NEIGHBORHOOD ASSISTANCE PROGRAM TAX CREDIT

INDEPENDENT FISCAL OFFICE

March 28, 2018

Introduction

Pennsylvania's Neighborhood Assistance Program (NAP) encourages businesses to invest in projects that serve distressed areas or support neighborhood conservation.[1] This tax credit program is administered by the Pennsylvania Department of Community and Economic Development (DCED) and consists of five components: (1) the Neighborhood Assistance Program Tax Credit, (2) the Special Program Priorities, (3) the Neighborhood Partnership Program, (4) the Charitable Food Program and (5) the Enterprise Zone Program Tax Credit. The total amount of tax credits available for award in any fiscal year is currently capped at $18 million, with $2 million allocated to pass-through entities. House Bill (HB) 645, Printer's Number 1695 (2017-2018) would increase the annual cap to $36 million annually and the amount reserved for pass-through entities would remain unchanged. This report provides an overview of each component of the NAP, explains how the program works and estimates the economic impact of state spending for this purpose.[2]

Program Overview

The Neighborhood Assistance Program utilizes tax credits to encourage private investment in projects that serve distressed or impoverished areas.[3] The program consists of five components, each with specific eligibility requirements and credit award structures. The five components include:

Neighborhood Assistance Program Tax Credit (NAP) – Provides a tax credit of up to 55 percent of eligible contributions to affordable housing, community service, crime prevention, education, job training or neighborhood assistance projects. (See Eligible Project Categories in the next section.)

Special Program Priorities (SPP) – Provides a tax credit of up to 75 percent of eligible contributions targeting specific, state designated priority problems or projects.[4]

Neighborhood Partnership Program (NPP) – Provides tax credits for eligible contributions targeting multiple projects over multiple years. The tax credit available is determined by the length of the financial commitment, with a credit of up to 75 percent

---

[1] The NAP is authorized under Article XIX-A of the Tax Reform Code of 1971 (Act 48-1994).
[2] This report is provided in response to a legislative request and does not constitute a tax credit review as required under Act 48-2017.
[3] The following areas are deemed distressed for purposes of the NAP: Enterprise Zones, Keystone Opportunity Zones, Keystone Opportunity Expansion Zones, Keystone Opportunity Improvement Zones, Keystone Communities, Keystone Main Streets, Keystone Elm Streets, Keystone Communities Enterprise Zones, Act 47 municipalities, cities of the First Class, cities of the Second Class, cities of the Second Class A and cities of the Third Class.
[4] Priorities include (1) disaster or economic recovery, (2) integrated weatherization and housing rehabilitation, (3) diversity initiatives, (4) mortgage foreclosure prevention, (5) blight elimination, (6) veteran initiatives, (7) rural transportation initiatives or (8) affordable housing and supportive services for at-risk populations.

of an eligible contribution for a five-year commitment, and a credit of up to 80 percent for a commitment of six or more years. The minimum annual contribution is $50,000 per business and the project must have a minimum of $100,000 in commitments.

Charitable Food Program (CFP) – Provides a tax credit of up to 55 percent of eligible contributions to approved regional food banks or emergency food providers. In addition to monetary contributions, donations of any food of nutritional value may also be eligible for credit. Credits for food donations are awarded based on a cost per pound valuation.

Enterprise Zone Program Tax Credit (EZP) – Provides a tax credit of up to 25 percent of qualified investments by private for-profit companies in designated Enterprise Zones. Qualified investments are limited to construction costs for the rehabilitation, expansion or improvement of buildings or land within the zone. Tax credits are capped at $500,000 per EZP project.

