Legislative Budget and Finance Committee

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Pennsylvania's Tax Credit Programs

Conducted Pursuant to
Senate Resolution 2009-20 and House Resolution 2009-127

June 2010

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Summary and Recommendations

Below are brief synopses of the individual tax credit programs we reviewed in this study undertaken as a result of the passage of Senate Resolution 2009-20 and House Resolution 2009-127. They are followed by overall findings and recommendations based on commonalities noted among programs. See the chart beginning on page S-11 for a comparison of various elements across the tax credit programs studied. Full program details and findings for the individual programs reviewed can be found in their respective reports beginning on page 4.

Call Center Tax Credit

The Call Center Tax Credit was created in 2003 and is administered by the Department of Revenue. Between 2005 and 2009, $6.4 million in tax credits (out of the $30 million available annually) were approved and awarded to 51 call centers applying for the credit. The number of applications for the tax credit, however, has dropped from 43 in FY 2004-05 to only 20 in FY 2008-09. The Department of Revenue did not know definitively why the number of applications has decreased, but believes one reason might be that some telecommunications companies may not be providing the required information to the call centers, making it difficult or impossible for the call centers to claim the credit. Because the department would not supply us with the names of the call centers (see Recommendation 2), we were limited in our ability to pursue why this decline has occurred or how many jobs may have been created or retained as a result of the credit.

We contacted four call centers, and while three indicated the call center credit was valuable to their company, the fourth told us that they had not filed for the credit in the last two years because the amount of the tax credit was not worth the required paperwork. We also note that Pennsylvania appears to be the only state that has enacted a tax credit program for call centers.

Coal Waste Removal and Ultraclean Fuels Tax Credit

The Coal Waste Removal and Ultraclean Fuels Tax Credit was enacted in 1999 and is available for certain capital expenditures for companies that produce synthetic fuels from coal, culm, or silt. The credit is capped at $18 million per year, and expenditures must be made by January 1, 2013. To date, no eligible developer has applied for, or claimed, this tax credit. We did, however, speak to officials at one company who told us they are pursuing building an eligible project and intend to begin utilizing the credit in FY 2010-11.

Educational Improvement Tax Credit for Scholarship Organizations

The Educational Improvement Tax Credit (EITC) was created in 2001 and is administered by the Department of Community and Economic Development. Under this program, companies can receive tax credits of up to 90 percent of the donations they make to a non-profit scholarship or educational improvement organization.[1] The EITC had been capped at $75 million; Act 2009-48 reduced the cap to $60 million for FY 2009-10 and $50 million for FY 2010-11.

Since the program's inception, a total of 3,854 individual companies have earned tax credits due to their contributions to approved EITC organizations. In FY 2009-10, 2,959 contributions, totaling $40.34 million, were made to approved Scholarship Organizations; 671 contributions, totaling $6.67 million, to Pre-K Scholarship Organizations; and 2,248 contributions, totaling $16.90 million, to Educational Improvement Organizations. Since the program's inception, there have been approximately 314,000 scholarships issued and 544 EIOs created. We found that most scholarships are being awarded to low-income families; the average annual income for families participating in the program is $29,000. The statutory maximum is $50,000, which rises to $60,000 in FY 2011-12.

The Department of Community and Economic Development has implemented several of the recommendations we made in our June 2009 Preliminary Report on this program. The final report contains several additional recommendations for program improvements, including issues related to the definition of an EIO program, modifying the amount of contributions retained for overhead, and the creation of a program advisory committee.

Employment Incentive Tax Credit

The Employment Incentive Tax Credit program was enacted in 1982 to encourage employers to hire job seekers who have received General Assistance or Temporary Assistance to Needy Families or who receive rehabilitative services through the Office of Vocational Rehabilitation. By statute, the program expired at the end of CY 2009.

Although the program had a statutory cap of $25 million, there was low utilization of the tax credit, averaging under $2 million per year. This may be due to several reasons, including that job applicants may be reluctant to inform prospective employers of their prior history as a General Assistance or TANF recipient, employees fail to complete the required year-long retention period, or employers forget to claim the credit. We note that the federal government also gives employers a tax credit for hiring people with certain barriers to employment, including disabled persons and former TANF recipients.

[1] Up to 100 percent if the first $10,000 of the donation is to a pre-kindergarten scholarship organization.

The report contains several suggestions for program changes that should be considered if the program is reauthorized by the General Assembly.

First Class Cities Economic Development District Tax Credit

The First Class Cities Economic Development District Tax Credit, which was enacted in 2004, was never implemented because the City of Philadelphia did not create the required economic development district. As the economic development district had to be designated by July 15, 2005, it appears this credit will not be used.

Homeowners' Emergency Mortgage Assistance Program

Although listed in the Governor's 2007-08 Executive Budget, this tax credit program, which allowed businesses to receive up to a 70 percent tax credit for contributions to the HEMAP fund, was repealed by Act 1998-160. According to a Pennsylvania Housing Finance Authority official to whom we spoke, while in existence, the credit was only utilized once.

Job Creation Tax Credit

Act 1996-67 created the Job Creation Tax Credit program, which is administered by the Department of Community and Economic Development. Businesses that create qualified jobs (jobs must pay at least 150 percent of the federal minimum wage) qualify for a tax credit of $1,000 per new job created. Until Act 2009-48, JCTC had been capped at $22.5 million annually, although actual utilization has been significantly below that amount (e.g., $13.3 million in FY 2007-08). Under Act 2009-48, the JCTC program is capped at $11.3 million for FY 2009-10 and $10.1 million for FY 2010-11.

Although DCED reported the JCTC program created 60,080 jobs from 2003 through 2006, we could not verify the jobs created figures reported by DCED. This is in part because the necessary documentation was often missing from the files and in part because, based on our review of a sample of files, the information appears to be entirely self-reported. We also had difficulty verifying if the minimum wage requirements were being met, again in part because the required documentation was missing and in part because the instructions for how to report wage information have been subject to varying interpretations.

The report contains several recommendations regarding efforts the department should undertake to help ensure that program requirements are being met and that reliable information is obtained on program outcome measures.

Limited (Malt Beverage) Tax Credit

The Limited (Malt Beverage) Tax Credit was authorized in 1974 and granted tax credits for capital improvements made by small brewers for an "emergency period." The original period for the credit ended in December 1976, but was subsequently extended to December 31, 2008, at which point the tax credit expired. In CY 2008, the last year the tax credit was available, 32 breweries were awarded a total of $1.6 million in tax credits. Although the price of hops increased dramatically in 2007 and 2008, leading some to advocate for re-establishing the credit, prices have since fluctuated downward. We also note that small "craft" brewers saw significant growth in 2009 (almost 9 percent nationally), which suggests that continuing the program may not be necessary.

Neighborhood Assistance Program

The Neighborhood Assistance Program (NAP) was established in 1967 and is administered by the Department of Community and Economic Development. The credit is available to companies that engage in certain assistance programs in impoverished areas or that contribute to neighborhood organizations that provide such activities. In FY 2007-08, DCED received applications for $35 million in tax credits, but the program was capped at $18 million. By FY 2009-10, the amount of credits requested had increased to $57 million, but due to budget concerns, Act 2009-48 reduced the cap to $9 million for FY 2009-10 and to $8.1 million for FY 2010-11.

As a result of these cutbacks, DCED reports it has given priority to those projects where businesses are willing to make substantial long-term contributions for five years or longer or that are tied to substantial job creation. This direction is of concern to some neighborhood organizations, such as food banks, which have in the past received NAP funding, but do not create jobs and have historically had difficulty obtaining long-term commitments from businesses.

We found that DCED uses a rather rigorous process to review applications and make awards, but has done relatively little to systematically assess actual program outcomes. The department has taken steps to better obtain quantifiable data by requiring approved organizations to file a new monitoring report beginning in FY 2010-11. This should allow the department to better track the success of individual organizations in meeting their outcome commitments.

Organ and Bone Marrow Donor Tax Credit

The Organ and Bone Marrow Donor Tax Credit was created in 2006 and is administered by the Department of Revenue. Businesses providing paid leaves of absences to employees for the specific purpose of organ or bone marrow donation can qualify for a tax credit. Since the act was passed, only three companies have applied for tax credits, and all three were approved. The combined amount of tax credits approved for these companies totaled $3,505. The Organ and Bone Marrow Donor Tax Credit program has not been well advertized, which may explain its low utilization. The program will end on December 31, 2010, unless reauthorized by the General Assembly.

Pennsylvania Insurance Guaranty Association Tax Credits

In 1978, the Legislature created the Life and Health Insurance Guaranty Association Tax Credit, and in 2000 created the Property and Casualty Insurance Guaranty Association Tax Credit. Should an insolvency occur, the Guaranty Associations issue assessments to their members, collect the fees, and make the necessary payments to the affected policyholders. The tax credit programs allow the insurers to recoup the assessment fee over a five-year period.[2] Insurers are statutorily prohibited from simultaneously claiming the credit and raising premiums to cover the assessment fee.

In recent years, only about $3,000 has been issued in life and health insurance tax credits; property and casualty tax credits are more significant, ranging from $26.7 million in FY 2005-06 to $4.7 million in FY 2008-09. Although all but six states provide for some form of a life and health insurance tax credit, only about half the states (21) provide for a property and casualty tax credit.

Research and Development Tax Credit

In 1997, Pennsylvania began offering tax credits to businesses that increase their research and development expenditures within the Commonwealth, 20 percent of which are set aside for small businesses. Businesses that have no tax liability can sell their unused tax credits.

Until recently, the R&D program, which is administered by the Department of Revenue, was capped at $40 million. Act 2009-48 reduced the maximum amount of tax credits available for several tax credit programs, including the R&D program. For fiscal year 2009-10, the R&D program's maximum amount of tax credits allowed was reduced by 50 percent, to a total of $20 million, and for fiscal year 2010-11, the total amount of credit allowed was reduced further, to $18 million.

The Department of Revenue has made several administrative changes in response to the recommendations in our June 2009 Preliminary Report. The final report makes several further recommendations, including additional steps to take to help ensure that credits are only awarded to companies with qualified research expenses.

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[2] The Property and Casualty credit only applies to amounts exceeding 1 percent of their net direct premiums written, with certain adjustments.

Resource Enhancement and Protection Program (REAP)

The Resource Enhancement and Protection Program (REAP), administered by the State Conservation Commission within the Department of Agriculture, was established in 2007 to encourage farmers to implement best management practices (BMPs)[3] in their agricultural operations. For the first two years of the program, credits were capped at $10 million; Act 2009-48 cut the available credits to $5 million for FY 2009-10.

The most frequently implemented BMP, no-till equipment, accounted for almost half of the available credits. Other frequently implemented BMPs include storage waste facilities, heavy use area protection, nutrient management plans, manure transfer, and roof runoff structures. The Department of Agriculture reports that in FY 2007-08 the REAP program was responsible for an estimated reduction of 162,176 pounds of nitrogen, 14,938 pounds of phosphorus, and 18,211 tons of sediment. The report contains several recommendations regarding the selection of projects, the one-year waiting period for selling tax credits, and other operational issues.

Strategic Development Areas

Act 2006-151 authorized the Governor to designate four areas in the Commonwealth as Strategic Development Areas (SDAs). The SDA program was modeled after the Keystone Opportunity Zone program and, with the approval of the local governments, provides virtually tax-free benefits to businesses located in the designated area for a 15-year period. Approved businesses must, within the first three years of full operation, commit to creating or maintaining a minimum of 500 jobs or invest a minimum of $45 million in capital investment in the business located in the SDA.

As of December 2009, the Philadelphia SDA reported having retained 100 jobs with capital investments of $592,917; the Westmoreland SDA reported having retained 675 jobs and created 96 jobs with capital investments of $25 million; and the Butler County SDA reported having not yet created or retained any jobs, but having made capital investments of $212 million. The fourth SDA (in Lehigh County) is not yet operational. According to the Department of Revenue, to date, the SDAs have claimed only $402 in SDA tax credits for state taxes. Forgone taxes at the local level are significantly higher, at $3.4 million in CY 2009 and an estimated $5.7 million in CY 2010.

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[3] Qualifying BMPs are those that are defined as practices determined by the Commission or US Department of Agriculture's Natural Resources and Conservation Service to be effective and practical, considering technological, economic, and institutional factors to manage nutrients and sediment to protect surface water and groundwater. The phrase includes the purchase and utilization of no till equipment.

Overall Findings and Recommendations

Recommendations on individual programs can be found in the individual report sections. We also noted several findings and recommendations that apply to the tax credit programs generally, as follows:

1. ***Although $344 million in tax credits were authorized in 2008-09, the tax credit amounts utilized are often far less than the amounts authorized in legislation.*** Although some tax credit programs are utilized up to, or nearly up to, their authorized limits, often the programs have authorized limits that far exceed their historical utilization rates (see the chart on page S-13). Examples include the Coal Waste Removal and Ultraclean Fuels Tax Credit, Employment Incentive Tax Credit, and the Call Center Tax Credit. Others have either expired (Malt Beverage Tax Credit and the Homeowners' Emergency Mortgage Assistance Tax Credit) or will soon expire with little or no utilization (First Class Cities Economic Development District Tax Credit and the Organ and Bone Marrow Donor Tax Credit). **Recommendation:** ***The General Assembly may wish to consider reducing or terminating those tax credit programs with historically low utilization rates.***

2. ***It was not possible to assess several tax credit programs due to the Department of Revenue's interpretation of the confidentiality requirements of the Commonwealth's Fiscal Code.*** The Commonwealth's Fiscal Code (72 P.S. §731) provides that the tax information collected by the Department of Revenue shall be confidential "except for official purposes." The Department of Revenue did not consider this review to be an official purpose, and therefore denied us access to virtually all specific individual information for several tax credit programs (Call Center, SDAs, and KOZs) because they deemed that the information was collected as a part of a tax filing. In contrast, the Department of Revenue did provide us with the information we requested for those programs that had a mandated reporting requirement (see the chart beginning on page S-11). **Recommendation:** ***We recommend that the General Assembly include a mandated reporting requirement that supersedes the confidentiality provision, such as is provided for in the Research and Development Tax Credit and the REAP programs, in any new or reauthorizing legislation pertaining to a tax credit program. This would ensure that these programs are able to receive the same level of legislative scrutiny as programs that receive direct appropriations.***

3. ***Agencies' files are largely paper files, which makes it difficult to administer and monitor the programs not only for Commonwealth agencies,***

but program participants as well. Our review of program files, particularly those at DCED, was often difficult and time-consuming because most of the programs we reviewed still use paper-based files and communications. Many of these programs have elements that require communications between program participants and the administering agencies several times throughout the program year. While investing in an electronic information management system involves significant up-front costs, over the long term such a system should pay for itself in greater efficiencies, such as being able to automatically generate letters when key documents (such as the annual job credit employment affidavits required by the Job Creation Tax Credit program) are not received in a timely manner. Such a system should also help free agency staff from routine clerical activities to better focus on important follow-up monitoring activities (see below). **Recommendation:** ***We recommend that agencies that have not yet converted their tax credit programs to a computer-based record-keeping system, undertake the process of doing so.***

4. ***Little is being done to monitor or verify program results.*** DCED had established a program monitoring unit, but it has been disbanded. Job creation and retention data, to the extent it is available at all, is typically self-reported, and we could find no evidence in the files we reviewed that DCED had made any effort to independently verify this information. In some programs, follow-up reports are submitted by program participants, but the information provided is either not reviewed or not utilized to monitor program performance (EITC, NAP, JCTC, and EIP). We have similar concerns with the monitoring and verification efforts in the Department of Revenue (R&D) and, in the long term, the Department of Agriculture's REAP program (on average, REAP-funded projects are supposed to remain functioning for about eight years). In several programs, we also found instances of a consequential lack of coordination and communication between the administering agencies and the Department of Revenue (the Insurance Guarantee Tax Credit programs, Employment Incentive Tax Credit, and JCTC).

   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 provisions are being met, program participants are complying with program requirements, and the programs are achieving meaningful results. Monitoring is also important if the programs are to invoke clawback provisions, which are included in some, but not all, of the tax credit programs we reviewed (see the chart beginning on page S-11). **Recommendations:** ***We recommend that DCED re-staff its monitoring unit and that the other administering agencies monitor the tax credit programs with the same level of scrutiny as programs with direct***

expenditures. We also recommend that all departments involved in the tax credit programs communicate on a regular basis with the Department of Revenue so that issues can be adequately discussed and addressed.

5. ***Most tax credit programs do not have clearly defined goals and objectives.*** To be fair to the executive branch agencies, it is difficult to monitor program results if the enabling legislation is not clear on the goals and objectives the program is to achieve. Even when the inherent goals and objectives of a tax credit program can be reasonably assumed, program elements that would measure how well these goals are being met have not, for the most part, been developed by the administering agencies. **Recommendations:** ***We recommend that when the General Assembly creates (or reauthorizes) a tax credit program, it attempt to articulate the program's goals and objectives and, if possible, identify program measures against which the program's success can be judged. We also recommend that, for those programs that do have measurable goals and objectives, data should be collected and evaluated and used to improve program performance.***

6. ***Tax credit programs do not appear to get the same level of scrutiny as programs that receive appropriations.*** Although tax credit 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. We also found that it was often difficult to determine how much tax revenue was actually being forgone through tax credit programs. Unlike for programs that spend money through an appropriation, the Governor's Executive Budget does not report actual amounts of tax credits utilized, only estimates. In some cases, these estimates vary widely from the actual amounts utilized.(See chart on page S-13).

   Some programs allow credits to be used and/or carried forward for five or more years after they are awarded, which contributes to the difficulty in assessing the actual cost of these programs. In addition, unlike most appropriations which lapse back to the General Fund if not expended, it is difficult to determine whether unawarded credits from one fiscal year are carried forward and awarded in subsequent years. This practice appears to vary from one tax credit program to another, and there does not appear, in most programs, to be a systematic reconciling of the books between the Department of Revenue and the administering agency. Awarding unused credits from one year in a subsequent fiscal year is statutorily authorized in only one of the tax credit programs, the Job Creation Tax Credit program. This relative lack of scrutiny and rigor may also contribute to some of the questionable interpretations we found of certain statutory requirements in, for example, the Educational Improvement Tax Credit and the Job Creation Tax Credit programs. **Recommendations:** ***We recommend that the Governors Executive Budget document report the utilized figures (for the year in which actual figures are presented for appropriations) for the tax credit programs, rather than estimates. We also recommend that, unless specifically authorized in statute, tax credit issuances be limited annually to their respective authorized amounts, if applicable. 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.***

7. ***Agencies are interpreting Act 2009-48 (which provides for cuts to several tax credit programs) differently.*** Act 2009-48 reduces the amount of credits available to most of the tax credit programs to 50 percent of the amount awarded in FY 2008-09 and, for FY 2010-11, to 45 percent of the amount eligible to be awarded in 2008-09. The act also states that the "award to each eligible taxpayer shall be determined such that the total amount available for award shall be 50 percent of the amounts otherwise available for award." The Department of Revenue has interpreted this language to mean that, for FY 2009-10, each individual taxpayer is to receive only half of what they would otherwise be eligible to receive. The Department of Community and Economic Development, however, has interpreted the language as applying to the overall limit, so that some program participants may receive most or all of the credits they are eligible to receive, while others may receive relatively few or no credits. In yet a third scenario, the administrator for the Department of Agriculture's REAP program asked for guidance from the Governor's policy office and received permission to award most or all of the credit to some participants, while awarding relatively few or no credits to other participants. **Recommendation:** ***The General Assembly may wish to clarify the provision of Act 2009-48 that states that the "award to each eligible taxpayer shall be determined such that the total amount available for award shall be 50 percent of the amounts otherwise available for award" to ensure consistency in the application of the provision across the tax credit programs.***

Pennsylvania Tax Credit Programs

Tax Credit Programs	Reporting Requirements[a]	Capped	Clawback Provision	Sellable	Assignable/ Transferable	Measureable Goals & Objectives	Finite Life to Tax Credit	Unused Credit Reissued After Fiscal Year
Call Center Tax Credit -DOR	No	Yes	No	No	No	No	No	No
Coal Waste Removal and Ultraclean Fuels Tax Credit DOR	No	Yes	Yes	Yes	Yes	No	Yes 1/1/2013	No
Educational Improvement Tax Credit – DCED	No	Yes	No	No	No	No	No	No
Emergency Tax Credit (malt and brewed beverages - DOR)	Yes Annual	Yes	No	No	No	No	Yes 12/31/2008	No
Employment Incentive Payments Tax Credit – L&I/DPW	Yes Only two specified by statute.	Yes	No	No	No	No	Yes 12/31/2009[b]	Yes
Film Production Tax Credit	Yes	Yes	Yes	Yes	Yes	No	Yes	No
First Class Cities Economic Development District Tax Credit – DCED	No	No	No	No	No	No	c/	No
Homeowner's Emergency Mortgage Assistance Fund Tax Credit – PHFA	No	Yes	No	No	No	No	d/	No
Job Creation Tax Credit - DCED-	No	Yes	Yes	No	No Unless assigned to an affiliated entity.	No	No	Yes
Keystone Innovation Zone Tax Credit	Yes	No	Yes	No	No	No	Yes	Not Applicable
Keystone Opportunity Zone Tax Credit	Yes	No	Yes	No	No	No	Yes	Not Applicable
Life and Health Insurance Guaranty Association Tax Credit - Department of Insurance	No	No	Yes	No	No	No	No	No

Pennsylvania Tax Credit Programs (Continued)

Tax Credit Programs	Reporting Requirements	Capped	Clawback Provision	Sellable	Transferable	Measureable Goals & Objectives	Finite Life to Tax Credit	Unused Credit Reissued After Fiscal Year
Neighborhood Assistance Program Tax Credit – DCED	Yes Annual	Yes	Yes[e]	Yes	Yes	Yes	No	No
Organ and Bone Marrow Donor Tax Credit – DOR	Yes Annual	No	No	No	No	Yes	Yes 12/31/2010	No
Property and Causality Guaranty Association Tax Credit – Department of Insurance	No	No	Yes	No	No	No	No	No
Research and Development Tax Credit – DOR	Yes Annual	Yes	Yes	Yes	Yes	Yes	Yes 12/31/2015	No
Resource Enhancement and Protection Tax Credit[a] – PDA	Yes Annual	Yes	Yes	Yes	Yes	Yes	No	No
Strategic Development Areas Tax Credit – DCED	No	No	Yes	No	No	No	Yes 12/31/2022	No

[a]Reporting requirements as required to the General Assembly.

[b]Eligible employees must have been hired by December 31, 2009.

[c]The tax credit was never activated. If the program had been implemented, it would not extend beyond December 31, 2018.

[d]Tax credit was repealed by Act 1998-160.

[e]Nonprofit awarded tax credits are to inform DCED if they are unable to obtain sufficient certification from businesses. The Department reallocates any returned tax credits to the other approved programs.

Source: Information was provided to the LB&FC by the Department of Revenue and the Department of Community and Economic Development. Additional information, in some cases, was obtained from the Governor's Executive Budget documents.

Tax Credit Data by Fiscal Year [1/]

$ Millions

Reduced utilization in recent fiscal years should not be construed to represent lesser activity with the tax credit program. It is more likely a representation of the amount of time it takes to officially reconcile a tax account, in particular corporation tax accounts.

	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Neighborhood Assistance/Enterprise Zone Program [2/]						
Cap	18.0	18.0	18.0	18.0	18.0	9.0
Awarded	13.7	13.5	16.4	17.7	17.7	8.5
Utilized	8.7	9.1	10.3	14.5	14.4	1.7
Employment Incentive Payment Program [3/]						
Cap	25.0	25.0	25.0	25.0	25.0	12.5
Awarded	2.6	2.8	3.0	1.8	0.7	0.1
Utilized	2.6	2.8	3.0	1.8	0.7	0.1
Job Creation Tax Credit [4/]						
Cap	22.5	22.5	22.5	22.5	22.5	11.3
Awarded	22.5	22.5	22.5	20.0	20.4	11.3
Utilized	5.7	11.5	17.6	13.3	8.5	0.3
Research & Development [5/]						
Cap	30.0	30.0	40.0	40.0	40.0	20.0
Awarded	30.0	30.0	40.0	40.0	40.0	20.0
Utilized	47.9	9.7	38.0	39.8	40.0	19.8
Educational Improvement [6/]						
Cap	45.0	49.0	61.0	75.0	75.0	60.0
Awarded	40.8	48.1	59.0	72.8	75.0	59.7
Utilized	38.9	45.7	54.7	61.1	67.0	51.2
Keystone Innovation Zones [7/]						
Cap	NA	NA	25.0	25.0	25.0	25.0
Awarded	NA	NA	5.5	7.3	9.6	12.9
Utilized	NA	NA	4.5	6.1	10.2	13.3
Resource Enhancement and Protection [8/]						
Cap	NA	NA	NA	10.0	10.0	5.0
Awarded	NA	NA	NA	3.2	9.1	4.8
Utilized	NA	NA	NA	0.6	3.2	1.8
Film Production [9/]						
Cap	NA	NA	NA	75.0	75.0	42.0
Awarded	NA	NA	NA	74.9	57.5	0.0
Utilized	NA	NA	NA	56.7	45.5	Nominal
Organ and Bone Marrow Donor						
Cap	NA	NA	-	-	-	-
Awarded	NA	NA	Nominal	0.0	Nominal	0.0
Utilized	NA	NA	Nominal	Nominal	Nominal	Nominal
Keystone Opportunity Zone [10/]						
Cap	-	-	-	-	-	-
Awarded	21.6	40.2	58.3	43.0	77.8	1.7
Utilized	21.6	40.2	58.3	43.0	77.8	1.7
Coal Waste Removal and Ultraclean Fuels [11/]						
Cap	18.0	18.0	18.0	18.0	18.0	18.0
Awarded	0.0	0.0	0.0	0.0	0.0	0.0
Utilized	0.0	0.0	0.0	0.0	0.0	0.0
Alternative Energy Production [12/]						
Cap	NA	NA	NA	NA	5.0	NA
Awarded	NA	NA	NA	NA	0.0	NA
Utilized	NA	NA	NA	NA	0.0	0.0
Strategic Development Areas [13/]						
Cap	NA	NA	NA	-	-	-
Awarded	NA	NA	NA	0.0	Nominal	0.0
Utilized	NA	NA	NA	0.0	Nominal	0.0
Life and Health Insurance Guaranty Association [14/]						
Cap	-	-	-	-	-	-
Awarded	Nominal	Nominal	Nominal	0.0	0.0	0.0
Utilized	0.1	Nominal	Nominal	Nominal	Nominal	Nominal
Property and Casualty Insurance Guaranty Association						
Cap	-	-	-	-	-	-
Awarded	33.9	0.0	0.0	0.0	0.0	0.0
Utilized	19.6	26.7	19.3	9.7	5.7	4.2
Call Center [16/]						
Cap	30.0	30.0	30.0	30.0	30.0	15.0
Awarded	1.4	1.3	1.2	1.6	1.0	NA
Utilized	1.4	1.3	1.2	1.6	1.0	NA
Total Tax Credit Caps	188.5	192.5	239.5	338.5	343.5	217.8
Total Tax Credits Awarded	166.5	158.4	205.9	282.2	308.8	118.9
Total Tax Credits Utilized	146.5	146.9	206.9	248.2	273.9	94.2

The Employment Incentive Payment Program, Keystone Opportunity Zone, and Call Center tax credits do not have a formal award process. Credits are awarded on an as-needed basis when the company files their tax returns. Therefore, *credits awarded* equal *credits utilized* for the purposes of these tax credit totals.

LB&FC Note: The footnotes are on the following page.

Source: Pennsylvania Department of Revenue.

Footnotes

1/ Tax credits utilized represent the amount credits applied towards corporation taxes and personal income taxes where applicable. Fiscal year estimates are determined by the transaction date representing the payment date on the Department's tax system. There could be additional flow-through entities that have passed the credits to shareholders. Also, tax credits redeemed in a fiscal year can change over time as tax liabilities are self-reported, settled and resettled. "NA" denotes that tax credit was not applicable in that fiscal year while "-" denotes that cap on the total amount of credits awarded does not exist.

2/ The amount of Neighborhood Assistance/Enterprise Zone tax credits awarded may not be consistent with those reported in the Governor's Executive Budget because of the timing of the inquiries. Act 48 of 2009 reduced the amount of Neighborhood Assistance/Enterprise Zone Program tax credits that could be awarded per program in FY 2009-10 by 50 percent. Additionally, the first year that the Neighborhood Assistance/Enterprise Zone tax credit could be applied to PIT liabilities was FY 2008-09.

3/ Act 48 of 2009 reduced the amount of Employment Incentive Program tax credits that could be awarded per program in FY 2009-10 by 50 percent.

4/ Act 48 of 2009 reduced the amount of Job Creation tax credits that could be awarded per program in FY 2009-10 by 50 percent.

5/ The annual cap on total Research and Development tax credits increased to $40 million for credits awarded after December of 2006. Act 48 of 2009 reduced the amount of tax credit that could be awarded in FY 2009-10 to $20 million.

6/ The cap on the total amount of Education Improvement tax credits awarded increased to $49 million, $61 million, and $75 million in July of 2005, 2006, and 2007 respectively. The enabling legislation of these cap increases were Act 46 of 2005, Act 114 of 2006, and Act 45 of 2007. Act 48 of 2009 reduced the amount of tax credits that could be awarded in FY 2009-10 to $60 million. Additionally, the first year that the Educational Improvement tax credit could be applied to PIT liabilities was FY 2008-09.

7/ The amount of Keystone Innovation Zone tax credits awarded may not be consistent with those reported in the Governor's Executive Budget because of the timing of the inquiries.

8/ Act 48 of 2009 reduced the amount of Resource and Enhancement Protection tax credits that could be awarded per program in FY 2009-10 by 50 percent.

9/ Act 48 of 2009 reduced the amount of Film Production tax credits that could be awarded in FY 2009-10 to $42 million.

10/ The amount of Keystone Opportunity Zone tax credits utilized may not be the same as reported in the Governor's Executive Budget. The amount in the Governor's Executive Budget represent estimates while these figures represent actual usage.

11/ The Coal Waste Removal and Ultraclean Fuels tax credit has yet to be awarded or utilized.

12/ The cap on total Alternative Energy Production tax credits will increase to $8 million, $10 million, and then decrease to $2 million in fiscal years 2012-13, 2013-14, and 2015-16 respectively. Act 48 of 2009 prohibits that any amount of tax credit be awarded in FY 2009-10. Additionally, the Alternative Energy Production tax credit has yet to awarded or utilized.

13/ While there is no overall cap on the total amount of Strategic Development Area tax credits that can be awarded, the amount of credits awarded to insurance companies and certain regulated transportation companies earned by the number of jobs created in a zone is limited to $2 million.

14/ PA Health and Life Insurance Guaranty Association tax credits can only be applied towards Insurance Premium Tax liabilities.

15/ PA Property and Casualty Insurance Guaranty Association tax credits can only be applied towards Insurance Premium Tax liabilities. The credit is applied against tax liabilities in equal portions for each of the 5 calendar years following payment of an assessment. Furthermore, the amount of tax creditsmay not be consistent with those reported in the Governor's Executive Budget because of the timing of the inquiries.

16/ The Call Center Tax Credit can only be applied towards Sales and Use Tax liabilities, however, data on FY 2009-10 utilization is not yet available. Act 48 of 2009 reduced the amount of Call Center tax credits that could be awarded per program in FY 2009-10 by 50 percent.

Source: Pennsylvania Department of Revenue.

I. Introduction

Senate Resolution 2009-20 and a companion resolution, House Resolution 2009-127, direct the Legislative Budget and Finance Committee (LB&FC) to study the impact and effectiveness of 18 Pennsylvania tax credit programs. In May 2009, the Committee released an analysis of Pennsylvania's Film Production Tax Credit program. In June 2009, the Committee released preliminary reports on Pennsylvania's Educational Improvement Tax Credit (EITC) program, the Research and Development Tax Credit (R&D) program, and a final report on the Keystone Opportunity Zone program. This document includes reports on the remaining tax credit programs, as well as final reports on EITC and R&D.

Study Objectives

The objectives of this audit are:

- to determine the extent to which each tax credit program has clearly defined goals and objectives and whether the Commonwealth collects the information necessary to assess whether those goals and objectives are being achieved;
- to determine if the Departments of Community and Economic Development and Revenue take reasonable steps to verify the accuracy of the information provided on the applications; and
- to determine if participant applications ask the questions necessary to determine (1) if applicants are eligible to participate in their respective programs and (2) that the activities for which credits are being awarded are in accordance with statute and program guidelines.

Scope and Methodology

To analyze performance, outcomes, and effectiveness of the tax credit programs, we sent detailed questionnaires to the individual departments that have responsibility for administering the specific programs, which most often was the Department of Community and Economic Development but also the Department of Revenue due to their role in the processing of tax filings. We also met with departmental officials involved in administering individual tax credit programs to ascertain what collection and measurement systems and fiscal and management controls are utilized to assess program achievements and accountability.

We reviewed documents (guidelines, policies, regulations, contracts, forms, etc.) that are used to administer each tax credit program, including information on the process involved in selecting applicants' tax credit awards, processes that are followed to ensure compliance with program guidelines, and steps that are followed to ensure that tax credits are properly granted to program participants. Additionally, we met with various stakeholder groups, where feasible, for each tax credit program.

To determine whether administrative controls were sufficient to ensure compliance with individual tax credit guidelines, we conducted randomly selected file reviews of program participants. In at least one instance, the Call Center Tax Credit, we were unable to review program files because the Department of Revenue did not believe that it could legally give us access to taxpayer information.

Based on our review of individual tax credit files, we then often conducted telephone surveys with a selected number of program participants. Specifically, we tried to determine whether their expectations of the program were fulfilled, whether they believed the program was beneficial to their organizations, and, if pertinent, their communities, and whether they had been assisted sufficiently by the administering agency in accessing the tax credit. Information from these surveys is included in the analysis of individual programs.

For selected programs we researched and compiled comparative tax credit program information from other states, when it was relevant to do so. We found that some of the tax credit programs, such as the Call Center Tax Credit, were unique to Pennsylvania, while others, such as the Neighborhood Assistance Program tax credit and the Research and Development tax credit program, were available in many other states.

We gathered and analyzed fiscal and program information and developed numerous tables and exhibits which are included throughout the report. We relied on fiscal information provided by the respective administering agencies and the Department of Revenue, as well as documents prepared by the Office of the Budget, in compiling these tables and exhibits.

Acknowledgements

We wish to thank the Honorable George Cornelius, former Secretary of the Department of Community and Economic Development; the Honorable C. Daniel Hassell, Secretary of the Department of Revenue; the Honorable Sandi Vito, Secretary of the Department of Labor and Industry; the Honorable Joel Ario, Commissioner, Department of Insurance; the Honorable Harriet Dichter, Secretary, Department of Public Welfare and the staff of each of these departments who assisted us in obtaining information pertinent to the different tax credit programs we were examining. We also wish to thank the legislative staff members who were helpful in directing us to individuals who could provide insight about why a particular tax credit was created. A special note of thanks goes out to the many individuals,

stakeholders groups, and organizations who spoke with us about the individual tax credit program with which they were involved, and, in some cases, helped us to identify issues.

Important Note

This report was developed by Legislative Budget and Finance Committee staff. The release of this report should not be construed as an indication that the Committee or its individual members necessarily concur with the report's findings and recommendations.

Any questions or comments regarding the contents of this report should be directed to Philip R. Durgin, Executive Director, Legislative Budget and Finance Committee, P.O. Box 8737, Harrisburg, Pennsylvania 17105-8737.

II. A. Call Center Tax Credit

Background and Overview

Act 2003-46 amended the Tax Reform Code of 1971 to require that telecommunications companies begin paying a 5 percent gross receipts tax on telegraph or telephone messages originating or terminating in Pennsylvania.[1] Prior to the amendment, the tax was only payable on telegraph or telephone messages transmitted wholly within the state.

Because it was anticipated that the cost of this tax would be passed along by telecommunications companies as a surcharge to those entities, including call centers from which such interstate calls were received and sent, the Legislature, also through Act 2003-46, created the Call Center Tax Credit (CCTC) program. The tax credit was created to retain jobs by providing an incentive for call centers to maintain and expand operations in Pennsylvania.

The tax credit program allows eligible call centers to receive a credit against the state sales and use tax,[2] up to the amount of the gross receipts tax paid by the telecommunications company.[3] According to department staff, although telecommunications companies are responsible for paying the gross receipts tax on interstate calls to and from call centers, they actually charge the call centers a fee to cover the increase in the gross receipts tax. The fee charged is based upon the number of interstate calls a particular call center handles on an annual basis.[4]

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[1] 72 P.S. §8101(a)(2).
[2] 72 P.S. §7202. Through the sales and use tax, call centers are required to pay a tax of six percent on the sale of tangible personal property or services and specific business services. This sales and use tax is imposed on telecommunications services utilized for call center activity.
[3] Sales tax Information Bulletin Relating to the Call Center Tax Credit, Pennsylvania Department of Revenue, January 7, 2005, p.2.
[4] A leading law firm which tracks tax changes in Pennsylvania noted in January 2004 that a tax credit "is permitted to a call center against sales tax paid on telecommunications services. The credit is equal to gross receipts tax paid by a telephone company on receipts derived from the sale of interstate telecommunications services to the call center."

Tax Credit Application Process

To obtain a refund for gross receipts charges paid to a telecommunication company, a call center must apply to the department in the following calendar year in which payments were made. The department maintains an application form on its web page that companies may download. A call center must meet the following five criteria before it is determined eligible for a tax credit:

- Applicant paid Pennsylvania sales or use tax on interstate communications services utilized for call center activity.
- The call center is located wholly in Pennsylvania.
- The call center employed, on a monthly basis, at least 150 individuals to initiate or answer telephone calls.
- The call center utilized, on a monthly basis, at least 200 telephone lines to initiate or answer telephone calls.
- The call center utilizes an automated call distribution system for customer telephone calls for customer service and support, technical assistance, help desk service, providing information, conducting surveys, revenue collections, receiving orders, and/or reservations.[5]

If all other criteria are met, a call center may apply for a tax credit equal to the number of eligible line charges multiplied by 4.762 percent no later than February 15 following the end of the calendar year in which the receipts were received by the telephone company.[6] The department, by April 15, must notify the applicant of the amount of tax credit approved. The credit is issued to the call center in the form of a cash refund against their sales and use taxes paid.[7]

The department noted that they do not allow call centers to estimate the first year of credit for which they are applying. Rather, the call center must request, from their telephone service provider, information to show the exact amount of gross receipts tax the call center was charged. Telephone service providers work with their customers (call centers) to provide them with the level of detail necessary to claim this credit. If the provider refuses, or is unable to provide the detailed billing information required by the department, the call center's request for a refund is denied.

