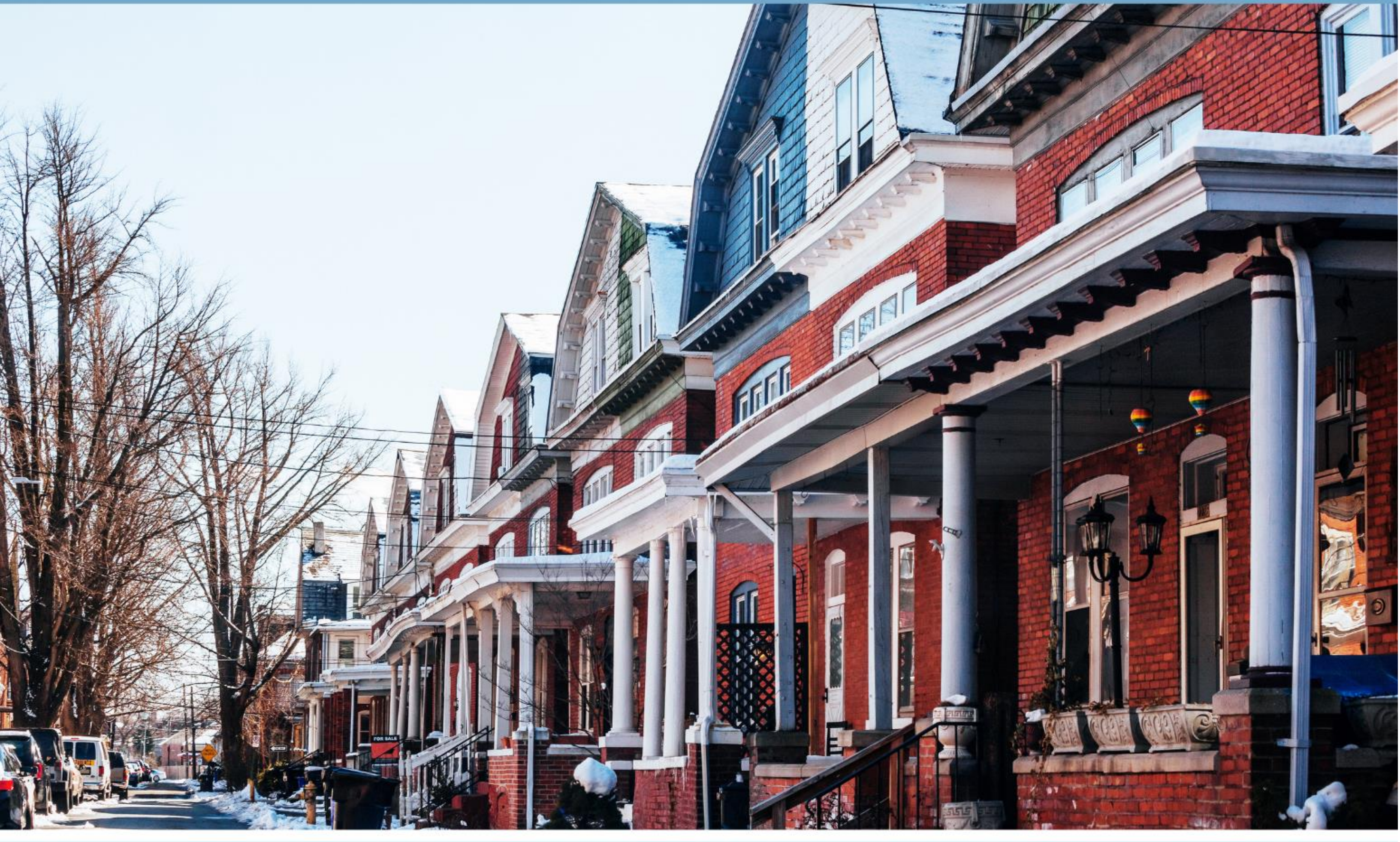
PENNSYLVANIA

NEIGHBORHOOD ASSISTANCE PROGRAM TAX CREDIT

An Evaluation of Program Performance



April 2021

COMMONWEALTH OF PENNSYLVANIA
INDEPENDENT FISCAL OFFICE

Independent Fiscal Office

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INDEPENDENT FISCAL OFFICE

April 19, 2021

The Honorable Members of the Performance-Based Budget Board and Chairs of the House and Senate Finance Committees:

Act 48 of 2017 requires the Independent Fiscal Office (IFO) to review various state tax credits over a five-year period. For the third year, the IFO reviewed five tax credits: the Neighborhood Assistance Program, Resource Enhancement and Protection Program, Entertainment Economic Enhancement Program, Video Game Production and Keystone Special Development Zone Tax Credits. The act requires the IFO to submit tax credit reviews to the Performance-Based Budget Board and the Chairs of the House and Senate Finance Committees and to make reports available to the public on the IFO website.

This report contains the tax credit review for the Neighborhood Assistance Program (NAP) Tax Credit. The IFO reviewed studies on state and federal charitable contribution and neighborhood assistance incentives, held discussions with stakeholders and met with agency staff who administer the tax credit. Based on that research, the IFO submits this report to fulfill the requirements contained in Act 48.

Currently, 18 states offer programs similar to Pennsylvania's NAP Tax Credit. Most states provide a nonrefundable credit equal to 50 percent of charitable contributions to qualified nonprofit organizations. Pennsylvania offers $36 million in total credit awards, which is the highest annual cap and the second highest in annual awards among states that have these tax credit programs. Pennsylvania is one of only two states that allows the tax credit to be sold.

The IFO welcomes all questions and comments on the contents of this report. Questions and comments can be sent to contact@ifo.state.pa.us.

Sincerely,

Dr. Matthew J. Knittel
Director

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General Findings and Recommendations

The Neighborhood Assistance Program (NAP) Tax Credit created by Act 48 of 1994 is available to firms that contribute to or invest in eligible projects that improve distressed areas and support low-income populations in Pennsylvania. Eligible projects include: affordable housing, community economic development, community services, education, neighborhood assistance, neighborhood conservation, crime prevention, job training or charitable food assistance. The annual program cap is currently $36.0 million and eligible firms can apply for a tax credit equal to 55 to 80 percent of charitable contributions to eligible neighborhood organizations or 25 percent of eligible investments in distressed areas.