Under the NAP, SPP, NPP and CFP, a nonprofit neighborhood organization (applicant) applies to DCED for tax credits based on pending contributions from private for-profit companies (contributors) to fund an eligible project in a distressed area. The neighborhood organization must be a registered 501(c)(3) organization and document that they are able to complete the proposed project. Upon approval, DCED notifies the contributor and provides the documentation required to redeem the tax credits. Businesses may contribute to an unlimited number of projects, but the maximum total annual tax credit is $500,000 for contributions to three or fewer projects, and $1,250,000 for contributions to four or more projects. The EZP differs from the other four NAP components because it benefits private for-profit companies making direct investments in Enterprise Zone building projects. (A nonprofit intermediary is not required.) For fiscal year (FY) 2015-16, 100 projects were awarded $17.9 million in tax credits (average of $180,000 in tax credits per project).

The portion of eligible contributions that may be used to offset project administrative costs is limited to 10 percent of the contributions received. Administrative costs include salaries and benefits for administrators, accounting fees, procurement costs, building maintenance, office supplies and equipment, etc. Administrative costs do not include the salaries or benefits for individuals directly responsible for the provision of services to the benefiting community.

Tax credits may be used against the corporate net income, bank shares, insurance premiums and mutual thrift institutions taxes. Credits issued to S corporations, limited liability companies, partnerships and business trusts may be passed through to other entities. Unused credits may be carried forward for up to five years, sold or transferred.

Eligible Project Categories

Neighborhood organizations may qualify for NAP tax credits (NAP, SPP, NPP and CFP) by investing in projects in one or more of the following categories:[5]

[5] *Neighborhood Assistance Program, Program Guidelines*, Pennsylvania Department of Community and Economic Development. July 2017. https://dced.pa.gov/download/neighborhood-assistance-program-nap-guidelines-2017/?wpdmdl=64056.

Affordable Housing – The renovation, repair, rehabilitation, construction or preservation of housing for low-income households.

Community Economic Development – The construction or rehabilitation of commercial or industrial buildings, the removal of blight, increased access to employment and job training, education and community service opportunities, and/or crime prevention.

Community Services – The provision of counseling or advice, emergency assistance, food assistance, or medical assistance.

Crime Prevention – Efforts to reduce crime.

Education – Educational instruction or scholarship assistance.

Job Training – Vocational instruction that allows an individual to attain a higher level of employment.

Neighborhood Assistance – A project or service that provides physical improvement to a distressed area.

Neighborhood Conservation – A project or service that addresses the decline of a neighborhood or the needs of a vulnerable population.

Impact on Federal Income Taxes

The award of a NAP tax credit in conjunction with a contribution to a qualified nonprofit organization results in a higher federal income tax liability, as compared to a direct donation absent the credit. However, the final cash outlay associated with the contribution is still lower when a NAP tax credit is utilized. For example, a NAP credit of 55 percent on a $100,000 contribution reduces the cost of the donation by $35,750. (See Table 1.) This calculation utilizes the 2017 federal corporate net income tax (CNIT) rate of 35 percent.

Table 1
Corporations: NAP Tax Credit vs Direct Donation

	NAP 55% Tax Credit	Traditional Donation
Donation	($100,000)	($100,000)
NAP Tax Credit	55,000	-
Interim Net Cash Outlay	(45,000)	(100,000)
Federal Tax Savings	15,750	35,000
Final Net Cash Outlay	(29,250)	(65,000)
Total Tax Savings	**$35,750**	

Note: Assumes a federal corporate income tax rate of 35%.

For 2018, the federal CNIT rate is reduced from 35 percent to 21 percent. This change increases the savings attributed to the NAP credit under the previous scenario from $35,750 to $43,450, or a 22 percent increase. (See Table 2.) The lower federal rates may increase corporate demand for NAP tax credits. The impact of the federal tax law changes on pass-through entities utilizing a NAP credit is more limited because the highest federal marginal personal income tax rates for 2017 and 2018 are largely the same or similar (depending on income and filing status). (See Table 3.) For income passed-through to a married taxpayer with taxable income of $350,000, the savings associated with the NAP tax credit for a contribution of $100,000 increases by only $550 (1.5 percent) between 2017 and 2018.