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[5] 72 P.S. §7201(ddd).

[6] According to the Department of Revenue, 4.762 percent is used in the calculation instead of 5.00 percent because the gross receipts tax is applicable to other ancillary charges, such as caller ID, call waiting, and equipment rentals, etc. The calculation had to be modified to ensure the department was refunding the gross receipts tax on the line charges only and not the ancillary charges.

[7] An application for tax credits may be denied by the department. In the first year that the tax credit was available, the department denied 13 applications. A call center denied the tax credit may appeal the department's decision; however no appeals have been filed. The department noted that they make every effort to help call centers meet eligibility requirements before filing an appeal.

The applicant's first year information is reviewed by the department in detail. This sets the level of credit expected from year to year. Subsequent applications are reviewed against the prior year's application. If there are measurable changes, the department requests additional information to be provided for verification purposes. The department notes that it has denied or reduced credits in the past for insufficient information or documentation on the amount requested.

Tax Credits Utilized

Prior to Act 2009-48, the amount of tax credits to be available for award under this program was $30 million per year. Since FY 2004-05, 55 unduplicated call centers have applied for approximately $7.1 million in tax credits. The Department of Revenue has approved approximately $6.4 million, or 89 percent, of such requests. Table 1 shows the sum of requested tax credits and the total annual amount approved by the department.

Since the tax credit began, the amount of tax credits requested annually by call centers decreased approximately $851,000 (39 percent) between FY 2004-05 and FY 2007-08, and $1.16 million (53 percent) between FY 2004-05 and FY 2008-09. The sum of tax credits approved by the department decreased approximately $19,000 (1.4 percent) between FY 2004-05 and FY 2007-08. However, between FY 2004-05 and FY 2008-09, total tax credits approved by the department decreased $343,191 (25 percent).

The number of call centers applying to the department for tax credits has decreased significantly since FY 2004-05. Table 2 shows that in FY 2004-05 a total of 43 applications were received. In FY 2008-09, a total of 20 applications were received, a decrease of 53 percent. The department believes the number of applications has declined because applicants filing for the first time are subject to review and verification of all information submitted, including a record of every telephone call received to determine if they qualify for a tax credit.[8] Call centers must request such information from the telecommunications company they contract with for telephone service. Department staff believes that some telecommunications companies may not be providing the needed information on individual telephone calls to the call centers, making it difficult if not impossible for such call centers to apply for the tax credit.[9] Subsequent year applicants are not required to submit supporting documentation, but they are required to have such information available if the department wishes to review it.

[8] Since the tax credit program began, the department has not undertaken any audits of a call center that applied for and received a tax credit. No other performance reports have been undertaken.
[9] The department does not have data to show how often telecommunication companies are failing to provide call centers with all necessary information so that such call centers can file for the tax credit.

Table 1

Summary of Call Center Tax Credits

File Year[a]	Requested Tax Credits	Approved Tax Credits
2004-05............	$2,201,272	$1,369,701
2005-06............	1,233,420	1,234,779[b]
2006-07............	1,355,709	1,423,854[b]
2007-08............	1,350,655	1,350,655
2008-09............	1,037,092	1,026,510
Total................	$7,178,148	$6,405,499

[a]File year refers to the calendar year for which the call center is requesting a refund and the calendar year in which the application was received by the department.
[b]The sum of approved tax credits is higher than the sum of requested tax credits because some call centers did not have all the necessary information available from the telecommunication company they contract with for telephone service when they submitted their original application. Subsequently, they contacted the department and amended their tax credit request. The numbers shown under sum of requested tax credits reflects the original total amount of tax credits requested on applications received.

Source: Data provided by the Bureau of Business Trust Fund Taxes, Department of Revenue.

Table 2

Number of Call Centers Which Have Applied for the Tax Credit

File Year[a]	Number of Applications Received	Number of Applications Approved
2004-05	43	30
2005-06	26	24
2006-07	25	25
2007-08	26	25
2008-09	20	17

[a]File year refers to the calendar year for which the call center is requesting a refund and the calendar year in which the application was received by the department.

Source: Data provided by the Bureau of Business Trust Fund Taxes, Department of Revenue.

Another possibility for the decrease in applications is that there are fewer call centers in Pennsylvania. The department does not track, and therefore does not know, the current number of call centers in the state that might be eligible for the tax credit.[10]

[10] Department staff indicated that the majority of call centers in Pennsylvania represent financial institutions and insurance companies.

The Center for Workforce Information and Analysis within the Pennsylvania Department of Labor and Industry collects information on the number of call centers in Pennsylvania and the number of employees at such businesses. For example, the center reported:

- In 2006, there were 243 telephone call centers employing 15,339.
- In 2007, there were 248 telephone call centers employing 16,079.
- In 2008, there were 246 telephone call centers employing 14,219.

However, the center's definition of telephone call centers includes establishments engaged in answering telephone calls and relaying messages to clients, and establishments primarily engaged in providing telemarketing services on a contract or fee basis for others, such as promoting clients' products or services by telephone, taking orders for clients by telephone, and soliciting contributions or providing information for clients by telephone. In addition, the center's list of call centers does not include call centers that are part of an existing business that chiefly provides other services, for example financial services or insurance services, to customers who have a business relationship with the company and its products.

According to the department, unsolicited sales calls are not included in the definition of acceptable call center activities found in the statute.[11] Although the department does not have regulations governing the CCTC program, on January 7, 2005, it did issue Sales Tax Bulletin 2005-01, which defines what types of activities a call center may provide. The activities noted are the same as identified in statute.[12] The department, in instructions provided to the staff that process CCTC applications, specifically state that "employees making unsolicited outgoing phone calls to solicit sales, no matter what the position is called, are not eligible call center employees as defined in the instructions."[13] This category of employee, however, is not specifically prohibited in the statute governing this program.

Reduction in Tax Credits as a Result of Act 2009-48

Act 2009-48 mandated that tax credits, including the CCTC, be reduced by 50 percent in FY 2009-10 and 55 percent in FY 2010-11. Accordingly, the Department of Revenue is adhering to this legislative requirement, and the maximum amount of

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[11] 72 P.S. §7201(ddd).

[12] The department issues written informational materials "to call attention to department procedures or to well established interpretations or principles of tax law without applying them to a specific set of facts. They are issued …when it is believed that general information will assist individuals or organizations. Examples of Revenue information are the Pennsylvania Tax Update, forms, pamphlets, tax bulletins or informational notices provided to taxpayers….If there appears to be a conflict between documents within the Revenue Information System, the order of precedence shall be regulations, statements of policy, letter rulings and revenue information." 61 PA Code Ch. 3.

[13] Department of Revenue written instructions, "Call Center Tax Credit Scope and Guidelines" that staff are to follow when processing CCTC applications.

CCTC tax credits available in FY 2009-10 is $15 million. In practical terms, because the amount of tax credits annually awarded was far less than the statutory cap that was allowed prior to Act 48, the total number of call centers participating in the program should not be affected by the decrease in credits available.

However, the Department of Revenue has interpreted Act 48 to also require that individual tax credit award amounts be reduced by 50 percent in FY 2009-10 and by 55 percent in FY 2010-11. This will mean that individual call centers will only be able to recoup half of what they typically received as a credit in prior years. Although it is unknown how this will affect the number of call centers that participate in the program, three of the four call centers we spoke to reported that they will continue to participate.[14]

Survey Results

We were interested in speaking with call centers to determine their satisfaction with the program. The department refused to provide the names, addresses and telephone numbers of call centers utilizing the program, citing the confidentiality provisions of the Fiscal Code.[15] However, we were able to identify four businesses which currently participate in the tax credit program or have participated recently in the program. Each of these businesses currently maintains a call center in Pennsylvania that meets the minimum size requirements for participation in the program. We contacted these businesses and asked about their experience with the program. The following information was noted based on these calls:

- Three of the four businesses plan to continue filing for a tax credit. One business made the decision in the last two years that the amount of the tax credit it was receiving was not worth the effort required to obtain it.
- All four businesses noted that the department required an extensive amount of information with the initial application. In subsequent years the information they had to provide was much less extensive. One business did indicate that it believes the subsequent year's information it were expected to provide was still burdensome.
- All four of the businesses reported they maintain information on calls as required by the program; however, no one from the Department of Revenue has asked to review those files.

[14] In February 2010, the department reported that all applicants who previously applied for the tax credit would be informed of the reduction in the total amount of the tax credit. As of March 2, 2010, the new application was posted on the department's web page. The instructions for filling out the application did not need to be updated according the department.
[15] Department staff was advised by their Office of Chief Counsel that they could not provide the names, addresses or telephone numbers of call centers that have applied for the tax credit pursuant to 72 P.S. §731. This issue is addressed in the Recommendations Section of this report.

- Three businesses thought the tax credit was valuable to their company because it refunded to them some of their tax payments.
- One business questioned whether other businesses participating in the program were claiming a refund higher than to which they were entitled. They noted that an employee at the department once told them that they were claiming too little credit compared to other companies participating in the program.

Other States

The LB&FC legal staff did not identify any other states with a tax credit comparable to Pennsylvania's CCTC. The director of the National Association of Call Centers was contacted about similar programs, and he was not aware of any. He did note that most states have some sort of call center incentive structure, which are part of general incentive programs, but are not call center specific. Most of these incentive programs offer tax breaks on equipment purchases or provide some level of tax credits to recoup costs associated with training new employees. Tax credits for training, he noted, have had the most success because typically a call center spends $3,000 to $10,000 per employee on training, with annual turnover of approximately 30 percent.

Although there is no state financed training program specifically targeted to businesses with call centers, Pennsylvania's Customized Job Training Program provides grant funds to new and existing companies in Pennsylvania for customized or advanced training for new, entry-level employees and for retention and training of existing employees on the use of new technologies. Businesses that maintain call centers may, if they choose, apply for grants to help pay for training costs of new or existing employees through this program.

Additionally, if reauthorized, Pennsylvania's Employment Incentive Payment (EIP) Program rewards employers with a significant state tax credit when they hire qualifying new employees. These include individuals who within the past year received Pennsylvania General (cash) Assistance (GA) or Temporary (cash) Assistance for Needy Families (TANF), and/or received approved vocational rehabilitation services through the State Rehabilitation Services program or the U.S. Department of Veterans Affairs. The EIP tax credit totaled up to $7,200 per qualifying employee during three years of employment. It was available to all businesses with locations in Pennsylvania.[16]

[16] "No employment incentive payment shall be provided for…wages paid to an individual during the time period for which the employer received federally funded or state funded job training payments for that individual." 72 P.S. §8703-A(b)(3).

Findings and Recommendations

1. The Call Center Tax Credit was enacted to retain jobs by providing an incentive for call centers to maintain and expand operations in Pennsylvania. However, the Department of Revenue has not tracked the number of jobs retained or created due to the availability of the credit and, in fact, does not ask for this type of information from applicants.

Without such information, it is virtually impossible to quantifiably ascertain the benefits of this tax credit, especially as they relate to employment opportunities at call centers in Pennsylvania. Given the declining number of call center tax credit applications (from 43 applications in FY 2004-05 totaling $2.2 million in requests to 20 applications in FY 2008-09 totaling $1.0 million), it would not appear that the credit is a major factor in a call center's business plan. We also note that Pennsylvania is the only state that offers a tax credit specific to call centers, which suggests that such a credit is not as essential to the industry as anticipated when it was created. Pennsylvania, like several other states, also offers state-financed training programs in which call centers may participate. Therefore, even if the tax credit was eliminated, state assistance would still be available.

Recommendation:

> ***Given the trend in declining utilization, the General Assembly may wish to consider reducing or terminating the Call Center Tax Credit.***

2. The Department of Revenue was unwilling to provide the names, addresses and credit amounts awarded for participants in the program, citing the confidentiality provisions of 72 P.S. §731.[17]

Unlike some of the other tax credit programs examined in this study, there is no statutory requirement that the department provide any report, annual or otherwise, on the CCTC program to the General Assembly. When such reports are mandated by the tax credit's authorizing statute, the language specifically supersedes the confidentiality language contained in the fiscal code. Without access to specific program participant's information, conducting meaningful cost/benefit analysis on this tax credit program was limited.

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[17] Section 731 provides that "any information gained by any administrative department, board, or commission, as a result of any returns, investigations, hearings or verifications required or authorized under the statutes of the Commonwealth imposing taxes or bonus for State purposes, or providing for the collection of the same, shall be confidential except for official purposes …." However, the LB&FC has the statutory power and duty to "request, receive, review, examine, study, ascertain, and compare fiscal information concerning the budget, the revenues, and expenditures of the Commonwealth" (see 70 P.S. §70.3(1)) and was specifically tasked pursuant to SR 20 and HR 127 to exercise that statutory authority in assessing the administration of the state's tax credit programs. While we believe this study constitutes "official purposes" under Section 731 thereby permitting release of needed tax credit information by the Department of Revenue, the Department of Revenue disagreed.

Recommendation:

We recommend that, if this program is continued, the statute should be amended to require that an annual report be published so that information about the program is more transparent and information pertaining to the benefit of the tax credit can be determined. Such a report should include the number of applications received, the names of the companies applying, and the amount of tax credit requested, approved, and utilized, by company. In addition, information should be gathered on the number of call center jobs retained and created by the companies participating in this program. Identifying this information would add transparency to the program and would allow decision makers to be better informed on the usefulness of this tax credit in accomplishing its stated goal of retaining and creating jobs.

II. B. Coal Waste Removal and Ultraclean Fuels Tax Credit

Background and Overview

The Coal Waste Removal and Ultraclean Fuels Tax Credit was established by Act 1999-4, an amendment to the Tax Reform Code of 1971. This tax credit is available for qualifying capital expenditures on facilities producing fuels from coal, culm, or silt and is intended as an incentive for companies to develop facilities dedicated to the production of synthetic fuels while removing waste from the environment. The credit can be used against sales and use tax, corporate net income tax, and capital stock/foreign franchise tax. The credit is capped, by statute at $18 million per year, and a qualifying property must be acquired or purchased between January 1, 2000, and January 1, 2013. Additionally, tax credits will not be granted unless the company has obtained an investment tax credit from the federal government or an investment by a person other than an agency or instrumentality of the Commonwealth or a combination thereof in an amount equal to or greater than the tax credit amount.

Any amount of allowable investment tax credit not used in the tax year for which the credit is claimed can be carried forward by the claiming taxpayer to succeeding tax years until the full amount has been used. Unused credits may be sold or assigned to other taxpayers; however, a taxpayer by sale or assignment must use the credit in the tax year in which it was acquired, but not subsequent to the filing of a tax return for the year 2012. If prior to the expiration of any qualifying property's useful life, the company disposes of any qualifying property upon which it has received a tax credit, a portion of the credit shall be recaptured and added to the company's tax liability for the tax year in which the qualifying property is disposed.

Additionally, to qualify for the credit, the developer must enter into a 25-year contract with the Commonwealth beginning with the first year credits are claimed. The contract requires periodic payments from the company to the Commonwealth in the amount of $9.36 million every five years, with various provisions allowing for offsets of this amount. Because no other tax credit program has a requirement for such a contract and the language of the statute is complex, we attempted to contact a variety of experts for an explanation of how the tax credit and its accompanying contract are to be implemented. We attempted to get information from industry representatives, legislative staff who might know of the statute's origins, and the Department of Revenue, however, no one we contacted had this information.

According to a representative of the Department of Revenue, Bureau of Business Trust Fund Taxes, no eligible developer has applied for, or claimed, the tax credit; nor have they sold or assigned the credit to any taxpayer or assignee. The department also does not have any information regarding how many corporate taxpayers the legislation was intended to affect and is not aware of any activities undertaken by any company in Pennsylvania that would qualify for this tax credit.

Reportedly, according to industry representatives, this legislation was targeted to one company in Pennsylvania that is in the process of constructing a waste coal to liquid fuels plant in the northeastern portion of the state. When contacted by LB&FC staff for purposes of preparing this report, this company's officials confirmed this supposition and went on to state that they are still pursuing the project and fully intend on utilizing the tax credit beginning in FY 2010-11.

II. C. Educational Improvement Tax Credit

Background and Overview

The Educational Improvement Tax Credit (EITC) was established by Act 2001-4, an amendment to the Public School Code, 24 P.S. §§20-2001-B – 20-2008-B. Act 2001-4 was repealed and replaced by Act 2009-48, which amended the Tax Reform Code at 72 P.S. §8701-F et seq. Act 2001-4 required the Department of Revenue (DOR) to grant tax credits to business firms[1] making a contribution—a donation of cash, personal property, or services—to any of three types of educational organizations: scholarship organizations (SOs); educational improvement organizations (EIOs); and pre-kindergarten scholarship organizations (PKSOs).

The amount of EITC tax credit available to a business is dependent upon the type of organization to which the contribution is made. Tax credits for business contributions to SOs and EIOs are not to exceed 75 percent of the contribution, up to $300,000 total tax credit per business annually. The tax credit can increase to 90 percent if a business commits, in writing, at the time of initial application, to provide two consecutive years of the same dollar amount of contribution. With the exception of second year commitments and the current program year (in which all awards were prorated), tax credits are awarded by DCED for SO and PKSO donations on a first- come, first- served basis and for EIOs on a random basis until the allocation for EIOs is exhausted, since more credits are sought than are available.

Tax credits for business contributions to PKSOs are 100 percent of the first $10,000 contributed and 90 percent of contributions over that amount, up to $150,000 per business annually. Combinations of these tax credits due to donations to multiple groups are also allowed, up to the maximum allowable per year in each category. A tax credit for any year may not exceed a business's tax liability and may not be carried forward or back, or be refunded or transferred. A pass-through entity, however, may transfer part or all of an unused tax credit to shareholders, members or partners (proportionately), who must immediately claim the credit in the taxable year in which the contribution is made or in the taxable year immediately following.

The amount of tax credits available to be distributed under the EITC program was originally capped at $30 million. The Legislature subsequently increased the cap several times to as high as $75 million. Table 3 shows the total allocation for each year, including the credit reductions made by Act 2009-48, and how the money is divided between program participants. Act 2009-48 reduced the total

[1]A "business firm" is an entity authorized to do business in Pennsylvania and subject to paying taxes or a pass-through entity.

amount of tax credits available to $60 million for FY 2009-10 and $50 million for FY 2010-11.

Table 3

Increase of EITC Tax Credit Limits, by Fiscal Year

Fiscal Year	Total Credits Available	Total Apportioned For Scholarship Organizations	Total For Pre-K Scholarship Organizations	Total Apportioned for Educational Improvement Organizations
2000-01.....	$30,000,000	$20,000,000	0	$10,000,000
2001-02.....	30,000,000	20,000,000	0	10,000,000
2002-03.....	30,000,000	20,000,000	0	10,000,000
2003-04.....	40,000,000	26,666,665	0	13,333,335
2004-05[a] ...	48,999,999	29,333,333	$5,000,000	14,666,666
2005-06.....	59,000,000	36,000,000	5,000,000	18,000,000
2006-07.....	59,000,000	36,000,000	5,000,000	18,000,000
2007-08.....	75,000,000	44,666,667	8,000,000	22,333,333
2008-09.....	75,000,000	44,666,667	8,000,000	22,333,333
2009-10.....	60,000,000	37,967,000	6,400,000	15,633,000
2010-11.....	60,000,000	40,202,400	6,396,000	13,401,600

[a]For the FY 2004-05 school year a new Pre-Kindergarten scholarship program was established.

Source: Annual tax credits available and the amount apportioned to each program under EITC, were identified from Act 2001-4, subsequent amendments to that act and Acts 2009-48 and 2010-46.

As of FY 2009-10, there are 238 SOs, 544 EIOs, and 141 PKSOs. Table 4 shows the growth of the number of these organizations since the program's inception. Each of the categories of participants has increased every year since the EITC was implemented. The greatest growth has been in the number of EIOs, an increase of 309 percent. The number of SOs and PKSOs has increased as well, by 107 percent and 172 percent, respectively.

Tables 5, 6, and 7 show total contributions made to organizations participating in the program, the corresponding credits issued and scholarships issued, if applicable. Prior to this year, contributions and credits issued had steadily increased to match the increase in tax credit allocations available in each category. As shown in Table 3, there have been four increases in the allocation for tax credits; increases occurred in FYs 2003-04, 2004-05, 2005-06, and 2007-08.

Table 4

Increase in Education Organization Participants

Fiscal Year	Scholarship Organizations	Educational Improvement Organizations	Pre-Kindergarten Scholarship Organizations
2001-02	115	133	NA
2002-03	140	190	NA
2003-04	158	203	NA
2004-05	172	254	52
2005-06	192	330	85
2006-07	203	424	105
2007-08	220	464	119
2008-09	239	503	136
2009-10	238	544	141

Source: Data provided by the Department of Community and Economic Development.

Table 5

Scholarship Organizations
Contributions, Tax Credits and Scholarships

Fiscal Year	Number of Contributions Made to Scholarship Organizations	Total Contributions Made to Scholarship Organizations	Total Credits Awarded to Businesses	Number of SO Scholarships
2001-02	1,057	$19,066,825	$16,929,332	17,350
2002-03	1,345	22,207,444	19,857,126	20,208
2003-04	1,721	28,434,178	25,202,568	25,875
2004-05	1,649	29,342,885	26,160,360	26,701
2005-06	1,743	32,569,421	28,954,734	29,638
2006-07	2,470	40,155,095	35,876,462	36,540
2007-08	3,456	48,709,293	43,530,565	44,334
2008-09	2,587	41,949,667	37,098,673	44,893
2009-10	2,959	40,338,741	35,897,506	38,646

Source: Data provided by the Department of Community and Economic Development.

Table 6

Educational Improvement Organizations
Contributions and Tax Credits

Fiscal Year	Number of Contributions Made to Educational Improvement Organizations	Total Contributions Made to Educational Improvement Organizations	Total Credits Awarded to Businesses
2001-02	657	$10,487,622	$ 9,095,670
2002-03	737	11,121,404	9,844,476
2003-04	1,152	15,092,106	12,999,322
2004-05	1,101	14,739,169	13,064,188
2005-06	1,206	16,624,733	14,565,087
2006-07	1,605	20,693,914	17,964,374
2007-08	2,280	25,082,358	22,317,368
2008-09	2,225	25,156,944	21,833,491
2009-10	2,248	16,895,001	14,663,135

Source: Data provided by the Department of Community and Economic Development.

Table 7

Pre-Kindergarten Scholarship Organizations
Contributions, Tax Credits and Scholarships

Fiscal Year	Number of Contributions Made to Pre-K Scholarship Organizations	Total Contributions Made to Pre-K Scholarship Organizations	Total Credits Awarded to Businesses	Number of PKSO Scholarships
2004-05	176	$3,023,258	$2,865,996	2,445
2005-06	321	5,389,543	4,968,629	4,358
2006-07	358	5,379,055	4,999,200	4,350
2007-08	609	7,519,133	6,963,218	6,081
2008-09	603	8,370,313	7,731,606	6,965
2009-10	671	6,666,017	6,178,583	5,533

Source: Data provided by the Department of Community and Economic Development.

Qualification and Application

The majority of the administrative responsibilities for the EITC program, including the qualification, application, and tax credit issuance processes, are overseen by DCED. The educational organizations—the SOs, PKOs, and EIOs—must be approved by DCED so that contributions to them are eligible for EITC tax credits. The educational organizations for which business contributions may qualify for EITC tax credits are statutorily defined as follows:

- A “scholarship organization” is a nonprofit entity which: (1) is exempt from federal taxation under section 501(c)(3) of the Internal Revenue

Code; and (2) contributes at least 80 percent of its annual cash receipts to a scholarship program.

- An "educational improvement organization" is a nonprofit entity which: (1) is exempt from federal taxation under section 501(c)(3) of the Internal Revenue Code; and (2) contributes at least 80 percent of its annual receipts as grants to a public school for innovative educational programs.
- A "pre-kindergarten scholarship organization" is a nonprofit entity which: (1) either is exempt from federal taxation under section 501(c)(3) of the Internal Revenue Code or is operated as a separate segregated fund by a scholarship organization that has been qualified under §8703-F; and (2) contributes at least 80 percent of its annual cash receipts to a pre-kindergarten scholarship program.

All educational organization must expend or otherwise irrevocably encumber all funds received for distribution during the then current fiscal year of the organization or during the next succeeding fiscal year of the organization. In addition to their initial application in which organizations submit proof of their 501(c)(3) status and describe their scholarship program(s) or innovative educational program(s), whichever is applicable, the organizations must also report annually to DCED on the results of their programs, including dollar amounts collected and dollar amounts spent/encumbered. The statute dictates that SOs and PKSOs must demonstrate that they have an application and review process for eligible students, with eligibility defined as being from a family that has verified family income of not more than $50,000, with an additional allowance of $10,000 per dependent in the family. Act 2009-48, discussed later, made changes to family income maximums.

Scholarship organizations have a great deal of flexibility under Act 2009-48 to establish their own criteria in choosing which families receive scholarships, as long as the family income guidelines are met. Our in-depth survey of 27 SOs and PKSOs found that these organizations often utilize selection criteria beyond the level of a family's income when awarding scholarships. Approximately 59 percent of the organizations indicated that they took factors other than income into consideration in rewarding scholarship funds. Some of these other factors are:

- Two organizations require that scholarship recipients live in the county where the scholarship organization is based.
- One organization retains 10 percent of their tax credit contributions to be awarded to students whose families are in hardship. This might include families where the chief breadwinner passed away or lost his or her job.
- Organizations indicated that they may take into consideration any existing physical disabilities or developmental learning issues a scholarship applicant may have.

- One organization requires families to undertake 10 hours of community service in the school each semester.
- One organization places all applicants in one of three categories (need significant assistance, need moderate assistance, or need supplemental assistance) and awards scholarships in each category. If there are more applications than available tax credits, scholarships are awarded through a lottery. Special consideration is given to returning applicants.

Scholarship organizations are required by the act to not limit the availability of scholarships to only students of one school. DCED has allowed this requirement to be met by scholarship organizations by awarding scholarships to students of a lower (elementary) school and an upper (secondary) school, as long as the schools have separate administrative offices. In addition, businesses may request that their EITC tax credit contributions be designated for a particular school served by a scholarship organization. Some of the larger organizations that we surveyed reported that 90 percent of their total contributions were designated for a particular school by the businesses making contributions, thus potentially limiting the availability of scholarships for students at the other schools they serve.

As stated above, EIOs are required to provide innovative educational programs. An innovative educational program is defined as "an advanced academic or similar program that is not part of the regular academic program of a public school, but that enhances the curriculum or academic program of the public school." DCED counsels applicants that to be approved, a program must be (1) innovative, i.e., beyond the normal offerings of a public school, (2) add value to the curriculum of a public school, and (3) be advanced academically, i.e., not general, remedial, counseling, motivation, or any other non-academic programming. If a program meets all three requirements, it is approved as an innovative educational program. An EIO may submit multiple programs for DCED review/approval.

There are over 500 EIOs that have been approved by DCED to participate in this program, and many different types of organizations are represented as EIOs throughout Pennsylvania. Over 100 EIOs are local educational foundations that are directly associated with school districts. The remainder is a diverse mix of organizations that include arts councils and artistic organizations, museums and science centers, symphonies and choruses, community and youth organizations, zoos, libraries, and various others. EITC organizations are not prohibited from serving multiple roles concurrently, and 71 organizations function as both SOs and PKSOs. In addition, there are a group of participants that function as SOs or PKSOs and EIOs and a group that functions as all three (SOs, PKSOs, and EIOs).

Organizations participating in EITC must provide the following information to be eligible to receive EITC qualifying contributions. As provided in the program's statute, DCED may not ask for additional information from education organizations other than what is required by law:

- The organization must submit information to DCED confirming the organization's 501(c)(3) status.
- SOs and PKOs
  - must certify to DCED that they are eligible to participate in the program, and
  - must agree to annual reporting requirements regarding scholarships awarded.
- EIOs must describe their proposed innovative educational programs and also agree to annual reporting requirements regarding their programming and contributions.

In order to receive a tax credit, business donors must apply to DCED no earlier than July 1 of every year and must follow up with their donation to a DCED-approved EITC organization within 60 days of their approval to receive a tax credit.

Program Responsibilities of Agencies

Administrative responsibilities for the EITC program are distributed among DCED, DOR, and the Department of Education (PDE). DCED must provide application forms for certification of the educational organizations and distribute report forms to listed SOs and PKOs by May 1 each year. DCED must also review and approve: 501(c)(3) information from SOs, PKSOs, and EIOs; certification information and reporting agreements from SOs and PKOs; and the program descriptions and reporting agreements from EIOs. Other responsibilities of DCED include:

- Receive annual reports from SOs and PKOs by September 1 each year.
- Consult with the Department of Education as necessary regarding EIO applications.
- Provide and distribute the forms for EIO information.
- Develop program guidelines in consultation with the Department of Education.

The Department of Revenue is required to process the EITC tax credits as set forth in the law, establish procedures for the pass-through entity transfer of part or all of its tax credit, and provide a list to the General Assembly by June 30 each year of all SOs, PKSOs, and EIOs receiving contributions from businesses granted a tax credit. According to the DOR, this annual requirement has been met every year. DCED also publishes this information and program guidelines on its website.

Tax Credit Limit and Program Changes Made by Acts 2009-48 and 2010-46

The distribution of EITC tax credits is made on a first-come, first-served basis. Prior to Act 2009-48, the annual program cap was $75 million each year. The statewide cap was distributed with (1) not less than $44.7 million of tax credits being directed to SOs, and (2) not less than $22.3 million in tax credits being directed to EIOs. Tax credits directed to PKSOs were not to exceed $8 million per year. Act 2009-48 made not only budgetary changes to the EITC program, but several programmatic changes as well.

Budgetary Changes. Act 2009-48 temporarily reduced the amount of tax credits that could be awarded in fiscal years 2009-10 and 2010-11 to $60.0 million and $50 million, respectively. In FY 2009-10, $37,967,000 was available to provide credits for those businesses that contribute to SOs, $15,633,000 was available to provide credits for those that contribute to EIOs, and $6,400,000 was available to provide credits for those businesses that contribute to PKSOs. Subsequently, Act 2010-46 restored $10.0 million in tax credits to the program to be distributed as follows; $40,202,400, $13,401,600, and $6,396,000, for businesses contributing to SO's, EIO's and PKSO's, respectively. As provided in Act 48, for FY 2009-10, DCED prorated all applications that it received prior to October 1. For FY 2010-11, all second year applications received prior to June 30 will be approved in full; all other applications will be approved on a first come, first served basis until funds are exhausted.

Students With Disabilities. Act 2009-48 extends the availability of scholarships funded with EITC credit to students with disabilities. A student with disabilities must meet several criteria, including that the student is either enrolled in a special education school or has otherwise been identified as a child with a disability, as defined by federal regulation;[2] needs special education and related services; is enrolled in a pre-kindergarten program or school; and is a member of a household with income not greater than the maximum annual household income.

The act allows SOs and PKSOs to provide scholarships to students with disabilities to attend special education schools. A special education school is defined as a school, or program within a school, that is designated specifically and exclusively for students with disabilities. One of the following criteria must also be met: the school must be licensed under the Private Academic Schools Act,[3] the school must be accredited by an accrediting association approved by the State Board of Education; the school is for the blind or deaf and receives Commonwealth appropriations; or is operated by or under the authority of a bona fide religious institution, or by the Commonwealth, or any political subdivision thereof.

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[2]34 CFR §300.8.
[3]24 P.S. §6701 et seq.

Maximum Income and Income Allowances. Before July 1, 2011, maximum household income cannot exceed $50,000; after June 30, 2011, this amount increases to not more than $60,000. With respect to a disabled student, maximum household income is calculated by multiplying the maximum amounts above by the applicable support level factor[4], 1.5 for Support Level Factor One and 2.993 for Support Level Factor 2. The statute also includes income allowances as follows: before July 1, 2011, $10,000 in additional income for each eligible student, pre-kindergarten student, and dependent member of the household. After June 30, 2011, the allowance amount increases to $12,000.

Beginning July 1, 2012, DCED is to annually adjust both the maximum income and the income allowance amounts to reflect any upward changes in the Consumer Price Index for All Urban Consumers for the PA, NJ, DE, and MD areas in the preceding 12 months. This amount is to be immediately submitted to the Legislative Reference Bureau for publication as a notice in the *PA Bulletin*.

Pre-Kindergarten Program. Originally, a pre-kindergarten program was required to provide a minimum of two hours of instructional and developmental activities per day for at least 60 days per school year. Act 2009-48 allows a pre-K program to provide a minimum of two hours of instructional and developmental activities per day for at least 20 days over the summer recess.

Pass-through Entities. Act 2009-48 changed the definition of pass-through entity. Originally, a pass-through entity was a partnership[5] or S corporation[6]. The Act added a single-member limited liability company as an eligible pass-through entity.

Other States' Educational Tax Credit Programs

Several other states have tax credit programs similar to the Commonwealth's EITC program; however, Pennsylvania appears to be the only state with an EIO component. Like Pennsylvania, other states have programs that allow commercial enterprises to reduce their tax liability by making contributions to scholarship organizations. Some states allow credits for individual taxpayers. In general, the scholarship programs are run by non-profit, tax-exempt organizations that use the contributions to provide scholarships that enable children to attend private schools. Typically, families must meet some level of income criteria, and SOs are generally

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[4]Support level factor is defined as the level of support needed by an eligible student with a disability. Of Support Level 1, the student is not enrolled in a special education school. Of Support Level 2, the student is enrolled in a special education school.
[5]The Tax Reform Code of 1971 defines a partnership as a domestic or foreign general partnership, joint venture, limited partnership, limited liability company, business trust, or other unincorporated entity that for federal income tax purposes is classified as a partnership.
[6]The Tax Reform Code of 1971 defines an S corporation as any small corporation which does not have a valid election under 72 P.S. §7307.

permitted to use their own criteria in distributing scholarships. Organizations are identified differently in various states: scholarship organizations, school tuition organizations, scholarship granting organizations, student scholarship organizations or scholarship funding organizations.

Arizona: Arizona has two tax credit programs. The Individual School Tuition Program allows taxpayers to receive tax credits of 100 percent for donations up to $500 ($1,000 for married couples) to School Tuition Organizations (STOs). There is no cap on this program. The Corporate School Tuition Organization Tax Credit allows businesses to receive dollar for dollar tax credits for donations to STOs. In 2007, there was $10 million available for credits; this amount is to increase by 20 percent per year. Credits are awarded on a first-come-first serve basis.

STOs provide scholarship assistance for students to attend qualified private schools, which are schools that may not discriminate on the basis of race, color, disability, or national origin. A student's family income cannot exceed 185 percent of the income limit required for students to qualify for federal free or reduced-price lunch program. The programs also require that the student attended a public school the previous year or be entering kindergarten. The maximum scholarship amount for K-8 is $4,300 and $5,600 for 9-12; these limits increase by $100 per year.

Florida: In Florida's program, the Corporate Tax Credit Scholarship Program, corporations can receive tax credits for donations to non-profit scholarship funding organizations (SFOs). The credit is equal to the donation and may be up to 75 percent of state income tax liability. As of July 1, 2008, $118 million was available for tax credits, and they are awarded on a first-come-first-serve basis.

Scholarships can be for attendance at private schools or for transportation to attend a public school outside the student's own school district. The program requires that a student qualify for free or reduced price lunches under the National School Lunch Program and also meet one of the four following criteria: was counted as a full-time equivalent student during the previous state fiscal year for purposes of state per-student funding; received a scholarship from an eligible non-profit SFO or from the state of Florida during the previous school year; is eligible to enter kindergarten or first grade; or is currently placed, or was placed in foster care during the previous state fiscal year. To attend public schools, SFOs provide annual scholarships of $3,950 or the cost of tuition and fees, whichever is less.

Georgia: The Georgia Scholarship Tax Credit Program allows corporations to receive a 100 percent tax credit, up to 75 percent of total state tax liability, for donations to student scholarship organizations (SSOs). SSOs must be tax-exempt and must allocate at least 90 percent of their annual revenue toward scholarships or tuition grants to attend a qualified private school. A qualified school is one that is accredited by a state-approved agency, is physically located within Georgia, adheres to provisions of the federal Civil Rights Act of 1964, and satisfies the private school requirements under Georgia law. Individuals may also receive tax credits for donations to SSOs under this program. An individual may receive a 100 percent tax credit for donations up to $1,000 ($2,500 for married couples).

Iowa: Iowa's Individual School Tuition Organization Tax Credit Program is different than other states' programs in that it is for individual taxpayers only and does not have a corporate component. Individuals may donate to an STO and receive a tax credit for 65 percent of the value of the contribution. Available tax credits amount to $7.5 million. STOs must be private, non-profit organizations. Students' family incomes may not exceed an amount equal to three times the most recently published federal poverty guidelines. Contributors may not identify specific students.

Rhode Island: Rhode Island's Corporate Scholarship Tax Credit program gives tax credits to corporations who donate to scholarship granting organizations (SGOs). $1 million is available for credits and it is awarded on a first-come, first-served basis. Like Pennsylvania, businesses can receive a 75 percent credit for a one-year donation and a 90 percent credit if they commit to donating for two years; however, the second year donation must be at least 80 percent of the first year's contribution. Students are eligible for scholarship money if their families' incomes do not exceed 250 percent of the federal poverty level.

Findings and Recommendations

The first five findings pertain solely to Educational Improvement Organizations, Findings 6 and 7 pertain solely to SOs and PKSOs, while the remainder of the findings applies to the program as a whole.