The **general findings** of this report are as follows:

- Eighteen states offer a program similar to Pennsylvania's NAP Tax Credit and many provide a list of qualified nonprofits on their program websites to assist the taxpayer in ensuring that their contributions are eligible for the credit.
- For FY 2019-20, 231 NAP Tax Credit projects were approved and $33.5 million in credits were committed to offset $67.8 million in anticipated contributions/investments. The analysis finds that the net return on investment (ROI) is 5 cents of state tax revenue for each tax credit dollar. However, that ROI excludes many positive externalities that cannot be quantified accurately in monetary terms.
- Multi-year awards for the Neighborhood Partnership Program (NPP) comprise the largest share of NAP Tax Credit commitments (roughly 40 percent of the total). Banks and corporations generate roughly 80 percent of credits. Participants in the Enterprise Zone Program (EZP) generally make investments two to four times greater than required to generate the committed tax credit.
- Although DCED collects a significant amount of project performance data on the required Community Impact Measures Report, it is difficult to aggregate and measure outcomes due to the wide variety of projects supported by the credit and the diverse measures used by those projects.
- Stakeholders report that the timing of the tax credit has become problematic in recent years. There is no advance announcement of when the application period will open, and approval decisions are often not transmitted until December. For tax planning purposes, firms generally want to make donation decisions by calendar year end.

The final section of this report contains various **recommendations**. A summary is as follows:

- DCED should work to standardize the NAP Tax Credit application period and announce application decisions earlier in the calendar year.
- Similar to other states, DCED should consider the creation of an approved project list/database to facilitate the ability of potential donors to find projects that align with their organizational priorities or mission.
- DCED/DOR should consider the creation of a tax credit system that would allow recipients to electronically track the status of their tax credit, submit required documentation, remit the tax credit claim form to DOR and allow the recipient to elect how the credit should be applied.

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Section 1: Introduction

Act 48 of 2017 requires the Independent Fiscal Office (IFO) to review various state tax credits over a five-year period.[1] For the third year, the IFO reviewed five tax credits: the Neighborhood Assistance Program, Resource Enhancement and Protection Program, Entertainment Economic Enhancement Program, Video Game Production and Keystone Special Development Zone Tax Credits. The act requires the IFO to submit tax credit reviews to the Performance-Based Budget Board and the Chairs of the House and Senate Finance Committees and to make reports available to the public on the IFO website.

The act specifies that tax credit reviews shall contain the following content:

- The purpose for which the tax credit was created.
- Whether the tax credit is accomplishing its legislative intent.
- Whether the tax credit could be more efficiently implemented through other methods.
- Any alternative methods which would make the tax credit more efficient.
- The costs to provide the tax credit, including the administrative costs to the Commonwealth and local government entities within this Commonwealth.

The act also specifies that the IFO shall develop a tax credit plan for all tax credits subject to review. The plans should include performance measures, and where applicable, the measures should reflect outcome-based measures (including efficiency measures), measures of status improvements of recipient populations, and economic outcomes or performance benchmarks against similar state programs or similar programs of other states or jurisdictions. The IFO submits this report to fulfill these requirements.

This review contains four additional sections. **Section 2** discusses how the tax credit is administered and presents historical data. **Section 3** presents relevant data for states that offer a similar tax credit and key findings from other state studies. **Section 4** contains an economic impact analysis. **Section 5** concludes with the tax credit plan, as required by Act 48. A complete list of reports and data sources used for this review can be found in the **Appendix**. If submitted, written comments provided by stakeholders and affected agencies are also included in the Appendix.

[1] Act 48 of 2017 is also known as the Performance-Based Budgeting and Tax Credit Efficiency Act. See the Appendix for the Tax Credit Review Schedule.

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Section 2: NAP Tax Credit Overview

Article XIX-A of the Tax Reform Code of 1971 (Act 48 of 1994) created the Neighborhood Assistance Program (NAP) Tax Credit. The NAP Tax Credit incentivizes businesses to contribute or invest in eligible projects carried out by neighborhood organizations to improve distressed areas and support low-income populations.[2] Eligible projects include: affordable housing, community economic development, community services, education, neighborhood assistance, neighborhood conservation, crime prevention, job training and charitable food assistance.[3] The NAP Tax Credit includes five components, each with specific eligibility requirements and credit award structures:

(1) **Neighborhood Assistance Program Tax Credit (NAPTC):** 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.

(2) **Special Program Priorities (SPP):** Provides a tax credit of up to 75 percent of eligible contributions that target specific, state-designated priority problems or projects.[4]

(3) **Neighborhood Partnership Program (NPP):** Promotes collaboration with partners and generation of long-term business relationships by providing tax credits for eligible contributions that target multiple projects over several years. The projects must be based on a community strategic plan and target specific development needs that produce measurable outcomes. The tax credit available is determined by the length of the financial commitment, with credits worth up to 75 percent of eligible contributions for a five-year commitment, and credits worth up to 80 percent for a commitment of six or more years. The minimum annual contribution is $50,000 per business partner, and the project must have a minimum of $100,000 in partner commitments.

(4) **Charitable Food Program (CFP):** Provides a tax credit of up to 55 percent of eligible contributions to approved regional food banks or emergency providers that maintain an operation involving the distribution of food provisions to residents of distressed communities (e.g., soup kitchens or homeless shelters). Donations of food of nutritional value may also be eligible for credit. Credits for food donations are awarded based on a cost per pound valuation.

(5) **Enterprise Zone Program (EZP):** Provides a tax credit of up to 25 percent of qualified investments made by private, for-profit companies in designated Enterprise Zones. Qualified investments are limited to

[2] A distressed area is an area that exhibits a high incidence of one or more demographic factors such as consistent unemployment, school dropout and public assistance dependency. Areas deemed distressed for NAP Tax Credit purposes include: Enterprise Zones, Keystone Opportunity Zones, Keystone Communities, Keystone Main Streets, Keystone Community Enterprise Zones and Act 47 Municipalities. For additional detail see: https://dced.pa.gov/download/neighborhood-assistance-program-nap-guidelines/?wpdmdl=86209.

[3] Due to the impact of the COVID-19 pandemic and social justice issues on the Pennsylvania economy, beginning with FY 2020-21, DCED guidelines note that priority will be given to projects that address critical issues related to the pandemic, support policy-changing movements or improve opportunities for marginalized populations.

[4] Priorities include: disaster or economic relief, weatherization and housing rehabilitation, blight elimination and affordable housing and supportive services for at-risk populations. For more detail see the NAP Tax Credit guidelines.

construction costs for the rehabilitation, expansion or improvement of buildings/land that promote community development.[5] The tax credit is capped at $0.5 million per EZP project.

