2021**

	2015	2016	2017	2018	2019	2020	2021
Employment	85	89	67	85	144	171	194
Establishments	8	9	10	10	15	17	18
Payroll (\$ M)	\$3.5	\$3.7	\$3.5	\$4.3	\$5.8	\$7.1	\$8.6
Avg. Wages	\$40,615	\$41,167	\$52,684	\$50,443	\$40,451	\$41,542	\$44,222

Source: Department of Commerce





# **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.<sup>11</sup>

Under the Act, effective January 1, 1988, 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.”

Following the Incentive Evaluation Commission’s review of this program in 2018, SB 485 of 2019 made the following changes:<sup>12</sup>

- Previously, the Act also included an income tax exemption for sponsors of an incubator on income earned from rental fees, other income derived from services provided to tenants, or for providing funding for an incubator site.<sup>13</sup> While the original program intended to provide income tax benefits to both tenants and sponsors, the primary beneficiaries were incubator tenants, as the vast majority of Oklahoma’s certified incubators operate as non-profits and are generally not required to pay income taxes. In fact, there are very few for-profit incubators in operation in the state – a fact which aligns with an early 2012 InBIA survey that found just four percent of U.S. small business incubators are for-profit. In light of these factors, effective January 1, 2020, the income tax exemption for sponsors was repealed.
- Previously, the Act required that, to qualify for the tax exemption for years 6 through 10, tenants make at least 75 percent of gross sales to buyers located outside the state, the federal government or to buyers in the state, if the product or service is resold to an out-of-state customer or buyer for ultimate use. In the process of the Incentive Evaluation Commission’s 2018 evaluation of this program, it was noted by the Department that most tenants did not fulfill this requirement and therefore did not remain in the program after the fifth year. To allow for additional flexibility, effective January 1, 2020, the requirement that tenants make at least 75 percent of gross sales out of state in order to qualify for years 6 to 10 was eliminated.

## Historic Use of the Tax Exemption

In attempting to compile and analyze exemption claims associated with this incentive, it should be noted at the outset that 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 that, with regard to this program, an “estimate [is] not available. This exemption is commingled with several others on the Oklahoma

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<sup>11</sup> 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 this act ~~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 ~~organizations which qualify as sponsors~~ tenants of small business incubators in this state ~~and a more favorable business climate for tenants.~~

<sup>12</sup> SB 485 of 2019 is provided in Appendix C.

<sup>13</sup> The State defined a sponsor as an organization “which enters into a written agreement with the Department to establish, operate and administer a small business incubator facility or to provide funding to an organization which operates such a facility, including municipalities, universities, industrial and commercial development authorities, redevelopment authorities or any private nonprofit or for-profit organization approved by the Department.”



income tax form 511; and therefore, the amount of income exempted under this expenditure item cannot be estimated.”<sup>14</sup>

The primary reason for this complication is that, as with several other tax incentives provided by the State, taxpayers claim this exemption by reporting associated income on the “Miscellaneous: Other Subtractions” line of Schedule 511-A, Oklahoma Subtractions. 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 2021 Form):<sup>15</sup>

- Royalty income: Enter “1”
- Manufacturer’s exclusion: Enter “2”
- Payments as a result of a military member combat zone death: Enter “3”
- Payments to a spouse of a military member killed in combat zone: Enter “4”
- **Small business incubator: Enter “5”**
- Allowable deductions not included in items 1-5; and if entitled to more than one deduction type: 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 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:

**Table 9: Small Business Incubator Income Exclusion, 511 Forms, 2015-2019**

Tax Year	Number of Returns	Amount of Income Claimed	Average	Median
2015	39	\$3,650,436	\$93,601	\$30,255
2016	50	\$3,588,145	\$71,763	\$18,393
2017	52	\$5,825,079	\$112,021	\$35,189
2018	61	\$3,534,072	\$57,936	\$23,288
2019	63	\$5,243,609	\$83,232	\$114,032

Source: Oklahoma Tax Commission

Note: This exclusion is reported on the Form 511 on a line with other exclusions and the data is based on codes reported by taxpayers. Under some conditions taxpayers report a ‘99’ code, signifying multiple or other deductions; therefore, this data may not be complete.