Table 2
Corporations: NAP Tax Credit vs Direct Donation

	NAP 55% Tax Credit	Traditional Donation
Donation	($100,000)	($100,000)
NAP Tax Credit	55,000	-
Interim Net Cash Outlay	(45,000)	(100,000)
Federal Tax Savings	9,450	21,000
Final Net Cash Outlay	(35,550)	(79,000)
Total Tax Savings	**$43,450**	

Note: Assumes a federal corporate income tax rate of 21%.

Table 3
Pass-Through Entities: NAP Tax Credit vs Direct Donation

	2017		2018	
	NAP 55% Tax Credit	Traditional Donation	NAP 55% Tax Credit	Traditional Donation
Donation	($100,000)	($100,000)	($100,000)	($100,000)
NAP Tax Credit	55,000	-	55,000	-
Interim Net Cash Outlay	(45,000)	(100,000)	(45,000)	(100,000)
Federal Tax Savings	14,850	33,000	14,400	32,000
Final Net Cash Outlay	(30,150)	(67,000)	(30,600)	(68,000)
Total Tax Savings	**$36,850**		**$37,400**	
Increased Savings Under Federal Tax Law Changes			**$550**	1.5%

Note: Assumes that taxpayer is married with total taxable income of $350,000. Marginal tax rate is 33% for 2017 and 32% for 2018. Assumes the income is not attributable to a businessthat qualifies for the 20 percent pass-through deduction.

ECONOMIC IMPACT

The initial round of economic activity (direct spending) associated with state spending of $18 million in NAP tax credits and corresponding private contributions/investments generates additional impacts as it ripples through the economy. For example, as a result of the increased direct spending, neighborhood organizations purchase goods and services from businesses in other industries (indirect spending). The additional direct and indirect spending increases earnings, as new jobs are created, existing wages are increased and enhanced profits flow through to business owners. The economic activity generated by the higher earnings creates yet another round of effects (induced spending).

A simplified way to measure the impacts of direct spending on the state economy is through the use of Regional Input-Output Modeling System (RIMS II) multipliers. RIMS II multipliers provide an estimate of the change in total economic output for a given change in direct spending. For example, an output multiplier of 2.2 implies that $1 in direct spending could be expected to increase total spending or output by $2.20, as the funds are spent and re-spent throughout the economy. The additional $1.20 of spending activity reflects the impact of the indirect and induced spending.

This analysis uses multipliers computed by the U.S. Bureau of Economic Analysis based on input-output data for 2007 and local industry data from 2015 (RIMS II, Type 2 multipliers).[6] The values for relevant Pennsylvania-specific output or spending multipliers are:

> **2.28** (non-residential structures) for EZP contributions (investments);
>
> **2.15** (maintenance and repair) for contributions related to the building, rehabilitation, repair or maintenance of residential structures;
>
> **2.19** (individual and family services) for contributions related to the provision of social and employment services; and
>
> **2.30** (community food, housing and other relief services) used for contributions related to the provision of food and other emergency relief services.

The multipliers for these industries are relatively high due to (1) the moderate salaries characteristic of jobs in these industries (i.e., any increase in wages is primarily spent not saved), and (2) most of the spending remains in-state by nature of the work (e.g., construction workers and those providing social services are likely to be located in Pennsylvania to provide services to those living in Pennsylvania neighborhoods).

For FY 2015-16, the state granted $17.9 million in NAP credits, which leveraged $43.1 million in business contributions/investments. After adjusting for the portion of contributions deductible from federal income tax, the estimated net business contribution was $37.8 million. The difference, or amount of reduced federal income taxes, is the same as if the federal government had contributed $5.3 million directly to the neighborhood projects.

---

[6] U.S. Bureau of Economic Analysis, Regional Input-Output Modeling System (RIMS II). December 2016. https://bea.gov/regional/rims/rimsii/.