Under all NAP Tax Credit components (except EZP), a nonprofit neighborhood organization applies for tax credits based on anticipated contributions from private, for-profit companies to fund an eligible project(s) in a distressed area.[6] In the case of the EZP, for-profit companies apply directly for tax credits without a nonprofit intermediary. Businesses may invest in an unlimited number of NAP Tax Credit projects, but the maximum amount of credit awarded may not exceed $0.5 million per applicant for contributions or investments in less than four projects and may not exceed $1.25 million for contributions or investments in four or more projects. Act 100 of 2018 increased the annual program cap from $18.0 million to the current $36.0 million.[7]

Tax credits may be utilized against Pennsylvania personal income, corporate net income, bank and trust company shares, title insurance companies shares, insurance premiums and mutual thrift institutions taxes for the taxable year in which the credit is issued. Credits not used in the first year may be carried forward for an additional five tax years. The credit is non-refundable and may not be carried back. The credit may be sold or assigned but must be used within the year of sale or assignment.

This section begins with a description of the goals and purpose of the tax credit. It then discusses the application process and the administration of the tax credit and concludes with a presentation of program data.

Goals and Purpose

Act 48 of 2017 requires that all tax credit reviews published by the IFO shall discuss (1) the purpose for which the tax credit was created and (2) whether the tax credit is accomplishing its legislative intent. For this credit, the IFO reviewed the authorizing legislation and documentation provided by the Pennsylvania Department of Community and Economic Development (DCED) regarding the NAP Tax Credit. For this review, the IFO has established the goals and purpose of the NAP Tax Credit as follows:

Goals

- Revitalize distressed areas through community development, educational assistance and job training.
- Encourage private investment in projects that serve distressed neighborhoods and communities.
- Improve living conditions in distressed areas through the construction and restoration of affordable housing sites and the provision of community services (e.g., food, emergency or medical assistance or counseling).

Purpose

- Enhance the safety and quality of life for residents of distressed communities.

[5] Eligible companies include agricultural, industrial, manufacturing or research and development enterprises.
[6] Neighborhood organizations must be registered as a 501(c)(3) to qualify. Business contributions may include cash, equipment and/or supplies, job training, real estate or technical assistance.
[7] Pass-through entities are allocated $2.0 million annually with any unused portion reallocated for general use.

Administration

DCED administers the NAP Tax Credit and reviews applications. Applicants for the NAP Tax Credit must provide a complete application package that includes the following:[8]

- Single Application for Assistance.
- Project narrative which includes: the target area and/or community for the proposed project, project description, how the project meets the eligibility requirements of the program, demonstrated need for the project and measurable goals and outcomes.[9]
- Community Impact Measures Report.[10]
- Documentation of capacity to complete the project.
- Confirmation that discrimination will not occur, disclose conflicts of interest and maintain records relating to every aspect of the project.
- Tax Compliance Form for each business firm that will contribute to the project along with a commitment letter stating amounts and terms of the contributions (or a strong solicitation plan).[11]

The application submission due date varies from year to year, and it generally takes 8 to 12 weeks to log, review and score applications, as well as establish business tax compliance. Applications are approved (or rejected) by DCED after evaluation of the above criteria. Approval may also be contingent on the availability of credits, proposed activities, reasonableness of the project and completeness of the application. DCED will recommend approval for projects and determine the tax credit amount.

Once approved, DCED sends an agreement letter to the applicant which must be signed and returned within 60 days. Upon receipt of the signed letter, DCED will notify business contributors of the project's acceptance and provide a copy of the approval letter. DCED will then provide the contributor with an Application for Tax Credit for Businesses. Any proposed changes to the project or activities must be sent to DCED in writing before changes can be implemented.[12]

To obtain a tax credit certificate from DCED, contributors must do the following:

- File an Electronic Clearance Form for Tax Credits.
- Complete and submit the Application for Tax Credit for businesses with proof of contribution.
- Finish the Application for Tax Credit and Food Donations Worksheet (if applicable). The worksheet must be submitted by December 31 or 180 days after the contribution period has closed.

The contribution year for NAP Tax Credits coincides with the state fiscal year. All contributions must be

[8] The five specific components within the NAP Tax Credit all have separate application requirements in addition to those listed. See program guidelines for details.
[9] The narrative should also include all data, maps, charts and partnership arrangements.
[10] The Community Impact Measures Report includes general applicant information, project purpose, project success measures, community impact measures (including taxes), private funds leveraged, business contribution funds leveraged and the annual report on project success.
[11] For the NPP, a commitment letter and Tax Compliance Form is required for every year of the project along with a memorandum of understanding for the long-term commitment.
[12] Only minor changes will be accepted by DCED on a case-by-case basis once an application is submitted. DCED will not accept modifications to the scope, breadth, budget or location of a project.

received before the end of the fiscal year in which the credit was authorized (June 30). Nonprofits then have until September 30 to expend contributions. (The additional three months allows contributions remitted close to the fiscal year end to be expended before the activity period closes.)[13]

Applicants must complete reports which include the final Community Impact Measures Report by December 31. The report must include a brief description of project accomplishments, how goals/objectives were met and any success stories related to the project.

The NAP Tax Credit claim form is submitted to the Department of Revenue (DOR) for application against the recipient's Pennsylvania state tax liability and DOR ensures that the tax credit is applied appropriately. DOR estimates that the NAP Tax Credit requires two full-time equivalent (FTE) staff to administer at a cost of $0.2 million annually. DCED estimates that the credit requires 0.8 FTE staff to administer at a cost of $0.1 million annually.

Historical Data

NAP Tax Credits are "committed" after the credit application has been received, the project has been approved and the agreement letter has been signed. Credits are "awarded" after the contributions/investments have been documented and the tax credit certificate has been issued. Credits committed by DCED are generally more than the amount awarded, as applicants may ultimately withdraw from the program or fail to reach their fundraising goals. The text that follows presents historical data for the NAP Tax Credit from fiscal year (FY) 2015-16 to FY 2019-20.

Table 2.1 provides NAP Tax Credit commitments for non-EZP projects. From FY 2015-16 to FY 2018-19, anticipated contributions grew at an average annual rate of 7.0 percent, while tax credit commitments grew at a rate of 4.4 percent. Credits committed averaged roughly 62 percent of anticipated contributions.

Table 2.1
NAP Tax Credit Commitments (Excludes EZP)

	Fiscal Year				
	15-16	16-17	17-18	18-19	19-20
Approved Applications	86	103	114	119	213
Anticipated Contributions[1]	$21.3	$24.6	$25.3	$26.1	$38.6
Credits Committed[2]	$13.5	$15.4	$15.8	$15.4	$26.2

Note: Dollar amounts in millions. Act 100 of 2018 increased the annual cap from $18.0 to $36.0 million.