While the amount of revenue foregone to the State as a result of the exemption is not known due to the complexities described previously, the following table provides potential ranges of revenue impact, based on the State’s income tax rates and brackets. Based on this proxy, the exemption was provided at an annual cost

<sup>14</sup> Oklahoma Tax Commission, “Tax Expenditure Report, 2019-2020.” Accessed electronically at <https://oklahoma.gov/content/dam/ok/en/tax/documents/resources/reports/tax-expenditure/TaxExpenditureReport-2019-2020.pdf>

<sup>15</sup> 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>



of less than \$300,000 to the State between 2015 and 2019. Importantly, however, this high-level analysis is intended to be illustrative.

**Table 10: Estimated Foregone State Income Tax Revenue Based on 511 Forms, 2015-2019**

	Amount of Income Claimed	0.5% Tax Rate	5% Tax Rate
2015	\$3,650,436	\$18,252	\$182,522
2016	\$3,588,145	\$17,941	\$179,407
2017	\$5,825,079	\$29,125	\$291,254
2018	\$3,534,072	\$17,670	\$176,704
2019	\$5,243,609	\$26,218	\$262,180

Source: PFM analysis of Oklahoma Tax Commission Data

Note: While the state's income tax rates were reduced in 2022, this analysis uses the prior rates in alignment with the years analyzed. Additionally, the analysis does not contemplate the impact of the state's graduated tax rates, as the incomes of individual businesses are not known.

Importantly, not all incubator tenants have income subject to taxation and therefore, the exemption is not utilized by all tenants of certified incubators. According to aggregated information collected for use in the Department's annual incubator reports, nine certified incubators were home to tenants earning income between 2018 and 2021 (fewer than 20 percent of all incubators in a given year).

**Table 11: Activity Associated with Incubators with Tenants Generating Income, 2018-2021**

	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	1174	\$0	\$0	\$32,153,540*

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 additional proxy for understanding the potential state revenue impacts of the program.

As shown in the following table, the income reported to the Department by incubators in 2018 likely resulted in \$115,000 or less (potentially much less) in foregone revenue to the state in 2018, and \$243,000 or less in 2019 (again, potentially significantly less).

**Table 12: Estimated Foregone State Income Tax Revenue Based on Incubators Survey, 2018-2019**

	Income Eligible for Exemption	0.5% Tax Rate	5% Tax Rate
2018	\$2,309,826	\$5,775	\$109,717
2019	\$4,876,904	\$12,192	\$231,653

Source: PFM analysis of Oklahoma Department of Commerce data

While the estimates from both analyses are approximations at best due to the data and reporting challenges described, the results suggest a level of reasonability of the estimates.

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 8, 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). Using the same methodology employed in the preceding analysis, foregone revenue in 2021 could reasonably range somewhere between \$160,000 and \$1.6 million – 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.

It is notable that the program's authorizing statute does not require businesses to be tenants in an incubator for a designated amount of time prior to becoming eligible for the exemption. In other words, a business could theoretically establish tenancy then immediately depart the incubator while becoming eligible for the exemption for 10 years. Further, there are no performance standards associated with eligibility for the incentive. Incorporating expectations and/or requirements regarding a tenant's investment of time and resources would likely strengthen the program.

- **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

Data collection for any incentive program is indisputably a best practice, and this process is undoubtedly beneficial to a wide variety of interested internal and external stakeholders across the state. However, certain modifications are likely to improve the quality of the analysis that the data is able to facilitate. These 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

Additionally, the Department should consider requiring participation in the survey (including in post-program years) as a condition of tenancy in a certified incubator and/or eligibility for the exemption. Alternatively, the Department could require that incubators include these provisions in their service agreements with tenants.



# **Economic & Fiscal Impact**



## Economic and Fiscal Impact

For calculating economic and resulting fiscal impact, the project team used the IMPLAN economic input-output model software. **A description of the IMPLAN economic impact methodology can be found in Appendix D.**

The total economic impacts for this incentive are calculated using survey data from incubator participants that is collected by incubator managers. In this survey, incubator managers report the number of tenants, the total employees, the associated payroll and sales (both of which are often unavailable based on the reviewed data), and the amount of income eligible for the exemption. Incubator companies claimed income exemptions of \$21.8 million from 2015-2019. Based on the survey results, this income is generally associated with light manufacturing, mixed use, a variety of medical and financial technology related firms, and aerospace industries.

Estimates for the foregone tax revenue to the state ranges from \$0.1 million (0.25 percent) to \$1.0 million (4.75 percent), depending on the effective tax rate applied. The State does not track exact income exemptions for these companies, which prevents calculating a more precise rate per business claiming the exemption. The state tax revenue estimates from IMPLAN were compared to the income exempted by incubator companies, and the economic impact model implies a 0.7 percent state tax rate. When considering just the direct impacts of the incubator companies, the economic impact model estimates the net state revenue is negative at -\$34,000.