1. The EIO program has been over-prescribed for at least the last six years, meaning that all businesses applying for credits are not able to receive them. DCED has managed this issue by randomly selecting business that are awarded the full amount of credits for which they are applying until all the credits are exhausted, causing other businesses to receive no credits.

This "all or nothing" approach, however, can create problems for EIOs, including loss of funding if their donors are not selected to receive credits and the inability to plan ahead for programming. It also has caused some businesses to lose interest in donating due to the unpredictability of the random selection process.

Businesses can apply for EITC tax credits on July 1, the first day of the fiscal year. Businesses must be authorized to do business in Pennsylvania and may have tax liability under a variety of taxes[7]. To receive tax credits, businesses must be selected/approved by DCED to make contributions. Historically, there have not there have not been enough tax credits to provide for all businesses wishing to contribute to EIOs, however, there are usually some credits left at the end of the fiscal year for businesses contributing to SOs and PKSOs.

According to DCED officials, all EIO tax credits are exhausted on the first day that application for it can be made. Also, because of the option to commit to two years of donations, the total allocation of tax credits is not available on July 1. For example, in FY 2007-08, on July 1st, only $15.4 million (of the $22.3 million total) was available for new applications; almost $7 million was encumbered for businesses applying in the previous year so that they could take advantage of the 90 percent tax credit that is allowed if a business commits to making donations for two years.

After receiving applications, which may be emailed, hand-delivered, or sent via U.S. mail or other delivery company, DCED assigns a number to each one, and the computer randomly selects applications until the tax credits are exhausted. Many businesses each year are denied tax credits, and DCED places these on a waiting list. If selected businesses reduce or do not make their donations, businesses on the waiting list may eventually receive their requested credits.

In FY 2008-09, the allocation for the EITC program was split between SOs - $44,666,667 and EIOs – $22,333,333, with an additional $8,000,000 available for PKSOs, giving EIOs slightly less than one-third of all EITC dollars. Data provided by DCED shows that the EIO portion of the EITC program has been overprescribed for at least the last six fiscal years. Table 8 shows the amount of over prescription and the associated number of businesses that were denied credits for these years.

According to a DCED official, if any tax credit money is left at the end of the fiscal year[8], the credits "lapse" and funds are not carried into the next fiscal year.[9] Table 9 shows the tax credits that were not utilized and therefore lapsed, due to insufficient demand for them from businesses seeking program credits.

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[7] Eligible taxes include: Corporate Net Income Tax, Capital Stock Franchise Tax, Bank and Trust Company Shares Tax, Title Insurance Companies Shares Tax, Insurance Premiums Tax, Mutual Thrift Institutions Tax, or Personal Income Tax of S Corporation shareholders or partners in a general or limited partnership.

[8] Businesses may apply for tax credits through June 30 and, if approved, tax credits will be credited from that fiscal year, not the new fiscal year beginning the next day.

[9] Other information we received, however, suggested that prior year credits may sometimes be issued in a subsequent year.

Table 8

Overprescription of EIOs

Fiscal Year	Amount Overprescribed	Number of Businesses Denied Tax Credits	Range of Individual Tax Credit Requests Denied
2004-05.........	$ 1,951,626	88	$ 45 to $200,000
2005-06.........	4,056,166	213	75 to 200,000
2006-07.........	6,376,496	222	432 to 200,000
2007-08.........	1,712,114	88	250 to 177,300
2008-09.........	5,196,143	276	135 to 200,000
2009-10.........	13,013,212	[a]	[a]

[a] This information is not included because the program year has not yet closed out.

Source: Developed by LB&FC staff from information from DCED.

Table 9

Unawarded Funds by EITC Category

Fiscal Year	Scholarship Organizations	Pre-Kindergarten Scholarship Orgs.	Education Improvement Orgs.
2004-05.......	$ 509,307	$2,134,004	$269,145
2005-06.......	378,599	31,371	101,580
2006-07.......	124,288	800	35,626
2007-08.......	1,176,253	1,036,782	37,582
2008-09.......	936,946	35,994	51,219

Source: Developed by LB&FC staff from information from DCED.

We were told of several instances when a business withdrew its donation from an EIO when it was not selected to receive a tax credit. Seventy-five percent of the EIOs with whom we spoke during our phone survey reported that they had lost donations because the donor did not receive the tax credit, therefore impacting their programming and the number of students that can be served. This can be a particular problem for EIOs that receive all or most of their funding from just one or two business, if these businesses happen to not be selected.

Recommendation:

We recommend that the General Assembly consider permanently changing the distribution of annual EIO tax credits available from a first-come, first-

> ***served basis to one of proration for all businesses that submit their applications by a certain date.*** This approach should provide a more stable funding stream for EIO programs and ensure that all businesses receive some credits.

2. In response to the finding in our preliminary report that some approved EIOs did not appear to be offering "an advanced academic or similar program" as required by Act 2009-48, DCED met with officials from the PA Department of Education to review the program's guidelines. PDE was satisfied that the DCED guidelines were appropriate.

Act 2009-48 allows businesses to receive tax credits for contributions they make to approved Educational Improvement Organizations that provide "innovative educational programs" to children in public schools. The act defines an innovative education program as "an advanced academic or similar program that is not part of the regular academic program of a public school but that enhances the curriculum or academic program of the public school." The act further states that "the department in consultation with the Department of Education shall develop guidelines to determine the eligibility of an innovative educational program."

In our *Preliminary Report on Pennsylvania's Educational Improvement Tax Credit Program* (June 2009), we reported that although DCED had developed internal guidelines, these guidelines had not been developed in conjunction with the Department of Education. In addition, we were concerned because many of the approved programs did not appear to meet the test of "an advanced academic or similar program." Examples of such programs include museums, zoos, aviaries, theaters, folk crafts, sports camps, and life skills and mentoring programs for underprivileged students. When we read descriptions and spoke to representatives of these programs as a part of our survey process, DCED-approved EIO programs often appeared to be little more than that normal tours and programs routinely offered to the public.

In February 2010, DCED communicated to us that in response to our preliminary report it had met with officials in the Department of Education, and the two departments agreed that DCED's existing guidelines were appropriate.

Recommendation:

> ***Although we acknowledge that the departments have conversed on this particular issue, we recommend the DCED establish an EITC Advisory Board that would be comprised of staff from DCED, PDE, and a representative sampling of all program participants.*** This would help ensure that balanced, customer-driven program parameters could be developed.

3. DCED should seek clarification of the requirement in Act 2009-48 that an EIO must contribute "at least 80% of its annual receipts as grants to a public school for innovative educational programs."

Act 2009-48 states that an Educational Improvement Organization is:

A nonprofit entity which:

- is exempt from federal taxation under section 501(c)(3) of the Internal Revenue Code of 1986; and
- contributes at least 80 percent of its annual receipts as grants to a public school for innovative educational programs.

When asked about the requirement that an Educational Improvement Organization must contribute at least 80 percent of its annual receipts as grants to a public school, DCED reported that, in practice, it has allowed EIOs to meet this requirement in three ways:

- the provision of grants directly to a school district to carry out a program;
- contracting with an educational vendor to provide a program or to bring a scholar in to visit a classroom to speak or perform for the students; or
- the provision of services to public school students at the EIO's facilities or by bringing school children to the EIO facility to observe a special exhibit or to observe a theatrical, musical, or other educational performance.

While the first interpretation is clearly permitted by statute, the other two do not involve contributions of annual receipts as "grants to public schools." When questioned, DCED opined that "In all these instances there is a nexus with the public school curriculum by the nature of the activity as well as pre-visit and post-visit activities in the classroom." DCED further explained that in the third scenario there are numerous organizations that "uniquely provide cultural, historical, and other innovative academic lessons tied directly to public school curriculum … [and] can do so more efficiently and more authentically than would be possible in a classroom setting." DCED also noted that most EIOs provide direct services to public school students rather than direct grants to schools.

Recommendation:

We recommend DCED seek a formal legal opinion from the Office of General Counsel as to the appropriateness of its interpretation of the requirement that 80 percent of an EIO's annual receipts be contributed to a public school as grants.

4. DCED does little to monitor compliance with the EIO program statute and guidelines.

Although DCED requires EIOs to submit annual monitoring reports, DCED has chosen not to staff its program monitoring unit. So while the EIO monitoring reports are received, they are not reviewed for purposes of monitoring program outcomes and performance.[10] We also found that although participants are required to keep all program information for three years, none of the EIOs with whom we spoke reported having been asked for any of this information.

The lack of monitoring of the program has also apparently resulted in EIOs modifying their programs without DCED's knowledge or approval. When conducting our surveys and asking participants to describe their programs, in some instances, we were given descriptions that did not align with the programs that had been approved by DCED. While many of these changes may be program adjustments that DCED ultimately would approve, we are concerned because in our survey of program participants, 25 percent of the EIOs responded that they believed that there are approved organizations that are offering programs that do not meet the program's criteria.

Recommendation:

> ***We recommend DCED reconstitute its program monitoring unit and review and follow-up on the monitoring reports submitted by EIOs to ensure the EIO programs are being implemented as described and approved in the program applications.***

5. To address concerns expressed in our *Preliminary Report*, the department has added language to help clarify what is allowable as a program expense.

As a condition for remaining in the program, EIOs must spend at least 80 percent of their EITC donations on programming. As part of their year-end monitoring reports, EIOs are to report on how much of their donations have been spent on programming and how much was spent on administrative "other costs." DCED reviews these reports solely to determine if a program participant meets the 80 percent/20 percent requirement as required by statute.

In our *Preliminary Report on Pennsylvania's Educational Improvement Tax Credit Program* (June 2009), we noted that EIOs are not required to report specific expenditures for which they used their discretionary funds; they instead provide a total dollar amount. Also, neither the statute nor program guidelines defined what

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[10] These reports are reviewed only for compliance with certain fiscal requirements (see Finding 5).

constituted an eligible program expense. We recommended DCED better define what types of expenses are allowable and not allowable as program expenses.

In March, 2010, DCED did add language to the EIO guidelines further defining allowable program expenses. The Guidelines give the following examples as allowable innovative educational program expenses for which 80 percent of an EIO's contributions may be spent: salaries, space, materials/supplies, equipment, contracts, legal, or audit expenses.

6. The majority of families receiving scholarships have annual income well below maximum limits set by the act.

The act defines a school-age student eligible to participate in the EITC program as a student "enrolled in a school and is a member of a household with an annual household income of not more than $50,000. An income allowance of $10,000 shall be allowed for each eligible student and dependent member of the household."[11] Act 2009-48 raises both the maximum income to $60,000 and the allowance per dependent to $12,000. These changes go into effect beginning in FY 2011-12[12].

According to data provided by DCED, the average income per family participating in the scholarship program is $29,000, which is 48 percent of the maximum allowed for a family with one child in the scholarship program. Families applying for scholarships funded with EITC dollars, therefore, appear to be well within the maximum family income allowed for participation in the program.

7. Scholarship Organizations surveyed by the LB&FC appear to be administering their programs successfully.

To better understand how organizations administer scholarship programs, we undertook a telephone sample of 27 SOs that provide EITC scholarships to eligible students. SOs were asked a series of questions related to how they locate students who might qualify for scholarships, whether they have an application process, whether they are audited, and what role they play in directing students to schools offering scholarships.

Our survey indicated that all programs we contacted have a formal application process when awarding scholarships. The application process for all these organizations requires parents to show proof of income; organizations may use this information by itself to award scholarships, or may apply it along with other criteria

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[11] 72 P.S. §8702-F.
[12] Beginning July 1, 2012, DCED is to annually adjust both the maximum income and the income allowance amount to reflect any upward changes in the Consumer Price Index for All Urban Consumers for the PA, NJ, DE, and MD areas in the preceding 12 months.

in determining the level of scholarship assistance for which a particular student qualifies.

The survey also indicated that almost all (88 percent) of the organizations had developed a process to identify families that would benefit from their scholarships. Such programs might include having participating schools inform families about the availability of scholarship funds; marketing the scholarship program through other non-profit agencies, churches, and businesses; or using direct marketing on radio and through newspaper advertising. None of the organizations reported that they required a student to attend a particular school if they wanted a scholarship. Organizations typically work with a number of schools, and parents are encouraged to explore which institution would be best for their child.

We also asked SOs whether they were audited (or reviewed) by a third-party accounting firm, and all indicated that such audits were undertaken. A review of selected audits provided by organizations to the Pennsylvania Department of State showed that audits were of the whole organization, not just the EITC scholarship program.[13] These audits are not required to be sent to DCED, although we found through our review of files that a few organizations had forwarded copies of such audits to the department.

SOs are required to provide proof to DCED that they are 501(C)(3) non-profit organizations under the Internal Revenue Code. To determine whether organizations were complying, we reviewed the files of 42 SOs offering scholarships. We found that 39 organizations had a copy of a letter from the Internal Revenue Service (IRS) indicating that they were a non-profit in their file. For three organizations we could not find such a letter, but the file did include a check-off box indicating that the organization was a 501(c)(3).

8. Educational Improvement Tax Credit program participants are permitted to retain 20 percent of the donations they receive for non-program purposes, which appears to be a high percentage, particularly for large, established organizations.

The Educational Improvement Tax Credit Act requires that EIOs, SOs, and PKSOs contribute at least 80 percent of their receipts to a scholarship program or utilize them for innovative educational programs, whichever is applicable. The act is silent on how the program participants can spend the remaining 20 percent. In discussing this provision with persons involved in the original legislation, it appears that the 20 percent figure was deemed reasonable, considering that it was a new

[13]Under the Commonwealth law, scholarship and educational improvement organizations that solicit more than $25,000 in contributions must register annually with the Bureau of Charitable Organizations and, depending on the level of contributions, must submit either an internally prepared, compiled, reviewed, or audited financial statement. Certain organizations, such as educational foundations which are directly responsible to educational institutions, are exempt from these requirements.

program and that participants were likely to incur administrative startup costs, at least during the initial years of the program. Program participants do not have to report how they use their retained amounts, and the statute precludes the department from inquiring.

However, our survey found that many EIOs, SOs, and PKSOs typically contribute far more than 80 percent to scholarships and programming. In fact, we found that the average amount of contributions used for scholarships and/or programming averaged approximately 92 percent statewide, with several participants contributing 100 percent of their donations for scholarships or direct programming. Conversely, we found others that routinely only contribute the minimum (80 percent) amount. There were variances among organizations as to type, age, geographic location, constituency, and size, but we could establish no patterns that would suggest that scholarship or programming funding levels are based on any particular set of factors. It appears that percentage retained is based more on historical usage and an organization's philosophy than on factors such as high initial start-up costs.

DCED staff confirms our findings and reports that 62 percent of current program participants are using 100 percent of their donations for direct program purposes, with only about 5 percent contributing the minimum amount allowed by statute (80 percent).

Our research into allowable administrative costs for publicly funded programs yielded results that varied from program to program, but we found that often administrative costs are limited to between 10 percent and 15 percent of total program costs. Our review of eight tax credit programs in other states found that five have a requirement that at least 90 percent of donations be utilized for scholarship purposes, and one had a requirement that 97 percent of donations be utilized for scholarship purposes.

Recommendation:

> ***We recommend that the General Assembly consider amending the EITC statute to increase the percentage of donations that must be used for scholarships or direct programming purposes from 80 percent to 90 percent.*** If this is deemed too onerous for small or start up organizations, whose administrative costs might be greater than those of larger, established organizations, thought should be given to enacting a sliding scale, where the percentage required to go to scholarships or programs increases as the amount of donations collected increases.

9. DCED staff assigned to the EITC program is serving program participants well.

As a result of phone survey questions, we found that the EIOs, SOs, and PKSOs we contacted are satisfied with the services they receive from DCED staff. Three analysts work under the Director of the Tax Credit Bureau within the Center for Business Financing in DCED; SOs, PKSOs, and EIOS are divided evenly between the analysts. The analysts have a variety of functions with the program, including initially recommending EIOs for approval, ensuring all documentation is in files, answering participant questions, and processing year-end monitoring reports.

As part of the phone surveys we conducted with EITC participants, we asked two questions relative to communications with DCED staff. We first asked if participants felt that DCED staff is timely in its responses to them. Ninety percent of EIO participants and 96 percent of SOs/PKSOs answered yes to this question. In general, the people with whom we spoke were complimentary, saying that there is no trouble getting in touch with DCED staff, that staff is good at getting back to them, and that they are very helpful.

We also asked if participants felt that DCED communicates adequately with them. Eighty-four percent of EIOS and 100 percent of SOs/PKSOs answered yes to this question. Participants commented that staff are helpful with the application process and usually give answers that were better than expected. Another commented that they were pleased with the email reminders sent by DCED. One EIO with whom we spoke commented that they found the program was initially very confusing and that DCED could possibly put more guidance on the web, or possibly hold webinars to answer questions.

10. The EITC program is an almost entirely paper-based operation, which creates inefficiencies in program administration.

Although many Commonwealth programs have been converted to electronic filings, the EITC program remains almost an entirely paper-based operation. This program has continued to grow every year since its implementation, with escalating numbers of business donors, EIOs, SOs, and PKSOs participating in the program. Every year, there are several documents that must be transmitted to DCED, by both organizational and business participants, for the department to adequately administer this program. These documents include:

- New applications and renewal applications for SOs, PKSOs, and EIOs and accompanying documentation.
- New applications/renewal applications for contributing businesses.
- Acknowledgement of a contribution by an organization.
- Year-end monitoring reports.

Because businesses, SOs, PKOs, and EIOs (approximately 3,000 program participants annually) must submit this information in a paper format every year to continue to participate in the program, DCED staff receives much paperwork throughout the year that must be sorted, reviewed, and filed appropriately. EITC staff consists of one Division Chief and three analysts. In addition to this program, these individuals also have responsibility for administering several other programs, including the Job Creation Tax Credit Program, and significant role in the PENNVEST and PENNDOT Infrastructure Bank programs.

Program participants must also meet certain deadlines, which further adds to the administrative challenges of this program. Finally, having all of the program participants' information online should make it easier to obtain a chronological, comprehensive picture of a participant's involvement in the program, thus making monitoring an easier task.

DCED reported that its IT staff has received a request to convert the existing EITC applications to an electronic version and that implementation of such action will occur when time and priorities permit.

Recommendation:

> ***We recommend that DCED begin the process of converting the EITC program into electronic files that SOs, PKSOs, EIOs and donating businesses can access on-line.*** After the conversion is completed, this should save a significant amount of time in accessing files and permit electronic flagging of missing information, such as overdue year-end reports or missing superintendent letters,[14] and an improved ability to monitor and analyze the program using computer-generated statistics and reports.

11. There may be an unfair advantage created with statutory language related to the addition of pass-through entities as eligible tax credit recipients.

Beginning in tax year 2009, Pennsylvania S corporations and other business entities, such as partnerships, that pay taxes through the shareholders/partners personal income tax—called pass-through entities—are now better able to participate in the educational tax credit program. The Legislature made this change to the program in anticipation of the phasing out of the capital stock and franchise tax to ensure that these businesses, who pay their taxes this way, could continue to participate in the program. Currently, the capital stock and franchise tax will expire for taxable years beginning after December 31, 2013. However, the statute dictates that those seeking a tax credit under these new categories added in 2009 must

[14]EIOs are required to obtain letters of support from superintendents in the school districts they propose to serve; we found several instances in which such letters were in not the EIO's file.

wait until after the first business day following July 7 every year to be eligible to make their applications to DCED.

Because the tax credits allocated for EIOs have historically almost always been fully exhausted on the first day of the new program year (July 1), there would almost certainly be no tax credits available after July 7 for pass-through entities that want to donate to an EIO. (Credits would, however, likely be available for contributions to SOs and PKSOs, as these programs have not historically been over prescribed.) It is our understanding that when the law was changed to allow additional types of taxpayers to be eligible for the tax credit, long-term program advocates did not want those businesses that had already been participating in the program to lose their ability to receive tax credits.

Recommendation:

> ***We recommend the General Assembly consider amending the EITC statute to remove the prohibition that restricts pass-through entities from applying for tax credits until after July 7.***

II. D. Employment Incentive Tax Credit

Background and Overview

The Employment Incentive Tax Credit program (EIP) was originally implemented by Act 1982-75 as an amendment to the Public Welfare Code. Currently, the statutory provisions for this program are found at 72 P.S. §8702-A et seq. The EIP is primarily administered by the Tax Credit Coordination Services (TCCS) office, Bureau of Workforce Development Partnership, within the Department of Labor and Industry (L&I). By statute, the program expired at the end of CY 2009, and qualifying employees must have been hired by December 31, 2009.[1,2] The limit for EIP tax credits was $25 million per year; however, this was cut to $12.5 million in FY 2009-10 by Act 2009-48.

The purpose of the program was to provide incentive for employers to hire individuals who:

- at any time within the 12 months preceding the start to work date, received General Assistance (GA) or Temporary Assistance for Needy Families (TANF) or

- were disabled persons who completed or were completing rehabilitative services approved through the State Rehabilitation Services Program or the U.S. Department of Veterans' Affairs.[3]

The tax credit encouraged employers to hire job seekers who have received GA or TANF or who receive or received rehabilitative services. By hiring individuals from these groups, an employer could earn tax credits that could be applied to the personal income tax, Corporate Net Income Tax, Bank and Trust Company Shares Tax, Title Insurance Companies Shares Tax, and Insurance Premiums Tax.[4] Any unused credits may be carried over against a qualified tax liability in the ten immediately subsequent taxable years, but may not be sold or assigned to another party.[5] There are certain circumstances in which the EIP statute prohibited the EIP credit from being claimed. These include:

- a person who displaces any other individual from employment except those discharged for cause;

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[1] 72 P.S §8706-A
[2] According to DOR Counsel, those employers who hired eligible employees by December 31, 2009, remain eligible for three years of the credit as provided for in the program. However, in the Governor's Budget Document for FY 2010-11, there is no credit amount beyond FY 2010-11.
[3] 72 P.S. §8702-A
[4] 61 Pa. Code §2.2. Additionally, employers who are savings and loan companies may use the credit against the Mutual Thrift Institutions Tax.
[5] 72 P.S §8702-A

- a person who is closely related[6] to the taxpayer or, if the taxpayer is a corporation, to an individual who owns, directly or indirectly, more than 50 percent of the outstanding stock of the taxpayer; and
- wages paid to an individual during the time period for which the employer also received federally funded or state-funded job training payments for that individual.[7]

EIP had no annual reporting requirement, and only two reports were required by the General Assembly: a 2004 report was required by Act 1999-63 and a 2008 report was required by Act 2004-116. Both reports were completed and forwarded to the General Assembly.

Although the statute called for EIP to be administered by the Department of Revenue (DOR) in cooperation with L&I and DPW, the regulations[8] promulgated by DOR required that DPW verify eligibility and issue certifications. In practice, this function was performed by L&I and taxpayers claimed the credit on their tax returns. Returns are submitted to DOR, with Schedule W, on which employers reported qualifying employees, wages, and day care/transportation costs, accompanying the return.

Application Process

In order to have received the tax credit, the employer and employee jointly filled out a Tax Credit Certification Request Form, on which employees certified that they received GA, TANF, or vocational rehabilitation services. This form was to be sent to L&I within 21 days of an employee's start date. Both employer and employee signed the form to attest to accuracy and validity. These forms were sent to L&I, where the request was input into a computer by an L&I employee, who verified employee eligibility.[9] To verify employee eligibility, verification was determined through access to DPW and L&I databases. Determination letters were then mailed to employers for their retention.

Credits

An employer could earn EIP credits for each qualifying employee for the first three years of employment. The employer could earn a tax credit for up to 30 percent of the first $9,000 in first year wages, 20 percent in the second year of the

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[6] As defined by §152(a) of the IRS Code.
[7] 72 P.S. §8703-A.
[8] 61 Pa. Code §2.3.
[9] Originally, the Tax Credit Coordination Services office generated a list of individuals requiring verification, which was forwarded to DPW and OVR where staff of the two departments completed verifications. According to L&I, its processors now have access to DPW and OVR databases and make the eligibility verifications themselves.

first $9,000 in wages, and 10 percent in the third year of the first $9,000 in wages.[10] Additionally, if the employer provided or paid for day care services for an employee's dependent children or any transportation services for employees to enable them to get to work, it could claim additional credits up to $800 for the first year and $600 and $400 for the second and third years, respectively.[11]

Table 10 shows the number of individuals certified by L&I for the period of July 1, 2007, to June 30, 2009. Forty-three percent of requests were certified; L&I received a total of 27,731 certification requests for this period and certified 11,842 of them. Of the total number of certifications, eligible employees who received GA/TANF comprise 95 percent of the total; the remainders of certifications were employees who received rehabilitative services. According to L&I, there are several reasons for so many denials of certification requests. These include:

- Requests were poorly screened by the employer prior to submission, resulting in requests that were untimely, had missing signatures, or lacked a check next to the qualifying target group.
- Applicants misunderstood the target group definitions and marked one, even though he or she was not eligible.
- Employers checking a target group box that the applicant left blank hoping the applicant had made an error.
- Errors with the verification process.

Table 10

Total Certifications, FY 2007-08 to 2008-09

Group	No. Certified	Avg. Start Wage	Male	Female	No. Unique FEINs
DPW.........	11,234	$7.76	1,695	9,269	584
OVR.........	608	$7.99	382	382	281
Total.......	11,842		2,077	9,651	865

Source: Developed by LB&FC Staff with data provided by the Department of Labor and Industry.

The low number of employer FEINs (Federal Employment Identification Numbers), as compared to number of certified employees, would indicate that at least several big employers hired multiple qualifying individuals. From FY 2003-04 to 2007-08, the number of unique FEINS ranged from 539 to 678.

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[10] 72 P.S. §8703-A.
[11] Ibid.

Departmental Promotion of the Tax Credit

Both L&I and DPW reported using the EIP as a tool in aiding their clients in attaining gainful employment. However, both departments expressed that their emphasis is on finding jobs, not necessarily the EIP. Although both departments trained their respective staffs on the EIP, various stakeholder groups with whom we spoke have commented that the program would have benefitted from a more concentrated marketing effort by both departments.

Within DPW, in the county assistance offices, job developers were educated and trained on the EIP. Job developers[12] work with DPW's TANF and General Assistance clients in assisting them find employment. DPW also reported it had reached out to employers to educate them on the tax credit.

Within L&I, the Office of Vocational Rehabilitation provides vocational rehabilitation services to help persons with disabilities prepare for, obtain, or maintain employment. There are 21 field offices, although not all have placement counselors. According to OVR officials with whom we met, including a Rehabilitation Specialist, OVR works with potential employers to place its customers. Staff reaches out to employers, and employers also contact OVR. Each employer is provided with a packet of literature, a Business Services Portfolio, that explains the various tax and work incentives available to help employers cover workplace accommodation costs for employees with disabilities. Included in this was a sheet with information on the EIP, explaining how the employer could use the credit.

According to OVR officials, OVR counselors encourage their clients to sell their skills, rather than the EIP, to potential employers as the basis for hiring them. An official stated that often their clients are reluctant to talk about the credit because they do not want to reveal their disabilities. OVR nevertheless saw the EIP as another tool that can assist in the placement of its clients. However, since so few of the EIP eligible employees coming from OVR used the credit—only 608 were certified over two years—the OVR official told us that the elimination of EIP will not have a significant impact on job placement.

CareerLink offices are also administered through L&I. We interviewed several CareerLink officials and they all used similar methods to inform both job seekers and employers about the tax credit. In general, CareerLink officials reported that employers were receptive to the EIP.[13] All officials stressed that the most important aspect of their work is to find qualified employees for those businesses seeking to hire so that they return to the CareerLink when they need additional

[12] DPW contracts with Workforce Investment Boards for the job developer positions within County Assistance Offices.
[13] One CareerLink official said that employers often use the EIP in conjunction with the Work Opportunity Tax Credit (WOTC). See page 41 for more information on the WOTC.

employees. They saw the EIP as an additional incentive, not as a primary selling point, for a particular individual. Additionally, several officials said that they thought utilization of EIP would increase if additional groups, e.g., veterans, were eligible. This would open the program to many more job seekers and allow them to give an employer an additional incentive to hire them.

Several officials told us that there is a certain stigma attached to the EIP, especially for the job seekers that are seeking employment who are currently receiving assistance from DPW. This kind of stereotyping occurs with both employers and employees. The employer who has bad experiences with such employees is going to be less likely to use the program in the future; however, there are employers who have had good experiences as well.

Tax Credits in Other States and Nationally

The Work Opportunities Tax Credit is a federal program that gives tax credits to employers for hiring certain categories of people. Several other states have tax credit programs similar to Pennsylvania's, although they are primarily targeted toward people with disabilities and veterans, rather than those who have received General Assistance or TANF.[14]

The Work Opportunities Tax Credit (WOTC). This federal program provides a tax credit for up to one year for employers who hire persons deemed to have barriers to employment. WOTC includes several categories of eligible employees that differ from Pennsylvania's EIP program. In addition to the two eligible Pennsylvania categories (disabled individuals who have received rehabilitative services or those having received TANF or General Assistance), eligible employees include food stamp recipients, veterans, disabled veterans, designated community residents, summer youth, SSI recipients, Hurricane Katrina employees, ex-felons, and disconnected youth.

The credit is 25 percent of qualified first-year wages for those employed at least 120 hours but fewer than 400 hours and 40 percent for those employed 400 hours or more. WOTC applies only to new employees who began to work for an employer after December 31, 2006, and before September 1, 2011. To receive certification that a new employee qualifies the employer for this tax credit, the employer must complete page one of IRS Form 8850 when the individual is hired, complete either the one-page Employment & Training Administration (ETA) Form 9061 or

[14] Some states have tax credit programs for employees who have been involved with the criminal legal system. Iowa and Illinois have tax credits for hiring convicted felons, and those on parole or probation. Texas, Indiana, and California have tax credit programs for prison inmates. Louisiana has a program for first-time non-violent offenders. Illinois has a tax credit for ex-felons.

Form 9062 as appropriate,[15] and mail the completed and signed IRS and ETA forms to the employer's state workforce agency within 28 days after the employee's employment-start date. This is different than Pennsylvania which requires that certification forms must be sent to L&I within 21 days of an employee start date.

Other States

Maryland. Hiring the Disabled. The Maryland Disability Employment Tax Credit (MDETC) encourages employers to hire qualified individuals with disabilities, including disabled veterans. It allows a credit of an amount equal to 30 percent of up to the first $6,000 of wages paid during the first year of employment and 20 percent of up to the first $6,000 of wages paid during the second year. There is also a credit for employer paid child care or transportation expenses, up to $600 during the first year and up to $500 for the second year. Credits may be taken on Corporate Income Tax, Personal Income Tax, Insurance Premiums Tax, or the Public Service Company Franchise Tax. Additionally, the Employment Opportunity Tax Credit gives employers the same credits as above for TANF recipients.

Louisiana. Employment of the Previously Unemployed. A credit against Louisiana income and corporation franchise taxes is allowed for employers who hire previously unemployed Louisiana residents and recipients of Family Independence Temporary Assistance Payment (ITAP) who are participating in the state's Family Independence Work Program (FIWP) program. The credit is $750 for each new job. The credit is available only after the employer has increased the number of jobs in the business by more than 5 percent over the base, i.e., by more than 5 percent of the average number of full-time jobs reported in the previous period.

Illinois. Wages Paid to Veterans. For taxable years beginning after 2006 and ending before 2011, a credit may be taken against Illinois corporate income tax for wages paid to qualified veterans. The credit amount equals 5 percent, but in no event is to exceed $600, of the gross wages paid by the taxpayer to a qualified veteran in the course of that veteran's sustained employment during the taxable year. For each year beginning with 2010, the credit amount equals 10 percent, but in no event is to exceed $1,200, of the gross wages paid by the taxpayer to a qualified veteran. The credits may not reduce the taxpayer's tax liability to less than zero. Excess credits may be carried forward for five taxable years.

Colorado. Employers of Public Assistance Recipients. Employers of persons receiving public assistance through the Colorado Works Program are allowed a two-year corporate or personal income tax credit equal to 20 percent of the employer's annual investment in providing any one or more of the following services to

[15] If the new employee has already been conditionally certified as belonging to a WOTC target group by a state workforce agency (SWA) or participating agency, he or she is to complete the bottom part of ETA Form 9062, sign and date it, or if the new employee has not been conditionally certified, the employer and the new employee must complete, sign, and date ETA Form 9061.

employees receiving public assistance: child care services, health care or dental insurance, job training or basic education, and programs for the transportation of employees. The credit may not exceed an employer's actual tax liability for that year. Any excess credit amount may be carried forward to each of the following three tax years.

Utah. Hiring the Disabled. Employers may claim a credit against the corporation franchise or personal income tax for hiring individuals with disabilities. The individuals must work in Utah for at least 180 days in a tax year and must be paid at least minimum wage. The credit is allowed for the first two years of employment in an amount equal to 10 percent of the gross wages earned by the individual in the first 180 days of employment and 20 percent of the gross wages earned by the individual in the remaining tax year. The credit may not exceed $3,000 per individual per year. Any unused credit may be carried forward to the two tax years following the tax year of the qualifying employment.

West Virginia. Job Creation/Hiring Credits. A personal or corporate net income tax credit is allowed to each person, partnership, or corporation that employs an economically disadvantaged Vietnam-era or Korean conflict veteran, a disabled veteran, an unemployed member of the WV National Guard, or a member of the U.S. Reserve Forces for a continuous period of one year. For each economically disadvantaged Vietnam-era or Korean conflict veteran employed, the credit is equal to 30 percent of the employee's wage base. For each disabled veteran, the amount of the credit is equal to the percentage of disability suffered by the veteran multiplied by the employee's wage base. For each unemployed member of the WV National Guard or member of the U.S. Reserve Forces, the credit is equal to 25 percent of the employee's wage base.

Findings and Recommendations

1. Although the program was authorized to award up to $25 million in credits annually, there has been low utilization of the tax credit, averaging just under $2 million per year.

For fiscal years 2000-01 to 2006-07, average use of the tax credit was $1.8 million per year, ranging from a low of $1.5 million to a high of $2.2 million. Table 11 shows tax credits redeemed for the above mentioned fiscal years and whether they were taken against corporate or personal income taxes.

Table 11

Annual Utilization of EIP
($ Millions)

Fiscal Year	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Tax Credits Redeemed Against							
Corporate Taxes	$1.40	$1.50	$1.30	$1.00	$1.50	$1.10	$1.00
Personal Income Tax	0.50	0.40	0.50	0.50	0.70	0.50	0.90
Total	$1.90	$1.90	$1.80	$1.50	$2.20	$1.60	$1.90
Number of Taxpayers Redeeming Credit:							
Corporate Taxes	59	67	68	78	88	65	39
Personal Income Tax	353	228	293	240	338	195	205
Total	412	295	361	318	426	260	244

Source: Department of Labor & Industry.

We spoke to various program officials, including L&I, DPW, OVR, and several CareerLink offices as to why they think the program was underutilized. Both OVR and CareerLink offices have direct contact with both job seekers and employers. Both entities provide information about the tax credit to both job seekers and employers. All have told us that placing an appropriate individual in an appropriate job is the priority, and although the EIP is an additional incentive, it is not a primary element in the organizations' efforts to place an individual.

Another official we spoke to suggested that the problem might be that, although employers fill out the initial paperwork to get the employee certified, they might neglect to fill out the final Schedule W with their tax returns that enables them to receive the credit. OVR officials suggested some reasons for underutilization might be: that employers did not understand the tax credit program, some distressed businesses might not have tax liability, and that there was reluctance on clients' parts to reveal that they are disabled or receiving assistance.

Although both OVR and CareerLink offices have told us that their counselors are trained on EIP and used it as a tool to aid in job placement, one CareerLink director with which we spoke informed us that she had not known about the program, which has been in existence since 1982, until recently, when an L&I official came to their office for a training session regarding various programs. L&I has suggested that, if reauthorized, all three departments involved with EIP should improve marketing efforts, including targeting new PA employers as they receive their Tax ID numbers. And another CareerLink official suggested putting more information about EIP in Chambers of Commerce newsletters and in unemployment offices.

Recommendations:

If the EIP program is reinstated we recommend:

a. ***The categories of eligible employees be expanded.*** The federal WOTC has twelve categories of individuals that an employer can hire to qualify for the tax credit. If the EIP program were to include more categories, e.g., veterans, SSI recipients, or food stamp recipients, more employers might be incentivized to hire these individuals. Both OVR and CareerLink officials expressed support for category expansion.

b. ***Program regulations be amended to extend the time for employers to submit the certification form to L&I.*** If employers are hiring individuals that are eligible for both the EIP and the federal WOTC program, the regulations for EIP should be amended to give employers 28 days to submit an application for employee certification, as is allowed with the WOTC, rather than the 21 days under EIP. This might help more employers utilize the EIP. Additionally, when an employer is applying for both WOTC and EIP, L&I should eliminate the need for a separate EIP form. If, when determining eligibility for WOTC, and the department sees that the employee is eligible for both programs, the department should certify for both.

c. ***L&I have the ability to accept electronic tax credit requests.*** This would reduce paperwork for employers and decrease processing time for the Tax Credit Coordination Services office.

d. ***DPW and L&I do more to market the EIP and increase utilization of the program.***

e. ***DOR consider amending 61 Pa. Code §2.3 of the EIP regulations to reflect that L&I verifies employee eligibility and issues certifications.*** The regulations required that DPW have responsibility for verification and issuance of certification, but L&I performed this function for EIP. According to L&I, it performs these functions in order to assist in administering the program on behalf of DOR.

f. ***DOR consider amending61 Pa. Code §2.1 and §2.4 of the EIP regulations to reflect that an additional tax credit can be claimed by the employer if that employer provides or pays for transportation services.*** The statute states that the additional credits can be claimed if the employer pays for or provides for day care services. The employer may also take this additional credit for providing or paying for transportation services that enable an individual to travel to and from work. The regulations, as written, do not reflect that an additional credit can be claimed for transportation services. This change would better align the statute and regulations.

2. Employers often do not claim the EIP credit.

There is a discrepancy with the number of unique FEIN's reported by L&I and the amount of credits that have been submitted to DOR. As Table 12 shows, from FY 2003-04 to 2006-07, an average of only 48 percent of employers that were issued certifications actually claimed their EIP credits, which implies that the majority of employers are not claiming their EIP credits.