1 Actual contributions are generally less than the amount anticipated.

2 Based on anticipated contributions. Actual credits awarded are lower due to lower actual contributions.

Source: Department of Community and Economic Development.

[13] Due to the nature of the EZP component, there is no three-month extension and the investment must be expended by June 30.

Table 2.2 displays data for NAP Tax Credits committed under the EZP component. For all years, data indicate that applicants made significant investments over and above what is required to generate the committed tax credit. This "excess" investment makes up roughly 80 percent of the total anticipated investment prior to FY 2019-20.

Table 2.2
EZP Tax Credit Commitments

	Fiscal Year				
	15-16	16-17	17-18	18-19	19-20
Approved Applications	14	14	11	17	18
Anticipated Investment[1]	$39.6	$62.5	$54.7	$51.4	$78.7
Credit Share[2]	$17.6	$10.6	$8.8	$10.1	$29.3
Excess[3]	$22.0	$51.9	$45.9	$41.3	$49.5
Credits Committed[4]	$4.4	$2.6	$2.2	$2.5	$7.3

Note: Dollar amounts in millions. Act 100 of 2018 increased the annual cap from $18.0 to $36.0 million.

1 Actual investments are generally less than the amount anticipated.

2 Portion of the investment eligible for credit.

3 Investment made over and above the amount eligible for credit.

4 Based on anticipated investments.

Source: Department of Community and Economic Development.

Table 2.3 displays the share of NAP Tax Credit commitments by component program for FY 2015-16 to FY 2019-20. The NPP component represents the majority in all five years and generates roughly 30 percent of total commitments for the latest year. The large number of ongoing NPP projects (multi-year commitments) contributes to the high share of NPP credits and DCED is required to allocate credits to ongoing NPP projects before allocating to new NPP or other NAP Tax Credit components.

Table 2.3
Share of NAP Tax Credit Commitments by Type

Component	Fiscal Year 15-16	16-17	17-18	18-19	19-20	Total Awards
NAPTC	4.0%	7.9%	5.9%	8.0%	13.8%	8.8%
NPP	39.7	43.4	46.9	45.2	30.2	39.5
SPP	15.0	17.4	18.2	16.3	17.2	16.9
CFP	16.7	16.7	16.7	16.4	17.0	16.7
EZP	24.6	14.7	12.2	14.0	21.8	18.1

Note: Shares are allocated based on total program dollars.
Source: Department of Community and Economic Development.

Table 2.4 provides detail on NPP projects committed by fiscal year. Prior to the cap increase for FY 2019-20, 80 to 90 percent of NPP commitments flowed to ongoing projects. (This will happen again in a few years as the number of NPP projects increase under the higher cap.) Therefore, most credits were allocated to NPP projects that had already been approved in a prior application year. Because these programs receive priority when credits are allocated, they effectively reduce the amount available to other NAP Tax Credit component programs.

Table 2.4
NPP Component Program Applicants and Commitments

	Fiscal Year 15-16	16-17	17-18	18-19	19-20
Total NPPs	**38**	**42**	**44**	**42**	**51**
New NPPs	5	7	8	5	14
NPP Credit Commitments	**$7.1**	**$7.8**	**$8.4**	**$8.1**	**$10.1**
New NPPs	$1.0	$1.4	$1.4	$0.7	$3.0
Ongoing NPPs	$6.1	$6.4	$7.0	$7.4	$7.1
Ongoing Share	86.1%	82.4%	82.9%	91.7%	70.0%

Note: Dollar amounts in millions. Act 100 of 2018 increased the annual cap from $18.0 to $36.0 million.
Source: Department of Community and Economic Development.

NAP Tax Credits are awarded by DCED after the contributions/investments are received and documented. **Table 2.5** displays actual contributions/investments by business entity type. For FY 2018-19, corporations claimed the largest share of credit awards (47.9 percent), with an average award of $49,900. These entities primarily participate in non-EZP component programs, most notably the NPP. Banks were the second largest beneficiary (36.0 percent), with an average credit award of $39,100.

Table 2.5
NAP Tax Credit Awards by Contributor Type (FY 2018-19)

	Contributors		Dollars ($000s)		Average Award
	Number	Share	Amount	Share	
Corporations	163	43.1%	$8,133	47.9%	$49,900
Banks	156	41.3	6,106	36.0	39,100
LLC	43	11.4	2,108	12.4	49,000
All Other	16	4.2	631	3.7	39,400
Total	**378**	**100.0**	**16,978**	**100.0**	**44,900**

Note: All Other includes partnerships, sole proprietorships, trusts and limited-liability partnerships. FY 18-19 is displayed due to variability in more recent years from the COVID-19 pandemic.

Source: Department of Community and Economic Development.

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Section 3: State Comparison

This section compares relevant 2020 data for the 18 states that offered a program similar to Pennsylvania's NAP Tax Credit. State programs that were based on the Low-Income Housing Tax Credit or other federal programs were excluded.

Table 3.1 displays key parameters for similar state tax credits. Most were enacted prior to 2000, and only five were enacted within the last decade. All states, except for Vermont, require the nonprofit organizations to meet specified criteria. Most states define qualified nonprofits based on the primary service provided, while other states require that a certain portion of the nonprofit organization's budget be spent on a specific service area, such as assistance to families with disabled children (Arizona) or housing and economic development (New Jersey). Because the criteria used to determine which nonprofit organizations qualify for the program are often complex, many states provide a list of qualified entities on their program websites to inform taxpayers whether their contributions are eligible for the credit.

Credit rates across states range from 5 percent (Vermont) to 100 percent (Arizona and New Jersey). Most states use a flat credit rate of 50 percent. States that provide multiple rates require specific types of investments to qualify for the higher credit rate, similar to the SPP and NPP components of the Pennsylvania NAP Tax Credit.

Tax credits are generally applied to corporate net income and personal income taxes. Pennsylvania and Kansas are the only states that allow credits to be sold or assigned to another taxpayer. Kansas (along with Colorado) also allows a taxpayer to obtain a refund for awarded credits.

A carryforward period of five years is typical across states. Connecticut is the only state to offer a two-year carryback. Four states (Idaho, Indiana, Utah and Vermont) require the taxpayer to utilize the credit against their tax liability in the year of award, with no carryforward, carryback, refund or transfer permitted.