When examining the total economic impacts of the income through the use of IMPLAN, net state tax revenue is estimated at \$186,400. This includes the indirect and induced economic and tax impacts of the incubator companies output.

Applying the 0.7 percent tax rate to the exempted income alone implies foregone tax revenue of \$153,000, among only the incubator companies. This indicates the foregone state tax revenue from the direct incubator income claimed is approximately equal to, or somewhat less than, the amount of state tax revenue generated from the induced and indirect impacts associated with the incubator activity. This indicates the incubator tax incentive program is effectively neutral to the state with respect to fiscal impacts.

**Table 13: Economic Impacts of Incubator Tenants' Claimed Income, 2015-2019**

Type	Employment	Labor Income	Value Added	Output	State Tax Revenue
Direct	48	\$3,915,248	\$5,477,772	\$18,051,868	(\$33,946)
Indirect	25	\$1,538,666	\$2,293,178	\$4,790,830	\$101,454
Induced	23	\$1,080,372	\$1,911,848	\$3,525,380	\$118,919
<b>Total</b>	<b>96</b>	<b>\$6,534,286</b>	<b>\$9,682,797</b>	<b>\$26,368,079</b>	<b>\$186,427</b>

Source: PFM; IMPLAN 2022





# Incentive Benchmarking



## Benchmarking Introduction

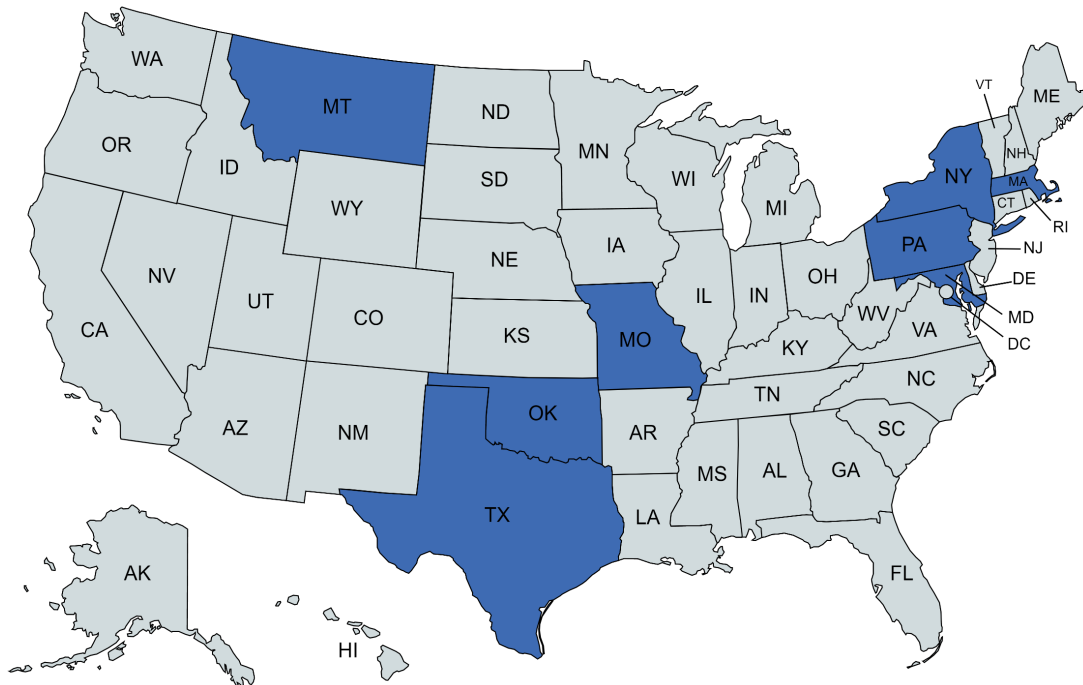
For evaluation purposes, benchmarking provides information related to how peer states use and evaluate similar incentives. At the outset, it should be understood that no states are ‘perfect peers’ – there will be multiple differences in economic, demographic and political factors that will have to be considered in any analysis; likewise, it is exceedingly rare that any two state incentive programs will be exactly the same.<sup>16</sup> 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.

## Peer State Incentives: Key Findings

A detailed description of the following comparable state programs is provided in **Appendix B**.

The process of creating a comparison group for incentive benchmarking typically begins with bordering states 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.