The application of appropriate multipliers to total contributions/investments (including both public and private funding) yields an estimated economic output of $138.1 million for FY 2015-16. (See Table 4.) The analysis utilizes data from unaudited year-end applicant reports and DCED's annual NAP report to estimate (1) the amount of total contributions associated with the tax credits, (2) the ultimate use of the contribution (e.g., residential structures, social services, etc.), and (3) whether the contribution originated from a corporation or a pass-through entity.[7]

Under the counterfactual scenario (no tax credit), the analysis assumes that the state still spends the $17.9 million as direct support for neighborhood programs, but businesses make only one-half of their current contributions/investments in the absence of the credit. This reduction in contributions reduces the federal tax savings (i.e., federal contribution to the projects) from $5.3 million to $2.6 million. The analysis assumes that the portion of the current contributions that are no longer used for the benefit of Pennsylvania neighborhoods are now used for some other purpose that does not provide a direct benefit to the Pennsylvania economy (e.g., paying down debt). This flow increases federal income tax liability (as compared to the NAP scenario). In total, the counterfactual has an economic benefit of $89.3 million, implying a net economic benefit of $48.8 million from state spending on NAP credits.

In practice, it is unclear to what extent the above assumptions would hold. The Independent Fiscal Office was unable to identify a reliable study that could quantify the predisposition of businesses to donate funds in the absence of tax incentives. This is particularly the case for EZP contributions, where it is unclear whether the investment would occur regardless, albeit possibly in another Pennsylvania location.

When determining budget priorities, policymakers must weigh the tradeoff between alternative spending programs. Funds directed to one program may enhance/incentivize out-of-state investment in the Pennsylvania economy, but some program funds may also flow out-of-state. To provide context for the economic impact of spending on the NAP, the following comparable output multipliers for other types of state spending are provided: 1.83 (infrastructure – water and sewer), 2.15 (infrastructure – highways and streets) and 1.26 (tax relief to households).[8]

Note that the analysis utilizes direct total output or spending multipliers to produce this result. These multipliers are consistent with the common approach used by other studies on similar topics. However, total output multipliers double count certain sales transactions because they include "intermediate" purchases that are also reflected in final sales. In order to derive the net impact on the state economy or gross domestic product, a value-added multiplier should be used.

---

[7] Reports provided by DCED.

[8] The comparable multipliers provide only general guidance regarding the potential economic impact from an alternative use of the state funding. To determine the full impact, a detailed analysis of the flow of funds under the alternative scenario is required. Due to the complexity of those computations, this report does not attempt to compute the economic impact from those alternative uses.

Table 4
FY 2015-16 NAP Net Economic Impact

NAP Program			
NAP Tax Credits	$17.9		
Federal Tax Savings[1]	5.3		
Net Contributions[2]	37.8		
Total Spending	61.0		
Spending Category	Multipliers[3]	Spend	Impact
Non-Residential Structures (EZP)	2.28	$39.6	$90.3
Maintenance and Repair	2.15	4.6	9.9
Community Food and Relief	2.19	6.1	13.4
Other Social Services	2.30	10.7	24.6
		61.0	**138.1**
Counterfactual			
PA State Spending	$17.9		
Federal Tax Savings[4]	2.6		
Net Contributions[5]	18.9		
Total Spending	39.5		
Spending Category	Multipliers[3]	Spend	Impact
Non-Residential Structures (EZP)[6]	2.28	$25.6	$58.4
Maintenance and Repair[6]	2.15	3.0	6.4
Community Food and Relief[6]	2.19	3.9	8.6
Other Social Services[6]	2.30	6.9	15.9
		39.5	**89.3**
Increased Federal Tax Liability[4]	$2.6		
Out-of-State Flow[7]	18.9		
Net Economic Impact			**$48.8**

Note: Dollar amounts in millions.

[1]Non-EZP contributions, less non-EZP NAP credits, multiplied by the applicable federal tax rate. The tax rate is assumed to be 35 percent for corporations and 33 percent for pass-through entities. EZP investments are not fully deductible in the first year, but would likely increase depreciation expenses related to buildings and structures over a significant number of years (27.5-39 depending on the type of structure).