The last columns of Table 3.1 display the annual dollar cap (if applicable) and the total credit awards for the latest year that data are available. Currently, 14 states have credit caps, and Pennsylvania has the highest annual cap at $36.0 million. Five states have no cap: Arizona, Colorado, Idaho, Utah and Vermont. Arizona dominates tax credit awards, providing more than $90.0 million for the latest year of data. Pennsylvania and four other states (Arizona, Idaho, Vermont and Virginia) awarded more than $10.0 million in credits. Colorado, Louisiana, Nebraska and South Carolina awarded less than $1.0 million in credits.

Table 3.1
State Comparison of NAP Tax Credits

					Annual[2]	
	Enacted	Credit Rate	Utilization[1]	Carryforward	Cap	Amount
Pennsylvania	**1994**	**25-80%**	**T**	**5 years**	**$36.0**	**$33.5**
Arizona	2011	100	-	5 years	-	90.1
Colorado[3]	2014	25	R	-	-	0.0
Connecticut	1982	60	-	*	5.0	4.1
Delaware	1999	50	-	5 years	1.0	1.0
Florida	1994	50	-	5 years	10.5	3.7
Idaho	1982	50	-	-	-	10.8
Indiana	1987	50	-	-	2.5	2.2
Kansas	1993	50-70	R/T	-	4.1	3.1
Louisiana	1982	50	-	5 years	**	0.0
Maryland	2006	50	-	5 years	5.0	1.0
Missouri[3]	2013	50-70	-	5 years	1.8	1.7
Nebraska	2013	40	-	5 years	0.4	0.3
New Jersey	2001	100	-	-	12.0	3.5
South Carolina	2000	33	-	3 years	1.0	0.5
Utah[4]	1983	50	-	-	-	n.a.
Vermont	2018	5	-	-	-	13.8
Virginia	1981	65	-	5 years	17.0	15.3
West Virginia	1996	50	-	4 years	3.0	2.7

Note: States excluded do not have a comparable NAP tax credit in effect for TY 2020.

1 R is refundable and T is transferable.

2 Millions of dollars. Credit amount is latest amount reported by the state agency that administers the credit. Most values pertain to FY 18-19 or FY 19-20.

3 Credit only for cash or food donations to a food pantry, homeless shelter or soup kitchen.

4 Credit only for cash contributions to nonprofit organizations that rehabilitate sheltered workshop facilities for persons with a disability.

*2-year carryback.

**Annual cap is calculated each year as one percent of state corporate income tax collections from the prior fiscal year.

Source: Credit amounts from various state tax expenditure reports. See https://itep.org/state-by-state-expenditure-reports/ for links to existing reports.

Key Findings from Other State Studies

Despite an extensive search for relevant studies regarding the impact of NAP-type tax credits on local economies, this analysis identified only two relevant studies. Both studies noted significant social impacts (i.e., positive externalities or spillovers) that could not be accurately captured by economic models. The studies also noted that any long-term economic impacts from these tax credits, such as access to higher-paying employment opportunities or enhanced property values, could not be quantified.

Assessment of the West Virginia Neighborhood Investment Program (2014)

For FY 2013-14, an independent review of West Virginia's Neighborhood Investment Program (NIP) found that the state spent nearly $3 million on credit awards and qualified nonprofit organizations were able to leverage those awards to provide services to over 623,000 low-income individuals. This represented $4.68 of state dollars per person served and leveraged $6.1 million in private funds. Community service projects, such as those that provide counseling and economic development assistance, were identified as the most common type of project undertaken with the contributions. Funds were least likely to flow to neighborhood assistance (e.g., physical or economic improvement of a location) and crime prevention projects.[14]

Arizona Income Tax Credit Review (2015)

A review by the Arizona Joint Legislative Income Tax Credit Review Committee analyzed the revenue impact, economic benefits and potential performance measures for the state's Contributions to Qualifying Charitable Organizations Tax Credit, which is a tax credit provided to taxpayers that make voluntary contributions to qualifying nonprofits. Because the goals of the tax credit do not include the direct promotion of economic development, the review found that no data were available to quantify the impact that state funds had on certain target groups, such as the working poor or children living in poverty. The report noted potential performance measures could be gathered via reporting requirements on items such as the number of recipients who benefited or the type of services provided by credit donations.[15]

[14] "Assessment of the West Virginia Neighborhood Investment Program," Terrell Ellis & Associates (2014).
[15] "2015 Income Tax Credit Review," Arizona Joint Legislative Budget Committee (December 2015).

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Section 4: Economic Analysis

The economic analysis contained in this section is based on NAP Tax Credit contributions and awards for FY 2018-19 and the IMPLAN state economic model.[16] Data from FY 2018-19 are used as the basis for the analysis because FY 2019-20 awards were impacted by the COVID-19 pandemic. The results for FY 2018-19 are used to inform an economic analysis that is representative of annual awards that would be made under the higher $36.0 million annual cap.

Economic Impact

A key parameter that drives the economic impact of any tax credit program is the amount of spending actually incentivized by the credit. To the extent that the spending would have occurred regardless of the program, the tax credit is a windfall and has negative economic implications because the state could have used the funds for another purpose.

In the case of the NAP Tax Credit, the IFO was unable to determine the incentivized share of spending due to a lack of applicable research from other states or academic studies. For purposes of this analysis, it is assumed that the NAP Tax Credit incentivizes 100 percent of non-EZP contributions (due to the high matching rates) and 50 percent of EZP investments.

Table 4.1 contains the economic impact analysis. The text that follows provides a brief description based on line number in the table. For ease of analysis, the computation assumes that all tax credits are awarded and claimed in the same year. Adjusting for actual delays between award and utilization would not change the overall results of this analysis.

Line 1 The analysis assumes that $36.0 million of tax credits are committed.

Line 2 Based on prior data, the analysis assumes that only $34.0 million are awarded, as some applicants ultimately withdraw from the program or fail to meet fundraising goals.[17]

Line 3 Share of activity that occurs due to the credit. The analysis assumes that 50 percent of EZP investment and 100 percent of contributions under all other NAP components are incentivized by the credit. The blended incentivized share is estimated to be 68.1 percent.

Line 4 The product of lines 2 and 3: value of credits that incentivize contributions/investment.