**Figure 4: States with Comparable Incentive Programs**



While nearly all states are home to business incubators, far fewer provide tax incentives. Including Oklahoma, eight states were found to have incentive programs related to small business incubators, and a great deal of variation exists among the incentives. No state was found to have a program mirroring Oklahoma’s. The following discusses key characteristics of these programs.

- **Montana** provides a **property tax exemption** for business incubators owned or leased and operated by a local economic development organization. The governing body of the county, consolidated

<sup>16</sup> The primary instances of exactly alike state incentive programs occur when states choose to ‘piggyback’ onto federal programs.



government, incorporated city or town, or school district in which the property is located must approve or disapprove the tax exemption by resolution.<sup>17</sup>

- In 2013, **New York** created the Innovation Hot Spot program to fund operations in business incubators and extend tax incentives to qualified ventures in participating incubators. Through a competitive process, the State designated 10 Innovation Hot Spots – one for each of New York’s economic development regions – and 20 certified business incubators, which receive funding to reach a greater number of early-state companies. To qualify, companies must be enrolled and in good standing with an incubator; in their first five years of operations; and in the formative stages of development. Once qualified, a company enters into a five-year window of **tax exemption** from state corporate income tax, and state sales tax on purchases. In that period, partners in the company are also eligible to deduct their income from the incubator company. This window lasts for five years, regardless of company age when entering the program, provided the company remains in good standing as a resident or graduate of its incubator.<sup>18</sup>
- **Missouri’s** Small Business Incubator **tax credit** aims to generate private funds to be used to establish a “protective business environment” where small businesses can collectively operate. Certified incubators receive contributions from taxpayers; the taxpayers in turn receive tax credits in the amount of 50 percent of the contributions. The program is focused on the incubators themselves, as opposed to tenants of incubators.<sup>19</sup>
- While **Pennsylvania** does not offer a tax incentive specifically for incubator tenants, some incubators within the state have been granted Keystone Innovation Zone (KIZ) tax credit status, whereby tenants may be eligible for **tax credits** that can be used to offset certain state tax liabilities. Eligible companies may claim a tax credit equal to 50 percent of the increase in the company’s revenues in the immediately preceding taxable year attributable to activities in the KIZ, over the company’s gross revenues in the second preceding taxable year attributable to its activities in the KIZ. The credit is limited to \$100,000 annually per company.<sup>20</sup>
- The **Texas** Product Development and Small Business Incubator Fund offers long-term, asset-backed **loans** to near-bankable businesses commercializing new or improved products and small businesses or entities which foster growth of small businesses. The program consists of two separate funds: one for Product Development and the other for Small Business Incubators; the latter is intended to foster and stimulate the development of new or existing small businesses in the state. Loan amounts are between \$1 million and \$5 million. The maximum term is 15 years if financing personal property or working capital, and 20 years for real property. Eligible small businesses must be domiciled in the state or have at least 51 percent of employees located in the state; have fewer than 100 full-time employees; and be independently owned and operated. Interestingly, any business in the state is eligible if the business is substantially likely to develop and expand the opportunities for small businesses in the state (for example, small business incubators) in preferred industries.<sup>21</sup>
- **Maryland’s** Technology Development Corporation (TEDCO) Incubator Assistance **grant** program is intended to assist the State’s incubators in providing additional added value to their client companies – including assistive services such as mentoring, coaching, advising and other incubator services which

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<sup>17</sup> Montana Code Annotated 2021. Accessed electronically at [https://leg.mt.gov/bills/mca/title\\_0150/chapter\\_0240/part\\_0180/section\\_0020/0150-0240-0180-0020.html](https://leg.mt.gov/bills/mca/title_0150/chapter_0240/part_0180/section_0020/0150-0240-0180-0020.html)

<sup>18</sup> New York State Empire State Development, “New York State Certified Business Incubators and Innovation Hot Spots.” Accessed electronically at <https://esd.ny.gov/certified-business-incubator>

<sup>19</sup> Revised Statutes of Missouri. Accessed electronically at <https://revisor.mo.gov/main/OneSection.aspx?section=620.495>

<sup>20</sup> Pennsylvania Department of Community and Economic Development – Keystone Innovation Zone (KIZ) Tax Credit Program. Accessed electronically at <https://dced.pa.gov/programs/keystone-innovation-zone-tax-credit-program/>