Table 12

Number of Unique FEINs to Taxpayers Claiming Credits

	No. Unique FEINs	No. Taxpayers Claiming Credit	% Claiming Credit
2006-07.......	650	244	38%
2005-06.......	610	260	43
2004-05.......	654	426	66
2003-04.......	678	318	47

Source: Developed by LB&FC Staff from data provided by L&I and DOR.

Both the DOR and L&I wanted to verify their data and find a reason for the variation between certifications issued and the number of credits being claimed. According to an L&I official, DOR was able to verify that most of the companies were not redeeming their certificates for credit. L&I cannot explain the reason why companies would apply for the certificates and fail to redeem them. However, anecdotally, it may be that employees did not complete the required year-long retention period, or that employers simply forgot to claim their credits.

Recommendation:

If the EIP is reauthorized, the Department of Revenue should contact a sampling of those taxpayers who have not claimed their credits to determine the reasons why they have failed to do so. A survey of those taxpayers could help both L&I and DOR understand why qualified taxpayers are not using this program. If DOR finds that taxpayers are redeeming their certificates, then DOR should determine why the system is not accurately capturing the data.

3. There are several program requirements that are not verified.

In addition to the EIP credit for employees' wages, employers are also eligible to receive tax credits if they provide any transportation or child care costs for EIP eligible employees. These costs are reported on Schedule W, a DOR form specific to the EIP. Although DOR maintains that they perform a comprehensive review of the taxpayer's corporate tax filing by comparing federal and state documents to the amounts reported on the PA corporate tax report, there is no requirement to provide evidence for child care services or transportation. DOR accepts that the dollar amounts for these services are true and valid.

Additionally, there are certain hiring scenarios where the EIP statute prohibits an employer from being granted the EIP credit. These include:

- A person who displaces any other individual from employment except those discharged for cause;
- A person who is closely related[16] to the taxpayer or, if the taxpayer is a corporation, to an individual who owns, directly or indirectly, more than 50 percent of the outstanding stock of the taxpayer;
- Wages paid to an individual during the time period for which the employer received federally funded or state-funded job training payments for that individual.

L&I processes the initial certification requests assuming that the employer has met the above requirements, yet these requirements are not listed on the application form nor on the schedule W. Currently the only time that it could be determined that these restrictions had not been adhered to would be if the DOR performs a field audit of a company that has claimed the EIP, during which, in some cases, employee records would be requested.

Recommendations:

a. We recommend that if this program is reinstituted, Schedule W be changed to include additional space for an employer to identify day care providers and transportation service providers when they are taking additional tax credit for paying for these services for eligible employees.

b. We also recommend that the application for this program "Tax Credit Certification Request Form" be changed to include information regarding the specific hiring restrictions outlined in the EIP statute and a place for the employer to certify that they are complying with the law in this regard.

[16] As defined by §152(a) of the IRS Code.

4. None of the departments responsible for the EIP program have measured longer-term impacts of the EIP.

One of DPW's most important goals is to help individuals move from welfare to work and to help families achieve economic independence. Measures of this goal could include the duration of employment of EIP-eligible employees and changes in wages.

The Tax Credit Certification Request form does ask if the availability of the EIP credit contributed to the employer's decision to hire that particular person, which could be used, in some respect, to evaluate the impact of the program. However, any data that is collected by L&I is not used for evaluative purposes because most employers do not answer the question. For example, in 2009 there were 1,230 employers who said the EIP program influenced their hiring decisions. However, the remaining 4,179 employers either answered "no" or did not answer the question at all.

Recommendation:

> ***If continued, the three departments should work together to develop performance measures for the EIP program.*** In the 2008 EIP Report and Recommendations to the General Assembly, L&I stated, that if the program were to continue, the department would implement a system for tracking the duration of employment of EIP workers plus any changes in their wages over the period that the employer claims the credit. According to L&I, retention data is available through its Center for Workforce Information and Analysis. Those measurements would be helpful in determining the impact of the EIP program.

II. E. First Class Cities Economic Development District Tax Credit

Background and Overview

The First Class Cities Economic Development District Act, Act 2004-226, 53 P.S. §18200.101 et seq.,

> …established within the Department of Community and Economic Development a program to be known as the First Class Cities Economic Development District Program.[1] The program shall encourage development of deteriorated property by providing the tax exemptions, deductions, abatements or credits provided by this act to persons who own interests in qualified pass-through entities and to residents of and qualified businesses located in economic development districts.[2]

The act allows companies leasing space in the Economic Development District (EDD) to earn tax credits for business conducted within the district. According to the act, tax credits may not extend beyond December 31, 2018. Credits may be taken against personal income tax or corporate net income tax. Companies are also exempt from sales and use tax on otherwise taxable services or goods consumed exclusively within the district. The act notes that "it is in the best interest of the Commonwealth to assist and encourage the creation of economic development districts and to provide temporary relief from certain taxes within the economic development districts."[3]

The tax credit created by the act was specifically intended to help support vendors that operate out of the Philadelphia Regional Produce Market (PRPM). The PRPM, which has been located in the city since 1959, had been trying to expand its operations since at least the 1980s, and intensified those efforts in 2004. Such expansion was impossible at its present location in the city, and the produce market was in negotiations with the State of New Jersey to relocate to the Camden, New Jersey waterfront. Not wanting to lose a major employer, the State of Pennsylvania and the City of Philadelphia stepped in and created a package of incentives, one of which was the tax credit, to encourage the PRPM to remain in Pennsylvania.

[1] An economic development district is a clearly defined geographic area comprised of deteriorated property located in a city of the first class which has been designated by the Department of Community and Economic Development under §18200.301(d) as an economic development district. The City of Philadelphia is the only first class city in Pennsylvania.
[2] 53 P.S. §18200.301(a).
[3] 53 P.S. §18200.102.

In order for the First Class Cities Economic Development District (FCCEDD) to be officially designated, i.e, the tax credit program to be in effect, several actions had to occur. First, a suitable site had to be designated by a Governor's Executive Order no later than July 15, 2005. This Executive Order, designating a large unused portion of the Philadelphia Navy Shipyard, was signed on July 14, 2005. Secondly, the act required the City of Philadelphia to petition the Pennsylvania Department of Community and Economic Development (DCED) for approval of the proposal to designate the deteriorated parcel of land as an economic development district, thus signifying agreement with the Governor's designation.[4] As of November 2009, this second step had not occurred because the site chosen in the Executive Order was found to be unsuitable for a number of reasons, mostly environmental in nature. Therefore, a second and current site, known locally as Essington Commons, was chosen for development as the expanded PRPM.

In September 2008, construction began on the new facility. It is anticipated that PRPM will relocate to its new facility by the fall of 2010. The development of the site, which was not the site designated in the Governor's July 14, 2005, Executive Order, and the construction of the new facility are moving forward despite not being eligible for the tax credit program created through Act 2004-226.

In response to our inquiry regarding the program, on August 24, 2009, DCED sent the LB&FC a letter formally indicating that the FCCEDD tax credit program was inactive because the City of Philadelphia had not applied for the approval of the designated property to be classified as an EDD. In addition, the Acting Director of the City of Philadelphia's Business Action Team confirmed that the City had taken no action to petition for the creation of an economic development district and did not anticipate taking any future action to petition DCED to designate a portion of the city as an EDD. As a result, the tax credits are no longer available to vendors who will occupy the new facility.[5]

Costs to administer the program were to be borne by DCED and the Department of Revenue.[6] The Governor's Executive Budgets did provide estimates of the tax credits anticipated to be awarded for the program. Please see Table 13 for this information. However, because the tax credit program was not implemented the estimates never became actual tax credits issued.

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[4] The request from the city was to be on a form provided by the department. However, no form was ever developed by the department.

[5] There were a number of specific requirements placed on DCED in development of the tax credit program which are not described here because the tax credit is no longer available. Please see Act 2004 -226 for information on these requirements.

[6] The Governor's Budget anticipated annual administration costs of $100,000 .

Table 13

Anticipated Tax Credits That Were to Be Awarded to Businesses Through the First Class Cities Economic Development District Tax Credit Program

Fiscal Year	Anticipated Tax Credits
2005-06	$2,200,000
2006-07	$2,500,000
2007-08	$2,800,000
2008-09	$2,900,000
2009-10	$3,100,000

Source: Governor's Executive Budget documents.

As discussed, the impetus for the statutory creation of the FCCEDD was to create an incentive for an expanded Philadelphia Regional Produce Market to remain in Philadelphia, which is occurring without the use of the tax credit program. Due to the language in the authorizing statute allowing tax credits to be available until December 31, 2018, at some point in the future there could be another designation of an economic development district in Philadelphia. However the General Assembly would have to amend the act or pass new legislation in order to allow the designation of a possible site through executive order. Although this is not anticipated, if this is not the intent of the General Assembly, the legislature may wish to repeal Act 2004-226, the First Class Cities Economic Development District Act.

II. F. Homeowners' Emergency Mortgage Assistance Fund Tax Credit

Background and Overview

The Homeowners' Emergency Mortgage Assistance Program (HEMAP), created by Act 1983-91, is a loan program designed to protect Pennsylvania homeowners who are financially unable to make their mortgage payments and are, therefore, in danger of foreclosure.[1] Currently, funding for the program comes from General Fund appropriations, and repayments to the fund from loan holders. The program, which is administered by the Pennsylvania Housing Finance Agency (PHFA), permits eligible applicants to receive assistance in an amount sufficient to bring mortgage payments current and they may also receive continuing assistance for up to 24 months. Repayment of HEMAP loans begins, and interest starts to accrue, when the recipient is financially able to pay.

Current law requires HEMAP loan recipients to repay their loans only when the recipient's housing expense (mortgage, taxes, utilities, and insurance) does not exceed 40 percent of net household income (gross income minus federal, state, and local income taxes). Since the inception of the program in 1983, the PHFA has channeled more than $217 million of General Fund monies and $239.5 million of repayments into HEMAP to save more than 41,000 homes from foreclosure.[2]

Act 1983-91 also established a program that gave businesses a tax credit for contributions made to the HEMAP fund. A tax credit against business income taxes of up to 70 percent of the total contribution given was allowed. An annual cap of $15 million in tax credits was established. According to an official with PHFA, the HEMAP tax credit program never caught on and was only ever utilized one time by a single business.

Through the years, direct General Fund appropriations and loan repayments into the fund have made up the bulk of the allocations available to write new loans. For these reasons and due to underutilization, the tax credit portion of the HEMAP program was repealed by Act 1998-160.[3] Although PHFA officials had communicated to LB&FC staff that they have contemplated seeking to resurrect the repealed tax credit portion of the HEMAP program, as of March 2010, they have not formally sought to do so. Also referenced in the Governor's budget is the Low Income Housing Tax Credit administered by the PHFA. This, however, is a federal income tax credit issued to businesses that build or rehabilitate low income housing, and no state tax credits are involved in this program.

[1] See Act 1983-91.
[2] Governor's Executive Budget FY 2009-10.
[3] The HEMAP tax credit was included in the FY 20007-08 Executive Budget document at a zero amount, but has not been included in subsequent budgets.

II. G. Job Creation Tax Credit

Background and Overview

With the passage of Act 1996-67, which was repealed and replaced by Act 2001-23, 72 P.S. §§8801-B - 8806-B, the "tax credit for new jobs program," was created. This tax credit is more commonly known as the Job Creation Tax Credit. It is administered by the Department of Community and Economic Development and is promoted as one of the Commonwealth's key economic development components because it offers incentives to encourage existing businesses to grow and attract new business. In addition to the statute, the department has developed guidelines that govern their administration of the program. As stated in these program guidelines,[1] this tax credit was established for the purpose of securing job-creating, economic development opportunities through the expansion of existing businesses and the attraction of economic development prospects to the Commonwealth of Pennsylvania.

Total Tax Credit Limits

When first enacted, the Job Creation Tax Credit program (JCTC) was authorized to award $15,000,000 annually in tax credits. The program's award total was later increased to $20,000,000 in FY 1998-99. An additional funding increase of $2,500,000 was authorized in FY 2001-02, for a total of $22,500,000 in tax credits annually. It is statutorily required that 25 percent of all job creation tax credits be available until April 30 of every year to those businesses that employ 100 or fewer employees.[2] DCED ensures that 25 percent is available for small companies, but reports that demand has never reached that level. Any portion of the 25 percent that is remaining after April 30 becomes available to other eligible businesses.

Due to the recent economic downturn, Act 2009-48 reduced several of the Commonwealth's tax credit programs, including JCTC, by 50 percent for FY 2009-10 and by 55 percent for fiscal year 2010-11. With the passage of Act 48, the job creation tax credit program is now authorized to award a maximum of $11,250,000, for FY 2009-10 and $10,125,000 for FY 2010-11. Table 14 shows the allocation of JCTC credits awarded by DCED for FY 2006-07 through May, FY 2009-10.

Prior to this year, there had been an average of 105 companies that participated in the program annually. Due to Act 48 the number of program participants has been reduced by about 50 percent, although the tax credit award amounts per participant have not changed. The enabling legislation for the Job Creation Tax

[1] Accessible via the Internet at www.newpa.com.
[2] 72 P.S. §8805-B(b).

Credit program provides that DCED may reissue or assign prior fiscal year tax credits which have been recaptured and may award prior fiscal years credits not previously issued.[3]

Table 14

Tax Credit Award Totals by Fiscal Year
($ Millions)

Fiscal Year	Number of Program Participants	Tax Credit Award Total	Tax Credits Utilized
2006-07	113	$29.1	$17.6
2007-08	100	24.4	13.3
2008-09	103	25.8	40.0
2009-10	50	13.3	19.8
Totals...........	366	$92.6	$90.7

Source: For FYs 2006-07 to 2008-09, data was obtained from DCED's "Job Creation Tax Credit Program (Investment)" Chart. For FY 2009-10, data was obtained from DCED's online "Investment Tracker" database. The inclusive dates for the FY 2009-10 were limited to July 1, 2009, through May 6, 2010, and do not cover a full fiscal year.

Tax Credit for New Jobs Created

Under the Job Creation Tax Credit program, businesses may claim a tax credit of $1,000 per new job created, up to the maximum job creation amount specified by DCED.[4] Businesses are given three years from the start date specified in the commitment letter to create the total number of jobs for which they are to receive a credit award and must keep jobs created in Years 1 and 2 "on the books" for the full three years. The maximum amount of credit awarded varies by several factors, including the respective employment goals and the multiplier applied, per job, approved by DCED.

Job growth is determined by calculating the increase in new jobs created that, for each successive year, exceed the number of jobs determined by DCED as the amount in existence in the business's base period.[5] To calculate the base period, the business is to select the site location where the new jobs are to occur. When applying for the program, a business selects a desired start date and counts backward three years, to tally the total number of jobs already in existence at the site. The three year tally is averaged and serves as the business's base period total.

To receive a tax credit, businesses are to add, at their option, within three years of the start date, either an additional 25 jobs to their base amount or to

[3] 72 P.S. §8804-B(e).
[4] 72 P.S. §8804-B(a).
[5] 72 P.S. §8801-B. Base period is defined as the three years preceding the date on which a company may begin creating new jobs, which may be eligible for job creation tax credits.

increase employment by 20 percent of the base amount. The start date shall be either the first day of the calendar year quarter in which the application is submitted or a date upon which that DCED and the business agree.[6] As provided in the program's guidelines, program participants are required, annually, to report their employment totals to DCED by submitting a signed employment affidavit. This affidavit specifies the employer's job growth in each of the successive three years past the base year. To receive the full tax credit allocated to them, companies must create the required number of jobs by the end of the third year. Any jobs created in years one and two must still be in existence at the end of year three in order for the company to receive and keep the full amount of the credit awarded.[7]

Table 15 shows the job creation totals committed to by employers approved by DCED to receive tax credits for the most recent three full fiscal years of the program.

Table 15

Employer's Base Jobs and Jobs Created Commitments Totals

Fiscal Year	Employer's Base Jobs	Employer's Job Creation Commitments
2006-07.........	60,648	14,908
2007-08.........	26,315	11,009
2008-09.........	23,569	12,771
Totals	110,532	38,688

Source: DCED's "Job Creation Tax Credit Program (Investment)" Chart

Program Eligibility and Requirements

To be eligible for the job creation tax credit, there are several additional program requirements to which an applicant must adhere. For example, each new full-time employee must be paid a minimum of 150 percent of the federal minimum wage. As the federal minimum wage increased to $7.25, on July 24, 2009, to be eligible for the job creation tax credit program, a company must pay a minimum of $10.88 per hour.[8]

In addition, to be considered for a job creation tax credit from DCED, a business must show that it has:

- the resources necessary to create the required increase in jobs within three years from the negotiated start date;

[6] 72 P.S. §8801-B. Start date is defined as the date on which a company may begin creating new jobs that may be eligible for job creation tax credits.
[7] 72 P.S. 8804-B(b), DCED Program Guidelines, and conversations held with DCED staff.
[8] Federal minimum wage information is accessible via the Internet at www.dol.gov.

- the ability to demonstrate leadership in its business operations by developing a new means of production, product technology, or the incorporation of a new innovative process;
- the financial stability within the business and financial stability in the business's project;
- the intent to maintain its operations within Pennsylvania for five years from the start date;[9] and
- affirmation from the business that the benefits conferred by this tax credit are largely responsible for its decision to expand or locate its operations within the state.

After successful completion of increased employment, DCED issues a tax credit certificate to the business. This certificate is then submitted by the employer to the Department of Revenue for a reduction of applicable taxes due the Commonwealth. From the date that Revenue receives the business's tax credit certificate, the business is required to maintain its operations within the Commonwealth for a total of five years thereafter or risk forfeiture of all credits granted to it by this program.[10]

The approval process for this program requires that the business and DCED execute a commitment letter[11] outlining in detail what is required of the business in order to obtain the tax credits. This letter includes:

- a description of the business's project,
- the required number of new jobs that the business is to create,[12]
- the amount of private capital to be invested by the business in the project,
- the total amount of tax credits the business may claim from this program,
- a signed statement from the company that it intends to maintain its operations in this Commonwealth for five years from the start date, and
- such other information as the department deems appropriate.

Taxes Applicable for Credit

The job creation tax credit may be applied against several categories of taxes in order for a business to reduce its tax liability to the Commonwealth. These taxes include:

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[9] The statute is inconsistent in this program requirement as §8802-B(4) and §8806-B(a) refer to five years from the date a tax credit certificate is first submitted to the DOR and §8803-B(5) refers to five years from the start date. In the program guidelines, DCED's requirement is five years from the start date.
[10] 72 P.S. §8806-B.
[11] The requirements of the commitment letter are outlined at 72 P.S. §8803-B.
[12] 72 P.S. §8801-B. Included in the definition of "new job" is the stipulation that the position must be created within a municipality located in this Commonwealth.

- Corporate Net Income Tax,
- Capital Stock and Franchise Tax,
- Capital Stock and Franchise Tax of a shareholder of the company if the company is a Pennsylvania S corporation,
- Gross Premiums Tax,
- Gross Receipts Tax,
- Bank and Trust Company Shares Tax,
- Mutual Thrift Institution Tax,
- Title Insurance Company Shares Tax,
- Personal Income Tax, and
- Personal Income Tax of a shareholder of a Pennsylvania S corporation.

As stated in DCED's program guidelines, after jobs have been deemed created by the department and a job creation tax credit has been issued to the business, the credit must be claimed within five years of the business's receipt of it. Further, prior to submitting the tax credit certificate to the Department of Revenue, in no case shall the certificate remain effective longer than six years from the start date, which is the date the business began creating jobs and became eligible for job creation tax credits.[13]

Prohibitions and Penalties

Act 2001-23 prohibits tax credits from being awarded for jobs that have been created prior to the start date and jobs that are being relocated from one municipality in the Commonwealth to another. The assignment, transfer, or use of the credits by any other company is also prohibited, unless the entity is an affiliated entity.

Businesses that received job creation tax credits are to meet the conditions agreed upon in the commitment letter or risk having to repay the Commonwealth some or all of the tax credits granted to it. A business is at risk if it:

- fails to substantially maintain existing operations and the operations related to the job creation tax credit for a period of five years from the date a company first submits a job creation tax credit certificate to the Department of Revenue (please see footnote 10); and
- fails to create the required number of jobs within three years of the start date.[14]

[13] Job Creation Tax Credit Program Guidelines (January 2009).
[14] 72 P.S. §8806-B.

The DCED may waive these penalties if it determines that the business experienced circumstances beyond its control, such as natural disasters, unforeseen industry trends, or a loss of a major supplier or market.

Review of Program Files

We conducted a file review of the Job Creation Tax Credit program using a random sampling of 50 files. This review included, but was not limited to, the participants' applications, commitment letters, employment affidavits, and tax credit award certificates. We conducted file reviews from two different time periods. For the first, DCED staff provided an untitled list of program participants with start dates ranging from April 1, 2003, to July 1, 2005. For the second, the department provided its "Job Creation Tax Credit Program (Investment)" document which lists program participants by county. The date range indicated on the list provided shows "2006-2007" through "2008-2009." The purpose of this review was to assess the completeness of the program files and recordkeeping management practices and to ascertain what information is requested by the department, and subsequently provided, to determine compliance with program requirements. The findings of our review are discussed below.

Other States

There are many states that offer a job creation tax credit similar to the program offered in Pennsylvania. The following is a review of those state's programs which may be competitors for Pennsylvania jobs, with program differences noted.

Some states' job creation tax credit programs have requirements similar to what is offered in Pennsylvania, while others have requirements lesser or greater than those stipulated by the job program offered here. Maryland and Michigan require that employers in their jobs program pay their employees 150 percent of the federal minimum wage, as is required in Pennsylvania. Ohio's requirement exceeds Pennsylvania in that employers must pay 175 percent of federal minimum wage, while North Carolina only requires a minimum wage of 110 percent of the average *county* wage. West Virginia simply requires an annual salary of at least $32,000 and health benefits.

The minimum number of jobs that must be created to qualify for tax credit varies by state. While Pennsylvania requires that employers create 25 new jobs or increase employment by 20 percent, Delaware's Blue Collar Job Act only requires that the employer hire five new employees. Maryland's job creation requirement is more stringent than Pennsylvania's as it requires the creation of 60 new full-time employees in a 24-month period, unless the jobs are created in a priority funding area, then the minimum required is 25 jobs. Michigan requires the creation of at least 75 jobs for in-state companies; however, out-of-state companies must create

150 new jobs. South Carolina offers credit to businesses increasing their average monthly employment by 10 new jobs unless the jobs are created by tourism facilities, in which case the increase in employment must be 20 new jobs.

Certain businesses offer more than Pennsylvania's standard tax credit of $1,000 per new job created, while others offer less credit. Other states offer that the geographic region that the jobs are created in may entitle the employer to more tax credit as well. Delaware provides that each new job created is entitled to $400 of credit unless the job is created in certain undeveloped areas of the state, earning $650 of tax credit. While South Carolina's program targets certain industries, its program allows retail facilities and service-related businesses to receive tax credit if the operations reside in a least-developed county. Maryland's jobs program limits the tax credit to $1,000 per new job created unless the job is created in a state enterprise zone, federal empowerment zone, or certain state-designated neighborhood; then the credit increases to $1,500 per new job created. Ohio's amount of tax credit varies according to a number of factors including the number of new jobs created and that the employer's payroll must be at least $660,000 in total annual payroll during the first three years of operations. West Virginia offers $3,000 of tax credit per year for five years for each new job created.

Findings and Recommendations

1. Key information was missing from the files for many program participants, which prevented us from determining if the program's job creation and other requirements are being met.

Companies that participate in this program have criteria mandated by statute to which they are to adhere in order to receive tax credits. The most important of these requirements, of course, is the commitment to create jobs within a three-year time frame of the start date, based on the base amount of jobs agreed to between the company and DCED. Other requirements include filling out an application with all required information, signing a commitment letter, attesting to eligibility requirements, filing annual employment affidavits (Attachment A, which is used to report both job growth and the minimum wage payment requirements), and not seeking credit for jobs which were created prior to the start date or for jobs that are moved from one municipality to another. Therefore, when conducting our file review of some of the participants in the program, we specifically looked for sufficient documentation that these program requirements were being met. Exhibit 1 below shows the results of our file review.

Exhibit 1

Review of Information Found in the Sampled Job Creation Tax Credit Files

File Review Criteria	Criteria Found in the File
Employment Affidavits[a]	For files with a Start Date in year 2003: • 7 businesses submitted Employment Affidavits for all three years in the program • 2 businesses submitted Employment Affidavits for two of three years in the program • 1 business submitted Employment Affidavits for one of three years in the program • 1 business did not submit any Employment Affidavits For files with a Start Date in year 2004: • 2 businesses submitted Employment Affidavits for all three years in the program • 1 business submitted Attachment A for one of three years in the program For files with a Start Date in year 2005: • 2 businesses submitted Employment Affidavits for all three years in the program • 3 businesses submitted Employment Affidavits for one of three years in the program. • 1 business did not submit any Employment Affidavits For files with a Start Date in year 2006: (At the time of the file review, it was not yet necessary for one of the employers to submit Employment Affidavits for year three.) • 1 business submitted an Employment Affidavit for all three years in the program • 1 business submitted an Employment Affidavit for one of three years in the program • 4 businesses did not submit any Employment Affidavits For files with a Start Date in year 2007: (At the time of the file review, it was not yet necessary for the employer to submit Employment Affidavits for year three.) • 1 business submitted an Employment Affidavit for one of three years in the program • 1 business submitted Employment Affidavits for two of three years in the program • 8 businesses did not submit any Employment Affidavits For files with a Start Date in year 2008: (At the time of the file review, it was not yet necessary for the employer to submit Employment Affidavits for years two and three.) • 2 businesses submitted Employment Affidavits for one of three years in the program • 4 businesses did not submit any Employment Affidavits For files with a Start Date in year 2009: (At the time of the file review, it was not yet necessary for the employer to submit Employment Affidavits for years one, two, or three.) • 1 business submitted an Employment Affidavit for one of three years in the program • 3 businesses did not submit Employment Affidavits

Exhibit 1 (Continued)

File Review Criteria	Criteria Found in the File
Application	46 out of 50 files contained an Application. Of the 4 files missing Applications: • 2 files did not contain Commitment Letters; however, still contained Employment Affidavits showing job growth; • 1 file contained a Commitment Letter and Employment Affidavits showing job growth; and • 1 file contained only a partially complete project narrative and no other information.
Commitment Letter	46 out of 50 files contained a Commitment Letter. Of the 4 files missing Commitment Letters: • 2 files still contained Employment Affidavits showing job growth; • 1 file contained only a partially complete project narrative and no other information; and • 1 file contained no other information.
Base Jobs	4 files showed no Base Jobs amount as those files did not contain Commitment Letters, 46 files did contain a Base Job amount
Evidence That Jobs Were not Created Before the Start Date	Out of 50 files reviewed, none showed any evidence that this information was sought.
Jobs Moved From One Municipality to Another	Out of 50 files reviewed, none showed any evidence that this information was sought.
Average Hourly Wage	Out of 50 files reviewed: • 23 files indicated an average hourly wage as reported by the employer for all three years in the program; • 6 files indicated an average hourly wage as reported by the employer and broken down by each year and quarter in the program; and • 21 files were found to show no average hourly wage paid by the employer
Tax Credit Certificates	Out of 50 files reviewed, 24 files contained tax credit certificates
Verification From the Company That They Have Maintained Operations in the Commonwealth for Five Years After the Start Date (see Footnote 9)	Out of 50 files reviewed, 14 files were found to show the business's start date was in years 2003 and 2004. No information was found in these files to indicate that the business had maintained its operations in the Commonwealth for five years after the start date nor was there any information to show that DCED verified if the business maintained its operations.

[a] For explanatory purposes, the document created by DCED, submitted to the employer, and returned to DCED with employment amounts indicated, is used to show job growth and is titled by the department as "Attachment A." For our purposes here, this title does not readily lend itself as a document reporting job growth. We are using the title "Employment Affidavit" here, in place of the document titled "Attachment A," as the form showing job growth.

Source: DCED's Job Creation Tax Credit files

As evidenced in the exhibit above, we found numerous instances in which important information was missing from the files. For example, employment affidavits, or Attachment A as it is referred to, were missing a total of 51 percent of the time when they should have been in the files. In calculating this number, we subtracted out those instances in which affidavits would not be expected to be in the files due to the recentness of a company's participation in the program. This is troublesome given that this submittal is the document in which the companies report their actual job creation data to DCED. It is required to be submitted annually for three years after the start date. In addition, data relating to maintaining operations for five years is not in the files as DCED does not ask for it, even though it is an element that is required by the statute, with a penalty for failure to do so.

The required minimum wage information was also often absent. Of the 50 files that we examined, we found that 21 did not contain any information on the level of wages paid. That line on the affidavit (Attachment A) was simply left blank. Of the remaining 29 files, only 6 reported it by quarter, as required.

Recommendations:

a. ***We recommend that DCED complete a comprehensive file review of companies participating in the program with start dates within the past five years to ascertain what pieces of information are missing from participants' files and take the necessary resulting actions, including rescinding the tax credits, if not already done so, for noncompliance with program requirements***.

b. ***We further recommend that DCED should begin to ask program participants to submit a statement five years after they have first redeemed their tax credits (or from their start date, please see footnote 9) verifying that they still maintain existing operations and operations related to the tax credit in Pennsylvania.*** DCED should also ask program participants to attest to the fact that they are not receiving tax credits for jobs created prior to the start date or jobs they are relocating from one municipality to another in Pennsylvania.

c. ***We recommend that DCED begin to migrate this program to one that is computer-based and -driven, so that required submittals and their deadlines can be better tracked and follow-up inquiries to program participants could be generated automatically.*** The nuances of this program, like several other tax credit programs, require that program participants submit paperwork to DCED several times throughout the span of their participation in the program. Yet, aside from the use of the department's single application for assistance which may be submitted electronically, this program is almost entirely paper-based, relying on limited staffing to process applications and follow-up submittals without the aid of computer generated processing or monitoring.

2. The data that is provided by program participants is self-reported and is not independently verified by DCED. In addition, instructions for several of the most critical submittals (Attachment A, used to report job growth and wages paid) are vague and open to interpretation by program participants. Therefore, it is difficult to substantiate whether program outcomes and requirements are being met even if the required documents are submitted.

There are several program eligibility conditions to which companies must commit to be considered for a tax credit. Our review found that, in most instances, these commitments are based on representations only and, when cited in the official commitment letters, do not contain company specific data. There were instances where a few companies did submit additional individualized information, but it did not appear to be in response to a request from DCED. Everything from eligibility requirement statements, base jobs, and employment growth affidavits to wage information is self-reported, with no independent verification data submitted or requested.

For example, as part of the file review, employment affidavits for both base employment and reported job growth were reviewed for the years 2003 through 2009. The completed and returned employment affidavits are required to include actual full-time job totals on a quarterly and annual basis. We removed the data for calendar years 2007–2009 since not all of those participants would have fulfilled their commitments at the time of our review due to the timing of their entrance into the program. Nonetheless, we found that the job creation numbers committed to by program participants are not realistic, and in many cases are falling short of their pledges. We also found that, due to a lack of clarity in the instructions, some employers are reporting job figures for their entire company, not just those that are specific to the JCTC program.

Overall, of the 26 files we reviewed with a start date in years 2003-2006, the following determinations can be made:

- 10 employers exceeded their employment goals,
- 7 employers created NO jobs,
- 8 employers did NOT meet their employment goals, and
- 1 employer lost jobs, below its base amount.

Table 16 provides a more specific comparison of aggregated job creation commitments and aggregated reported jobs created for the 26 program participants whose files we reviewed with start dates between 2003 through 2006, including percentage change.

Table 16

Total Job Growth/Decrease for Sampled Program Files
(Files With Start Dates in Years 2003 - 2006)

Year	Number of Businesses	Job Creation Commitment	Jobs Created	Jobs Created vs. Jobs Creation Commitment/Percent Change
2003.......	11	1,134	820	-314/-27.7%
2004.......	3	750	797	+ 47/+6.3%
2005.......	6	2,992	4,309	+1,317/+44.0%
2006.......	6	1,256	664	-592/-47.1%

Source: DCED's sampled Job Creation Tax Credit files. For those files missing affidavits, we utilized the latest year's data provided by participants, making the assumption that they did not lose additional jobs in the years not reported which may or may not be true.

Table 16 shows that the reported number of actual jobs created varies widely from the job creation commitment for the program participants whose files we examined. Although in some instances DCED did take appropriate steps to reduce credit awards accordingly, in other instances we could not determine what actions, if any, DCED had taken. In either case, DCED is making decisions based wholly on self-reported, and therefore potentially unreliable, data.

DCED reports that for this same time frame (2003-2006), the job growth totals amount to 60,080 jobs for all credits issued.[15] It is not clear whether these publicly announced figures have been adjusted for job creation commitments made but not kept, but they do not appear to have been, based on the tax credit awards also reported in the same document. The same applies to the amounts of capital investment reported by DCED to have been made by the companies participating in the program. Although it is information that is requested in the initial application and contained in the individual commitment letters, it is never followed up or reported on again. Nevertheless, DCED uses these figures in its annual reports as to how much private investment program's participants have generated as a result of having received job creation tax credits.[16]

Another example of self-reported, unverified information is the required minimum wage information. Employers in this program are required to pay their JCTC eligible employees an average hourly wage of at least $10.88. Our review of the sampled files, found that the format for the information provided on the employment affidavits varied. This may be caused by a lack of clarity in the instructions

[15] Source: DCED, Investment Tracker database at http://www.dced.state.pa.us/investmenttracker.
[16] Source: DCED Annual Financing Strategy, 2007-2008, JCTC, Program Performance and Impact.

for Attachment A. Some employers indicated an average hourly wage paid over all three years in the program. Other employers provided their average hourly wage by each individual year of participation in the program. At least one reported it as an annual salary amount as opposed to an hourly wage amount. In addition, it appears that most participants are reporting the data of average hourly rate of pay for all employees company-wide, rather than just JCTC eligible employees because that is how they are reporting their employment data. Therefore, any conclusions drawn about whether this statutory requirement is being met are unreliable, at best.

Tables 17 and 18 illustrate, based on our file review, how different reporting methods produce different conclusions. For employers who reported their average hourly rate of pay on a year-by-year basis, the overall average hourly rate found was $18.39. Table 17 shows a breakdown of the average hourly rate of pay found, by year of participation, in the program (year 1, year 2, and year 3) for all employers combined who reported it this way.

Table 17

Average Hourly Wage Paid by Year of Participation in the Program

	Year 1	Year 2	Year 3
Average Hourly Wage	$18.05	$18.31	$18.88

Source: DCED's Job Creation Tax Credit files.

For those employers who reported their average hourly wage paid for their entire length of time in the program, or only reported it for a subset of their time in the program, the average rate found was $23.49. The following table, Table 18, represents the average hourly wage paid to employees by those employers.

Table 18

Average Hourly Wage Paid, All Years Combined

Year	Average Hourly Wage Paid Over All Three Years
2003	$21.86
2004	41.16
2005	12.06
2006	31.26
2007	17.06
2008	18.00
2009	23.00
Average Hourly Wage	$23.49

Source: DCED's Job Creation Tax Credit files.

Inconsistent and unclear language may also be contributing to reporting inaccuracies. In several locations throughout the application, program guidelines and instructions to various follow-up submittals, there is language that talks about project/ site specific data, including job growth. Yet, DCED reported to us that they encourage program participants to think about their job growth as statewide in nature. The resulting inconsistency in reported data that could be occurring makes it difficult to ensure that accurate relative comparisons are being made.

To illustrate, the instructions for Attachment A, clearly the most important report of the program, appear to apply to all employees of an organization, not just those that qualify the company for JCTC tax credits. However, both the application and the commitment letter refer to "project site or site specific" data and the statutory requirements only apply to those employees for which employers are receiving JCTC credit. In addition, it is not clear to applicants that jobs must be maintained for all three years of participation in order to retain any credits issued. This lack of clarity may impact all information included on submitted affidavits, including job growth calculations and minimum wage reports.

Recommendations:

a. ***We recommend that DCED conduct follow-up inquiries on a random or targeted sample of JCTC current and future program participants to help ensure the integrity of the job growth and wage data being reported***. Although the program guidelines state that "DCED reserves the right to request proof or verification of job figures, such proof to be provided by, but not limited to, a review of the company's unemployment compensation filings, payroll records or other company employment records", we found no evidence in the files that DCED has ever undertaken any independent verification of any piece of information in the files, including job figures. Such follow–up would also help ensure that the prohibitions against receiving tax credit for jobs created prior to the start date and for jobs that are relocated from one municipality to another are being adhered to.

b. ***We also recommend that DCED review the language in its program guidelines, applications and other required submittals (Attachment A, in particular) to ensure that it is clear and consistent.*** Should the statute ever be amended, we further recommend that the General Assembly address the inconsistent language pertaining to the length of time that a company has to maintain operations in Pennsylvania.

3. Although the statute states that the amount of tax credit a company may claim is limited to $1,000 per new job created, we found that DCED often exceeds this limit, in some cases awarding up to $5,000 per job created.

The JCTC statute states that "A company may claim a tax credit of $1,000 per new job created up to the maximum job creation tax credit amount specified in the commitment letter." Our review found, however, that DCED has awarded tax credits ranging from $1,000 per new job created to $5,000 per new job created. Table 19 provides a breakdown of the 50 files sampled and includes the applicant's start date in the program, the number of jobs the business agrees to create, the total tax credit award authorized by DCED, and the tax credit award authorized per new job created.[17]

The files we reviewed did not indicate why certain companies receive more credit per job than others, and we could not discern any standard methodology as to how these decisions were made. For example the amount of credits awarded per job varied greatly, even for companies that were creating the same number of jobs.

To illustrate this variation in tax credit award practice further, the data illustrated in Table 19 has been summarized in Table 20. The data below provides each level of tax credit awarded by DCED and the number of businesses approved to receive that level.

As Table 20 shows, there is significant variation between the amount of tax credit approved per job and the number of companies that were authorized to receive it. Of the 45 files included in this analysis, DCED awarded the $1,000 per job tax credit, as per the statute, only 33 percent of the time.