Line 5 Total incentivized contributions/investments for a typical year less the amount funded via the credit. For FY 2019-20, the commitment data imply that every $1 in EZP tax credits was associated with $10 in private investment (i.e., the analysis includes the amount of the EZP investment over and above

[16] IMPLAN is an economic input-output model that captures the interrelationships between individual sectors of state and local economies. It incorporates the most recent data published by the U.S. Bureau of Economic Analysis on supply chains and economic multipliers. The model produces static impact estimates because various technical parameters (e.g., relative price levels and migration patterns) are assumed constant.

[17] The amount awarded is not adjusted for sales of the credit because DCED does not track sales separately from transfers. Therefore, the estimate is overstated to the extent that it includes value lost to a purchaser or third-party facilitator when the credit is sold.

what is required to generate the tax credit).[18] However, as noted above, the analysis assumes that only one-half of EZP investment is incentivized by the credit.

Line 6 Sum of lines 4 and 5: total direct spending or the state amount plus the net private amount. The analysis assumes that all direct spending occurs in local communities and remains in Pennsylvania.

Line 7 Line 8 divided by line 6: computed IMPLAN output multiplier.

Line 8 The IMPLAN total output or spending that results from the NAP Tax Credit. Contributions/investments were allocated across seven IMPLAN industry sectors to run a simulation that projects the economic impact of the incentivized funds. Utilizing the results of that simulation, the contributions/investments for FY 2019-20 are assumed to increase total output by $140.8 million. This includes the direct, indirect and induced effects of the spending.[19]

Line 9 Net incremental spending is equal to Line 8 less the total output or spending from the alternative use of state and private funds.[20] To finance the credit, this analysis assumes that state discretionary spending is reduced and those monies would have been spent on education and health care.[21] The alternative use of private funds assumes that one-third of the incentivized private investment would have been spent in the state in the absence of the credit.[22] These economic offsets are also reflected in the next four lines.

Line 10 IMPLAN applies a GDP (also referred to as value added) multiplier to the new Pennsylvania spending (line 6) that results from the NAP Tax Credit. The GDP impact is smaller than total output or spending because it does not double count sales that occur in the supply chain.

Line 11 IMPLAN applies an earnings multiplier to the new Pennsylvania spending that results from the NAP Tax Credit.[23]

Line 12 IMPLAN applies an employment multiplier to the new Pennsylvania spending that results from the NAP Tax Credit. When combined with the earnings impact, the results suggest an average annual wage of roughly $55,000 to $58,000.

Line 13 Tax collections due to the NAP Tax Credit.

Line 14 The gross return on investment (ROI) for the tax credit. The gross ROI is 12 cents for every $1.00 spent. The gross return does not reflect other uses of the tax credit monies. A gross ROI less than 1.0

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[18] For FY 2019-20, committed EZP credits were $7.3 million and anticipated investment was $78.7 million. (See Table 2.2.)

[19] The indirect effect represents the impact from other businesses that supply inputs to NAP projects (i.e., the supply chain). The induced effect represents the impact from employees that spend their wages and business owners that spend higher profits. The analysis assumes that all CFP donations are monetary.

[20] Under the balanced budget requirement, states must reduce spending or raise taxes to fund the tax credit. If the alternative use of the state spending is not incorporated into the analysis, then the net economic impact of the credit will be overstated.

[21] The state spending is reduced by 20 percent to reflect the fact that the portion used to pay state or public school employee compensation includes pension contributions and employer and employee payroll taxes, which do not have immediate implications for the state economy.

[22] Corporations and banks claim a large share of the NAP Tax Credit. If they did not donate those funds, they could use them to raise compensation, advertise, make other investments, pay shareholder dividends, engage in share buybacks or simply retain the funds.

[23] Earnings include employee compensation such as wages and salaries, employer contributions for health insurance and the net earnings of sole proprietorships and partnerships. It excludes personal contributions for social insurance programs (e.g., Social Security) and employee pension plans.

indicates that the tax credit does not "pay for itself." In this case, the gross ROI indicates that a portion of the tax credit is self-financed. (See the Appendix for a discussion of the factors that would allow a tax credit to be self-financed.)

Line 15 The net return on investment (ROI) for the tax credit. The net ROI is 5 cents for every $1.00 spent ($1.7 million in tax collections divided by $34.0 million in tax credits). This figure represents a net positive return, because it deducts the amount of tax revenues that would have been generated if the state funds had been used for other purposes and if one-third of the amount firms donated or invested had been spent in state.

Table 4.1
Net Economic Impact of NAP Tax Credit

	Spending Category or Adjustment	Amount
1	Tax Credits Committed	$36.0
2	Awarded Amount	$34.0
3	Incentivized Share	68.1%
4	Incentivized Tax Credits	$23.1
5	Leveraged Private Contributions	$49.4
6	Total Direct PA Spending	$72.5
7	Multiplier	1.94
8	Total Output or Spending	$140.8
	Net Economic and Revenue Impact[1]	
9	Output or Spending	$52.1
10	Gross Domestic Product	$22.7
11	Labor Earnings	$20.9
12	Full-Time Equivalent Jobs	320
13	Tax Revenues[2]	$1.7
	Return on Investment	
14	Gross Return[3,4]	$0.12
15	Net Return[3,5]	$0.05

Note: Millions of dollars.

1 Net Economic and Revenue Impacts include direct, indirect and induced impacts for the portion of the tax credit that incentivizes activity.

2 Tax revenues reflect state tax revenues only.

3 Gross and Net ROI are cents per tax credit dollar spent.

4 Gross ROI excludes alternative use of tax credit monies.

5 Net ROI reflects alternative use of tax credit monies (see text).

Non-Economic Impacts

In addition to economic development, private investment in projects that serve distressed neighborhoods and communities provides social, environmental and aesthetic benefits for residents. Private investment via NAP Tax Credit projects can improve the quality of life in distressed Pennsylvania neighborhoods that would not otherwise benefit from such investment. A previous review of the Historical Preservation Tax Credit found that many of the benefits from that tax credit were externalities that flowed to other firms, residents and land holdings in the surrounding communities. Similar to that study, this analysis does not attempt to derive a monetary estimate of those benefits.

Section 5: Tax Credit Plan

Act 48 of 2017 directs the IFO to review all tax credits and develop a tax credit plan for credits subject to review. The act states that tax credit plans should include performance metrics for each credit. The act does not specify any other elements of the tax credit plan. For this review, the IFO defined the tax credit plan more broadly to include the following elements: (1) the general findings of the review, (2) specific recommendations, including performance metrics and (3) key decision points for policymakers to consider.