<sup>21</sup> Texas Economic Development, “Product Development and Small Business Incubator Fund.” Accessed electronically at <https://gov.texas.gov/business/page/product-development-and-small-business-incubator-fund>



help client companies successfully scale their businesses. Grant proposals are accepted for amounts between \$3,000 and \$12,000.<sup>22</sup>

- Administered by the **Massachusetts** Clean Energy Center, the IncubateMass **grant** program funds incubator activities, including but not limited to operations and management expenses, facilities and infrastructure build-outs, equipment purchases, networking events and workshops, growing strategic clusters, and professional development of incubator staff, with the goal of growing the clean energy innovation ecosystem and commercializing cleantech start-ups through incubator membership. Grants are up to \$150,000 per year and award payments are typically tied to incubator management deliverables and startup member milestones.<sup>23</sup>

## Peer State Program Evaluations and Other Studies: Key Findings

### *What is the Best Way to Support Small Businesses?*

While many are supportive of using tax preferences to support small businesses, others are critical of the effectiveness of this approach. In 2015, Good Jobs First surveyed leaders of small business organizations (representing 24,000 members in 25 states) regarding the utility of tax breaks in aiding small businesses. According to the results, 87 percent of respondents said small business interests in economic development are not represented in state capitals, and 85 percent indicated that their state's economic development incentives do not address the needs of small businesses. Perhaps most importantly, more than two-thirds said that traditional incentives – like tax breaks – are not that valuable to small business owners.<sup>24</sup>

Further, a Canadian McKinsey study found that the most effective way to support small and medium sized enterprises is by pairing financial support with advisory services by identifying enterprises with high growth potential and providing them with the one-on-one support they need to realize that potential over a defined period of time. Support could include building capabilities (such as digital, marketing and leadership skills), providing advice from experts on how to navigate the market, guiding transformation efforts and arranging introductions and networking opportunities.<sup>25</sup> Notably, many incubators provide such services, indicating that they – at the very least – have the ability to positively impact small businesses.

### *Small Business Incentives: Return on Investment*

Studies have produced varying results regarding the return on investment associated with incentives for small business incubator activity (and other small business supports). As examples:

- According to a 2018 analysis of **Missouri's** Small Business Incubator Tax Credit, the State expects that, for the \$500,000 in tax credits authorized, it will receive a return of \$10 for every \$1 spent. In addition, over 10 years, the State expects that, for every dollar in tax credits authorized, \$423 in new personal income will be realized. Based on this, tax credits issued through the program from its inception through November 30, 2018 totaled approximately \$3.9 million and attracted contributions totaling an estimated \$7.8 million.<sup>26</sup>

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<sup>22</sup> Maryland Technology Development Corporation (TEDCO) Annual Report and Financial Report, 2017. Accessed electronically at [http://dlslibrary.state.md.us/publications/TEDCO/EC10-415\(a\)\\_2017.pdf](http://dlslibrary.state.md.us/publications/TEDCO/EC10-415(a)_2017.pdf)

<sup>23</sup> Massachusetts Clean Energy Center, "IncubateMass." Accessed electronically at <https://www.masscec.com/program/incubatemass>

<sup>24</sup> Good Jobs First, "Small Businesses Losing Out in Subsidy Game: Survey," (October 6, 2015). Accessed electronically at <https://goodjobsfirst.org/small-businesses-losing-out-subsidy-game-survey/>

<sup>25</sup> McKinsey & Company, "Beyond Financials: Helping Small and Medium-Size Enterprises Thrive," (January 26, 2022). Accessed electronically at <https://www.mckinsey.com/industries/public-and-social-sector/our-insights/beyond-financials-helping-small-and-medium-size-enterprises-thrive>

<sup>26</sup> Missouri Department of Economic Development, "Small Business Incubator Tax Credit Annual Report," (2018). Accessed electronically at <https://ded.mo.gov/sites/default/files/2018%20Small%20Biz%20Incubator%20Annual%20Report.pdf>



- A 2018 study of several of **Virginia's** workforce and small business incentives found that the economic benefit of workforce and small business incentives varies: <sup>27</sup>

**Table 14: Economic Benefits of Virginia Small Business Incentives**

	Spending, FY10-17 (millions)	Incentive Type	Economic Benefit per \$1M of Spending
Small Business Jobs Grant	\$2.51	Grant	Moderate
Small Business Investment Grant	\$1.40	Grant	Moderate
Small Business Loan Programs*	\$0.47	Loan	High

Source: Virginia JLARC, *Workforce and Small Business Incentives Evaluation*

\* Encompasses four distinct loan programs: Loan Guaranty Program; SWaM Business Microloan Fund, State Cash Collateral Program, Virginia Economic Development Loan Fund

The study ultimately found that small business loan programs generate a low amount of economic activity in Virginia but have the highest economic benefit per \$1 million in state spending. The small business jobs grant is estimated to have a moderate economic benefit and generally succeeds in targeting projects that have some characteristics of high economic impact. However, neither grant program incentivizes the creation of high-wage jobs, and few jobs created by grant-funded projects can be directly attributable to the grant funding.