The Legislative Budget and Finance Committee previously released a report titled *Department of Community and Economic Development: Performance Audit of Economic Development Programs.*[18] This report discussed, in part, the above-mentioned variation in the amount of tax credits awarded, per new job created, to businesses in this program. This report describes DCED's use of a "multiplier-effect" in calculating the amount of tax credit awarded. Using the multiplier-effect, a business that created one new job in year one of the program would be awarded a tax credit award of $1,000. However, the business would be permitted to count that same job for additional credit in years two and three of the program, without actually creating more jobs. The business, therefore, could receive a $3,000 tax credit award for creating only one new job during the first year of the program.

[17] While our review included a total of 50 job creation tax credit files, we were only able to include a total of 45 files for this part of the review because five were missing vital information, needed to do the calculations required.
[18] Report date October 2000 and accessible via the Internet at http://lbfc.legis.state.pa.us/ .

Table 19

New Jobs Created by Tax Credit Award Amount

Start Date	Company	Number of Jobs to Be Created	Total Tax Credit Awarded by DCED	Tax Credit Awarded Per New Job Created
7/1/03	A	85	$85,000	$1,000
7/1/03	B	200	$200,000	$1,000
10/1/03	C	150	$150,000	$1,000
10/1/03	D	1	$1,000	$1,000
10/1/03	E	120	$120,000	$1,000
1/1/05	F	1,000	$1,000,000	$1,000
4/1/06	G	5	$5,000	$1,000
7/1/06	H	195	$195,000	$1,000
10/1/06	I	500	$500,000	$1,000
4/1/07	J	71	$71,000	$1,000
7/1/07	K	31	$31,000	$1,000
1/1/08	L	10	$10,000	$1,000
1/1/08	M	25	$25,000	$1,000
1/9/08	N	25	$25,000	$1,000
1/1/09	O	32	$32,000	$1,000
4/1/03	P	55	$110,000	$2,000
10/1/03	Q	109	$218,000	$2,000
1/1/05	R	720	$1,440,000	$2,000
1/1/05	S	170	$340,000	$2,000
1/1/06	T	205	$410,000	$2,000
1/1/07	U	350	$700,000	$2,000
1/1/07	V	100	$200,000	$2,000
1/1/07	W	250	$500,000	$2,000
4/1/07	X	44	$88,000	$2,000
4/1/07	Y	78	$156,000	$2,000
1/1/08	Z	250	$500,000	$2,000
10/1/08	AA	120	$240,000	$2,000

Table 19 (Continued)

Start Date	Company	Number of Jobs to Be Created	Total Tax Credit Awarded by DCED	Tax Credit Awarded Per New Job Created
4/1/03	BB	148	$444,000	$3,000
7/1/03	CC	39	$117,000	$3,000
10/1/03	DD	166	$498,000	$3,000
4/1/04	EE	300	$900,000	$3,000
4/1/05	FF	149	$447,000	$3,000
7/1/05	GG	270	$810,000	$3,000
10/1/05	HH	683	$2,049,000	$3,000
1/1/06	II	251	$753,000	$3,000
1/1/07	JJ	327	$981,000	$3,000
1/1/07	KK	210	$630,000	$3,000
1/1/07	LL	624	$1,872,000	$3,000
4/1/08	MM	308	$924,000	$3,000
1/1/09	NN	354	$1,062,000	$3,000
1/1/09	OO	300	$900,000	$3,000
7/1/03	PP	61	$244,000	$4,000
1/1/04	QQ	300	$1,500,000	$5,000
4/1/04	RR	150	$750,000	$5,000
7/1/06	SS	100	$500,000	$5,000

Source: DCED’s sampled Job Creation Tax Credit files.

Table 20

Number of Businesses Approved by Amount of Tax Credit Award

Tax Credit Approved Per New Job Created	Number of Businesses by Corresponding Level of Tax Credit Approved
$1,000	15
$2,000	12
$3,000	14
$4,000	1
$5,000	3

Source: DCED's sampled Job Creation Tax Credit files.

In addition, the Department of the Auditor General recently released a report titled *A Special Performance Audit of the Department of General Services: Procurement of Deloitte Contracts*.[19] This report discusses, in part, DCED's practice of awarding job creation tax credits and discusses disagreement with the tax credit award practice used by DCED. As an example, the report discusses a company that received a tax credit award of $3,000 per new job created and outlines the disagreement that DCED and the Auditor General have over the amount of credit that is statutorily permissible.

In conclusion, there has been a long-standing and problematic disagreement over the tax credit award practice used by DCED in the JCTC program. This is compounded by the fact that there is no readily apparent rationale as to what standard is applied from company to company, if any, in the decision-making process when awarding tax credits for new jobs created. In their written response to study questions posed by the LBFC team, DCED acknowledges that awarding certain priority projects a multiple year tax credit (e.g., $3,000 per job rather than the standard $1,000) is not provided for in the statute and is merely a "practice." They went on to note that, in 2009, the administration endeavored to codify the practice. This legislation (SB 1358, PN 1945, Session of 2008) failed to be enacted, yet the award by DCED of tax credits above the $1,000 level allowed in the program's authorizing statute continues.

Recommendation:

> ***Until such time as the program statute is amended to allow it, DCED should stop the practice of awarding JCTC tax credit above the $1,000 per new job created above a company's base amount.***

[19] Report date October 2009 and accessible via the Internet at http://www.auditorgen.state.pa.us/Reports/Performance/Special/speDGSDeloitteContracts102109.pdf.

4. DCED and the Department of Revenue do not reconcile their records with regard to the awarding and rescinding of JCTC tax credits.

The enabling legislation for the job creation tax credit program provides that DCED may reissue or assign prior fiscal years tax credits that have been recaptured or were never issued. Due to these provisions, DCED advises the Department of Revenue of those businesses that have failed to meet the program's requirements and whose credits must be recaptured. There are several points in the process where this can, and does, occur, including tax credits rescinded before issuance but after commitment, tax credits rescinded after issuance, but before utilized, and tax credits rescinded after utilized.

After informing the Department of Revenue that a tax credit has been rescinded, DCED's current procedure is to reissue those same tax credits to other participants in the same year or to hold them for reissuance in future years of the program. Our office was informed, however, that before reissuance, DCED does not verify with the Department of Revenue that the tax credits have first been recaptured. As Revenue's staff stated, in some instances they are successful at recapturing tax credits quickly. In other instances, the process may take years to see a return or may see no return of credit at all.[20] This is potentially problematic because DCED staff informed us that they maintain their records regarding job creation tax credits that are rescinded from program participants separately from records maintained by Revenue.

We reviewed both DCED's and Revenue's records on job creation tax credits. DCED staff provided a print-out from its records management system showing the amount of credit authorized, issued and recaptured since the program began. From these records, we randomly selected fiscal year 2002-03 and compared it against the Department of Revenue's records for the same fiscal year. This review found discrepancies between the departments' corresponding tax credit records, as shown in Table 21.

As seen in Table 21, DCED's credits issued and recaptured totals are higher by $59,000 and $985,000 respectively. Since the statute provides no limitation on the number of years that the department can hold previous years' tax credits before they reissue them, this problem may be compounded from year to year, resulting in a discrepancy exceeding millions of dollars. Because of the high level of rescindment rates, DCED informed us that as of the end of FY 2008-09, they had a balance of over $73 million in tax credits that they were holding and could use for future reissuance. While the program statute does provide for the reissuance and reassignment of recaptured tax credits from prior fiscal years, without regular reconciliation of records between departments, DCED's records may not reflect an accurate count of credits available to be reissued.

[20] Meeting with Department of Revenue staff, October 14, 2009.

Table 21

Comparison of Tax Credit Recapture Totals for FY 2002-03

FY 2002-03	Amount of Job Creation Tax Credit Awarded	Credits Issued Total	Recapture Total
Department of Community and Economic Development	$16,869,000	$11,470,000	$5,917,000
Department of Revenue	$16,869,000	$11,411,000	$4,932,000
Difference (+/-)	No Difference	DCED's Issued total is $59,000 higher than Revenue's total	DCED's Recapture total is $985,000 higher than Revenue's total

Source: DCED's Job Creation Tax Credit files and the Department of Revenue's Job Creation Tax Credit records.

Recommendations:

a. ***Because so many of the tax credits are rescinded prior to certificates being issued, (a total of 67.4 percent of total commitments from program years FY1999-00 to FY 2009-10 were rescinded prior to certificates being issued), we recommend that the Department of Revenue not post JCTC tax credits to a specific company's ledger until such time as a tax credit certificate is actually issued by DCED.***

b. ***In addition, we recommend that DCED and DOR regularly compare and reconcile their job creation tax credit amounts available for issuance, recapture and reissuance, but at least once a year prior to the start of the next program year.***

II. H. Limited (Malt Beverage) Tax Credit

Background and Overview

The Emergency Tax Credit, later renamed the Limited Tax Credit, was authorized in 1974 under the Tax Reform Code of 1971, 72 P.S. §9001 et seq. This credit grants a limited tax subsidy for capital improvements made by small brewers for an "emergency period." The original emergency period for the credit was January 1, 1974, through December 31, 1976. The credit was extended, by amendment, to December 31, 2008, at which point the tax credit expired.[1] The program, amended several times throughout its history, was administered by the Bureau of Trust Fund Taxes (BTFT) within the Department of Revenue.

The limited tax credit, to be applied against any Malt Beverage Tax (currently set at $2.48 per barrel) owed, provided manufacturers of malt or brewed beverages, whose annual production of malt or brewed beverages did not exceed 1.5 million barrels, a maximum annual credit of $200,000 for capital improvement expenditures. Prior to January 1, 2004, the tax credit was limited to manufacturers whose annual production of malt or brewed beverages did not exceed 300,000 barrels. Eligible expenditures included the purchase of items of plant, equipment, and machinery intended for use in the manufacture and sale of malt or brewed beverages within the Commonwealth.

There was no formal application for the Limited Tax Credit; applicants simply notified the BTFT of their intent to utilize it. Within 30 days of completion of construction or installation of equipment, the applicant was to notify the DOR and include pertinent documents. A tax examiner forwarded all received documents to the Bureau of Audits in the Department of Revenue for its review. Documents included invoices, cancelled checks and other pertinent items, which were required as proof of capital expenditures. This review resulted in a recommendation to BTFT for the amount of credit requested, amount approved, and the year for which the credit was approved. The Chief of Miscellaneous Tax[2] made the final decision to approve or deny the credit.

Breweries receiving the tax credit were to report to the BTFT on an annual basis, and as required in the program's authorizing statute, BTFT was to report that information to the Chief Clerk of the House of Representatives and the Secretary of the Senate. Reports were to include the number of employees, total production of malt or brewed beverages, the amount of capital expenditures made by each taxpayer, and the authorized tax credit amounts. Table 22 shows a summary, in

[1] The Department of Revenue issued notice of the expiration of this tax credit on December 31, 2008, and stated that the malt beverage tax report due January 15, 2009, was the last one on which tax credits could be claimed.
[2] The Chief of Miscellaneous Tax is also the Director of the Bureau of Trust Fund Taxes.

aggregate, by calendar year, of these required data elements. In CY 2004, 22 breweries took advantage of the tax credit. This number rose to 32 breweries for CY 2008, the last year the tax credit was available.

Table 22

Limited Tax Credit History

	No. Breweries	Employees	Production	Average Production	Authorized Credit	Average Auth. Credit/Brewery	Tax Credit Used	Average Tax Credit Used/Brewery
2004	24	1,107	514,692	21,446	$499,464	$20,811	$486,958	$20,290
2005	24	1,258	1,348,541	56,189	$1,038,351	$43,265	$570,946	$23,789
2006	25	857	1,215,991	48,640	$1,183,175	$47,327	$736,010	$29,440
2007	31	1,213	441,318	14,236	$1,324,068	$42,712	$815,114	$26,294
2008	32	1,664	1,020,646	31,895	$1,562,229	$48,820	$762,367	$23,824

Source: Developed by the LB&FC with data provided by the Department of Revenue.

Efforts to Reinstate the Tax Credit

Senate Bill 2007-1231 was introduced to continue the availability of the malt beverage tax credit for small Pennsylvania breweries past its December 31, 2008, termination date. The bill cited an effective date of July 1, 2009. This effort was unsuccessful, and the credit expired on December 31, 2008. Two House bills were introduced in May 2009, one to extend the tax credit to December 31, 2009, and the second to make the credit permanent. Both bills were referred to the House Finance Committee, where they remain. We spoke to a representative of the PA Brewers Guild, an association representing about 20 small brewers in Pennsylvania. They are in favor of the credit being reinstated. He felt that the tax credit was important to ensure that brewers continue to invest in their businesses, especially in light of the economy and the dramatic increase in the price of hops, an essential brewing ingredient, that occurred several years ago.[3]

The PA Budget and Policy Center, felt that this tax credit was not necessary, and in an analysis of SB 1231, stated that "no other industry is aided by such a provision, which is available to all small PA brewers, regardless of their financial circumstances". They also stated that the market for small breweries had rebounded considerably since the credit was first enacted, making the credit unnecessary in the current market. Although we could not find any definitive data, we do note that an article published in early February 2010 reported that, although recent years have seen a downturn in U.S. beer sales overall, "craft brewers" or those producing fewer than 2 million barrels per year, saw shipments "leap by almost 9 %," thus lending credence to the PA Budget & Policy Center's position.[4]

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[3] We note, however, that the price of hops has recently returned to a more normal level.
[4] Frankel, Todd "Craft Beers Outshine Big Beer at Market in 2009," St. Louis Dispatch, February 5, 2010.

II. I. Neighborhood Assistance Program Tax Credit

Background and Overview

The Neighborhood Assistance Tax Credit program was established by Act 1967-292.[1] It is one of the earliest tax credit programs established in Pennsylvania and one of the oldest such programs nationwide. The program encourages private businesses to provide funding to support education, job training, crime prevention, community services, and physical improvement projects in impoverished neighborhoods. Companies that participate are eligible to receive tax credits toward the following taxes: personal income tax, corporate net income tax, capital stock franchise tax, bank and trust company share tax, title insurance company's share tax, insurance premiums tax, or mutual thrift institution tax. The program has been capped at $18 million since 1997; Act 2009-48 reduced the available credits to $9 million for FY 2009-10 and to $8.1 million for FY 2010-11.

Under the Neighborhood Assistance Act, Act 1994-48, 72 P.S. §8901-A et seq., the Pennsylvania Department of Community and Economic Development (DCED) is authorized to administer the Neighborhood Assistance Program (NAP).[2] As stated in the regulations for the program, the objectives and goals of the act are:

- To encourage private business firms as defined in the act to provide private capital as described in the act to generate, provide or establish projects which will improve impoverished neighborhoods by providing job training for both the unemployed and the underemployed, education, community services and crime prevention and by enhancing the living conditions of people in impoverished areas.[3]
- To encourage private companies to invest in physical improvements in enterprise zones that result in community economic development.
- To directly involve business firms in assisting and improving impoverished communities. The act provides for a wide range of innovative projects by offering a business firm the option of sponsoring its own project in the community or contributing to a nonprofit neighborhood organization. The purpose of the act is to help impoverished individuals

[1] Since the program was created, the legislature has amended the act five times. The act was last amended in July 2007 with the passage of Act-55. Since 1997, the annual tax credit cap had been $18 million.
[2] In July 1998, the LB&FC released a report examining the department's community development programs. The Neighborhood Assistance Program was one of the programs examined.
[3] Regulations, at 12 Pa. Code §135.11, defines what factors the department must consider when certifying a census unit or part of a census unit of the Commonwealth as impoverished. When such areas have high incidences of these conditions compared to the statewide average the department may certify such areas as impoverished. The social conditions include persistent unemployment or underemployment; dependence upon public assistance; overcrowded, unsanitary, or inadequate housing; crime and delinquency; disease or disability; infant mortality; and school dropouts or other evidence of widespread social problems or poverty conditions.

or neighborhoods, or both, by using the business firm's technical assistance abilities or resources, or both.[4]

In 1998, the LB&FC reported that NAP was comprised of three tax credit programs. Currently, four tax credit programs are available to applicants under the umbrella of the NAP. The department has developed and published guidelines for each program. Each program has its own distinct level of tax credits and corresponding match requirements that are available to businesses which contribute.

The four NAP tax credit programs currently available are:

- General Tax Credits (GTC) - Tax credits can be used in support of projects and are available to neighborhood organizations seeking contributions or to a business firm that makes a contribution to a neighborhood organization for an approved project. The tax credits awarded are 55 percent of the amount of a business firm's contribution to the project. Projects must serve distressed areas or support neighborhood conservation.
- Neighborhood Partnership Program (NPP) - Business firms that make a substantial long-term contribution over a minimum of five years to support an affordable housing, community economic development, crime prevention, education, job training, and neighborhood assistance approved project are eligible for a tax credit of 75 percent of the amount of the contribution (or 80 percent in the case of a commitment to contribute for six years or longer). Applications for this type of credit are evaluated on the strength of the neighborhood partnership plan.
- Enterprise Zone Program (EZP) - A private company located in a distressed area that has been designated as an enterprise zone may seek tax credits to rehabilitate, expand or improve buildings or land which promote community economic development. The tax credits awarded are 25 percent of the project amount with a maximum of $500,000. Preference is given to projects that show substantial job creation for the community or commitment for job creation. Eligible costs include architecture, engineering and acquisition expenditures.
- Special Programs Priorities (SPP) - Projects that meet the guidelines for special priorities designated from time to time by the department are eligible for tax credits at 75 percent of a qualified investment in a project by a private company. If an EZP project becomes an SPP, the tax credit level granted is 35 percent. Tax credits are geared toward community economic development in rural communities, affordable housing, crime prevention, and immigrant communities. According to DCED, the special program priorities are matched to those of the current administration, the

[4] 12 Pa. Code §135.3.

department, the Commonwealth's Keystone Principles,[5] and to those of the deputy secretary.

To be eligible for tax credits, a project must qualify under one or more of the following categories and either serve a distressed area or support neighborhood conservation:

- Affordable Housing
- Community Economic Development
- Community Services
- Crime Prevention
- Education
- Job Training
- Neighborhood Assistance
- Neighborhood Conservation

Areas in the Commonwealth that are particularly distressed or impoverished, and therefore possibly more in need of NAP projects, are not identified or certified for the purposes of this program by the department.[6] According to department staff, in deciding which applications to grant tax credits it is the responsibility of the applicant "to provide evidentiary discussion as to the socio-economic conditions of their projected target areas and based on their assessment why the conditions therein met the definition of a distressed area. It is incumbent on the applicant to assess their area in order to plan an eligible project and therefore part of the needs assessment should include/discuss the area demographics, socio/physical conditions that the project will seeks to address. No other criteria are used."[7]

It is the responsibility of applicants to identify businesses that might consider financially supporting a project. The department is willing to assist applicants in identifying businesses that might be interested in reducing their taxes by participating in NAP. However, most organizations are well aware of such businesses in their area and already undertake outreach programs as part of their ongoing fundraising activities.

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[5] The Keystone Principles & Criteria for Growth, Investment & Resource Conservation were adopted by the Economic Development Cabinet May 31, 2005. The Principles & Criteria are designed as a coordinated interagency approach to fostering sustainable economic development and conservation of resources through the state's investments in Pennsylvania's diverse communities. The Principles lay out general goals and objectives for economic development and resource conservation agreed upon among the agencies and programs that participated in their development. The Criteria are designed to help measure the extent to which particular projects accomplish these goals.

[6] Enterprise zones are certified by DCED but such certifications are separate from NAP.

[7] August 2009 response from DCED to an information request from LB&FC staff.

All applicants within a distinct program type are reviewed and evaluated against the same criteria. Tax credits are awarded to applicants based upon the strength of the project and an applicant's history of success in the program, where applicable. There is no requirement that projects be distributed geographically statewide. The department also does not attempt to equally distribute the tax credits by the four programs available through NAP. Historically, no percent of available tax credits is guaranteed for each of the four program options under NAP. Tax credits are allocated without regard to the program option for which an organization is applying. Neither the specific location of a submitted project or the project category an application is submitted under is seen as the most relevant factor in deciding which applications to grant tax credits. Decisions to grant tax credits are made primarily on how closely individual applications meet the guideline criteria and the strength of projects.[8]

Beginning in 2007, as per Act 55, the department is required to "provide a report listing of all applications received and their dispositions in each fiscal year. The secretary's report shall include all taxpayers utilizing the credit and the amount of credits approved, sold or assigned."[9] Such annual reports are to be submitted to the General Assembly by October 1st of each succeeding fiscal year. Prior to Act 55, the Department of Community Affairs was authorized, but not required, to provide a listing of applications received and their disposition. Since 2007 the department has provided the required annual reports. Both reports include the name of each organization or business which was approved or denied or withdrew their applications and the tax credit amount that was approved or denied. The earlier annual report showing FY 2007-08 data breaks such tax credit award information out by the individual NAP program (NAP, EZP, and NPP) an applicant was applying for. The annual report for FY 2008-09 does not provide such a breakout. Both reports also include information on tax credits utilized by businesses or sold.

Application Process

In 1998, DCED implemented a Single Application for Assistance for all financing programs, including the Neighborhood Assistance Program.[10] Applications must be filed electronically and are accepted twice a year, with due dates of July 1 and October 1st. The Secretary approves or disapproves projects and establishes the amount of tax credit to be provided to a neighborhood organization or business firm. Projects may be approved for only one fiscal year; however, projects with multiyear funding commitments from businesses are given greater consideration. Future tax credits depend on the project being approved in subsequent years. Once a project is

[8] The department may consider NPP applications first because they are long-term, multiple year projects.
[9] Act 2007-55, §9.
[10] The department's website notes that the Single Application "allows applicants to apply for various programs using one form while capturing specific program information needed to evaluate the project for possible funding. The application is designed to help applicants comprehend the program requirements upfront and expedite the review process."

approved, applicants may solicit business contributions. If an applicant fails to obtain the necessary contributions by the following March 15th, they must notify the department so that the department may reallocate the tax credits.[11]

The department has developed criteria that it follows to review and rank applications for each of the four sub-programs that comprise the Neighborhood Assistance Program. These criteria are included in the guidelines issued for each of the programs. For all programs, applications are expected to be complete and concise and include measurable goals and objectives. Applicants who have a long history of meeting goals and objectives are also given preference when evaluating applications, as are applicants with a strong history of soliciting contributions. Projects are also not to be duplicative of other projects or services existing in the community and should describe linkages and/or collaboration with other organizations or initiatives in the area. Department staffs in both Harrisburg and the regional offices are involved in selecting applications to be awarded tax credits. Staffs in the regional offices deal with organizations interested in applying for state funding and are most aware of how successful local organizations have been in meeting goals and objectives.

If a project application is approved, a neighborhood organization will receive a confirmation letter confirming approval of the project, a copy of the notification letter to contributors that provided commitment letters, an application for tax credits and a description of reporting requirements. A business firm, upon approval of a project, will receive a notification letter from DCED and the application to file for tax credits.

Funds Available and Expended

Currently, the authorizing statute limits the amount of tax credits for which businesses can qualify. The act requires that tax credits "shall not exceed $500,000 annually for contributions or investments to fewer than four projects or $1,250,000 annually for contributions or investments to four or more projects in any of the NAP programs," an increase from 2006.[12] The limits apply to all projects approved under the NAP, NPP, EZP, or SPP or a combination of the programs. Once a business is awarded tax credits, it has up to five tax years to utilize the credits against state taxes due. If a business cannot use this credit, it may elect to sell or transfer the

[11] The department could not provide the number of instances in each of the last three fiscal years where tax credits had to be reallocated because, prior to 2007, applications were accepted on a rolling basis with no specific due date. In 2008, as a result of changes to the act, application due dates were established. However, many contracts were not completed until February and March 2009 and it was not feasible to contact organizations to recoup tax credits awarded because they had not had sufficient time to solicit contributions. Several requests were received to increase tax credit awards, and one request was made to rescind an award that was made. As a result of these requests, the department was able to reallocate an additional $107,877 in tax credits to four organizations which had been approved and were receiving tax credits. However, there is no formal reallocation process in place.

[12] Act 2007-55, §10. Prior to Act 2007-55, credits a business could earn could not exceed $250,000.

credit to its shareholders, members, or partners. Such tax credits which are sold or transferred must be used in the taxable year in which they were purchased or transferred. Taxpayers who purchase such tax credits may apply the credit against personal income taxes owed the Commonwealth. As of 2007, pass-through entities are also eligible to utilize the tax credit.[13]

The total amount of NAP tax credits available to be awarded in FY 2008-09 was $18 million. Due to the passage of Act 2009-48, the amount of tax credits available for FY 2009-10 was reduced by 50 percent to $9 million. This amount will be further reduced to $8.1 million for FY 2010-11, a reduction of 55 percent of the previous total. Beginning in 2007, the legislature mandated that $2 million be allocated exclusively for pass-through entities. If the $2 million is not used, then the unused portion was to be made available for other applicants.

Table 23 shows that between FY 2004-05 and FY 2008-09, actual neighborhood assistance tax credits awarded annually rose by $4.2 million (31 percent). According to department staff, the main reason for the increase is the 2007 act which increased the allowable amount of tax credits in the individual programs and the corresponding percentage of credits that businesses could earn per donation. These increases occurred because

> …when the NAP credit was established in the 1960s, there were few competing investment opportunities for businesses in which to invest and support neighborhood revitalization efforts. Today, businesses have multiple opportunities to invest, many of which provided a greater economic return on investment than did the NAP credits. To that end, millions of tax credits were being lost. The changes were made in an effort to improve the competitiveness of the NAP tax credit.[14]

Costs to administer the Neighborhood Assistance Program are borne by the Department of Community and Economic Development and the Department of Revenue. Estimated costs for both departments total $300,000 annually.[15]

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[13] Pass-through entities are partnerships or a Pennsylvania S corporation as defined under 72 P.S. §7301. The act defines a partnership to mean "a domestic or foreign general partnership, joint venture, limited partnership, Limited Liability Company, business trust, or other unincorporated entity that for federal income tax purposes is classified as a partnership." An S corporation "means any small corporation which does not have a valid election under 72 P.S. §7307.

[14] Response provided by DCED in August 2009 to an information request of the LB&FC.

[15] The Governor's Executive Budget for FY 2009-10 notes that approximately 385 companies doing business in Pennsylvania benefit from this tax expenditure.

Table 23

Neighborhood Assistance Tax Credits Awarded Annually by the Department of Community and Economic Development

Fiscal Year	Tax Credits Available	Tax Credits Awarded[a]
2004-05	$18,000,000	$13,500,000
2005-06	$18,000,000	$13,500,000
2006-07	$18,000,000	$16,379,316
2007-08	$18,000,000	$17,730,877
2008-09	$18,000,000	$17,749,290
2009-10	$ 9,000,000	$ 8,999,680

[a] Just prior to Act 2009-48, available tax credits were capped at $18,000,000.

Source: Governor's Executive Budget documents, the Department of Community and Economic Development annual reports, and other data on the program provided to the LBFC by DCED.

The department provided more specific numbers for FYs 2007-08, 2008-09, and 2009-10. Table 24 provides a breakout of the number of applications received, the number of applications awarded and denied, the total amount of tax credits requested, and the total amount of tax credits awarded. In FY 2009-10, the number of tax credits approved dropped 65 percent from FY 2007-08 and 64 percent between FY 2008-09 and FY 2009-10 because of the decrease in the amount of tax credits available.

The NAP program continues to be popular with businesses in Pennsylvania. In FY 2007-08, the department received applications requesting approximately $35 million in NAP tax credits. In FY 2009-10, the total amount of tax credits requested had increased to $57 million, an increase of 65 percent.

By analyzing data provided by the department, we determined the approximate percent of applications received for each NAP subprogram from FY 2007-08 through FY 2009-10 (please see Table 25). Because of the 50 percent cut-back in available tax credits in FY 2009-10, the total percent of credits awarded to individual NAP programs was also cut. For FY 2009-10, only 21 percent of tax credits were directed toward NAP general tax credits, 61 percent of tax credits were directed toward NPP, and 18 percent of tax credits were directed toward EZP. As shown in the table, this represents a significant decrease in NAP applications being funded and a significant increase in the number of NPP applications being funded. The department reported that no tax credits were awarded to the SPP program in FY 2009-10.

Table 24

Neighborhood Assistance Tax Credits Applications Statistics*

(FY 2007-08 Through FY 2009-10)

	FY 2007-08	FY 2008-09	FY 2009-10	Percent Change Between FY 2007-08 and FY 2008-09	Percent Change Between FY 2007-08 and FY 2009-10
Applications Received..........	188	213	196	13%	4%
Applications Denied	16	52	147	225	819
Applications Withdrawn........	32	25	0	(22)	(100)
Applications Awarded Tax Credits...............................	140	136	49	(3)	(65)
Percent of Applications Awarded Tax Credits..........	74%	64%	25%		
Total Amount Requested	$34,815,900	$43,663,174	$57,364,813	25	65
Total Amount Approved	$17,730,877	$17,749,290	$ 8,999,680	0	(49)
Percent of Total Dollar Requests Awarded.............	51%	41%	16%		

* Because of the delay in passage of a budget by the Governor and state legislature, the awarding of tax credits had been delayed for FY 2009-10. The budget adopted by the legislature reduces the amount of available tax credits from $18,000,000 to $9,000,000 for FY 2009-10 and $8,100,000 for FY 2010-11.

Source: Department of Community and Economic Development annual reports and other data provided to the LB&FC staff.

Table 25

Allocation of Tax Credits to Each of the Four Programs Under the Neighborhood Assistance Program

(FY 2007-08 Through FY 2009-10)

NAP Programs	FY 2007-08 Amount	Percent[b]	FY 2008-09[a] Amount	Percent[b]	FY 2009-10 Amount	Percent[b]
NAP General Program	$ 9,977,755	56%	$ 7,574,232	43%	$1,875,500	21%
Enterprise Zone Program....	3,924,372	22	3,888,603	22	1,633,715	18
Neighborhood Partnership Program............................	2,933,750	17	5,069,850	29	5,490,465	61
Special Program Priorities[c]	895,000	5	1,216,505	7	0	0
Total	$17,730,877		$17,749,190		$8,999,680	

[a]Total dollar amount is $100 less than reported in Table 24.
[b]Total percent may not equal 100 percent because of rounding.
[c]The dollar amounts shown for Special Program Priorities (SPP) for FY 2007-08 were tax credits allocated for the Comprehensive Services Program (CSP). The CSP was discontinued and projects redirected to the NPP and SPP beginning in FY 2008-09.

Source: Department of Community and Economic Development .

Review of DCED NAP Files

We reviewed 43 applications and corresponding program files that were submitted and were awarded tax credits in FYs 2006-07, 2007-08, and 2008-09 by 23 different organizations. This was done in order to determine whether the department is administering the program in a manner which ensures that required program eligibility criteria are being met.[16] Over the three fiscal years, these 23 organizations represented in the 43 applications were awarded a total of $10,575,196 in tax credits by the department.[17] This $10,575,196 in tax credits issued represents 20 percent of NAP tax credits issued to all approved applicants over the three fiscal years examined and 12 percent of total project budgets ($91,472,872) identified by the 23 organizations. Historically, participants in the NAP program have sought and received donations from a variety of sources.[18]

From our review of the files, we concluded that the department has sufficient internal controls to ensure that applications are complete before any awards of tax credits are made. In the majority of cases (33 of 43 applications), department staff requested applicants to provide additional information before a decision was made concerning the awarding of tax credits. No tax credits were approved until all required information was provided to the department. To ensure that all required information was provided, the department utilized a detailed checklist on which staff processing applications made notations when information was received, reviewed, and approved. For all applications reviewed, we found it took approximately three-and-a-half months for applications to be processed from the date the application was received to final approval.

Part way through our review, the department provided us a copy of a new two-page application review sheet that, along with the criteria set forth in the guidelines, they began to use to review applications in FY 2009-10. Prior to that, there was no standardized application review document utilized by those reviewing the applications for award determination. On the application review form, it is noted that the program summaries presented "are not full explanations from the application but rather a high level summary by which a ranking and award decision can be made."[19] However, the department indicated to us that the intent and use of

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[16] We also reviewed an additional five applications that were denied by the department. One application was withdrawn voluntarily by the applicant. Two applications were rejected as incomplete and the applicants did not forward the needed information as requested. Two applications were denied because the applicants' proposed programs did not meet criteria sufficiently in order to be awarded tax credits.

[17] For FY 2006-07, the organizations whose applications were reviewed received approximately 14 percent of all NAP tax credits approved. In FY 2007-08, the applicants reviewed received approximately 21 percent of NAP tax credits approved, and in FY 2008-09 applicants reviewed received approximately 26 percent of all NAP tax credits approved.

[18] Other sources of funding that organizations drew upon for NAP projects included federal funding, other state funding (Elm Street program), United Way grants, county funding, private donations, contributions from foundations, and in-kind donations such as food for Food Banks.

[19] Neighborhood Assistance Program Application Review Sheet.

the review sheet is not to rank applications, but to ensure consistency in the review process. NAP applications have not been ranked in the past and will not be ranked in the future by the department. The review sheets help the department to present information in a uniform manner so that it is easier to make final tax credit awards. The review sheets also ensure that applications meet the program guideline requirements. They are not an official part of the application process but solely a means to ensure consistency.

The review sheets describe the proposed project, the problems that will be addressed or corrected, where the project will take place, and a summary of anticipated outcomes. The application review sheet notes any previous NAP tax credit activity by the applicant and whether additional information is needed to complete the application. Account managers in each of the department's regions completed the review sheets for FY 2009-10. They are responsible for maintaining the review sheets as well.

Program Monitoring

The department requires approved applicants to submit regular progress reports. Prior to FY 2008-09, organizations were required to complete three progress reports over the course of the fiscal year. They were to document the progress of their program, identify how they were meeting expected outcomes, and identify whether they were securing enough commitments to support the tax credits. Organizations filed these reports via an electronic database, and they were maintained on the department's computer system.[20] As part of our file review, we reviewed a sampling of these reports that were submitted by eight NAP approved organizations.[21] The reports reviewed showed that the organizations were providing information on the number of persons served, number of homes refurbished, and other outcome data.

To better quantify such data, the department implemented a new project measures reporting process. Beginning in FY 2008-09, organizations have been required to submit two electronic reports that detail plans against actual achievements. For FY 2010-11, these biannual reports will be incorporated into the application process. A draft copy of the reporting form provided to us included 26 "placed-based" (location specific) performance measures that organizations applying for tax credits are to use to report on projected outcomes. Organizations applying for tax credit awards will have to identify expected outcomes and, at the appropriate time, report the actual outcomes achieved. This process will allow the department to compare projections against actual accomplishments. Project performance measures that applicants are to report on include:

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[20] Copies of the progress reports were not in the application files.
[21] Two of the organizations were private businesses that had been approved for NAP EZP tax credits.

- Number of neighborhood residents served/impacted.
- Number of housing units rehabbed/constructed.
- Number of commercial/industrial properties rehabbed/constructed.
- Number of blighted properties cleared.
- Number of foreclosures prevented.
- Number of jobs created or retained.
- Number of residents receiving food subsidies.
- Number of youths participating in after-school activities.
- Number of residents employed as a result of job training.

An independent audit is required of all program participants that have received a tax credit award of over $100,000 within 120 days after the termination date of the project. The audit is the responsibility of the organization that received the tax credit and must be performed by a registered or certified public accountant. Once the department has reviewed the audit and is satisfied with it, a close-out letter is issued to the organization informing them that the audit was acceptable and the file has been closed. Our review of the files showed that all organizations had filed an audit report with the department.[22] In one instance, the department required an organization to submit a revised audit with additional information.

Interview of Selected Grantees

Of the 43 files reviewed, we contacted 11 of the organizations to ask about the need for the program and their experience with the program. All the organizations praised what they had been able to accomplish in their communities because of the tax credit program. Many were concerned about the decrease in the amount of tax credits available beginning in FY 2009-10 because of budgetary concerns experienced by the state. Many organizations indicated that local businesses want to support projects in their communities that support the lives of local people. This may take the form of providing support for the improvements to or creation of new housing, supporting projects that save or lead to the creation of additional jobs, or helping to ensure that the local food bank has the necessary support to continue to serve those in need.

Organizations we spoke to that provide food for the poor or for the unemployed would like to see a dedicated state program for food banks. They realize, however, that there is little likelihood of such a program being created at this point in time. The Neighborhood Assistance Program, therefore, remains the only state funding source available that offers tax credits to businesses that choose to

[22] At the time of our review, the audits for tax credits awarded in FY 2008-09 were not due yet.

financially support their operations. Organizations that provide food felt that due to the reduction in available tax credits in FY 2009-10, the department is focusing more on projects that might lead to the creation of jobs and less on meeting the needs of those organizations that chiefly distribute food or offer counseling services. They note such services are even more vital when the economy is doing poorly.[23]

A number of organizations we spoke with expressed concern that the department wants them to begin to provide the amount of donations that companies are committing to give the organization as part of the application process. Although organizations did provide such information in the past if it was known at the time of application, they told us that the department had now made such reporting an important part of the application evaluation process. In many cases, according to some organizations, individual businesses are not prepared to commit to a specific amount when the organization is filing their application. Only after the organization has been awarded a specific amount of tax credits do some businesses agree to provide funding. Organizations that operate food banks noted that it was especially difficult to get restaurants, grocery stores, markets, or other food retailers to make such a commitment because they do not know what they will have available or exactly when they will have food to donate.

Impact of Program

The overall impact of the NAP program on sustaining Pennsylvania communities and creating economic opportunities has not been systematically measured or quantified by the department. No comprehensive review has ever been conducted by DCED to better determine what is working and what needs to be changed to make the program more useful to communities.[24] Our review of 43 applications submitted by 23 different organizations and interviews with 11 organizations did, however, indicate that positive change was being effected in those communities by the program. Table 26 shows the types of programs undertaken by the 23 organizations whose applications we reviewed. Although we could not determine how many individuals were assisted through these programs, our review of program files indicates that many Pennsylvania citizens benefited from the projects undertaken with NAP tax credits. Organizations were able to hire or keep current staff or contract with local businesses to undertake projects funded with contributions from businesses that received tax credits.