General Findings

For the purpose of this report, the IFO reviewed tax credit studies and spoke with multiple stakeholders, as well as the agencies that administer the tax credit. The following bullet points summarize the main findings of this research:

- Eighteen states offer a program similar to Pennsylvania's NAP Tax Credit and many provide a list of qualified nonprofits on their program websites to assist the taxpayer in ensuring that their contributions are eligible for the credit.
- For FY 2019-20, 231 NAP Tax Credit projects were approved and $33.5 million in credits were committed to offset $67.8 million in anticipated contributions/investments. The analysis finds that the net return on investment (ROI) is 5 cents of state tax revenue for each tax credit dollar. However, that ROI excludes many positive externalities that cannot be quantified accurately in monetary terms.
- Multi-year awards for the NPP component make up the largest share of NAP Tax Credit commitments (roughly 40 percent of the total). Banks and corporations generate roughly 80 percent of credits. Participants in the EZP component make investments two to four times greater than required to generate the committed tax credit.
- Although DCED collects a significant amount of project performance data on the required Community Impact Measures Report, it is difficult to aggregate and measure outcomes due to the wide variety of projects supported by the credit and the diverse measures associated with those projects.
- Stakeholders report that the timing of the tax credit has become problematic in recent years. There is no advance announcement of when the application period will open, and approval decisions are often not transmitted until December. For tax planning purposes, firms generally want to make donation decisions by calendar year end.

Specific Recommendations

Based on these general findings, the IFO submits the following recommendations to enhance the efficiency of the tax credit and improve its ability to achieve its goals and purpose.

DCED should work to standardize the NAP Tax Credit application period and announce commitment decisions earlier in the calendar year.

Stakeholders expressed frustration that decisions on NAP Tax Credit applications sometimes arrive in mid-December or later, making it difficult for potential donors to participate in the program and still take advantage of tax benefits associated with donations made before the calendar year end. A standardized application timeline and earlier announcement of NAP Tax Credit commitments would facilitate business donor/investor participation in the program.

Similar to other states, DCED should consider the creation of an approved project database to facilitate the ability of potential donors to find projects that align with their organizational priorities/mission.

Several states have created a database of approved projects to assist donors in finding projects that meet the criteria of the program (i.e., are eligible for credit) and align with the organizations philanthropic goals. Stakeholder feedback indicated a similar database would be a useful tool for firms wishing to participate in the NAP Tax Credit Program.

DCED/DOR should consider the creation of a tax credit system that would allow recipients to electronically track the status of their tax credit, submit documentation, remit the tax credit claim form to DOR and allow the recipient to elect how the credit should be applied.

Several stakeholders noted that although applications are submitted electronically, there is no way for applicants to electronically check the status of their application or tax credit. In addition, other documentation must be mailed to DCED, the tax credit certificate is then mailed to the donor and the donor sends the claim form to DOR. This process is inefficient and may result in the loss of documents, as well as the application of the credit to an incorrect business unit. Consideration should be given to the creation of an electronic tax credit management system that is accessible to applicants/donors and facilitates the flow of information/documentation between DCED, DOR and the applicant.

DCED should consider more reporting requirements and educational materials for one-year project applicants.

Some stakeholders indicated a preference for the multi-year NPP programs because the extended projects cultivate donor/charity relationships and provide better reporting of outcomes. For one-year projects, donors report that sometimes they receive no recognition or end of project report on the impact of the funds. DCED should consider creating education materials to assist charities applying for one-year NAP Tax Credit projects to facilitate donor relationships.

Key Decision Points

In addition to the specific recommendations above, policymakers should also consider general issues that merit discussion if the NAP Tax Credit is amended. These issues are strategic and will be related to the overall goals and purpose of the tax credit as envisioned by policymakers.

- How do policymakers measure program success? The NAP Tax Credit provides significant incentive (25 to 80 percent of private funding) for investment in distressed neighborhoods and communities. However, funding for such a wide variety of projects makes it difficult to aggregate typical outcome performance measures in a meaningful way. Is the program successful if it simply generates some level of private investment or should other goals/metrics be established?
- Consideration should be given to the funding of a tax credit management system that would facilitate the processing of all Pennsylvania tax credits. A central system could ease the administrative burden on agencies and make the programs more user friendly to participants.
- Currently, there is no cap or limits on administrative expenses for the non-profits that facilitate the donations and direct expenditures into the community. Hence, it is not clear what proportion of the donated funds make it into the target community. Given the size of the tax credit program, policymakers might want some assurance that overhead costs do not absorb a significant portion of state funds.

Conclusion

Act 48 of 2017 requires that the IFO make a determination regarding whether the NAP Tax Credit has achieved its goals and purpose. For this report, the IFO established the goals and purpose as follows:

Goals

- Revitalize distressed areas through community development, educational assistance and job training.
- Encourage private investment in projects that serve distressed neighborhoods and communities.
- Improve living conditions in distressed areas through the construction and restoration of affordable housing sites and the provision of community services (e.g., food, emergency or medical assistance or counseling).

Purpose

- Enhance the safety and quality of life for residents of distressed communities.

Based on existing research, conversations with stakeholders and reasonable assumptions, this review finds that it is likely that the NAP Tax Credit incentivizes private investment in projects that serve distressed neighborhoods and communities. However, the General Assembly should consider the program revisions discussed in the recommendations section of this report to improve outcomes associated with the state spending.

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Appendix

Performance-Based Budgeting and Tax Credit Review Schedule

Year	Performance-Based Budgets					
1	Corrections	Board of Probation and Parole	PA Commission on Crime & Delinquency	Juvenile Court Judges' Commission	Banking and Securities	General Services
2	Economic & Community Development	Human Services – Part 1	Health	Environmental Protection	PA Emergency Management Agency	State
3	PennDOT	Human Services – Part 2	State Police	Military & Veterans Affairs		
4	Education	Human Services – Part 3	Aging	PA Historical & Museum Commission	Agriculture	Labor and Industry
5	Drug and Alcohol Programs	Insurance	Revenue	Executive Offices	Environmental Hearing Board	Conservation and Natural Resources
Year	**Tax Credits**					
1	Film Production	New Jobs	Historic Preservation Incentive			
2	Research and Development	Keystone Innovation Zones	Mobile Telecom and Broadband	Organ and Bone Marrow		
3	Neighborhood Assistance	Resource Enhancement and Protection (REAP)	Entertainment Economic Enhancement Program	Video Game Production	Keystone Special Development Zones	
4	Educational Tax Credits	Coal Refuse and Reclamation	Mixed Use	Community-Based Services		
5	Resource Manufacturing	Brewers'	Computer Data Center	Manufacturing and Investment	Waterfront Development	Rural Jobs and Investment

IFO Independent Fiscal Office

Tax Credit Review Mandate

Act 48 of 2017 is the Performance-Based Budgeting and Tax Credit Efficiency Act. The act requires the Act 48 of 2017 is the Performance-Based Budgeting and Tax Credit Efficiency Act. The act requires the Independent Fiscal Office (IFO) to review tax credits based on a five-year schedule determined jointly by the Secretary of the Budget and the Director of the IFO. The act specifies that the schedule must ensure that tax credits are subject to a review by the IFO at least once every five years. The IFO will submit reviews to the Performance-Based Budgeting (PBB) Board and the Chairs of the House and Senate Finance Committees and make the report available to the public through its website.