<sup>27</sup> Virginia JLARC, "Workforce and Small Business Incentives: Economic Development Incentives Evaluation Series," (July 9, 2018). Accessed electronically at <http://jlarc.virginia.gov/pdfs/reports/Rpt506.pdf>



# Appendices



## **Appendix A: Small Business Incubators Incentives Act**

### **§74-5071. Short title.**

This act shall be known and may be cited as the "Small Business Incubators Incentives Act".

*Added by Laws 1987, c. 228, § 1, eff. Jan. 1, 1988.*

### **§74-5072. Purpose of act.**

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.

*Added by Laws 1987, c. 228, § 2, eff. Jan. 1, 1988. Amended by Laws 2019, c. 320, § 1.*

### **§74-5073. Definitions.**

As used in this act:

1. "Director" means the Director of the Oklahoma Department of Commerce;
2. "Incubator" means 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;
3. "Sponsor" means an organization, with a registered office or other office or offices in this state, which enters into a written agreement with the Oklahoma Department of Commerce to establish, operate, and administer a small business incubator facility or to provide funding to an organization which operates such a facility, including municipalities, universities, industrial and commercial development authorities, redevelopment authorities, municipal authorities, or any private nonprofit or for-profit organization approved by the Oklahoma Department of Commerce; and
4. "Tenant" means a sole proprietorship, business partnership, or corporation operating a business for profit and leasing or otherwise occupying space in an incubator.

*Added by Laws 1987, c. 228, § 3, eff. Jan. 1, 1988.*

### **§74-5074. Director - Powers and duties.**

The Director of the Oklahoma Department of Commerce shall have the power and authority to carry out the following functions:

1. Solicit support and participation of public and private agencies, universities and other institutions for the purposes of establishing and operating incubators;
2. Assemble, publish and disseminate information to potential sponsors and tenants in this state regarding small business opportunities, techniques for forming incubators, sources of public and private assistance and sources of related financing;
3. Organize, host and participate in seminars and other forums designed to disseminate information and technical assistance regarding incubators to small businesses in this state;
4. Review and approve applications from potential sponsors which seek to qualify for exemption from state income tax pursuant to Sections 5 and 6 of this act; and
5. Establish a volunteer, local advisory committee, consisting of representatives from business and administrators at educational institutions and other groups, to assist in the performance of these functions.

*Added by Laws 1987, c. 228, § 4, eff. Jan. 1, 1988.*



**§74-5075. State income tax exemption for sponsor.**

A. For tax years ending before January 1, 2020, income earned by a sponsor from rental fees, service fees or any other form of payment for services provided to a tenant as an operator of an incubator, or for providing funding for such a facility, shall be exempt from state income tax for a period not to exceed ten (10) years from the date of the tenant's occupancy in an incubator.

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

*Added by Laws 1987, c. 228, § 5, eff. Jan. 1, 1988. Amended by Laws 1997, c. 230, § 1, eff. Nov. 1, 1997; Laws 2019, c. 320, § 2.*

**§74-5076. Application to become sponsor.**

A. Any company or association proposing to qualify as a sponsor under this act shall file an application with the Director of the Oklahoma Department of Commerce for approval. The application shall contain such information as the Director may by regulation require, and shall specifically acknowledge applicant's agreement to be bound by the conditions set forth in rules and regulations issued pursuant to this section.

Each applicant also shall demonstrate:

1. That a facility exists that can be transformed into an incubator at a specified cost;
2. The ability directly to provide, or arrange for the provision of, business development services for tenants of the incubator. These services shall include, but not be limited to, financial consulting assistance, management and marketing assistance, and physical services;
3. A potential for sustained use of the incubator facility by eligible tenants, through a market study and other means; and
4. The ability to manage and operate the incubator facility in accordance with Section 7 of this act.

B. In determining whether to approve an application for qualification as a sponsor, the Director shall consider:

1. The ability of the sponsor to carry out the provisions of Section 7 of this act;
2. The economic impact of the incubator on the community;
3. The incubator's conformance with state, areawide and local economic development plans if such exist; and
4. The location of the incubator, in order to encourage geographic distribution of incubators across the state.

