

Legislative Budget and Finance Committee

Final Report on Pennsylvania's Tax Credit Programs

Report Presentation by Elizabeth Voras at September 28, 2010, Meeting

Good morning. Senate Resolution 20 and a companion resolution, House Resolution 127, both of 2009, directed the Legislative Budget and Finance Committee to study the impact and effectiveness of 18 of Pennsylvania's tax credit programs. We previously released reports on the Keystone Opportunity Zone, the Keystone Innovation Zone, and the Film Production Tax Credit programs, as well as preliminary reports on the Educational Improvement Tax Credit and the Research and Development Tax Credit. The final report being discussed today covers the 15 tax credit programs for which final reports have not yet been issued.

The tax credit programs we studied as a result of these resolutions varied widely in what they are trying to achieve and how they are administered. Although it was possible in some ways to compare and contrast them, each program is distinct in many ways and required a separately performed analysis. In terms of sheer size, the programs ranged in annual award amounts from a low of \$3,500 total to a high of \$75 million. We also found that some programs, such as the Homeowners' Emergency Mortgage Assistance Tax Credit and the First Class Cities Economic Development District Tax Credit, are essentially defunct and made no awards.

As result of Act 48 of 2009, passed in response to last year's budget problems, all of the tax credit programs with finite limits saw major reductions in the amount of credits they were authorized to award, with several essentially being cut in half for both FYs 2009-10 and 2010-11. Barring further legislative action, these programs will return to their pre-Act 48 levels beginning in FY 2011-12. Act 48 did not, however, apply to those programs, such as the Keystone Opportunity Zone, that do not have finite annual caps.

Some of the tax credit programs we reviewed have had three participants since their inception; others have thousands of participants every year. Some of the tax credit programs are narrowly focused in their objectives, and others are broad-based. Several programs have an application process with a significant amount of administrative rigor, while in others the application process can best be described as minimal. Some are similar to, or work in tandem with, federal tax credit programs and other state programs, while others are stand alone programs or are unique to Pennsylvania.

In terms of tax revenues affected and participation rates, the four largest programs included in this report are the Educational Improvement Tax Credit, the Research and Development Tax Credit, the Job Creation Tax Credit, and the Neighborhood Assistance Program Tax Credit. A complete table of credit amounts

authorized, awarded, and utilized for the most recent fiscal years can be found in the report at Page S-13.

Over the course of the study it became clear that there were a number of statutory provisions that varied from program to program. Some of the elements we compared are: whether the program has mandated reporting requirements, statutorily defined goals and objectives, and claw back provisions and whether the tax credit is sellable, assignable, or transferable. We also found that in some programs the amount of tax credits that can be authorized is subject to an annual cap while others are unlimited, and that some programs have a finite life and must be reauthorized at some point (sunset), while others continue indefinitely. A complete list of these elements and the results of these comparisons can be found on page S-11 of the report.

Although we respect the intricacies of the programs that may bring about such variations, we believe there would be benefits to be gained if there was more legal and administrative consistency across certain aspects of the various tax credit programs. This is particularly true with regard to such issues as mandated reporting requirements, measureable goals and objectives, and statutory caps on how many credits can be issued in any given year.

As we reviewed all 15 of the programs, it became clear that there were themes or “overarching” issues, as we called them, that we thought could be useful as the General Assembly considers the future of these tax credit programs. Therefore, the final report contains both individual findings and recommendations for the specific programs and several overall findings and recommendations. In the interest of time, I will not review all the individual findings and recommendations for each program included in the report, although each have specific issues that could be addressed, in our opinion, to make them better programs. I would like to note, however, that in several instances the administrators responsible have already made improvements to their programs due to the results of our efforts. This is especially true with regard to the Educational Improvement Tax Credit program, with suggested changes made by DCED to the program guidelines, and the Research and Development Tax Credit program, with suggested changes made by the Department of Revenue to the R&D application to help ensure that credits will only be issued for research conducted in Pennsylvania.

The overall findings and recommendations, not in any particular order of importance, are the following: first, while some tax credit programs are utilized up to, or nearly up to, their authorized limits, others have authorized limits that far exceed their historical utilization rates. We recommend that the General Assembly may wish to consider reducing or terminating those tax credit programs with historically low utilization rates.

Secondly, the ability for anyone other than the Department of Revenue to fully assess the effectiveness of several tax credit programs is limited due to the confidentiality provision of the Commonwealth's fiscal code regarding tax filings, which only allows the Department of Revenue to share tax information "for official purposes." Since our review was not deemed to fall under the definition of an official purpose, we were limited in our ability to review internal controls, determine program costs, and even contact program recipients. We did not, however, have these types of restrictions for the tax credit programs that had a statutorily created reporting requirement. Our recommendation is that the General Assembly include a mandated reporting requirement, similar to the requirement in the Research and Development Tax Credit statute, in any new or reauthorizing legislation pertaining to a tax credit program, thereby promoting program transparency and accountability.

Our third overall finding deals with the lack of administrative efficiency in several of the programs we reviewed. In particular, we found that, especially at DCED, the files and communications with participants were often paper-based. Filing and otherwise managing all this paper makes it difficult to administer and monitor the programs for both the Commonwealth and program participants. We recommend that agencies that have not yet converted their tax credit programs to a computer-based communications and record-keeping system begin to do so.

We also found that, for many tax credit programs, little is being done to monitor or verify program results. DCED, for example, had established a program monitoring unit, but it has now been disbanded. While we recognize the budget constraints facing all agencies, it is difficult to justify continuing a program if reasonable efforts are not made to ensure that statutory requirements are being met and that the program is achieving meaningful results. So we recommend DCED re-staff its program monitoring unit and that it and the other administering agencies monitor the tax credit programs with the same level of scrutiny as programs that receive direct appropriations.

As I mentioned earlier, many of the tax credit programs we examined did not have clear goals or objectives, either in statute or in program guidelines. And even when the goals of the program can be identified, program elements and quantitative measures to assess how well these goals are being met have not, for the most part, been developed by the administering agencies. We recommend that when the General Assembly creates or reauthorizes a tax credit program, it attempt to articulate the program's goals, objectives, program elements, and the measures against which the program's effectiveness can be judged.

Finally, we found that, for a variety of reasons, tax credit programs do not appear to get the same level of scrutiny as programs that make direct expenditures. Although tax credit tax programs can have a significant impact on Commonwealth tax revenues and can result in millions of dollars of tax benefits to individual

companies, they do not require an annual appropriation, and therefore may go relatively unscrutinized for years at a time. The report contains several recommendations that we believe would facilitate greater legislative and public understanding and scrutiny of tax credit programs, including reporting actual utilized, rather than estimated, figures in the Governor's Executive Budget document and not allowing unused tax credits that are authorized in one year to be issued in subsequent years unless specifically authorized in statute. Finally, we recommend that the Department of Revenue work with the various administering agencies to annually reconcile the amount of tax credits awarded and utilized so that everyone is working with the same set of numbers.

I would be remiss if I did not acknowledge the excellent assistance provided by the myriad of staff persons, at all of the executive branch departments involved, and the many interested persons, organizations, and program participants who provided the needed data and helped us understand the nuances of these programs.

Thank you.