[23] Please see pages 81-82 of this report for an explanation of how tax credits were awarded in FY 2009-10.
[24] In February 2004, the department released a report analyzing the Comprehensive Services Program (CSP) in Philadelphia. The CSP was one of the tax credits available through NAP at that time. As a result of the report, the department began phasing out the CSP and replaced it with the Neighborhood Partnership Program (NPP). An evaluation of all of the CSP programs statewide was never undertaken.

Table 26

Programs Undertaken With the Assistance of NAP Tax Credits
(FY 2006-07 Through FY 2008-09)

Programs Where Tax Credits Were Directed by Organizations Reviewed	Number of Organizations Undertaking Such a Program
Renovation of Homes or Businesses	12
Distribution of Food	5
Homeownership Assistance	5
After School Programs	5
High School and Adult Job Readiness Training	5
Demolition of Blighted Properties	4
Technical Assistance to Businesses	3
Emergency Services Assistance	3
Senior Center Assistance	2
Provision of Health Care Supplies	2
General Neighborhood Improvements	2
Crime Prevention	1
Weatherization of Homes	1
Early Childhood Care	1
Social Services Referral Assistance	1
Clothing and Furniture Distribution	1

Source: Department of Community and Economic Development NAP application files.

According to the department, prior to FY 2009-10, impacts or outcomes were one facet of the application review process. Outcomes were used specifically for capital campaign projects, and other multi-year projects to determine continued awards. Currently, in addition to expected impacts or outcomes, which remain important, actual commitments obtained from contributors for a particular project have become more of a factor in the decision-making process of the department. This is because the department believes that if an applicant can identify commitments early, positive outcomes or impacts are more likely to result.

We asked the department to provide information showing the impact of the program on Pennsylvania's communities. Although the department was unable to provide a statewide comprehensive report of the outcomes that organizations receiving NAP tax credits had accomplished in their communities, they were able to report on a limited number of organizations' projects. Fiscal years covered in this sampling included FYs 2005-06 through 2009-10. Exhibit 2 outlines these "success stories" and outcomes provided to us by the department for each of the four programs under NAP. The department noted that information was limited because only recently had applicants been asked to provide reports that compared plans against achievements.

For the programs listed in Exhibit 2, a total of $3,731,475 in tax credits were allocated. This represents approximately 9 percent of total project budgets ($41,633,826) reported by the organizations. Beginning in FY 2010-11, the forms will be incorporated into the application process, with the eventual plan to have these reports migrated into a database that can be tracked.

Changes Resulting From Act 2009-48

Act 2009-48 reduced the amount of available NAP tax credits by 50 percent in FY 2009-10 and 55 percent in FY 2010-11. As a result of the budget cutbacks, DCED identified three priorities to be funded; Neighborhood Assistance Program (food banks only), Neighborhood Partnership Programs (NPPs), and Enterprise Zone Projects (EZPs). Please see Table 25 on page 82 for information illustrating the shifts in funding priorities due to the budget cuts. For FY 2011-12, the department reported it will maintain the NPP as the first priority.

According to DCED, the NPPs and EZPs have priority because both have high impact and/or support jobs. The review and award process also placed strong emphasis on past history of tax credit usage (based on applications by the contributors after the department's approval of the tax credit project). Regional staff had the flexibility to recommend lesser amounts than were requested by the applicants based on staff knowledge of projects and/or of applicants. Additionally, regional office staff negotiated voluntary reductions of amounts in an effort to fund a larger number of projects.[25] The department believes that the NPP projects show long term investor commitments to neighborhoods through strategic planning. The EZP projects are the next priority because EZP's investments are made with specific job creation and retention outcomes.

Food banks have historically received the necessary contributions from businesses, but those business contributors often do not apply for the tax credits with DCED after making the contributions. During the initial review process, DCED used the past three-year history of tax credits that were processed (applied for by contributors) as the basis for the 2009 awards. Due to the reduction in the total NAP allocation available to DCED and based on the application rate for the tax credits by food bank contributors, DCED reduced the tax credit award by 35 percent below the three-year history of the contributor applications. All food banks were given 90 days to secure letters of commitment from contributors. No NAP regular projects other than the food bank projects were approved for 2009-10.

[25] Once the contributor applies for the tax credits with DCED, the contributor has up to five tax-years to actually use the tax credits when filing for state taxes. This actual usage is information retained by the Department of Revenue, and DCED does not have access to it.

Exhibit 2

Outcomes for Selected Organizations Which Received NAP Tax Credits

DCED NAP Program	Organization	Tax Credits Awarded	Outcomes Reported[a]
NPP	Project H.O.M.E.	Between FY 2005-06 and FY 2009-10 a total of $1,684,900	-Renovated 24 single-room units of housing. -Conducted safety programs with 45 teens and local police. -Assisted 500 residents to receive primary, preventive, and educational health services.
	Crispus Attucks Association	Between FY 2005-06 and FY 2009-10 a total of $724,750	-Provided renovated housing to 276 low-income individuals. -Rehabilitated 8 housing units. Reduced vacancy rates from 19% to 4%.
	Housing Association and Development Corporation	Between FY 2005-06 and FY 2009-10 a total of $629,575	-Constructed 15 new houses. Employed 5 new residents in construction. -23 youth participated in summer programs. -15 blighted properties cleared.
	The Inner City Group	Between FY 2006-07 and FY 2008-09 a total of $240,000	-Undertook improvements to 16 neighborhood facades. -Provided employment training for 100 individuals. -45 housing units rehabbed. -300 clients received crime prevention services.
SPP	Warren-Forest Counties Economic Opportunity Council	FY 2008-09 a total of $37,500	-Acquired 5 acres of land to build a five-unit lodge to serve persons with mental health needs.
EZP	WP Real Estate, LLC	FY 2007-08 a total of $250,000	-Expanded manufacturing site and hired 37 new employees.
	Johnson & Markley Redevelopment, LP	FY 2009-10 a total of $125,000	-Began construction of a film studio and will hire 300 new employees.
NAP	St. Martin Center	FY 2008-09 a total of $11,000	-Served 2,059 low-income persons. -Provided food subsidies to 2,078 people and emergency services to 3,494 people.
	Boys and Girls Club of Northeastern PA	FY 2006-07 a total of $15,000	-Provided after-school education to 300 low-income youth.
	Community Health Services	FY 2007-08 a total of $13,750	-Provided health care, dental services and education services to 18,160 income eligible individuals.

[a]Because of space limitations not all outcomes for each organization are reported.

Source: Department of Community and Economic Development.

Neighborhood Assistance Tax Credit Programs in Other States

We identified several other states have neighborhood assistance tax credit programs that encourage neighborhood revitalization, economic development, and other types of assistance. Appendix B presents information on 10 states that the LB&FC found had a statewide neighborhood assistance program similar to ours.[26] Pennsylvania's program exceeds the other states in the amount of total annual credits allowed. For FY 2008-09, Pennsylvania's tax credit program was capped at $18 million.[27] New Jersey had a cap of $10 million and Connecticut a cap of $5 million, of which $3 million is set aside for energy conservation, job training, and programs serving low-income persons.

As regards the amount of tax credit allowed as a percent of the contribution made, some states allow a larger amount of the contribution to go toward a tax credit. Connecticut allows 100 percent of cash invested in energy conservation or 60 percent for investments in other neighborhood assistance projects to be claimed as a tax credit. Kansas allows 50 percent of contributions to be claimed as tax credits, however, if the contribution is made by businesses in rural communities with a population less than 15,000, a total of 70 percent of the contribution may be claimed. In New Jersey, a tax credit may be granted up to 100 percent of approved assistance provided to a nonprofit organization.

Findings and Recommendations

1. The Department of Community and Economic Development appears to be administering the Neighborhood Assistance Program in a manner consistent with the enabling legislation and is working to improve outcome reporting.

The department annually publishes guidelines and undertakes a thorough review of each application to determine how closely proposed programs meet the criteria established by the guidelines. Although program applications are not ranked, department staff utilizes an application review sheet to ensure both consistency in the review process and that applications clearly meet program guidelines. In addition, the department's selection of applicants, which involves staff at both the central and regional offices, is based on how well the applicant performed in prior years.

The success of an organization in meeting its commitments in earlier years was determined, in part, by reviewing progress reports documenting their achievements. We reviewed a sample of these reports and found them lacking in sufficient detail to accurately determine how successfully the organization had met

[26] The LB&FC also looked at programs in California, Massachusetts, New York, Ohio and Texas, but determined they were not statewide programs.
[27] Act 2009-48 reduced the cap to $9 million for FY 2009-10.

its commitments. Although we were told that department staff attempt to determine how successful a program has been, we did not find any such documentation in subsequent years' application files.

The department recognizes this deficiency and has taken steps to better obtain quantifiable data by requiring approved organizations to file a new monitoring report with their application beginning in FY 2010-11. Specifically, the reports will require approved organizations not only to identify projected outcomes, but also to assess their actual performance for each project measure they identify.[28] This should allow the department to better track not only an individual organization's success in meeting outcome commitments and further assist the department in the compilation of an objective-based report on overall program outcomes.

Recommendation:

> ***We recommend the department proceed with its plans to implement a new performance monitoring report for NAP recipients, and that this information be used when awarding tax credits in subsequent years.*** We also recommend that this information be included in the required annual reports to be submitted for the program with the goal of developing a comprehensive, statewide report on the achievements of the NAP program.

2. Unlike some of the other tax credit programs we examined, there is nothing in the NAP statute, regulations, or the guidelines that address how much of the contributions received from the businesses that are awarded tax credits may be used for administrative expenses.

For example, the Educational Improvement Tax Credit (EITC) program allows those utilizing tax credit funded donations to use a maximum of 20 percent of contributions for nonprogram expenses. While several of the program recipients we spoke to viewed the lack of such restrictions favorably, it is common for limits to be placed on the percentage of public funds that can be used for administrative overhead costs.

Recommendation:

> ***We recommend the Department of Community and Economic Development consider the amount of the NAP tax credit to be used for administrative overhead costs as one of the criteria when awarding tax credits to NAP participants.*** While this would require some additional information on NAP applications and monitoring reports, it would also help ensure that at least a

[28] The auditors recognize that adequate oversight can only be achieved if there is a level of staffing available to the department that allows it to sufficiently review applications, monitoring reports, and other material submitted by organizations.

significant portion of the tax credit would go to providing direct services to the state's communities and citizens.

3. Recently, the Department of Community and Economic Development has chosen to emphasize Neighborhood Assistance programs that provide economic development, particularly job creation and retention, benefits to communities.

Given the economic difficulties of recent years, this emphasis is understandable. Nevertheless, we spoke to several community organizations that expressed concern that other types of community development services will receive disproportionate cuts if the economic development emphasis continues.

Recommendation:

We recommend that as the economy improves, DCED consider reinstituting a more balanced approach between economic and community development programs and projects when awarding tax credits.

II. J. Organ and Bone Marrow Donor Tax Credit

Background and Overview

Act 2006-65 created the Organ and Bone Marrow Donor Act.[1] The act authorizes every business firm providing paid leaves of absences to employees for the specific purpose of organ or bone marrow donation to qualify for a tax credit.[2] A covered "paid leave of absence" is not to exceed five working days (or the hourly equivalent) per employee and does not include periods of annual or sick leave that an employee is given. The tax credit is equal to the amount of employee compensation paid during the leave of absence, costs of any temporary replacement help, and other miscellaneous expenses provided for in Department of Revenue regulations incurred in connection with the leave of absence.[3] Unused credits may be carried over for three taxable years but may neither be applied against preceding years nor refunded. The act applies to taxable years beginning on or after January 1, 2006, through taxable years beginning in 2010. Carryover credits may be used after 2010, but no later than taxable year 2013. The Governor's Executive Budget for FY 2010-11 includes the tax credit program but gives no indication that the program will be extended beyond December 31, 2010. For the program to continue, statutory amendment is required.

Under the act, the Department of Revenue administers the program and is responsible for promulgating regulations, publishing necessary forms, as well as providing an annual report to the General Assembly as to tax credits granted.[4]

In December 2006, the department promulgated regulations (61 Pa. Code Ch. 11) to implement the tax credit program. A one-page application with instructions was also developed by the department. Applications for tax credits must be filed with the department by the 15th day of the fourth month following the close of the business firm's tax year. An application must include (1) the signature of an authorized business representative, (2) the individual or entity's name for whom the credit is sought, (3) identifying numbers, (4) address, and (5) sufficient proof of the

[1] In June 2007, we released *A Performance Evaluation of Pennsylvania's Organ and Tissue Donor Awareness Program*. A summary of the Organ and Bone Marrow Donor Act was included in that study.
[2] The credit may be applied by businesses against taxes due including personal income tax, corporate net income tax, capital stock and franchise tax, bank and trust company shares tax, title insurance companies shares tax, insurance premiums tax or mutual thrift institutions tax of the Tax Reform Code of 1971 but the credit may not be applied against taxes withheld by an employer from an employee under the personal income tax provisions of the Tax Reform Code of 1971.
[3] Credits calculated for a business firm subject to tax in another state are apportioned to the Commonwealth pursuant to regulation. Also, a tax credit relating to employees of pass-through entities (partnerships or Pennsylvania S corporations) is calculated in proportion to the member's or shareholder's portion of the pass-through entity's income.
[4] The annual report is to be given within five months after the close of any calendar year in which tax credits given under the act were used.

length and purpose of the donor's leave and the amount of the employee's compensation as well as the need for and the costs associated with temporary replacement help.[5] After reviewing the application and required documents, the department notifies the applicant whether it qualifies for the tax credit, as well as the amount of tax credit for which it is are eligible. Incomplete applications may be returned for needed information before any decision is made.

Since the act was passed, only three companies have applied, and all three were approved for the tax credit.[6] The amount of tax credit approved for these companies totaled $3,505.73, with an average of $1,168.58 in tax credits approved per firm. All applicants were issued tax credits for the 2007 tax filing year.[7]

The department has provided annual reports to the legislature within five months after the close of the calendar year, as required by the act. The reports include the employers name, address, standard industrial classification code, and the amount of tax credits granted.

Advertising the Program

The Department of Revenue has taken limited steps to advertise the Organ and Bone Marrow Tax Credit. It made practitioners aware of the tax credit program through its fall 2006 tax seminar series, the year it was first introduced. Reference to the tax credit was also made in at least two copies of the department's bi-monthly e-newsletter and in instructions published for taxpayers filing their 2006 Personal Income Tax Return.[8] A press release was also issued in July 2006 by the Governor announcing the program. The department's forms continue to carry the tax credit, and mention is made of it, from time to time, in department publications when referring to all the restricted tax credits.

With the passage of Act 1994-102, the Pennsylvania General Assembly created the Organ and Tissue Donor Awareness Program (OTDAP). The program seeks to increase organ and tissue donation rates in Pennsylvania primarily through conducting and coordinating public education and awareness programs and activities. The Departments of Health, Education, Revenue, and Transportation

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[5] The department may require such proof at its discretion, which proof may include written verification by a physician or similar documentation regarding the length and purpose of the donor's leave.
[6] The three companies provide legal services; heating, ventilating, and air conditioning services; and accounting services respectively.
[7] One application was postmarked in February 2009 but the expenses were incurred in 2007. The department approved the application because it was initially filed appropriately with extensions. Because expenses were incurred in 2007, the tax credit award was given for 2007 so the taxpayer could apply it against 2007 taxes.
[8] The bi-monthly newsletters note that the tax credit was part of a package of tax cuts developed with input from the legislature and business community. The Organ and Bone Marrow Donor Tax Credit is identified as a credit of $1.7 million available to businesses.

work with the Organ Donation Advisory Committee[9] and the state's two federally-designated organ procurement organizations to administer OTDAP. We reviewed the annual reports prepared by the advisory committee, as well as other material on the Department of Health's web page and found no reference to the Organ and Bone Marrow Donor Tax Credit program. In August 2009, we also spoke with a representative of the organ donor program in the Department of Health, which is responsible for administering the program, who noted that neither the department nor the advisory committee has promoted the tax credit program.

Finding and Recommendation

The Department of Revenue appears to be administering the Organ and Bone Marrow Donor Tax Credit program as was intended by the Legislature. One possibility as to why the tax credit is underutilized is because few businesses know about it. Although the department did promote the program when it was first created by the Legislature in 2006, there has been little promotion since then.

According to the Pennsylvania Department of Health, an estimated 7,075 individuals in Pennsylvania were on the waiting list to receive an organ transplant as of March 2007. Approximately 917 individuals donated organs in Pennsylvania in 2006, while approximately 43 percent of individuals in Pennsylvania are designated organ donors on their driver's license, photo identification card, or permit. The Department of Health has, for a number of years, undertaken efforts to promote programs to encourage organ and tissue donation. These efforts have included:

- Distributing health promotion materials through the Pennsylvania Department of Health's Public Health Information Clearinghouse.
- Health education consultative services to Department of Health programs and reviewing existing educational strategies concerning cultural appropriateness and selection of health education methods.
- Undertaking statewide awareness campaigns to spread the message about the importance of organ and tissue donation through radio advertisements, billboards, television promotions, direct marketing at photo license centers, e-mails, website promotions, and special initiatives.
- Distribution of organ and tissue donation education materials to every individual when they are mailed their driver's license renewal materials from the Pennsylvania Department of Transportation.
- Distribution of organ and tissue donation education materials at the Pennsylvania Department of Transportation Photo Licensing Centers.

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[9] The Organ Donation Advisory Committee is a 15-member body that is charged with reviewing progress within the state in the area of organ and tissue donation. The Advisory Committee also provides recommendations on education and awareness training programs and program spending priorities, advises the Secretary of Health on program matters, and recommends legislation.

- Development and implementation of an on-line organ designation website.[10]

However, the Department of Health, through its various promotional activities, nor its website, makes any reference to the Organ and Bone Marrow Donor Tax Credit program.

Recommendation

If the Legislature extends the program past its December 31, 2010, expiration date, we recommend that the Department of Revenue and the Department of Health work together to promote the availability of this tax credit through their websites and through future public awareness and promotional activities.

[10] The website is www.donatelife-pa.org.

II. K. Pennsylvania Insurance Guaranty Association Tax Credits

Background and Overview

A. Pennsylvania Life and Health Insurance Guaranty Association Tax Credit

Act 1978-280 modified the Insurance Company Law of 1921 to establish the Pennsylvania Life and Health Insurance Guaranty Association (Guaranty Association). With the passage of this act, all licensed insurers in the Commonwealth that have been issued a certificate of authority to transact life, accident, and health insurance, as well as individual annuities, are included in the Guaranty Association and fall under the definition of member insurer.[1]

Act 280 provided for a tax credit that could be applied against a member insurer's premium liability tax paid to the Commonwealth. This tax credit is based on assessments paid to the Guaranty Association. The Association performs its duties in accordance with its plan of operation, which is submitted for approval to the Commissioner of the Pennsylvania Insurance Department.

The Association's powers are exercised through a board which is comprised of not less than five but no more than nine members selected by member insurers. The Insurance Department plays an approval/oversight role in its governance and operation of the Guaranty Association, including the selection of board members. Later, Act 1992-178 repealed Act 1978-280, further modifying the Insurance Company Law, but retaining the assessment and tax credit provisions.

Purpose of the Guaranty Association

The purpose of the Guaranty Association is to provide protection for Pennsylvania residents who are claimants of life and health insurance policies in the event that the member insurer is ordered liquidated by the Commonwealth Court and declared insolvent. The Guaranty Association may pay covered claims on behalf of insolvent insurers, within specified periods of time, before or after an event of insolvency is determined. To the extent necessary, the Association is to take on the rights, duties, and obligations of the insolvent insurer, just the same as if the insurer had not been declared insolvent.[2] The Association is not liable to pay more than

[1] 40 P.S. §991.1702. Member insurer is defined generally as any insurer licensed or which holds a certificate of authority to transact in this Commonwealth any kind of insurance for which coverage is provided.
[2] 40 P.S. §991.1706.

$300,000 in the aggregate with respect to any one individual, unless it is for the holder of an unallocated annuity contract, which is $5,000,000.[3] Prior to petitioning for liquidation of an insurer, the Pennsylvania Insurance Department has many options at its disposal to attempt to restore the company to solvency. The department advocates for the option that is in the best interest of the policyholders.[4]

Assessments

The Guaranty Association assesses member insurers under two categories of assessment, Class A and Class B assessments.[5] Class A assessments are made for the purpose of meeting the Association's administrative, legal, examination, and miscellaneous costs, which are made annually. These assessments may be made without regard to the status of any particular insurance company's insolvency. Class A assessments are made on a pro rata or non-pro rata basis and, if non-pro rata, shall not exceed $200 per member insurer in any one calendar year.

In the event of an insolvency, the Guaranty Association imposes Class B assessments upon its member insurers to cover a policyholder's claims against an insolvent insurer. Class B assessments are made to the extent necessary to carry out the powers and duties of the Association, with regard to an impaired or insolvent insurer, and are based on a proportion of premiums received by the member insurer. As provided by Act 178, the limit at which Class B assessments may be imposed upon member insurers for life, annuity, and health coverage shall not, in any one calendar year, exceed 2 percent of that member insurer's average premiums received in this state. This average shall consist of applying the last three years of premiums received, preceding the year in which the member insurer became insolvent. The prior three-year average of premiums received represents the member insurer's assessment base. A member insurer's assessed fees shall not exceed 2 percent of their assessment base. On the Life and Health Guaranty Association website, there are 51 insolvent insurance companies listed.

Tax Credits for Assessments Paid

Member insurers annually pay to the Commonwealth a premium liability tax of 2 percent. This tax is based on premiums received by the insurer for policies or contracts written in Pennsylvania. Act 178 provides that member insurers may then offset their premium liability tax by a corresponding amount based on their

[3] 40 P.S. §991.1703(c).
[4] Source: Meeting and telephone discussion with staff from the Pennsylvania Insurance Department
[5] 40 P.S. §991.1707.

assessed value from both Class A and Class B assessments.[6] There are approximately 541 licensed life and health insurance providers in Pennsylvania that may benefit from this tax credit.[7]

It should be noted that, while the Guaranty Association has the authority to impose and collect assessment fees from the member insurers, it does not have access to the amount of tax credit that the member insurers receive after filing their corporate taxes. This information is obtained by the Department of Revenue in the course of the member insurers taking the available tax offset when the business files its corporate taxes.[8] According to the executive director of the Guaranty Association they are not informed as to the extent that member insurers avail themselves of the tax credit.

For each of five years following the year in which the assessment fee is paid to the Guaranty Association, a member insurer may offset its assessed value by claiming a tax credit for 20 percent of the assessment.[9] The result for the member insurer is that it is allowed to recoup the entirety of its assessment fee paid to the Guaranty Association over a five-year period.

Act 178 provides that the board may, if in its determination that its assets held in account exceed the amount necessary to carry out its obligations for the coming year, issue refunds to its member insurers.[10] The refunds shall be issued proportionately according to the amount of assessment paid by each member insurer. However, Act 178 also stipulates that, if a member insurer has been issued a refund, and has already offset the amount of premium liability tax due through the tax credit, the insurer must return any excess funds to the Commonwealth. Act 178 states:

> Any sums which are acquired by refund from the Guaranty Association to the member insurers, which have then been used to offset against its premium taxes due and are not then needed for purposes of this Act, shall be paid by the member insurers to the Commonwealth. The Guaranty Association shall notify the Commissioner of the Insurance Department that such refunds have been made.[11]

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[6] 40 P.S. §991.1711(a).
[7] Source: Pennsylvania Department of Insurance's 2009 Annual Statistical Report for the period July 1, 2008 to June 30, 2009, which provides data for calendar year 2008, and is accessible via the Internet at http://www.insurance.pa.gov/portal/server.pt/community/industry_activity/9276. This total includes licensed life insurance and health entity providers, both foreign and domestic.
[8] Source: Telephone discussion with the executive director of the Life and Health Insurance Guaranty Association, November 6, 2009.
[9] 40 P.S. §991.1711.
[10] 40 P.S. §991.1707(f).
[11] 40 P.S. §991.1711(c).

Tax Credit Expenditure by Fiscal Year

Table 27 illustrates actual tax credit expenditures that have been received by life and health insurers in Pennsylvania for fiscal years 2003-04 to 2008-09. Although the expenditures were significant in FY 2003-04, at $3.1 million, the expenditures have been only nominal since that time.

Table 27

Life and Health Insurance Guaranty Association
Tax Credit Expenditure by Fiscal Year
($ Thousands)

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Expenditure Amount	$3,078.6	$55.0	$3.6	$3.5	$3.2	$2.4

Source: Pennsylvania Department of Revenue.

The Legislature recently passed Act 2009-48, which reduced the amount of tax credit available in several of the Commonwealth's tax credit programs. The tax credit made available to member insurers of the Life and Health Insurance Guaranty Association has not, however, been impacted by Act 48.

Other States

A tax offset similar to that made available to member insurers of the Pennsylvania Life and Health Insurance Guaranty Association is available in all other states except Alaska, California, Illinois, Maryland, New Mexico, and West Virginia and the territory of Puerto Rico.[12]

B. Pennsylvania Property and Casualty Insurance Guaranty Association Tax Credit

Act 1970-232[13] amended the Insurance Company Law of 1921, 40 P.S. §341 et seq., and created what is known as the Pennsylvania Property and Casualty Insurance Guaranty Association (Guaranty Association). This was done to provide benefits coverage for property and casualty insurance policyholders in the event that an insurer became insolvent. As a condition of an insurer's authority to write property and casualty insurance policies within Pennsylvania, insurers are required to participate as member insurers in the Guaranty Association.[14] Through this required participation, it can then monitor the viability of its members in an effort to detect and prevent an insurer's insolvency. Pennsylvania residents are protected from an insurer's insolvency through the association's issuance and collection of assessment

[12] Source: The Pennsylvania Department of Insurance.
[13] Act 1970-232 was later repealed by Act 1994-137.
[14] 40 P.S. §991.1803.

fees upon its member insurers. The assessment fees enable the association to carry out its duties and make payments on policies of an insolvent insurer.

Act 2000-23 amended the Tax Reform Code of 1971 to provide, in part, tax credits for member insurers.[15] This act established a means for member insurers to recoup a percentage of their assessment fees paid to the Guaranty Association. Act 23 provides that member insurers may apply the tax credit as an offset against its premium liability tax due to the Commonwealth. Act 2001-23 also provided additional changes, including revisions to the definition of the member insurer's assessment base.

The Guaranty Association is governed by a board of seven directors. Each director is selected by the member insurers with the consent of the Insurance Commissioner. The board is required to execute a plan of operation, with the prior consent of the Insurance Commissioner, to carry out the duties and powers of the Guaranty Association.

Purpose of the Guaranty Association

The purpose of the Guaranty Association is to provide protection for Pennsylvania residents who are claimants of property and casualty insurance policies in the event that the member insurer is ordered liquidated by the Commonwealth Court and declared insolvent. The Guaranty Association may pay covered claims on behalf of insolvent insurers, within specified periods of time, before or after an event of insolvency is determined. To the extent necessary, the Association is to take on the rights, duties, and obligations of the insolvent insurer, just the same as if the insurer had not been declared insolvent.[16] Act 1994-137 provides that, in the event of an insolvency, claimants shall be paid an amount not exceeding $10,000 for the return of unearned premiums and an amount not exceeding $300,000 for all other claims.[17] Prior to petitioning for liquidation of an insurer, the Pennsylvania Insurance Department has many options at its disposal to attempt to restore the company to solvency. The department advocates for the option that is in the best interest of the policyholders.

Assessments

Act 1994-137 provides that, in the event that a member insurer is found insolvent, the Guaranty Association conducts assessments to collect the funds necessary to meet the insolvent insurer's obligations. As required, the Association divides its assessment types into two accounts.[18] The first required account is for

[15] 72 P.S. §7902.1.
[16] 40 P.S. §991.1803(b)(2).
[17] 40 P.S. §991.1803(b)(1).
[18] 40 P.S. §991.1808(a).

automobile or motor vehicle insurance assessments. The second required account is for all other remaining insurance assessments applicable.

Each insurer is assessed separately to determine the amount of funds necessary for the Guaranty Association to meet its obligations. The Association is to provide at least 30 days notice to the member insurer that an assessment is due. The maximum amount a member insurer may be assessed in any calendar year is 2 percent of that member's net direct written premiums.[19] As provided on the Property and Casualty Guaranty Association website, there are just under 100 insolvent insurance companies listed.

Tax Credits for Assessments Paid

Member insurers that have paid assessment fees to the Guaranty Association are entitled to a tax credit against premium liability taxes. Property and Casualty insurers are taxed at a rate of 2 percent on premiums received in the Commonwealth. The Association collects assessment fees based on the amount of the member insurer's assessment base.[20] Members are entitled to a tax credit that is equal to the amount of the assessment fee that exceeds 1 percent of their assessment base and may be applied to premium taxes due to the state. The credit may only be taken in equal portions, over a five calendar-year period, after payment of an assessment fee. Any amount of unused credit is not entitled to a refund. There are approximately 1,050 property and casualty insurance providers in Pennsylvania that may benefit from this tax credit.[21]

Tax Credit Expenditures by Fiscal Year

Table 28 illustrates actual tax credit expenditures that have been received by property and casualty insurers in Pennsylvania for fiscal years 2003-04 to 2008-09.

Table 28

Property and Casualty Insurance Guaranty Association
Tax Credit Expenditure by Fiscal Year
($ Thousands)

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Expenditure Amount	$20,008.6	$19,619.8	$26,736.2	$19,304.2	$9,705.1	$4,713.3

Source: Pennsylvania Department of Revenue.

[19] 40 P.S. §991.1802. Net direct written premium is defined as direct gross premiums written in this Commonwealth on property and casualty insurance not designated as reinsurance contracts, less return premiums thereon and dividends paid or credited to policyholders of such policies, but does not include premiums on contracts between insurers or reinsurers.
[20] 72 P.S. §7901. Assessment base is defined as the amount of net direct written premiums used by the Guaranty Association to calculate a member insurer's assessment on an account.
[21] Source: Governor's Executive Budget FY 2010-11.

The Legislature recently passed Act 2009-48, which reduced the amount of tax credit available in several of the Commonwealth's tax credit programs. The tax credit available to member insurers of the Property and Casualty Insurance Guaranty Association was not, however, affected by Act 48.

Other States

A tax offset, similar to the offset available to member insurers of the Pennsylvania Property and Casualty Insurance Guaranty Association, is also available in 20 other states. In the remaining 29 states, the District of Columbia and the territory of Puerto Rico, member insurers either absorb these costs or recoup fees lost to assessments through their rates and premiums charged to policyholders.

Exhibit 3 provides a breakdown of the assessment fee recoupment means available in each state, the District of Columbia and the territory of Puerto Rico. This table provides the availability of a tax offset in each state, how the tax offset is applied, and, if no tax offset is available, how the member insurer recoups its fees from the Guaranty Association's assessments.

There are a total of 21 states, including Pennsylvania, that offer some form of tax offset to its member insurers for assessments paid. Of these 21 states, 16 offer a tax offset that allows the member insurer to recoup its fees within five years of an assessment. Three states, Louisiana, Texas, and Virginia, provide that member insurers may recoup their assessment fees within ten years of an assessment. Tennessee provides that its member insurers may recoup their assessment fees within four years while Missouri, the most advantageous state-offered tax offset available, allows its member insures to recoup their fees in three years. The state of Washington does allow its member insurers to recoup their assessment fees within one year, if the total allowable credit is less than $1,000; otherwise member insurers revert to recouping their fees over a five-year period. In the remaining states, member insurers either absorb these costs themselves or recoup their assessment fees through either rate and premium increases or a policyholder surcharge.

Findings and Recommendations
(For Both Insurance Tax Credit Programs)

1. The tax credit helps smaller insurance companies, in particular.

According to the Pennsylvania Department of Insurance, without the availability of the tax credit, insurance companies would presumably pass on any added costs imposed upon them through assessment fees to their policyholders. Insurance companies could simply raise their premium rates and, consequently, the policyholder would pay for the additional costs. The tax credit, by contrast, provides a deterrent to the member insurers from raising their premium rates because Act 1994-137 prohibits premium rate increases as a result of assessment fees for insurers that accept the tax credit.

Exhibit 3

Availability of a State Offered Tax Offset for Property and Casualty Insurance Guaranty Association Assessment Fees

State, District, or Territory	Availability of State Offered Tax Offset	Application of Tax Offset to Recoup Assessment Fee	Other Means Used to Recoup Fees Lost to Assessment
Alabama	Y	Premium Tax Offset of 20% of assessment fee taken for five years.	
Alaska	N		Policyholder surcharge on premiums received.
Arizona	Y	Premium Tax Offset of 20% of assessment fee taken for five years.	
Arkansas	Y	Premium Tax Offset of 20% of assessment fee taken for five years.	
California	N		Policyholder surcharge on premiums received.
Colorado	N		Recoupment through rates and premiums.
Connecticut	Y	Premium Tax Offset of 20% of assessment fee taken for five years.	
Delaware	Y	Insurer has the option of offsetting against its premium tax by 20% of assessment fee taken for five years or recoup fees through rates and premiums received.	
District of Columbia	N		Recoupment through rates and premiums.
Florida	N		Recoupment through rates and premiums.
Georgia	N		Policyholder surcharge on premiums received.
Hawaii	N		Policyholder surcharge on premiums received.
Idaho	Y	Premium Tax Offset of 20% of assessment fee taken for five years.	

Exhibit 3 (Continued)

State, District, or Territory	Availability of State Offered Tax Offset	Application of Tax Offset to Recoup Assessment Fee	Other Means Used to Recoup Fees Lost to Assessment
Illinois	N		Recoupment through rates and premiums.
Indiana	Y	Insurer has the option of offsetting against its premium tax by 20% of assessment fee taken for five years or recoup fees through rates and premiums received.	
Iowa	N		Recoupment through rates and premiums.
Kansas	Y	Insurer has the option of offsetting against its premium tax by 20% of assessment fee taken for five years or recoup fees through rates and premiums received.	
Kentucky	N		Recoupment through rates and premiums.
Louisiana	Y	Premium Tax Offset of 10% of assessment fee taken for ten years.	
Maine	N		Recoupment through rates and premiums.
Maryland	N		Recoupment through rates and premiums.
Massachusetts	N		Recoupment through rates and premiums.
Michigan	N		Recoupment through rates and premiums.
Minnesota	Y	Premium Tax Offset of 20% of assessment fee taken for five years.	
Mississippi	N		Recoupment through rates and premiums.
Missouri	Y	Premium Tax Offset taken in equal amounts for three consecutive years.	
Montana	N		Recoupment through rates and premiums.

Exhibit 3 (Continued)

State, District, or Territory	Availability of State Offered Tax Offset	Application of Tax Offset to Recoup Assessment Fee	Other Means Used to Recoup Fees Lost to Assessment
Nebraska	Y	Premium Tax Offset of 20% of assessment fee taken for five years.	
Nevada	Y	Premium Tax Offset of 20% of assessment fee taken for five years.	
New Hampshire	N		Recoupment through rates and premiums or policyholder surcharge.
New Jersey	N		Policyholder surcharge on premiums received.
New Mexico	N		Recoupment through rates and premiums received.
New York	N		Recoupment through rates and premiums received.
North Carolina	Y	Premium Tax Offset of 20% of assessment fee taken for five years.	
North Dakota	N		Recoupment through rates and premiums.
Ohio	Y		Recoupment through rates and premiums.
Oklahoma	Y	Insurer has the option of offsetting against its premium tax by 20% of assessment fee taken for five years or recoup fees through rates and premiums received.	
Oregon	N		Policyholder surcharge on premiums received.
Pennsylvania	Y	Premium Tax Offset on amounts exceeding 1% of member insurers assessment base. The excess is applied in equal 20% amounts over five years.	
Puerto Rico	N		Recoupment through rates and premiums.
Rhode Island	N		Recoupment through rates and premiums.

Exhibit 3 (Continued)

State, District, or Territory	Availability of State Offered Tax Offset	Application of Tax Offset to Recoup Assessment Fee	Other Means Used to Recoup Fees Lost to Assessment
South Carolina	N		Recoupment through rates and premiums.
South Dakota	N		Recoupment through rates and premiums.
Tennessee	Y	Premium Tax Offset of 25% of assessment until all assessment fees have been recouped.	
Texas	Y	Premium Tax Offset of 10% of assessment fee taken for ten years.	
Utah	Y	Premium Tax Offset of 20% of assessment fee taken for five years.	
Vermont	N		Recoupment through rates and premiums.
Virginia	Y	Premium Tax Offset of 10% of assessment fee taken for ten years.	
Washington	Y	Premium Tax Offset of 20% of assessment fee taken for five years. If allowable credit is less than $1,000, the entire amount may be offset in one year.	
West Virginia	N		Recoupment through rates and premiums.
Wisconsin	N		Recoupment through rates and premiums.
Wyoming	N		Recoupment through rates and premiums.

Source: National Conference of Insurance Guaranty Fund's online database of Guaranty Fund Laws and Summaries by State, accessible via the Internet at http://ncigf.org/GF-laws-and-summaries-by-state

Additionally, it is felt that, without the availability of the tax credit, smaller insurance companies would be less able to absorb any additional costs from assessment fees than larger insurance companies. Smaller firms would generally have fewer assets available than larger firms to pay the imposed fees. Consequently, those smaller firms might then need to rely on rate increases more so than the larger insurance firms to absorb the additional costs. Ultimately, the potential impact in the market place could lead to policyholders leaving the small insurance firms for the larger firms. The tax credit provision was therefore seen as a mechanism to help stabilize rates between the large and small insurance firms.[22]

As a supplementary means to assess the value of the tax credit, we contacted the Pennsylvania Insurance Federation. We spoke with the president and chief executive officer of the federation to ask his opinion on the current structure of the tax credit, on whether it is seen favorably in the industry and if there have been changes recommended by its members. He believes that the fees collected by the Guaranty Association "go for the good of the policyholder" and that no changes to it have been offered by insurers writing premiums in Pennsylvania. The general response to the value of the tax credit is that it appears to be operating satisfactorily and was discussed in a positive tone.