The act specifies that reviews shall contain the following content:

- The purpose for which the tax credit was created.
- Whether that tax credit is accomplishing the tax credit's legislative intent.
- Whether the tax credit could be more efficiently implemented through alternative methods.
- Any alternative methods which will make the tax credit more efficient.
- The costs of providing the tax credit, including the administrative costs to the Commonwealth and local government entities within this Commonwealth.

The act also specifies that the IFO shall develop a tax credit plan for all tax credits subject to a review. The plans should include performance measures, and where applicable, the measures should reflect outcome-based measures (including efficiency measures), measures of status improvements of recipient populations, and economic outcomes or performance benchmarks against similar state programs or similar programs of other states or jurisdictions.

Note on Return on Investment

An important metric used by many studies to assess the effectiveness of tax credits is the gross or net return on investment (ROI). The **gross ROI** is the ratio of all new tax revenues generated by the tax credit to the dollar amount of the tax credit. That metric does not consider alternative uses of state funds and is best used to determine the portion of the tax credit that is self-financed (i.e., "pays for itself"). The **net ROI** is a similar ratio, but the numerator deducts the tax revenues that would have been generated if the state funds had been used for a different purpose such as local education, road repairs or tax cuts. The gross and net ROI are useful metrics, but they are limited because the ultimate objective of most tax credits is to generate economic activity and jobs that would not otherwise exist, as opposed to generating a net profit for the state.

If a tax credit was fully self-financed or paid for itself, two strong conditions must generally hold. First, nearly all of the activity undertaken by firms that receive the credit must have been motivated by the credit and not other factors. That is, the tax credit must be the factor that tips the decision of a firm to locate or expand in the state. Second, the economic activity induced by the tax credit must generate sufficient new tax liability (through direct, indirect and induced effects) to offset the entire tax credit.

For example, assume that a new firm locates in a state and would not have done so without the tax credit. The firm qualifies for a $1 million tax credit, and all new activity attributable to the tax credit generates $500,000 of tax revenue, either from the firm and its employees or from others (firms in the supply chain, other secondary effects). The firm sells the residual tax credit that it cannot use to another firm that can use it. The net cost to the state of the new economic activity is then $500,000. Hence, even if it were true that all firms receiving a tax credit were fully incentivized by the credit and the new activity would not have otherwise occurred, they must still also generate or cause sufficient new tax liability (both directly and indirectly through supplier firms and induced spending by households) to offset the tax credit. If they do not, then there is a net cost to the state.

An illustrative computation demonstrates the amount of new activity that would need to be generated for a tax credit to be self-financed. In general, personal income tax and sales taxes are by far the main state taxes that will increase to offset the cost of a tax credit. Assume a $1 million tax credit that had an equal impact on both taxes in terms of new revenue. In order for the tax credit to be self-financed:

- Labor earnings would need to increase by $500,000 / 3.07% = $16.3 million if all earnings were subject to Pennsylvania personal income tax. An average wage of $55,000 implies 296 new full-time employees.
- Total purchases (sales or output) would need to increase by ($500,000 / 30%) / 6.0% = $27.8 million if 30 percent of any new spending was subject to state sales tax.[24] The computation may or may not include any "first round" spending by the firm that qualifies for the tax credit. Typically, most expenses that qualify for a credit are for labor or are not subject to state sales tax (i.e., various services, contractors).

[24] The 30 percent assumption is an average spend on goods and services subject to state sales tax based on data from the U.S. Bureau of Labor Statistics Consumer Expenditure Survey. The computation is based on consumer spending patterns, and the actual percentage could be different than 30 percent.

Sources

"2015 Income Tax Credit Review," Arizona Joint Legislative Budget Committee (December 2015).

"Assessment of the West Virginia Neighborhood Investment Program," Terrell Ellis & Associates (2014).

"Neighborhood Assistance Program Enterprise Zone Program Tax Credit Guidelines," Pennsylvania Department of Community and Economic Development (March 2021).

"Neighborhood Assistance Program Guidelines," Pennsylvania Department of Community and Economic Development (March 2021).

Stakeholder Feedback

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November 24, 2020

Michaela A. Bowers
Independent Fiscal Office
Rachel Carson State Office Building
400 Market Street
Harrisburg, PA 17105

Dear Ms. Bowers:

I am writing on behalf of UPMC Health Plan in response to the conversation we had on November 13, 2020, regarding the Independent Fiscal Office's evaluation of the Neighborhood Assistance Program (NAP).

UPMC Health Plan has participated in the NAP since 2006. We began by supporting a single nonprofit organization located in Pittsburgh but our participation in the NAP has grown exponentially and annually since then. Over the past 15 years, we've become one of the largest corporate funders of this valuable program by investing tens of millions of dollars in hundreds of nonprofit organizations across the Commonwealth.

The tax credits awarded to UPMC Health Plan through the NAP enable us to support a larger number of organizations at a higher dollar amount than we can through our standard charitable giving. Additionally, NAP focus areas strongly align with our community relations priorities and our mission to address social determinants of health for all who live in the communities we serve. This program has allowed UPMC Health Plan to forge stronger relationships with nonprofit organizations and spearhead collaborative efforts that improve access to health and human services. Most of the projects we support are focused on improving community-based facilities, distributing fresh food to families who live in food deserts, creating affordable housing in low-income areas, business district beautification, and workforce/education initiatives for unemployed and underemployed individuals.

UPMC Health Plan is grateful to the Pennsylvania Department of Community and Economic Development for its oversight of this program and its continued encouragement of businesses to invest in their local communities. We view the NAP as an important part of our overall community relations strategy, and we believe it is a win-win for both the industry and nonprofit sectors.

Sincerely,

Scott M. Lammie

Scott M. Lammie
Senior Vice President, Business Development, UPMC Health Plan
Treasurer, UPMC Insurance Services Division