



*Presentation to the
Performance-Based Budget Board*

Tax Credit Reviews

April 26, 2021

Tax Credit Reviews for Year 3

Theme: improving the lives of PA residents

- NAP – incentivizes investment in distressed communities
- REAP – reduces water pollution from agricultural operations
- EEEP – increases economic activity in the live entertainment sector
- VGP – encourages expansion of the video game production industry
- KSDZ – redevelopment of former industrial sites

Many positive outcomes cannot be easily measured

- Social impacts (i.e., positive externalities or spillovers)
- Enhanced property values
- Health benefits of cleaner environment

Using Economic Metrics to Assess Progress

Economic impact analysis has 3 key steps

- What share of spending is incentivized by the tax credit?
- What type of spending and industries are affected?
- Use IMPLAN to estimate jobs, output and “multiplier” impacts

Economic metrics for NAP, EEEP and VGP

- Gross ROI vs. net ROI (deducts alternative use of monies)
- Output or spending | labor earnings | number of jobs
- Not possible to estimate certain spillover effects and synergies
- Keys: incentivization parameter, “leakages” and “injections”

Some Notes on the Return on Investment (ROI)

What does the **Gross ROI** represent?

- **Gross ROI**: share of tax credit that is “self-financed”
- Most tax credits have a Gross ROI < 0.25
- This is true even if all activity associated with credit is incentivized
- Firm must also generate enough new economic activity and tax liability attributable solely to the tax credit to reimburse the state
- This is a large amount of activity (see Appendix to reports)

Net ROI deducts impacts from alternate uses (e.g., spending)

- **Net ROI** = Gross ROI – impact from gov’t spending or tax change
- In nearly all cases, Net ROI > 0 but relatively low

Neighborhood Assistance Program (NAP)

Investment in distressed communities | \$36 million annual cap

- Five separate components generally encourage donations to nonprofits
- EZIP component incentivizes for-profit investment in distressed areas
- Credit 55-80% of contribution | 25% of EZIP investment
- EZIP investment far exceeds amount necessary to generate credit

18 states have a similar program

- Many provide a list of qualified nonprofits on program website
- Most provide credit at a rate of 50%

Performance data difficult to compile

- DCED collects significant amount of project performance data
- Unable to measure outcomes due to nature of diverse projects/measures

Neighborhood Assistance Program (NAP)

Economic impacts

- Assume 68% of private funds incentivized | lack of relevant studies
- Gross ROI: 12 cents per dollar | Net ROI: 5 cents per dollar
- +\$22.7m GDP | +\$20.9m labor earnings | +320 FTEs

Other effects

- Social, environmental and aesthetic benefits to communities

Recommendations

- Standardize application period and commitment decisions
- Create project database to facilitate donor/investor participation
- Consider creation of an interagency electronic tax credit system

Resource Enhancement and Protection Program (REAP)

Credit 50-75% of agricultural best management practices (BMP)

- Credits offset roughly 42% of project cost (avg. cost = \$60,400)
- Must be maintained for a predetermined lifespan (5-10 years)
- Research concludes incentives combined with regulation are effective
- 55% credits sold | farmers lack necessary tax liability
- Credits awarded for previously completed projects are ineffective

Pollution reduction difficult to measure

- Other factors (e.g., soil composition and location) impact effectiveness
- No cost-effective way to measure pollution from nonpoint sources
- Impact not easily separated from grants awarded for the same project

Resource Enhancement and Protection Program (REAP)

Collaborate with DEP on environmental modeling

- Evaluate impact of BMPs at the program level
- Award credits based on objective data for maximum impact
- Identify most cost-effective BMP for farming operation/location
- IFO identified the EPA-funded CAST model as a potential tool

Convert tax credit to a competitive grant

- Target operations that likely release high levels of pollution
- Provide up-front funds for farmers that may lack access to capital
- Benefits small farmers that must wait 12 months to sell credit

Review policy of awarding credits after BMP is already in place

Entertainment Economic Enhancement Program (EEEP)

Credit 25-40% of qualified rehearsal and tour expenses

- Live performances that meet location and expenditure requirements
- Effective tax credit is 10% after imposition of per tour cap
- May make tours of less established performers more financially viable
- Provides substantial benefit to the only qualified rehearsal facility

Three other states offer similar credit

- Recently increased cap of \$8m (from \$4m) is third highest

Limited actual tax credit data

- Program was effective beginning with FY 2018-19
- Rehearsal/tour schedules for recent years impacted by COVID

Entertainment Economic Enhancement Program (EEEP)

Economic impacts

- Concerts and tours highly mobile | credit likely has material impact
- Range of 33% to 67% incentivized | relevant studies limited
- 96% of qualified spending remains in state
- Gross ROI: 19-39 cents per dollar | Net ROI: 15-35 cents per dollar
- +\$7.1-\$22.5m GDP | +\$4.1-\$13.0m labor earnings | +53-203 FTEs

Recommendations

- Eliminate requirement for “qualified rehearsal facility”
- Evaluate tour caps and credit rates for effectiveness
- Tax credit should be made refundable | nearly all credits are sold

Video Game Production (VGP)

Enhance economic activity related to video game production

- Credit = 25% first 4 years, 10% thereafter | avg project = 2.2 years
- >50% goes to established PA firms | limited impact on location decisions
- May enhance long-term viability of young firms
- Credit is oversubscribed | significant potential demand

19 states offer video game production incentives

- 12 states offer a tax credit | remaining offer grants or rebates
- Most combine program with film production
- 5 states offer uncapped incentive
- Software publishing jobs expand | +17% PA, +8% U.S. (2014-19 AAGR)

Video Game Production (VGP)

Economic impacts

- Range of 25% to 50% incentivized | limited relevant studies
- Most qualified spending remains in state
- Gross ROI: 12-20 cents per dollar | Net ROI: 8-16 cents per dollar
- +\$1.0-\$2.3m GDP | +\$0.7-\$1.7m labor earnings | +11-25 FTEs

Recommendations

- Convert to a grant program | target credits to maximize impact
- Limit credits (or grants) to young firms that may not be otherwise viable
- Grant or refundable credit may provide needed capital for start-ups

Keystone Special Development Zones (KSDZ)

Incentivizes private investment in former industrial sites

- \$2,100 per FTE employed in zone | July 1, 2012 - June 30, 2035
- Only 2 designated KSDZs | Aliquippa and Bethlehem
- Only 1 taxpayer participates | limited analysis

Recommendations

- Documentation of baseline employment | ensures all jobs are new
- Implement program/project caps | limits tax impact
- Allow program to expire | limited use not worth admin cost

Concluding Comments

Most credits are effective

- NAP, REAP and EEEP likely achieving intended results
- Not enough data on VGP | defer comment
- KSDZ underutilized | not achieving results
- EEEP generates highest ROI | significant impact on location decisions

Agencies have little flexibility to enhance tax credit effectiveness

- Must administer the tax credit as enacted
- Most recommendations require statutory amendments

Consider an interagency tax credit system (w/applicant interface)