*Added by Laws 1987, c. 228, § 6, eff. Jan. 1, 1988.*

**§74-5077. Responsibilities and duties of sponsor - Not-for-profit enterprises as tenants.**

A. A sponsor shall have the following responsibilities and duties in establishing and operating an incubator:

1. Securing title to the facility or a lease with a sufficient length of term or other security, deemed sufficient by the Director of the Oklahoma Department of Commerce, to assure that the purposes of this act are carried out;
2. Managing the physical development of the incubator facility, including the provision of common conference or meeting space;
3. Furnishing and equipping the facility to provide business services to the tenants;
4. Marketing the facility and securing eligible tenants;
5. Providing financial consulting, marketing, and management assistance services or arranging for the provision of these services for tenants of the incubator, including assistance in accessing private financial markets;
6. Setting rental and service fees; and
7. Encouraging the sharing of ideas between tenants and otherwise aid the incubator and setting policy for the termination of occupancy of tenants so as to maximize the opportunity to succeed for the greatest number of tenants, consistent with the other criteria specified in this act.





B. Not-for-profit enterprises are not permitted as tenants in incubators assisted under this act except by specific consent of the Director in cases in which such tenancy would be exceptionally helpful in promoting the purposes of this act or such tenancy is essential to the economic viability of the incubator.

*Added by Laws 1987, c. 228, § 7, eff. Jan. 1, 1988.*

**§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.*

**§74-5079. Annual report to Legislature.**

On or before December 31 of each year, the Director of the Oklahoma Department of Commerce shall provide a report to both the Speaker of the House of Representatives and the President Pro Tempore of the Senate which shall include, but not be limited to:

1. The number of applications for incubators submitted;
2. 2. The number of applications for incubators approved;
3. 3. The number of incubators created under this act;
4. 4. The number of tenants occupying each incubator;
5. 5. The number of jobs provided by each incubator and tenants of each incubator; and
6. 6. The number of firms still operating in the state after ending their tenancy in incubators and the number of jobs they have provided.

*Added by Laws 1987, c. 228, § 8, eff. Jan. 1, 1988.*



### Appendix B: Peer State Benchmarking

State	Name	Incentive Category	Targeted to	Incentive Amounts
Oklahoma	Small Business Incubator Income Tax Exemption for Tenants	Tax Exemption	Tenants	100% of income earned
Montana	Property Tax Exemption for Business Incubators	Tax Exemption	Incubators	100% of property taxes owed
New York	Innovation Hot Spot Program	Tax Exemption	Tenants	50% of the increase in company revenues in the immediately preceding taxable year
Missouri	Small Business Incubator Tax Credit	Tax Credit	Sponsors	50% tax credit; can be applied to income tax, corporate franchise tax and bank/insurance premium/other financial institution tax
Pennsylvania	Keystone Innovation Zone	Tax Credit	Small Businesses	\$100,000 annually
Texas	Product Development and Small Business Incubator Fund	Loan	Small Businesses	\$1-\$5 million
Maryland	Technology Incubator Program	Grant	Incubators	Determined via a competitive application process
Massachusetts	IncubateMass Grant Program	Grant	Incubators	Up to \$150,000 per year



## Appendix C: SB 485 of 2019

BE IT ENACTED BY THE PEOPLE OF THE STATE OF OKLAHOMA:

SECTION 1. AMENDATORY 74 O.S. 2011, Section 5072, is amended to read as follows:

Section 5072. The purpose of ~~this act~~ 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 ~~organizations which qualify as sponsors~~ tenants of small business incubators in this state ~~and a more favorable business climate for tenants.~~

SECTION 2. AMENDATORY 74 O.S. 2011, Section 5075, is amended to read as follows:

Section 5075. A. ~~Income~~ For tax years ending before January 1, 2020, income earned by a sponsor from rental fees, service fees or any other form of payment for services provided to a tenant as an operator of an incubator, or for providing funding for such a facility, shall be exempt from state income tax for a period not to exceed ten (10) years from the date of the tenant's occupancy in an incubator.

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

SECTION 3. AMENDATORY 74 O.S. 2011, Section 5078, is amended to read as follows:

Section 5078. 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. ~~In~~ 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.