We note, however, that 29 out of 50 states do not offer any form of tax credit to their insurance companies for assessments paid to a pooled fund used to cover insolvencies. In those states, additional assessments are either covered by the policyholders or the insurance companies, not by the taxpayers. This was also the case in Pennsylvania until 1978.

2. Communication between the Departments of Insurance and Revenue was found to be lacking in terms of handling administrative matters for tax credits and refunds.

After meetings with the Departments of Insurance and Revenue, as well as telephone discussions with the executive director of the Life and Health Insurance Guaranty Association, we found that communication was lacking in the handling of administrative matters related to tax credits and refunds for insurance providers. Department of Revenue staff discussed an instance where a refund check was submitted by an insurance provider to the department for return of tax credit received.[23] Revenue staff noted, however, that prior to receiving the check, they had not been informed by the Department of Insurance that refunds had been issued to the member insurers by the Guaranty Association.

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[22] Source: Meeting with staff from the PA Departments of Insurance and Revenue

[23] Source: Meeting with staff from the Departments of Insurance and Revenue on July 21, 2009 in LB&FC offices.

After discussions with the Executive Director for the Life and Health Guaranty Association we found that, if at any time an insurance provider has received a refund from the Life and Health Insurance Guaranty Association, a full disclosure report of such transaction is prepared and submitted to the Insurance Commissioner. It is his understanding that the Department of Insurance then forwards a copy of this report on to the Department of Revenue.[24]

It is statutorily required that, if a refund creates an excess amount of credit received by the insurance company, it is then obligated to calculate any necessary return of tax credit and return that portion to the Department of Revenue.[25] However, if the insurance company does not voluntarily return the appropriate portion of excess tax credit and the Department of Revenue does not review the Guaranty Association's report to identify the amount of credit due in return, the Department of Revenue will be unaware of the amount of tax credit that should be returned to the Commonwealth. In these instances, the Commonwealth may not be collecting the full amount of tax credit due from the insurance companies.

Recommendation:

> ***We recommend that the Insurance Department take steps to ensure that the Department of Revenue is aware of excess tax credits due to the Commonwealth.***

3. The Insurance Department needs additional information to help ensure that member insurers receiving a tax credit do not also receive a premium rate increase to cover assessment costs.

Act 1994-137 prohibits member insurers from receiving a tax credit if they have increased their premium rates in response to an assessment fee imposed by the Guaranty Association. Act 137 states generally that member insurers are permitted to determine their rates and policyholder dividends in order to reasonably meet their assessment obligations to the Guaranty Association. A member insurer's decision to increase its rates and/or dividends is contingent upon the member not also taking the available tax credit.[26] Throughout this study we found no evidence that the information regarding which insurance companies had taken the tax credit is provided to the Pennsylvania Insurance Department for their use when considering premium rate and dividend increase requests from insurance companies.

Through conversations held with the executive directors of both guaranty associations, we learned that they are not informed, nor aware of whether its member

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[24] Source: Telephone discussion with the Executive Director of the Life and Health Insurance Guaranty Association on November 6, 2009.
[25] 72 P.S. §991.1711.
[26] 40 P.S. §991.1707(g).

insurers elect to take the available tax credit.[27] Therefore, this information could not be supplied by them to the Insurance Department.

Recommendation:

> ***To prevent member insurers from receiving a premium rate increase and a tax credit simultaneously, the Department of Revenue should annually provide a report of which insurance companies have taken the tax credit to the Pennsylvania Insurance Department.*** This would help ensure that the instance of an insurance company receiving both a rate increase and a tax credit due to an assessment does not occur.

[27] Source: Telephone discussion with the executive director of the Life and Health Insurance Guaranty Association, November 6, 2009.

II. L. Research and Development Tax Credit

The federal government began its program for federally funded tax credits for increasing research activities in 1981. It was quickly followed the next year in 1982 by Minnesota, who was the first state to enact such a program. Pennsylvania's research and development tax credit program began in 1997. Currently, 40 states, including Pennsylvania, offer some form of tax credit for a business's research and development expenses, many of which are patterned after the federal program. An advantage for businesses who apply for the tax credit at both the state and federal levels is that credit may be received from both entities for the same research expenses.

The Federal Credit for Increasing Research Activities Program

Under the federal program, individuals, estates, trusts, organizations, and corporations are eligible to claim a credit for qualified research expenses.[1] S corporations, partnerships, estates, or trusts that pass the credit through to their shareholders, partners, or beneficiaries are also eligible. The federal government does not cap the amount of research activity credit that can be claimed. For 2006, 10,788 corporations claiming the federal research tax credit were awarded $7.311 billion.[2]

The Internal Revenue Code defines qualified research activities as those that are undertaken for discovering information that is technological in nature and is intended for use in developing a new or improved business component. Research credit is generally not allowed when the research is conducted after commercial production, adaptation, or duplication of an existing product; surveys; internal use computer software; the social sciences, arts, or humanities; research funded by another person or government entity; and research conducted outside the United States.

To claim the credit for increasing research activities, the applicant completes the Internal Revenue Service's Form Number 6765,[3] which is called the Credit for Increasing Research Activities. This completed form is then attached to and submitted with the applicant's income tax return. Applicants may choose between three different types of credit for which they may apply: the regular credit, alternative incremental credit, and alternative simplified credit. The federal program differs from Pennsylvania's program in that it applies varying percentages for the type of qualified research expenses incurred. A fixed-base percentage is applied,

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[1] The term "qualified research expenses" means the sum of the following amounts that are paid or incurred by the taxpayer during the taxable year in carrying on any trade or business of the taxpayer - in-house expenses, and contract research expenses.
[2] Source: PA Department of Revenue
[3] IRS form 6765, Credit for Increasing Research Activities, is accessible online via the Internet at http://www.irs.gov/pub/irs-pdf/f6765.pdf.

as opposed to Pennsylvania's rolling-base percentage, to the number of years of qualified research expenses and the aggregate gross receipts for the corresponding tax years.

The Internal Revenue Service also conducts audits of program participants who receive credit for increasing research activities. IRS personnel review the nature of the expenditures that businesses report on their application to determine if those expenses can be substantiated as qualifying research. According to the IRS' Audit Techniques Guide: Credit for Increasing Research Activities, determinations are based in part on whether the activity or project meets the definition of a qualified research expense, the amount and nature of expenses reported, job titles within the scope of research activities, and contract research costs.

Discussions with program participants in Pennsylvania's research and development tax credit program who have been audited by the Internal Revenue Service found that IRS auditors conduct site-visits of participants' research and development facilities to evaluate the methods and practices taken to verify that the reported expenses meet the definition of a qualified research expense. IRS personnel that conduct these investigations have the necessary technical skill and expertise to review a wide range of research and development activities.

Pennsylvania's Research and Development Tax Credit Program

Act 1997-7 amended the Tax Reform Code of 1971 to create the Research and Development Tax Credit in Pennsylvania. Administered by the Department of Revenue, the intent of the tax credit is to "encourage taxpayers to increase their research and development expenses in the Commonwealth in order to enhance economic growth."[4] Taxpayers incurring qualified research expenses in the Commonwealth may apply to the department for a tax credit. If approved, the credit may be applied against the taxpayer's personal income tax, corporate net income tax, or capital stock/franchise tax. This tax credit also applies to shareholders of an S corporation. In these instances, persons within the partnership may claim the tax credit on a pass-through basis where each partner (taxpayer) calculates the credit on a pro-rata basis. Each year the Secretary of the Department of Revenue is required to submit a report to the General Assembly indicating the effectiveness of the tax credit.[5] This report is to indicate the names of all taxpayers claiming the credit and the amount of credits approved and utilized. The department has met this requirement each year, as required by Act 7.

Pennsylvania's program was structured similarly to the program offered by the federal government, as filing deadlines are the same and certain definitions are

[4] Source: The Department of Revenue's Report to the General Assembly on the Research and Development Tax Credit, accessible via the Internet at http://www.portal.state.pa.us/portal/server.pt/gateway/PTARGS_0_775704_0_0_18/2010_rd_report.pdf
[5] 72 P.S. §8711-B.

defined by direct reference to those contained within the Internal Revenue Code (IRC). For example, Pennsylvania qualified research and development is based on the federal definition of Qualified Research, as defined by the IRC, at 26 U.S.C. §41(d). The definition at §41(d) is:

> …that which is undertaken for the purpose of discovering information, which is technological in nature, and the application of which is intended to be useful in the development of a new or improved business component[6] of the taxpayer, and substantially all of the activities of which constitute elements of a process of experimentation for a new or improved function, performance, or reliability or quality.[7]

Further, Pennsylvania qualified research and development expense is defined by §41(b) of the IRC as the sum of the following amounts that are paid or incurred by the taxpayer during the taxable year in carrying on any trade or business:

> …in-house or contracted research expenses, which includes in general any wages paid or incurred to an employee for qualified services[8] performed by such employee, any amount paid or incurred for supplies[9] used in the conduct of qualified research, and any amount paid or incurred to another person for the right to use computers in the conduct of qualified research.

Pennsylvania's Research and Development Tax Credit program was designed to encourage businesses to invest more annually in their research expenses to maintain eligibility. The calculation of the program's tax credit is based on the additional expense made above the previous year's research expenses. The Department of Revenue is authorized to award a 20 percent tax credit to small businesses for qualified research expenses and a 10 percent credit to non-small businesses for qualified

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[6] The term "business component" means any product, process, computer software, technique, formula, or invention which is to be held for sale, lease, or license, or used by the taxpayer in a trade or business of the taxpayer.
[7] As provided by 26 U.S.C. §41(d), the term "qualified research" shall not include any of the following: (1) any research conducted after the beginning of commercial production of the business component; (2) any research related to the adaptation of an existing business component to a particular customer's requirement or need; (3) any research related to the reproduction of an existing business component (in whole or in part) from a physical examination of the business component itself or from plans, blueprints, detailed specifications, or publicly available information with respect to such business component; (4) surveys including any efficiency survey, activity relating to management function or technique, market research, testing, or development (including advertising or promotions), routine data collection, or routine or ordinary testing or inspection for quality control; (5) certain computer software related activities; (6) any research conducted outside the United States, Puerto Rico, or any possession of the United States; any research in the social sciences, arts, or humanities; and (7) any research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity). Research relating to style, taste, cosmetic or seasonal design factors of a product is not considered to be qualified research.
[8] The term "qualified services" means services consisting of (1) engaging in qualified research, or (2) engaging in the direct supervision or direct support of research activities which constitute qualified research.
[9] The term "supplies" means any tangible property other than (1) land or improvements to land; and (2) property of a character subject to the allowance for depreciation.

research expenses. Credits may be carried forward[10] up to a maximum of 15 years; however, credits may not carry back[11] for previous tax year liabilities. Unless the Legislature extends this program, the department shall not approve research and development tax credits after December 31, 2015.[12]

Program Participants

The Department of Revenue categorizes applicants in the research and development tax credit program with total asset values of less than $5 million as small businesses. Businesses with total asset values at or exceeding $5 million are categorized as non-small. Since the program's inception in 1997, there has been an average of 110 small businesses applying for research and development tax credit. Non-small businesses have applied for this tax credit, on an annual basis, at an average of about 203 applicants per year. Table 29 provides a breakdown of the number of businesses that have applied for the Research and Development Tax Credit program, from the program's beginning, by year and size of business.

Review of Total Tax Credit Approval

At the program's beginning, Act 1997-7 provided that the Department of Revenue was authorized to approve not more than $15 million in tax credits annually. In 2003, the maximum amount of annual credit approved was increased to $30 million by Act 2003-46. With the passage of Act 2006-116, the amount of annual tax credits issued under this tax credit program was raised to $40 million.

Due to recent actions taken to balance the Commonwealth's budget, Act 2009-48 was passed to reduce the maximum amount of tax credit available for several tax credit programs. For fiscal year 2009-10, the research and development program's maximum amount of tax credit allowed was reduced by 50 percent, to a total of $20 million. (The small business set-aside was reduced to $4 million; leaving $16 million for non-small businesses.) For fiscal year 2010-11, the total amount of credit allowed was reduced further, to $18 million total. (The small business set-aside was reduced to $3.6 million; leaving $14.4 million for non-small businesses.)

[10] The term "carryover" means if the taxpayer cannot use the entire amount of the Research and Development Tax Credit for the taxable year in which the Research and Development Tax Credit is first approved, then the excess may be carried over to succeeding taxable years and used as a credit against the qualified tax liability of the taxpayer for those taxable years.
[11] The term "carry back" means that a taxpayer may not apply the Research and Development Tax Credit to previous year's tax liabilities or obtain a refund of an unused Research and Development Tax Credit.
[12] 72 P.S. §8712-B.

Table 29

Number of Program Participants by Year and Size of Business*

Year	Small Businesses (Businesses With Assets Less Than $5 Million)	Non-Small Businesses (Businesses With Assets at or Exceeding $5 Million)	Total Program Participants
1997	67	225	292
1998	85	185	270
1999	82	193	275
2000	83	201	284
2001	75	218	293
2002	79	175	254
2003	81	161	242
2004	94	180	274
2005	108	183	291
2006	173	206	379
2007	193	246	439
2008	205	261	466
2009	211	296	507

*The numbers of program participants indicated here differ from those reported previously by this office in its *Preliminary Report on Pennsylvania's Research and Development Tax Credit Program*, June 2009. In that report, the information provided in response to an information request by the Department of Revenue included both approved and not approved participants in this program. The number of program participants provided here includes only those participants approved to receive tax credit and is based on the department's annual report to the General Assembly.

Source: Department of Revenue's *Report to the General Assembly on the Research and Development (R&D) Tax Credit* (March 2010).

Tax Credit Assignment:Sale of Unused Credits

Act 2003-46 created the Research and Development Tax Credit Assignment Program. This program is administered by DCED and was established to "assist the growth and development of technology-oriented businesses, particularly small start-up technology businesses."[13] This program is particularly helpful, the guidelines explain, to small start-up technology businesses as they do not yet have significant tax liability. Prior to Act 46, small start-up businesses would likely not apply for this tax credit as it would be of little to no value. Since the passage of this Act, small start-up businesses may now apply to the department to sell their unused tax credits, even if they have no tax liability.[14] The buyer may apply up to 75 percent of the value of the credit to their own tax liability; however, the credit must be used within the tax year of the assignment of the credit. Credits may only be assigned once, and the buyer may not apply to assign the credits again. Often, third party facilitators are utilized to match buyers with approved tax credit sellers.

[13] Source: DCED's Research and Development Tax Credit Assignment program guidelines, September 2004. Accessible at https://www.mepcenters.nist.gov/cims2-web/html/docs/PennsylvaniaRDTaxCredit.pdf
[14] Provided that the seller of any unused tax credit does not have any outstanding tax liability against which the tax credits may be used.

Prior to 2009, participants were required to wait one year after approval of their tax credit from the Department of Revenue before applying to DCED to sell an unused credit. With the passage of Act 2009-48, the one-year waiting period to sell an unused credit has been removed, although departmental preapproval of the sale is still required. Table 30 indicates data on the research and development tax credit program's approved sales/assignments for years 2003 to 2007. As stated previously, 2003 was the first program year in which unused research and development tax credits could be transferred or sold.

Table 30

Research and Development Tax Credit Approved Assignments

Program Year	Number of Approved Assignments	Amount of Credits Assigned	Sale Price	Percentage of Full Value	Facilitator Fee	Facilitator Fee Percentage of Sale Price
2003	21	$1,204,361.00	$1,102,953.50	89.3%	$22,379.68	2.0%
2004	38	3,521,572.00	3,155,193.80	88.9	86,818.18	2.8
2005	47	8,457,505.00	7,900,269.65	92.2	139,664.88	1.8
2006	58	6,525,410.00	6,092,618.08	93.2	222,184.63	3.6
2007	55	2,840,819.00	2,625,686.57	91.6	133,365.26	5.1
Totals	219	$22,549,667.00	$20,876,721.60	92.6%	$604,412.63	2.9%

Source: Department of Community and Economic Development.

Research and Development Tax Credit Application Description

The Pennsylvania Research and Development Tax Credit application (form number: REV-545CT(4-10)PC) is a four-page document that includes two pages of instructions.[15] Revised in April 2010 in response to concerns raised in our June 2009 preliminary report on this tax credit program, the application asks for the applicant's address, an indication as to whether the business is a small business, current and prior year's research and development expenses, line items for the calculation of expenses (line items 4 through 7), and a section for signature and verification that includes the signature of an officer of the company and the name of the person preparing the application. Newly added sections of the application instruct applicants to provide a breakdown of their research and development expenditures by Pennsylvania location. Applicants are also required to indicate any research and development expenditures that took place within a Keystone Opportunity Zone.[16]

[15] See Appendix C.

[16] Source: Act 1998-92, the Keystone Opportunity Zone Act, provides that a person or qualified business that is entitled to claim an exemption, deduction, abatement or credit in accordance with the provisions of this act shall not be entitled to claim or accumulate any of the following exemptions, deductions, abatements, or credits that it may otherwise have qualified for, due to activity within a subzone, improvement subzone or expansion subzone: …(iii) Article XVII-B relating to research and development tax credits.

Application Process

The Department of Revenue requires that applicants complete and submit the Pennsylvania Research and Development Tax Credit application, with all necessary supporting documentation, by September 15. Supporting documentation includes the Internal Revenue Service's Form 6765 – Credit for Increasing Research Activities and, if a small business, a balance sheet reflecting total assets. The IRS Form 6765 is a key document that is filed with the applicant's tax credit application as the department includes this completed form in its decision making process for awarding tax credits. The department may also require additional documentation as necessary.

By December 15 of the same year, the department is to notify applicants of their approved Research and Development Tax Credit amount. The approved tax credit amount may be applied the following calendar year toward the business's tax liability. For example, an applicant may submit an application for Research and Development Tax Credit to the department on or before September 15, 2010. The most recent year of research and development expenses reported on that application would be for the calendar year 2009. Assuming a tax credit is awarded to the applicant, the earliest the applicant may apply the tax credit is for tax returns filed in calendar year 2011. In effect, from the time the research and development expenses are incurred, the applicant waits two calendar years to apply the tax credit to their tax liability.

Research and Development Tax Credit Calculation Process

Businesses with total asset values of less than $5 million qualify in the Research and Development Tax Credit program as a small business. They are eligible for a tax credit of 20 percent on the increased expense made above the average of their base amount expense. This calculation is the same for non-small businesses, which have total assets at or exceeding $5 million. Non-small businesses are eligible for a 10 percent credit on the increase above the average of their base amount expense made.

Pennsylvania's Research and Development Tax Credit calculation uses what is called a rolling base amount to calculate its tax credit. The "base amount" is defined in the Internal Revenue Code as

> . . . the product of (1) the fixed-base percentage, and (2) the average annualized gross receipts of the taxpayer for up to the four taxable years preceding the taxable year for which the credit is being determined. In no event shall the base amount be less than 50 percent of the qualified research expenses for the credit year.

The "fixed-base percentage" means the percentage that the Pennsylvania qualified research and development expense for the four taxable years immediately preceding the taxable year in which the expense is incurred is to the gross receipts for such years. The fixed base percentage for a taxpayer who has fewer than four but at least one taxable year shall be determined in the same manner using the number of immediately preceding taxable years to arrive at the percentage.

Thus, the current year's research and development expense is subtracted from either the greater of 50 percent of the credit year or the average of up to the last four years of research and development expenses. This amount is then multiplied by 10 percent for non-small businesses or 20 percent for small businesses to determine the eligible tax credit.

Proration of the Research and Development Tax Credit

According to the Department of Revenue in 2009, 211 small businesses and 296 non-small businesses were approved for the Research and Development Tax Credit. Any amount remaining after the allocations have been made to the small businesses is then applied toward the non-small businesses. Each year, the program has received application requests for more tax credit than the total amount of credit allowed by the Legislature. As a result, the amount of approved tax credit is prorated to account for all approved recipients. The proration is equal to the amount of tax credit applied for by the applicant, divided by, the amount of tax credit applied for by all applicants, multiplied by the total amount of tax credit allocated.[17]

For program participants to receive the full amount of Research and Development Tax Credit they were approved for by the department, the total credit amount for both small and non-small businesses for 2009 would have had to have been $80,208,000. Table 31 provides the effective level of credit received by both small and non-small businesses, including year, requested credit amount, and approved credit amount.

[17] 72 P.S. § 8709-B.

Table 31

Effective Rate of the Research and Development Tax Credit by Year and Size of Business

Calendar Year	Small Business Requested Credit Amount	Small Business Approved Credit Amount	Small Business Effective Credit Rate	Non-Small Business Requested Credit Amount	Non-Small Business Approved Credit Amount	Non-Small Businesses Effective Credit Rate
1997........	$889,054	$889,054	100.0%	$65,481,984	$14,110,946	21.5%
1998........	1,821,354	1,821,354	100.0	54,750,985	13,178,646	24.1
1999........	3,001,986	3,000,000	99.9	50,454,503	12,000,000	23.8
2000........	1,545,359	1,545,359	100.0	57,662,134	13,454,641	23.3
2001........	1,373,382	1,373,382	100.0	70,034,222	13,626,618	19.5
2002........	1,615,602	1,615,602	100.0	72,640,198	13,384,398	18.4
2003........	1,082,263	1,082,263	100.0	69,109,659	28,917,737	20.3
2004........	1,419,845	1,419,845	100.0	69,513,068	28,580,155	41.1
2005........	2,268,046	2,268,046	100.0	63,538,082	27,731,954	43.6
2006........	7,081,079	7,081,079	100.0	71,558,946	32,918,921	46.0
2007........	6,845,879	6,845,879	100.0	87,887,039	33,154,121	37.7
2008........	8,052,975	8,000,000	99.3	82,659,890	32,000,000	38.7
2009........	8,688,383	4,000,000	46.0	80,208,000	16,000,000	20.0

Source: Department of Revenue's Report to the General Assembly on the Research and Development Tax Credit (2010).

Review of Program Files

Using the Department of Revenue's list of 2008 approved tax credit recipients, we randomly selected 39 participants for review. A phone survey of the selected participants was conducted, of which 21 participants were contacted successfully. We asked questions regarding the participant's application filing procedures and the nature of their research and development practices. The results of this review are included in the findings below.

Other States' Research Tax Credit Programs

A review of programs in other states indicates that most states do not have a program cap, such as that imposed in Pennsylvania. There are 34 states with similar research and development tax credit programs without a cap. Only seven states have a program cap. Theses caps range from $1 million to $60 million. There are two additional states, Florida and Colorado, which target their tax credits more specifically.

The amount of credit offered to program participants varies by state. New York's program provides that companies are eligible to receive a 10 percent capital tax credit on qualified investments if the company agrees that the investment will not be sold, transferred, traded, or disposed of within four years of the close of the tax year in which the credit is claimed. Companies are eligible for a 20 percent capital tax credit on qualified investments if the company agrees that the investment will not be sold, transferred, traded, or disposed of within nine years of the close of the tax year in which the credit is claimed.

Delaware's tax credit program provides a credit amount that is equal to either 10 percent of the excess of the taxpayer's total qualified research and development expenses over the base amount or 50 percent of the apportioned alternative incremental credit method under the Internal Revenue Code.

New Jersey offers two different tax credits for research and development with an additional option of selling unused tax credits through their technology business tax transfer program. The basic tax credit program is limited to the applications of scientific experimentation or engineering activities. The remaining tax credit program is targeted at small New Jersey based high-technology businesses. A taxpayer may claim a 10 percent tax credit for investments made in a small high-technology business within the state.

Maryland's program for research and development credit allows businesses that incur qualified research and development expenses to apply for either a 3 percent basic credit, which is for eligible research and development expenses that do not exceed the firm's average research and development expenses over the last four years.

West Virginia's program provides that the allowable tax credit is the greatest of either 3 percent of the annual combined qualified research and development expenditures within the state or 10 percent of the excess of the annual combined qualified research and development expenditures within the state over the base amount. The base amount equals the average annual combined research and development expenditures within the state during the three years preceding the current year.

Up until 2005, an applicant's eligible tax credit in Pennsylvania could not exceed 50 percent of their tax liability; however, this was removed in years 2005 and forward. Delaware's program still contains the provision that an applicant's eligible tax credit shall not exceed 50 percent of their tax liability. New Jersey's program provides that tax credits received may be combined with other tax credit amounts while total credits cannot exceed 50 percent of total tax liability. For program participants in California's research and development program, business credits shall only offset 50 percent of the net tax liability if income is $500,000 or more.

Similar to Pennsylvania, states such as Connecticut, Delaware, Minnesota, and Massachusetts allow their research and development tax credits to be carried forward up to 15 years. In California, unused credits may be carried over as many years as the number of taxable years the credits were not allowed. Illinois' program, however, provides that participants may only carry forward unused credits for five years. New Jersey allows participants to carry unused credits forward for seven years unless the credit is for research in advanced computing, advanced materials, biotechnology, electronic device technology, environmental technology, or medical device technology. In those instances the credit may be carried forward for 15 years.

Findings and Recommendations

1. The Pennsylvania Research and Development Tax Credit application may mislead applicants to report the incorrect tax year of research and development expenses to include in their application.

As the research and development application is currently structured, the year indicated in the heading of the form may lead to some misinterpretation as to which tax year expenditures are to be reported. For example, the 2009 application may be misconstrued by applicants as intended to report 2009 tax year research and development expenses; the 2009 application is actually for research expenses incurred in the 2008 tax year. This is unlike most tax forms, where the year in the heading refers to the tax year for which the information is to be reported (e.g., 2009 tax year information is reported on the 2009 PA-40). We discussed this issue with Department of Revenue staff who informed us that they have received questions from applicants in the past stating they were uncertain which tax year of expenditures should be reported on the application.

Recommendation:

> ***We recommend that the Department of Revenue revise the current Research and Development Tax Credit application to clarify for which tax year expenses are to be submitted.*** This could be done simply by including in the application header: 2010 Application (For 2009 Tax Year Expenses).

2. Although called the Research and Development Tax Credit, credits can only be awarded for research activities, not development.

Businesses may be inadvertently submitting expenses that do not meet the statutory definition of a Pennsylvania qualified research and development expense and, therefore, may be receiving tax credits inappropriately.

Act 1997-7 stipulates that tax credits can only be awarded for "qualified research and development expense." It further defines the term by reference to §41(d)(4) of the Internal Revenue Code. The federal definition is quite lengthy, but in general refers to research which is undertaken for the purpose of discovering information:

- which is technological in nature, and
- the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and
- substantially all of the activities of which constitute elements of a process of experimentation for the purpose of a new function or improving performance, reliability, or quality. The act specifically excludes such activities as research after commercial production, adaptation, or duplication of existing business components; marketing studies or surveys; social sciences routine data collection; and computer software developed for internal use by the business.

Act 1997-7 defines the terms “Pennsylvania Qualified Research and Development” and “Pennsylvania Qualified Research and Development Expense” by referring to certain definitions contained within §41(d) of the Internal Revenue Code. The word “development,” however, is not defined by §41 of the IRC. Because businesses are only to obtain tax credit for activities which meet the federal definition of qualified research, the use of the term “development” in the Pennsylvania statute is confusing and implies that the credit is available for activities other than research. This is heightened by the fact that over 30 percent of those that we surveyed do not claim the tax credit at the federal level, and therefore, may not be as familiar with what is acceptable at the federal level.

This ambiguity in the definitions is supported by the responses we received from program participants on this issue. When asked if their business ever sought clarification for the term “Qualified Research Expense”, three businesses stated they contacted the department directly for clarification while five businesses asked their accountant for clarification. Survey responses also support the assessment that the department has not sought to substantiate the nature of the activities for which businesses are submitting research and development expenses.

Recommendation:

> ***We recommend that the Department of Revenue provide clarification on the application and accompanying instructions as to what is considered to be an acceptable qualified research expense, rather than merely referring to the federal statute.*** In addition, if the General Assembly chooses to reauthorize this program (it is scheduled to sunset in 2015), it should consider renaming it the Research Tax Credit to more accurately reflect the types of qualified expenses allowed.

3. The Department of Revenue does little to verify that credits are awarded only to businesses with qualified research and development expenses.

To assess whether a business has incurred qualified research and development expenses, the Pennsylvania Department of Revenue requires businesses to submit a copy of their Federal Form 6765 (Credit for Increasing Research Activities) or a "pro-forma 6765." The Department of Revenue, however, does not routinely verify with the IRS that the Form 6765 was actually used to claim the federal tax credit, or if it was submitted with the business's federal tax return.

If an applicant decides to submit a pro-forma 6765, the department does not verify the adherence of the information reported to federal guidelines. This could be especially troublesome for those claiming the credit in Pennsylvania that do not also claim the credit at the federal level, since the department relies so heavily on applicants' knowledge of the federal rules to "police" our program.[18]

In addition, the Department of Revenue does not audit the businesses receiving the Research and Development Tax Credit, unless a business's tax return is being audited for other purposes. Based on discussions with Department of Revenue staff, contact with an applicant only occurs when a business's submitted expenses differ from expenses on previously submitted applications. We were informed, however, that even when such follow up occurs, the department does not attempt to assess or verify the nature and amount of expenses submitted to determine their compliance with the definition of a qualified research expense.

In contrast, the federal government does have specialized staff that audit the federal research tax credit. IRS personnel review the nature of the expenditures that businesses report on their application to determine if those expenses can be substantiated as qualifying research. According to the IRS' Audit Techniques Guide: Credit for Increasing Research Activities, these determinations are based on factors such as whether the activity or project meets the definition of a qualified research expense, the amount and nature of expenses reported, job titles within the scope of research activities, and contracted research costs.

Program participants in Pennsylvania's Research and Development Tax Credit program who have been audited by the Internal Revenue Service told us that IRS auditors conduct site-visits of participant's research and development facilities to determine if the reported expenses meet the definition of a qualified research expense. These participants told us that the IRS personnel that conduct these investigations appear to have the necessary technical skills and expertise to review a

[18] In our telephone survey of 21 Pennsylvania businesses applying for the R&D tax credit, 70 percent reported that they applied for both the federal and Pennsylvania credits. Those that applied only for the Pennsylvania credit were generally firms that did not incur a tax liability but planned to sell their credits to another business, an option not available in the federal program.

wide range of research and development activities. In contrast, none of those that we surveyed said that the expenses reported on their research and development application have ever been audited by the Pennsylvania Department of Revenue nor have they ever received a request from the department for access for a site visit of their research and development facility.

Therefore, program participants' submitted expenses are not verified to determine if they meet the definition of a qualified research expense and the department is relying solely on the participant to verify that the expenses, as submitted, are legitimate qualified research expenses. Since the credits are prorated among all applicants, the end result may be that businesses who do have qualified expenses may have their credit amounts reduced by those businesses that receive credit for expenses that do not meet the definition of qualified research.

Recommendations:

a. ***The Department of Revenue should match the data reported to the IRS on the Federal Form 6765 to the data reported on the Pennsylvania Research and Development Tax Credit application to provide reasonable assurance that businesses applying for the Pennsylvania tax credit have incurred legitimate research expenses and that the relative amounts claimed are appropriate.*** In addition, since it appears that the IRS is performing audits of Pennsylvania businesses as a result of their receiving the federal research credit, we encourage the department to utilize the results of these audits for those companies also receiving the Pennsylvania credit. This would provide a further check on the company's eligibility to receive a tax credit.

b. ***We also recommend that the department conduct (or contract to perform) audits of some or all businesses that receive substantial PA Research and Development Tax Credits.*** We believe that a threshold of $500,000 annually (of which there were 32 businesses in that category in calendar year 2008) would ensure that the largest amount of tax credits is receiving scrutiny. To promote the concept of greater transparency, the department should insert a mandatory "check-off box" on the application making it clear that if you receive a credit, Pennsylvania state officials may conduct an audit, which may include file reviews and facility site-visits.

4. To ensure that the research activity is conducted in Pennsylvania, the Department of Revenue recently updated the Research and Development Tax Credit application to require companies to specify that the research was conducted in Pennsylvania.

In our *Preliminary Report on Pennsylvania's Research and Development Tax Credit Program* (June 2009), we noted that the Department of Revenue's Research and Development tax credit application did not require applicants to indicate the location at which the research was conducted. This is important information as credits are only available for research conducted in Pennsylvania. In our review of the R&D applications, we found that often (in 6 out of 39 files reviewed, or 15 percent) the only address on the application was an out-of-state corporate address. Even for those applicants that did provide a Pennsylvania based address it is unclear if the address provided is corporate in nature or is actually where the research and development occured. We recommended the Department of Revenue revise the Research and Development application to require businesses to provide the address and telephone number of the location at which the research is being conducted.

In response to our recommendation, the Department of Revenue subsequently revised its Research and Development application (REV 545CT(4-10)) to require that applicants indicate the specific Pennsylvania address and contact information where the research and development expenditures for which they are seeking credit took place.

5. The Department of Revenue may be unaware if expenses claimed by businesses contracting out to firms for research and development services are also being claimed for tax credit by third party contractors.

Businesses may outsource various parts of their research and development needs to third party contractors. Payment is made to the third party and included as an expense in the business's overall operations. While the research and development work may not be conducted on site, the payment made by the business to the third party is still an eligible expense for the research and development tax credit, provided the research was conducted in Pennsylvania.

The department states that, under §41(d) of the Internal Revenue Code, an entity that performs research and development under contract for another entity (i.e., a third party) is not allowed to claim those expenses in calculating their own research and development tax credit. The department noted that if this procedure were not in place, the same research and development expenses could be claimed by both the business paying for the work and the third party contractor.

Since the federal program does not allow third-party contractors to claim credits for those expenses for which they received payment from another, this should help eliminate the chance of this occurring in Pennsylvania's program for those that also apply for credits at the federal level. It does little, however, to address the situation for those that only apply to receive credit through Pennsylvania's program, since they may not be familiar with the federal rules. Based on our survey sample, only about 70 percent of the businesses applying for the Pennsylvania also apply for the federal credit.

Recommendation:

> ***We recommend the Department of Revenue revise the Research and Development application to require that an applicant indicate whether any of the research and development activities they are claiming as expenses on the application were performed by a third party and, if so, to provide the identity of the contractor and where the third-party research was conducted.*** Similarly, we recommend the application also be revised to ask applicants to identify whether the research expenses they are reporting on the application were conducted under contract with another party. If so, they should be required to include the names of the businesses for which they did the work so the department can cross check to ensure that credits are not being claimed by both parties for the same work.

6. The Department of Revenue has recently revised the Research and Development application to make it clear that research and development expenditures incurred in a Keystone Opportunity Zone (KOZ) are not eligible for Research and Development Tax Credits.

Businesses that receive tax-exemption benefits from the Keystone Opportunity Zone (KOZ) program are not allowed to also claim Research and Development tax credits for their research expenditures. In our *Preliminary Report on Pennsylvania's Research and Development Tax Credit Program* (June 2009), we noted that the Department of Revenue's Research and Development Tax Credit application stated, "If the PA R&D expenditures were not incurred in a KOZ, the taxpayer must include a statement to that effect in order to be considered for the credit."[19] In our sample file review, however, none of the applicants included a statement indicating that the applicant's research and development expenses were not in a KOZ. We also noted that the department processed all of the applications and approved the applicants for tax credit.

LB&FC staff conducted phone surveys with 21 of the 39 applicants, and one of the questions we asked was whether they included the required KOZ statement with their application. None of the participants indicated they included such a statement, nor had they been asked subsequently to provide one.

To address this concern, the Department of Revenue has recently developed a draft of the 2010 Research and Development application, which includes a breakdown of a company's research and development expenditures that were located in a Keystone Opportunity Zone (KOZ). These expenditures that were made in a KOZ are not then eligible for the Pennsylvania Research and Development Credit.

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[19] Accessible online via the Internet at
http://www.portal.state.pa.us/portal/server.pt/document/629531/2009_rev-545_pdf.

II. M. Resource Enhancement and Protection Program

Background and Overview

The Resource Enhancement and Protection Program (REAP), established by Act 2007-55 and administered by the State Conservation Commission within the Department of Agriculture, encourages private investment in the implementation of best management practices (BMPs)[1] on agricultural operations, the planting of riparian buffers, and the remediation of legacy sediment buffers.[2] In traditional conservation programs, monies have come in the form of grants, wherein the farmers receive funding before the project starts. REAP is different in that the tax credit is issued after the installation of a practice or purchase of eligible equipment. For the first two years of the program, credits were capped at $10 million; Act 2009-48 cut the available credits to $5 million for FY 2009-10.

REAP credits may be applied against the following taxes: personal income tax, corporate net income tax, capital stock and franchise tax, bank shares tax, title insurance company tax, insurance premiums tax, and mutual thrift institutions tax.[3] According to the Conservation Commission, 50 percent of issued tax credits are used to offset the personal income tax. If a credit recipient cannot use the entire amount for the taxable year in which the credit is granted, the credit may be carried over and applied to eligible tax liability for no more than 15 succeeding taxable years.

Eligible applicants may receive between 25 percent and 75 percent of project costs in tax credits, up to $150,000 per agricultural operation,[4,5] and applicants may apply for credits for multiple projects on one application. Tax credits may not be applied to any portion of a project's cost for which public funding was received. Eligible costs of a project to which a credit may be applied include:

- project design, engineering, and associated planning;
- project management costs, including contracting, document preparation, and applications;

[1] Qualifying BMPs are those that are defined as practices determined by the Commission or U.S. Department of Agriculture Natural Resources and Conservation Service to be effective and practical, considering technological, economic, and institutional factors to manage nutrients and sediment to protect surface water and groundwater. The phrase includes the purchase and utilization of no-till equipment.
[2] 72 P.S. §8703-E(a).
[3] 72 P.S. §8702-E.
[4] Under the statute, recipients may receive tax credits for 25 percent of eligible costs for remediation of legacy sediment. Legacy sediment is a dirt removal process, mainly from dams and mill dams. These projects have not yet been accepted by REAP because the Department of Environmental Protection has not yet promulgated regulations on this type of practice.
[5] There is no limit on the total amount of tax credits that can be granted to a sponsor (Please see page 136 for information on sponsorship).

- project construction or installation;
- equipment, materials, and all other components of eligible projects;
- post-construction inspections; and
- interest payments on loans for project implementation for up to one year prior to the award of the tax credit.