[2]Total contributions less total NAP tax credits and federal tax savings.

[3]U.S. Bureau of Economic Analysis, Regional Input-Output Modeling System (RIMS II) Total Output Multipliers. December 2016. https://bea.gov/regional/rims/rimsii/.

[4]Represents 50 percent of non-EZP contributions multiplied by the applicable federal tax rate. The tax rate is assumed to be 35 percent for corporations and 33 percent for pass-through entities. Corporate/pass-through split is estimated based on an analysis of FY 2015-16 NAP contributors. Under the counterfactual, these monies are retained by the federal government for the portion of the contribution that is no longer donated in the absence of the credit.

[5]Total business contributions to neighborhood programs less federal tax savings.

[6]Represents state spending, 50 percent of the business spending and the federal tax savings, proportioned based on NAP spending under current law.

[7]Represents 50 percent of contributions (the portion that is not donated/invested in the absence of the NAP credit) less the increase in federal tax liability resulting from the reduced charitable contributions. The analysis assumes that this portion is used for a purpose that does not provide a direct benefit to the Pennsylvania economy.

Similar Programs in Other States

Other states have implemented programs similar to the NAP and use tax credits as an incentive to induce private investment in disadvantaged communities. However, the level of credits and aggregate caps differ among the states. For example, West Virginia allows a 50 percent credit to businesses and individuals who qualify for their program and caps the annual credits allocated at $3 million. In contrast, New Jersey offers a 100% tax credit but reserves it strictly for businesses that invest in comprehensive revitalization plans. New Jersey caps their annual credit allocation at $10 million. The table below summarizes programs offered by surrounding states.

Table 5
State Comparison

State	Eligible Contributors	% of Donation	Contributor Cap	Program Cap
Delaware	Business & Individuals	50%	$50,000 (not exceeding $100,000 over 3 years)	$500,000
Maryland	Business & Individuals	50%	$250,000	$1.75 million
New Jersey	Business	100%	$1 million	$10 million
Pennsylvania	Business	25%-80%	$500,000	$18 million
Virginia	Business & Individuals	65%	$125,000 on individuals, no cap on business	$17 million
West Virginia	Business & Individuals	50%	$100,000	$3 million

Source: “Neighborhood Assistance Act Tax Credit”, Joint Subcommittee to Evaluate Tax Preferences, Commonwealth of Virginia Division of Legislative Services (September 2016)
http://dls.virginia.gov/commissions/tax/files/Neighborhood%20assistance.pdf

Summary

Pennsylvania’s NAP tax credit encourages private investment in projects that serve distressed areas or support neighborhood conservation. Available tax credits range from 25 to 80 percent, depending on the type of project and the length of commitment. Assuming that the NAP credit doubles the amount of contributions/investments that would have otherwise occurred, FY 2015-16 NAP spending of $17.9 million leveraged $21.6 million of new investment. Moreover, the cost to the contributors is less than $21.6 million due to reduced federal taxes of $2.6 million. In effect, the program pulls in federal monies to the state economy that would not otherwise be present.

For FY 2015-16 the estimated net economic impact of NAP spending is $49.9 million. Lower federal corporate net income tax rates effective for tax year 2018 will increase the tax savings realized for corporations participating in the NAP. Moving forward, corporate demand for NAP tax credits may increase as a result of the recent federal tax law changes.

This report was motivated by a request from Representatives Bernie O'Neil and Jake Wheatley. The IFO would like to thank the Department of Community and Economic Development for their assistance in providing the information necessary to complete this report.

IFO Independent Fiscal Office

Rachel Carson State Office Building
400 Market Street
Harrisburg, PA 17105
Email: contact@ifo.state.pa.us
Website: www.ifo.state.pa.us

Staff Acknowledgments:
Tessa Dorr and Matthew Lindsay