SECTION 4. AMENDATORY 68 O.S. 2011, Section 2359, is amended to read as follows:

Section 2359. A. A person or organization exempt from federal income taxation under the provisions of the Internal Revenue Code shall also be exempt from the tax imposed by Section 2351 et seq. of this title in each year in which such person or organization satisfies the requirements of the Internal Revenue Code for exemption from federal income taxation. If the exemption applicable to any person or organization under the provisions of the Internal Revenue Code is limited or qualified in any manner, the exemption from taxes imposed by this article shall be limited or qualified in a similar manner.



B. Notwithstanding the provisions of subsection A of this section, the unrelated business taxable income or other income subject to tax, as computed under the provisions of the Internal Revenue Code, of any person or organization exempt from the tax imposed by ~~this act~~ Section 2351 et seq. of this title and subject to the tax imposed on such income by the Internal Revenue Code shall be subject to the tax which would have been imposed by this act but for the provisions of subsection A of this section.

C. Insurance companies paying, during or for the taxable year, a tax to this state on gross premium income shall be exempt from the provisions of this article and the taxes levied thereby.

D. Royalty earned by an inventor from products developed and manufactured in this state shall be exempt from the tax imposed by Section 2355 of this title for a seven-year period, pursuant to the provisions of Section 5064.7 of Title 74 of the Oklahoma Statutes.

E. ~~Sponsors and tenants~~ Tenants of small business incubators shall be exempt for the tax imposed by Section 2355 of this title, pursuant to the provisions of ~~Sections 5075 and~~ Section 5078 of Title 74 of the Oklahoma Statutes.

SECTION 5. REPEALER 74 O.S. 2011, Section 5062.8a, is hereby repealed.

SECTION 6. This act shall become effective in accordance with the provisions of Section 58 of Article V of the Oklahoma Constitution.



## Appendix D: 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.



## Appendix D: IMPLAN Economic Impact Methodology

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### Economic Indicators

#### *Employment*

Employment data in IMPLAN follows the same definition as Bureau of Economic Analysis Regional Economic Accounts (BEA REA) and Bureau of Labor Statistics Census of Employment and Wages (BLS CEW) data, which is full-time/part-time annual average. Thus, 1 job lasting 12 months = 2 jobs lasting 6 months each = 3 jobs lasting 4 months each. A job can be either full-time or part-time. Similarly, a job that lasts one quarter of the year would be 0.25 jobs. Note that a person can hold more than one job, so the job count is not necessarily the same as the count of employed persons.

#### *Labor Income*

Labor Income represents the total value of all forms of employment income paid throughout a defined economy during a specified period of time. It reflects the combined cost of total payroll paid to employees (e.g. wages and salaries, benefits, payroll taxes) and payments received by self-employed individuals and/or unincorporated business owners (e.g. capital consumption allowance) across the defined economy. Labor Income (LI) encompasses two additional representative metrics called Proprietor Income (PI) and Employee Compensation (EC).

#### *Value Added*

Value Added represents the difference between *Output* and the cost of *Intermediate Inputs* throughout a defined economy during a specified period of time. It equals gross Output minus Intermediate Inputs (consumption of goods and services purchased from other industries or imported). Value Added is a measure of the contribution to GDP made by an individual producer, Industry, or Sector.

#### *Output*

All analysis in IMPLAN is based on Output, which is the value of production by industry in a calendar year. IMPLAN Output data largely come from the same sources as those used by the BEA in developing their Benchmark Input-Output tables. Since output is the total production value of a Sector, it includes all components of production value or output for a given Sector: Output = Employee Compensation + Proprietor Income + Intermediate Expenditures + Tax on Production and Imports + Other Property Income.

### Economic Effects

Input-Output (I-O) Analysis and IMPLAN (SAM) is designed to predict the ripple effect of an economic activity by using data about previous spending. Production in a given Sector in an economy supports demand for production in Sectors throughout the economy, both due to supply chain spending and spending by workers.

#### *Direct Effect*

A Direct effect is the initial exogenous change in final demand in terms of Industry Output, Employment, and Labor Income Dollars. When consumers purchase goods and services, they create final demand to the



Industries producing the goods and services they consume. When you analyze final demand in IMPLAN, we call this a Direct Effect.

*Indirect Effect*

Indirect effects are the business to business purchases in the supply chain taking place in the region that stem from the initial industry input purchases. As the Industry specified in an Event spends their money in the region with their suppliers, this spending is shown through the Indirect Effect.

*Induced Effect*

The Induced Effects stem from income being spent throughout the Selected Region. Typically, the income being analyzed are the wages of employees working in the Direct/Indirect Industries.

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