Tax credit recipients may receive tax credits for 75 percent of eligible costs for:

- nutrient management plans, agricultural erosion and sedimentation (E&S) control plans, and/or conservation plans; and
- BMPs for animal concentration areas and barnyard runoff, stream bank fencing with 50 foot riparian buffers, and 50 foot forested riparian buffers.

Tax credits for 50 percent of eligible costs include:

- any Commission-approved BMP or equipment necessary to reduce existing sediment and nutrient concerns to surface waters such as: manure storage systems, alternative treatment practices, filter strips, grassed waterways, management intensive grazing systems, and no till planting equipment; and
- stream bank fencing with 35 foot riparian buffers (grassed or forested).

In accordance with 72 P.S. §8710-E, the Commission is to issue an annual report to the General Assembly on the REAP program which includes:

- the number of projects and the dollar amount of tax credits granted under the program in the aggregate, by best management practice, and per project;
- the types, locations, and costs of projects; and
- the estimated benefits of the projects including pollution reduction.

In addition to the data that is required in the REAP annual report, the Commission is also to make available, as a public record, the identity of each taxpayer who received a REAP credit and the associated amount of approved credits for each. This data is to be available annually within a year of when the credits were granted. To date, however, there has been only one annual report issued that included program data for 2007-08. At this time, the Commission is preparing its second annual report, which will include the data from the program year 2008-09.

Program Eligibility/Application Process/Internal Controls

Farmers may apply for credits for projects that have been completed or for proposed projects which will be completed after the Commission determines eligibility.[6] To aid with the application process, the Commission also publishes guidelines that direct applicants through the tax credit process and has held informational "webinars" for interested parties. The Commission accepts applications on a first-come, first-served basis.[7] At the end of the first day that applications are accepted, all applications received by mail or hand-carried are date stamped and randomly assigned a number beginning with number one. All applications received on following days are numbered sequentially. Applications are reviewed in numerical order and are approved as eligible REAP projects if they have met the criteria required in program guidelines.

In order to apply for credits, an agricultural operation must have in place a current conservation plan, a current agricultural erosion and sediment plan (if engaged in plowing and tilling), and a current nutrient management plan. If these plans are not in place, the costs for their development and implementation may be included in a tax credit application. An agricultural operation with an animal concentration area must have implemented BMPs to abate storm water runoff, loss of sediment and nutrients, and runoff of other pollutants. If these plans are not in place, the costs for their development and implementation may be included in a tax credit application.

If the approved project is a completed project, as attested to by the applicant with a signed certification and copies of receipts for the project, the Commission notifies the Department of Revenue (DOR). DOR conducts a compliance check to determine if the applicant has filed all required state tax reports and returns for the applicable tax year and paid all taxes due. If all taxes are in order, DOR issues a notice of award of tax credit within 60 days. For projects that are not concluded, upon completion, the applicant must forward proof of the completed project to the Commission in order to be awarded the credit.

Part of the application includes a requirement for verification signatures. Signatures may be provided by:

- certain conservation district employees,
- qualified technical service providers,
- individuals with certification under Act 2005-38, and
- USDA NRCS employees who are certified in conservation planning.

[6] During the first year of REAP, farmers were required to complete BMP projects in three years. Subsequently, farmers were required to complete these projects within two years. Equipment purchases must be completed within one year.
[7] 72 P.S. §8707-E.

These individuals, by signing on the Verification Signature Line for Conservation Plans, AG E&S Plans, Animal Concentration Plans, and Nutrient Management Plans, are verifying that: the plans exist, that they reflect the current operation on the agricultural operation (tillage, number of acres, animal numbers, crop rotation, etc.) and that plans are either fully implemented or being actively implemented on a reasonable implementation schedule.

In addition to verification of plans, in order to be awarded the tax credit for BMPs, the recipient must send a Project Completion Certification form to the Commission. This form must be signed by either the project designer/engineer or signed and sealed by a registered professional engineer. This form attests that the project met the design and construction standards established by the Commission.[8] For BMPs, the Commission adopted the standards contained in the PA Technical Guide, a publication of the National Conservation and Resource Service (NRCS).

In addition to being designees who are able to verify that applicants have the required plans in place, Conservation Districts also have other roles within the REAP program, which are not designated by statute or guidelines. We spoke to several different districts about other functions they may perform for REAP applicants. The representatives with whom we spoke vary in the services they provide REAP applicants. Most offer assistance in completing applications for the tax credit. Some districts offer project design and project management. All districts with which we spoke do offer services in addition to verification.

In order to receive the tax credit, recipients must agree to maintain the BMP or equipment for a specified life span.[9] To help ensure that this criterion is being met, the Commission has a compliance check in place, which involves mailing a "self-compliance" report to tax credit recipients who have purchased equipment. The form requires the recipient to sign and certify that the no-till equipment for which a tax credit was received was being used on the agricultural operation. The Commission made compliance visits to those participants who did not return the form, making 14 such visits as of July 2009, and found all operations to be compliant. For those tax credit recipients that installed BMPs other than equipment, the Commission performed spot checks on 1 percent of them and found them to be compliant. The Commission is working on developing a process for more comprehensively monitoring these recipients.

[8] 72 P.S. §8704-E(a)5.

[9] Life spans of specific projects are included in an attachment to the program guidelines. The life spans of BMPs required by the Commission are taken from the PA Technical Manual, published by the National Resource and Conservation Service (NRCS) within the federal Department of Agriculture. Because the NRCS does not establish life spans for equipment, the Commission added them for equipment purchases.

If a recipient of a tax credit is found to be non-compliant,[10] the tax credit is to be returned to the Commonwealth in its entirety.[11] However, no mechanism is currently in place within the DOR for such default recovery. According to a Commission official, they are working with DOR to develop such a process. If a tax credit recipient provides prior written notification to the Commission that the recipient will be unable to maintain a BMP due to the sale of the property, cessation of an agricultural operation, or other factors, the Commission may direct DOR to prorate the amount of tax credit that shall be returned, based on the remaining life span of the BMP.[12]

Tax Credits Issued

Table 32 shows the total tax credits issued for the first three years of the REAP program, each of which were capped at the aforementioned $10 million. Credits were nearly exhausted for all three years of the program. For FY 2009-10, with the passage of Act 2009-48, the cap for REAP was cut in half, to $5 million. This figure will be further reduced to $4.5 million in FY 2010-11. Although the total amount of available credits was reduced by 50 percent in FY 2009-10 and 55 percent in FY 2010-11, the Governor's Office elected to allow recipients to remain eligible for the original amount of up to $150,000 in tax credits per agricultural operation.

In fiscal years 2007-08 and 2008-09, there were 293 and 356 recipients, respectively. With the cut in funding for FY 2009-10, only 171 applicants received approvals for the REAP credit. Table 33 shows the number of BMPs that were approved, rather than the number of recipients, because one recipient may use credits for multiple projects.

During the first year of the program (which ran from December 2007 to June 2008), the Commission took applications for 10-15 days before funding was exhausted. The second year, funds were exhausted[13] within several days. The first day that applications were accepted for FY 2008-09, the department received about $13.5 million in requests. After receiving a volume of applications that was considerably higher than the capped amount of REAP tax credits, the Commission notified the public that it would not accept further applications. In FY 2009-10, the Commission received applications for $9.9 million worth of credits. A Commission official speculated that the number of applications that the Commission received decreased in FY 2009-10 because of the lateness of the passage of the budget.

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[10] As of March 2010, no projects have been found to be non-compliant.
[11] 72 P.S. §8706-E.
[12] Ibid.
[13] Although Table 32 shows that available credits were not completely exhausted, all tax credits were accounted for on the first day applications were accepted for all three years of REAP's implementation. The total amounts are generally always fluid, due to the fact that farmers may decide not to implement a BMP or may implement different BMPs than those for which they originally applied. In all cases, tax credits are then cycled to the next project in line.

Table 32

Resource Enhancement and Protection (REAP) Program

March 1, 2010

REAP FY 2007-08	Number of Practices	Total Project Cost	Total Other Public Funds	Total REAP Tax Credit
Approved-Credits Pending Completion of Project(s).....	114	$ 4,099,991	$ 965,466	$1,541,254
Credit Awarded....................	498	18,537,817	2,178,399	7,947,087
Total[a]................................	612	$22,637,807	$3,143,865	$9,488,341

REAP FY 2008-09	Number of Practices	Total Project Cost	Total Other Public Funds	Total REAP Tax Credit
Approved-Credits Pending Completion of Project(s)..........	318	$ 7,406,340	$ 766,169	$3,229,359
Credit Awarded.........................	569	14,994,715	2,088,827	6,318,333
Total[a].....................................	887	$22,401,055	$2,854,996	$9,547,692

REAP FY 2009-10	Number of Practices	Total Project Cost	Total Other Public Funds	Total REAP Tax Credit
Approved-Credits Pending Completion of Project(s)..........	190	$ 5,789,884	$1,070,548	$2,219,797
Credit Awarded.........................	235	5,774,612	493,436	2,643,167
Credit Award Pending With Dept. of Revenue....................	5	275,894	91,392	91,251
Total[a].....................................	430	$11,840,390	$1,655,375	$4,954,216

Total REAP Program to Date FY 2007-08 Through 2009-10	Number of Practices	Total Project Cost	Total Other Public Funds	Total REAP Tax Credit
Approved-Credits Pending Completion of Project(s)..........	622	$17,296,214	$2,802,182	$ 6,990,410
Credit Awarded.........................	1,302	39,307,144	4,760,662	16,908,587
Credit Award Pending With Dept. of Revenue....................	5	275,894	91,392	91,251
Total[a].....................................	1,929	$56,879,253	$7,654,236	$23,990,248

[a]May not add due to rounding.

Source: PA State Conservation Commission.

Tables 33 through 36 show some of the BMPs that have been funded through REAP in FY 2007-08. The first table shows the 20 BMPs that farmers most frequently selected to implement. The most frequently implemented BMP, no-till equipment, accounts for almost half of the $10 million that was available for REAP credits that year. Table 34 shows the top 20 BMPs by total tax credits approved.

Most of the equipment purchased by tax credit recipients was for no-till planting equipment. No-till farming practices do not turn the soil over to plant seeds, but rather cut through the soil and crop residue to plant the seeds. This practice helps prevent soil erosion and keeps moisture in the ground. According to the Commission, the no-till equipment for which it approved tax credits has potentially reduced tons of sediment each year, therefore helping to protect Pennsylvania streams and rivers, as well as the Chesapeake Bay.

As depicted, a variety of best management practice projects were completed with the REAP tax credits. The second two most implemented BMPs are Heavy Use Area Protection, which helps reduce phosphorous levels, and Waste Storage Facilities, which helps reduce nitrogen levels.

Table 33

2007-08 Best Management Practices Approved and Awarded By Quantity of BMP
(As of July 2010)

BMP Type	Number	Total BMP Cost	Total Tax Credit Approved	Credit Awarded to Date
No-Till Planting Equipment-Drill	124	$4,617,625	$2,291,516	$2,255,100
No-Till Planting Equipment – Planter	98	5,105,615	2,533,490	2,466,540
Waste Storage Facility	50	6,788,737	2,348,391	1,807,010
Heavy Use Area Protection	38	1,288,939	406,343	266,296
Nutrient Management Plan	29	72,370	42,866	27,783
Manure Transfer	26	1,015,771	377,126	231,818
Roof Runoff Structure	23	282,554	138,045	31,786
Fence	20	186,372	55,594	46,897
Underground Outlet	18	67,370	16,416	14,878
Grassed Waterway	17	143,211	33,978	14,558
Access Road	17	117,122	37,250	19,260
Manure Incorporation	15	429,530	214,765	214,765
REAP Application Preparation	14	7,860	5,895	4,958
Diversion	12	61,792	11,240	7,589
Animal Trails and Walkways	11	87,187	29,948	25,839
Subsurface Drain	11	46,625	13,829	10,060
Critical Area Planting	10	10,878	5,591	3,241
Terrace	8	134,931	25,790	18,507
Manure Separation	8	479,335	187,939	142,491
Structure for Water Control	7	44,178	11,242	11,191

Source: Developed by LB&FC staff from information provided by the PA State Conservation Commission.

Table 34

2007-08 Best Management Practices Approved and Awarded by Tax Credits Approved
(As of July 2010)

BMP Type	Number	Total BMP Cost	Total Tax Credit Approved	Credit Awarded to Date
No-Till Planting Equipment – Planter........	98	$5.105.615	$2.533.490	$2.466.540
Waste Storage Facility..............................	50	6.788.737	2.348.391	1.087.010
No-Till Planting Equipment-Drill................	124	4.617.625	2.291.516	2.255100
Heavy Use Area Protection	38	1.288.939	406.343	266.296
Manure Transfer	26	1.015.771	377.126	231.818
Manure Incorporation................................	15	429.530	214.765	214.765
Manure Separation	8	479.335	187.939	142.491
Composting Facility..................................	1	284.937	142.468	142.468
Roof Runoff Structure	23	282.554	138.045	31.786
Agriculture E&S Plan	2	98.337	72.960	2.250
Waste Treatment	2	147.460	61.505	0
Closure of Waste Impoundments	4	160.524	59.702	4.309
Fence	20	186.372	55.594	46.897
Silage Leachate Management..................	1	115.661	50.501	50.501
Nutrient Management Plan.......................	29	72.370	42.866	27.783
Access Road..	17	117.122	37.250	19.260
Solid/Liquid Waste Separation Facility	3	102.398	35.358	17.091
Composting..	3	69.944	34.546	34.546
Pond Sealing or Lining.............................	1	68.533	34.266	34.266
Grassed Waterway	17	143.211	33.978	14.558

Source: Developed by LB&FC staff from information provided by the PA State Conservation Commission.

Table 35

2008-09 Best Management Practices Approved and Awarded by Tax Credits Approved

(As of July 2010)

BMP Type	Number	Total BMP Cost	Total Tax Credit Approved	Credit Awarded to Date
No Till Planting Equipment – Planter....	103	$4,890,653	$2,421,498	$2,327,215
Waste Storage Facility..........................	64	6,683,662	2,366,119	881,317
No Till Planting Equipment-Drill............	106	3,941,694	1,966,145	1,795,988
Heavy Use Area Protection	48	1,583,282	622,994	207,720
Manure Transfer	44	749,048	315,004	103,255
Composting..	5	420,625	172,813	172,813
Nutrient Management Plan...................	90	302,430	159,419	117,422
Solid/Liquid Waste Separation Facility .	2	398,358	146,409	146,309
Manure Separation	3	274,985	136,924	87,779
Fence	37	358,960	126,470	37,318
Silage Leachate Management..............	4	251,944	123,892	
Manure Incorporation............................	10	247,232	123,375	123,375
Grassed Waterway	27	258,427	79,434	55,429
Underground Outlet	29	146,959	53,887	28,739
Manure Incineration	1	286,038	49,841	49,841
Closure of Waste Impoundments	3	73,850	31,351	
Pipeline	19	102,744	30,539	4,763
Subsurface Drain	10	83,422	28,884	20,413
REAP Application Preparation..............	121	37,763	28,195	22,686
Access Road...	16	102,172	28,100	10,183

Source: Developed by LB&FC staff with information provided by the PA State Conservation Commission.

Table 36

2008-09 Best Management Practices Approved and Awarded By Quantity of BMP
(As of July 2010)

BMP Type	Number	Total BMP Cost	Total Tax Credit Approved	Credit Awarded to Date
REAP Application Preparation	121	$ 37,763	$ 28,195	$ 22,686
No-Till Planting Equipment-Drill	106	3,941,797	1,966,145	1,795,988
No-Till Planting Equipment – Planter	103	4,890,653	2,421,498	2,327,215
Nutrient Management Plan	90	302,430	159,419	117,422
Waste Storage Facility	64	6,683,662	2,366,119	881,317
Heavy Use Area Protection	48	1,583,282	622,994	207,720
Manure Transfer	44	749,048	315,004	103,255
Fence	37	358,960	126,470	37,318
Underground Outlet	29	146,959	53,887	28,739
Roof Runoff Structure	28	67,419	25,286	11,629
Grassed Waterway	27	258,427	79,434	55,429
Pipeline	19	102,744	30,539	4,763
Access Road	16	102,172	28,100	10,183
Diversion	16	62,881	22,777	1,649
Watering Facility	13	56,438	15,922	6,272
Animal Trails and Walkways	11	79,278	14,750	10,365
Manure Incorporation	10	247,232	123,375	123,375
Subsurface Drain	10	83,422	28,884	20,413
Terrace	10	70,945	24,577	2,973
Structure for Water Control	9	18,132	5,979	2,949

Source: Developed by LB&FC staff with information provided by the PA State Conservation Commission.

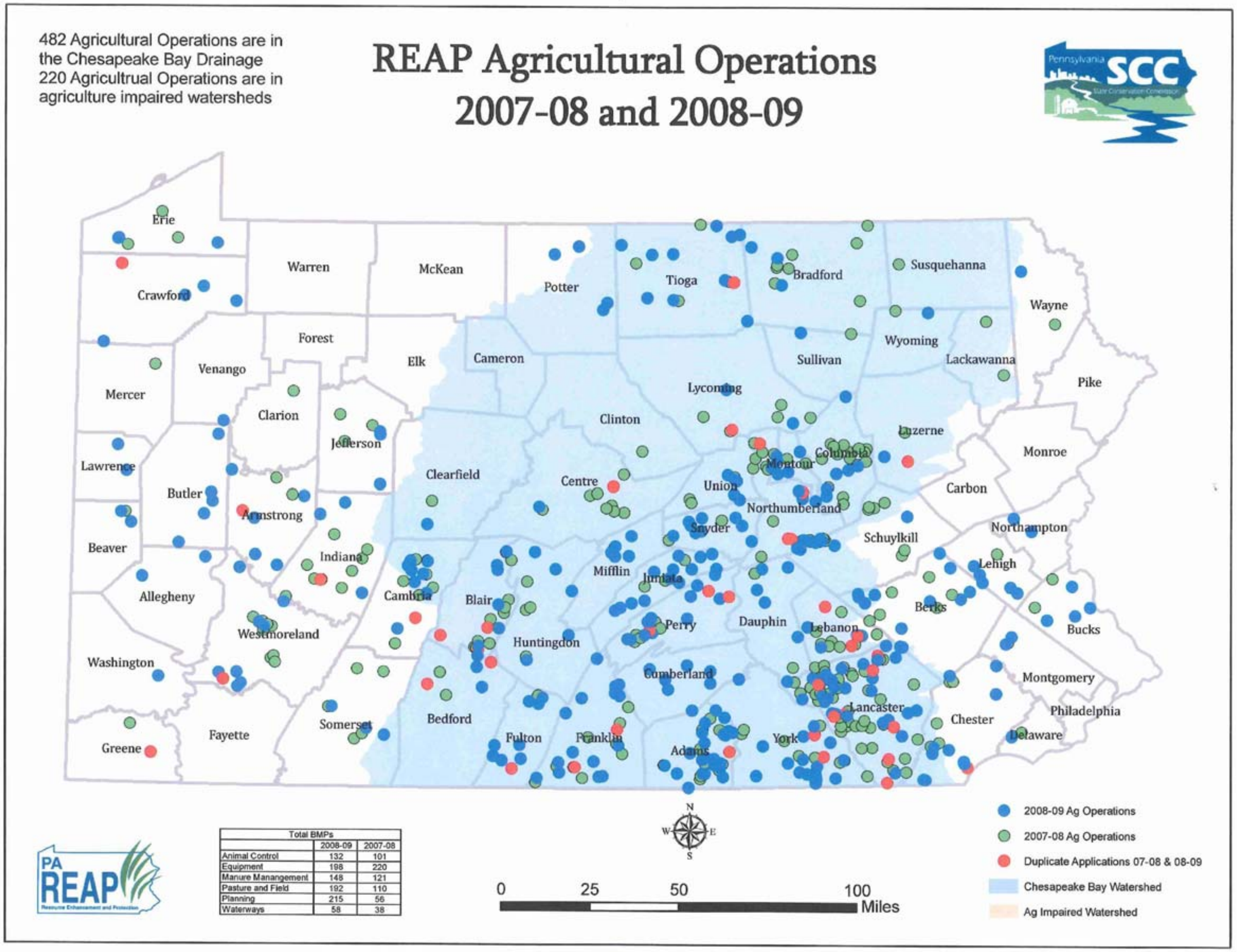
Exhibit 4 shows the locations of the agricultural operations that have been approved for REAP credits for the first two years of the program. Although there are concentrations of agricultural operations in certain counties, there have been approved projects in most counties throughout the Commonwealth.

Sale, Assignment, and Sponsorship of Tax Credits[14]

A recipient of a REAP tax credit may sell or assign the received credits. The credit must first be applied against the recipient's own tax liability for the taxable year during which the credit is granted. If the recipient's current tax liability is less

[14] 72 P.S. §8703-E.

Exhibit 4



Source: Pennsylvania State Conservation Commission.

than the amount of the tax credit, the recipient may take one of two actions. The recipient may carry the unused portion of the tax credit for up to 15 years and use the credit to offset an eligible tax liability during those years. Alternatively, the recipient may apply to the Commission for approval for the sale or assignment of all or a portion of the unused credit. The recipient must wait one year before selling or assigning the remaining credit.

Additionally, a farmer may work with a sponsor that can help finance BMPs and/or equipment purchases.[15] In such an arrangement, the farmer will be compensated for making improvements, and the sponsor will be the applicant and receive the tax credit. Examples of sponsors include banks and other lending institutions or businesses wishing to make an investment in conservation projects. When we met with the PA Farm Bureau, they informed us that this option has been minimally used, which is shown in Table 37. They stated that this could be a part of the program that could be better utilized and offered an example of how this could be achieved: a company or farm consultant could develop a BMP package for its clients, fund the projects, ensure that the BMPs are installed and then receive the tax credit. There were no sponsorship projects in FY 2007-08. The two following years of the program had nine sponsors receiving tax credits on nine agricultural operations that supported 15 different projects.

Table 37

Sponsorship of REAP Projects

	No. Projects	No. Sponsors	Total Dollars
2007-08	n/a	n/a	n/a
2008-09	11	6	$454,812
2009-10	4	2	77,747

Source: Developed by the LB&FC with data from the State Conservation Commission

File Reviews and Interviews With Selected Recipients

As part of our review of the REAP program, we performed a file review of a random sampling of REAP tax credit recipients from FY 2007-08. We chose this year because more projects would have been completed than those from FY 2008-09. We reviewed a total of 21 files, or about 7 percent of recipients for that year. About half the files were those recipients who implemented BMPs and half were those who purchased equipment. We found the files to be generally complete and in

[15] A sponsor is defined as a business subject to the following taxes (personal income tax, corporate net income tax, capital stock and franchise tax, bank shares tax, title insurance company premiums tax, insurance premiums tax and mutual thrift institutions tax) which receives a REAP tax credit equal to the amount of money it contributes toward eligible farm conservation projects. In return, the business receives its entire investment back in for form of a tax credit. The sponsor, not the farmer, is the applicant for the credit.

compliance with record keeping requirements. Please see Finding 4 below for more information regarding our file review.

We also attempted to contact those same 21 recipients by telephone and were able to reach 10. The total amount of tax credits awarded to the 10 applicants was approximately $221,151, with the lowest award being $5,950 and the highest award being $53,370. The average award was $22,115. Overall, all the farmers interviewed expressed support for the REAP program and felt it was of real benefit to farmers interested in implementing best management practices on their properties. They noted that the financial benefits available through the REAP program, along with the federal EQIP program, help farmers to implement needed conservation improvements.[16] These improvements, in turn, help clean up Pennsylvania's streams and rivers.

Pennsylvania County Conservation District (CCD) employees assisted six of the 10 farmers in completing their applications. Three farmers used a private accountant or other contractor to help with the paperwork. One farmer completed the application himself. Possibly because the majority of the farmers utilized the services of their local CCD or hired someone privately, they had no complaints about the application and approval process. They also reported no issues with the program's ongoing reporting requirements. In only 2 cases, applicants reported they had to contact the Department of Agriculture for clarification or assistance. Staff of the department was helpful and answered questions that they had.

All of the farmers interviewed were aware of the various program parameters, including the ability to keep the tax credit and apply it against future tax liabilities for a period of 15 years and the ability to sell the tax credit one year after the project is completed. Seven of the 10 farmers reported that they kept their tax credits to apply to their own taxes. Three farmers sold their tax credits or were planning on selling them. They reported no problems selling the credits. One farmer did note that it would be better if they could sell the credits immediately after the project for which the credits were issued was complete.

Other States

We were able to identify one other state, Virginia, that has a program similar to REAP. The Virginia Agricultural BMP Tax Credit Program, which began with the 1998 tax year, supports voluntary installation of BMPs to address

[16] According to the Natural Resources Conservation Service, "the Environmental Quality Incentives Program (EQIP) was reauthorized in the Farm Security and Rural Investment Act of 2002 to provide a voluntary conservation program for farmers and ranchers that promotes agricultural production and environmental quality as compatible national goals. EQIP offers financial and technical help to assist eligible participants install or implement structural and management practices on eligible agricultural land." Source: www.nrcs.usda.gov

Virginia's nonpoint source pollution water quality objectives. Agricultural producers with an approved conservation plan can take a credit of 25 percent of the first $70,000 spent on agricultural BMPs against state income tax. The amount of the tax credit cannot exceed $17,500, or the total state income tax obligation. Completed BMPs are inspected and certified by local Soil and Water Conservation Districts, after which tax credit approval is granted.

Findings and Recommendations:

1. The REAP Program has funded many projects that have led to a positive environmental impact.

Of the $10 million available in tax credits granted in FY 2007-08 and 2008-09, about half the credits were approved for equipment purchases and the other half for BMPs. These on-farm conservation projects contribute to cleaner waterways in Pennsylvania by reducing nitrogen, phosphorous, and sediment discharges that flow into the Chesapeake Bay. The reductions in these nutrients also help Pennsylvania attempt to meet the goals set for it by the federal Environmental Protection Agency under the Clean Water Act. When we met with the Chesapeake Bay Foundation, they estimated that it would cost approximately $600 million and take about ten years to achieve the EPA-set agricultural goals for Pennsylvania's Chesapeake Bay watershed. Although REAP has been capped at $10 million, and now at $5 million, it is a step in reducing these harmful nutrients.

Table 38 shows, through 2009, the Commission's estimates of reductions of nitrogen, phosphorus, and sediment, respectively. In excess, nitrogen and phosphorus become pollutants that cause excessive algae growth and reduce oxygen levels, which destroys aquatic and plant life. The table shows the BMPs, supported with the REAP tax credits, and the associated estimated resulting reductions.

According to the Chesapeake Bay Foundation, it took Pennsylvania 10 years to complete its Total Maximum Daily Load (TMDL)[17] plans, as required by the federal Clean Water Act. Sixteen thousand of 83,000 water ways are compromised in Pennsylvania, 96 percent of which are contaminated because of non-point source issues. None of the states (PA, VA, and MD especially, and NY, DE, and WV peripherally) are going to achieve their reduction goals by the 2010 deadline. The states involved were required by the federal Environmental Protection Agency (EPA) to enforce reductions in TMDLs. However, because states have not met said requirements, and the EPA had not, to this point, stringently enforced these requirements, a presidential executive order has been signed directing the EPA to assume full enforcement responsibilities. Hence, there will be sanctions for non-compliance beginning in 2011.

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[17] A TMDL is a calculation of the maximum amount of a pollutant (examples are sediment, phosphorus and bacteria) that a stream or lake can receive and still meet water quality standards.

Table 38

Statewide Environmental Impact of REAP
Estimated Pollution Reduction Through 2009

Nitrogen – Pounds Per Year:

Ag E&S Plans	320
Conservation Plan	1,610
Nutrient Management	35,860
Critical Area Planting	140
Heavy Use Area Protection	64,770
Waste Storage Facility	105,980
Off-Stream Watering w/Fencing	80
No-Till	807,160
Total Estimated Reduction	1,015,920

Phosphorus – Pounds Per Year

Ag E&S Plans	20
Conservation Plan	100
Nutrient Management	2,150
Critical Area Planting	5
Heavy Use Area Protection	4,180
Waste Storage Facility	6,830
Off-Stream Watering w/Fencing	3
No-Till	60,950
Total Estimated Reduction	74,238

Sediment – Tons Per Year

Ag E&S Plans	24
Conservation Plan	120
Critical Area Planting	4
Off-Stream Watering w/Fencing	1
No-Till	64,180
Total Estimated Reduction	64,329

Source: *REAP 2007-08 Report*, PA Department of Agriculture.

Recommendation:

The Legislature should consider amending the REAP statute to change the first-come, first-served nature of the application process to one that is based on greater environmental need. Because REAP resources are very limited and compliance deadlines are looming, we recommend tax credits be awarded for BMPs on a rated basis, wherein funding can be targeted toward projects with the greatest nutrient reductions. Applications could be reviewed on a variety of factors, including proximity to more polluted waterways (those with TMDL restriction requirements) or implementing BMPs that are more cost-effective in reducing nutrients. Credits could be awarded on a points basis and then ranked, thus allowing the program to maximize its positive environmental impact.

2. The one-year waiting period to sell credits may be negatively impacting Pennsylvania farmers.

The REAP statute includes a provision that a tax credit recipient may not sell tax credits for a period of one year after the credit is granted. Furthermore, the credit is not granted until after the project has been verified as completed. Various stakeholders with whom we have spoken, including the PA Farm Bureau and the Chesapeake Bay Foundation, have expressed that this provision is a problem with the program; they both stated that many farmers using the REAP program do not have a great tax liability, and the ability to take advantage of the credit during the same year the project is completed, by selling it to another party, would be advantageous to them. Several conservation districts commented that dairy farmers especially have concerns about having to wait one year, given that milk prices have declined in the past year. In response to being asked what could be done to enhance the program, the Commission also agreed that this waiting period should be eliminated.

Table 39 shows how many credits have been sold thus far for fiscal years 2007-08 and 2008-09. Please note that although we have included data for two fiscal years, they cannot be compared because many more projects from FY 2007-08 have been completed than for FY 2008-09.[18] For FY 2007-08, the total tax credits to be sold represent 25 percent of the total tax credits granted.

Table 39

Amount of REAP Tax Credits Sold to Third Parties
(As of February 2010)

	Total Amount of Original Credits	Amount of Credits Applied to Current Year	Amount of Credits Carried Forward	Amount of Credits to Pass Through	Net Available Credit	Total Credits to Be Sold	Sold Credits as % of Total Credits
2007-08	$2,518,175	$72,636	$19,637	$51,514	$2,372,277	$2,333,400	25%
2008-09	545,026	24,927	6,209	0	494,196	486,365	5

Source: Developed by LB&FC staff with data provided by the Conservation Commission.

Currently, REAP is the only tax credit program we reviewed that requires a one year waiting period before tax credits can be sold.

[18] To date, not all projects from FY 2007-2008 have been completed.

Recommendation*:*

> ***We recommend that the restriction that applicants must wait one year after being awarded the credit before selling or assigning excess tax credits be eliminated***. According to a stakeholder group with which we spoke, the original rationale behind this restriction was to ensure that projects were completed. However, as shown above, there are many checks within the REAP program to ensure that projects are completed, and a tax credit is not issued until project completion. A significant number of REAP recipients could be positively impacted by this change.

3. Monitoring the REAP Program will become increasingly burdensome.

Because the BMPs and the equipment that farmers implement or purchase for their farms have defined life spans, some up to 15 years, the Commission needs to be able to check that recipients are keeping and maintaining equipment and continuing and maintaining BMPs for the required prescribed life spans.

For those farmers who used their credits for equipment, the Commission has issued a REAP Equipment Compliance and Report Form. This form asks recipients for specific information regarding the equipment they purchased, when the equipment was purchased, and if the equipment is still in use on the same agricultural operation that was identified in the approved REAP application. These letters were sent for the projects approved for FY 2007-08, and as stated above, the Commission completed 14 site visits with those farmers who had not completed their forms. All 14 were found to be compliant. In March 2010, the Commission is again mailing self-certification letters to tax credit recipients who have purchased equipment. Letters went out to all equipment purchasers from the three years that the program has been implemented (FY 2007-08 to FY 2009-10). The Commission has not sent similar self certification compliance letters to the remainder of the REAP credit recipients (i.e., those that did not purchase equipment).

Although the Commission spot-checked about 1 percent of the BMPs and found them to be compliant, it has not yet determined a practice for more fully monitoring the BMPs, some of which have life spans of up to 15 years. Many BMPs are permanent fixtures and are likely to remain on a particular agricultural operation, but they must be maintained as well. To address this issue, among others, the Conservation Commission is forming a REAP committee. Because the REAP program has been operating for three years, the Commission wanted to re-evaluate the program and is forming the committee to do so. One of the issues it will review is BMP compliance and how best to monitor it. According to a Commission official, the committee will likely recommend continuing spot checks of BMPs. REAP staff consists of one person and there are limited resources to perform site checks on all BMPs, especially as the program grows and farmers continue to implement more

BMPs with long life spans. According to a Commission official, when such visits are required, staff from the Commission's Nutrient Management Program perform the visits.

Recommendations:

> ***a. The Commission should continue to spot check agricultural operations that have implemented BMPs to ensure that they are maintained and in place for the required life span, until such time as additional staff could be employed to monitor a larger sample of REAP recipients, possibly a certain percentage of recipients on an annual basis.***
>
> ***b. The Department of Revenue should continue to work with the Conservation Commission to develop a process to "claw back" the tax credit if it is determined that a recipient has failed to complete or maintain a BMP.***

4. File reviews found that all required elements are in place.

We reviewed a random sampling of REAP files for projects funded during FY 2007-08. We chose this year because more projects would have been completed than those funded during FY 2008-09. Of the 293 approved projects, we randomly reviewed 21 files, a total of 7 percent. We checked for elements and file documents that are required by statute. These items included:

- application,
- notification letter from the Conservation Commission,
- signed certification that a project has been completed,[19]
- receipts for purchases,
- verification page and/or no-till purchase certification,
- notice of award of tax credit, and
- self-certification letter for equipment purchases.

All files included the required documentation required by program statute and guidelines. Two files did not include self-certification letters, however, this was because they did not have their equipment at the time the department sent the letter out. In one file, it was not clear if a recipient was using other public money[20]

[19] A project file may not always have this certification because a recipient who has received a tax credit in FY 2007-08 has three years to complete a project.
[20] The statute stipulates that a tax credit shall not be applied to that portion of project cost for which public funding was received.

and requesting a tax credit for that portion of the project cost. At the time of our review, the Commission was awaiting verification from the recipient.

5. The Conservation Commission does not provide all required information to the General Assembly or make it available as a matter of public record.

Act 2007-55 requires the Commission, in consultation with the Department of Agriculture, to annually report on the REAP program to the General Assembly. The report is to include:

- The number of projects and the dollar amount of tax credits granted under the program in the aggregate, by BMP, and per project.
- The types, locations, and costs of projects.
- The estimated benefits or the projects including pollution reduction.

The annual report does include the number of projects and the dollar amount of tax credits in the aggregate and by BMP; however, it does not report on a per-project basis, as required. The types of projects are included, as well as location, which is reported on a county basis, though not a specific location or address. The annual report also includes the estimated environmental benefits (see Table 36 above).

The statute also provides that the identity of each taxpayer who received a REAP credit and the associated amount of approved and utilized credits for each is to made available as a public record. We note that, initially, we had difficulty getting complete information from the Commission. We were initially given names, location by county and dollar amounts of credits awarded for each recipient, but not specific addresses (we were, however, later given the specific addresses). This information was not sufficient to identify who exactly received credit, which according to the statute, is to be made available as a matter of public record.

Recommendation:

The Conservation Commission should report all required information to the General Assembly as required by statute. In addition, it should maintain and make available, if requested, sufficient information to identify specific program participants and accurately report, by recipient, the amount of credit awarded and utilized, as is also required by statute.

II. N. Strategic Development Areas

Background and Overview

Act 2006-151 amended the Tax Reform Code of 1971 to provide for the inclusion of Strategic Development Areas (SDA) in the Commonwealth. The goals of this program are to develop a community's "abandoned, unused, underutilized land and buildings into business districts and residential areas that present a well-rounded and well balanced approach to community revitalization." Due to the tax benefits that approved businesses and residents are entitled to, SDAs are "virtually tax free."[1]

Under the statute, the Governor was to designate, by Executive Order, not more than four SDAs in the Commonwealth on or before September 30, 2007. Each designated area is to be a minimum of 10 acres and not in excess of 1,500 acres. In the aggregate, all designated SDAs are not to exceed 5,000 acres. Qualified residents and businesses within a designated and approved SDA are entitled to all tax exemptions, deductions, abatements, or credits offered under this program for a 15-year period. The benefits afforded under this program start on the approval date granted by all applicable political subdivisions or January 1, 2007, whichever occurs last. The deadline for approval by the political subdivisions was December 31, 2007.[2]

The Department of Community and Economic Development (DCED) primarily administers the SDA program, fostering a partnership with the local political subdivisions involved, while the Departments of Revenue and Labor and Industry administer matters pertaining to state taxes as well as unemployment compensation taxes. All benefits conferred under this act are to expire by December 31, 2022.[3]

Approval Process and Qualification Requirements

After the Governor's designation of an SDA, entitlement to any of the benefits provided under this act shall not be effective until all applicable political subdivisions have granted their approval. Upon the Governor's designation, DCED shall promptly issue notice to all political subdivisions affected by the SDA designation, in whole or in part. Any ordinances or resolutions granted by the political subdivisions shall be binding and non-revocable for the full 15-year period specified.[4] After

[1] DCED's February 2008 Strategic Development Area program guidelines.
[2] 72 P.S. §9911-C.
[3] 72 P.S. §9979-C.
[4] 72 P.S. §9914-C. Political subdivisions may apply to DCED for decertification and removal of the SDA designation; however, this must be with the consent of all entities with an interest in the real property in which the SDA designation is to be removed.

approval has been made by the local political subdivisions, notification shall be sent to DCED of the approval and granting of benefits to the applicant.[5]

As specified in Act 2006-151, businesses may qualify for the benefits afforded under the act by owning or leasing real property located within a strategic development area, which the business actively conducts a trade, profession, or business involving energy, bioscience, or manufacturing or a related activity and meets one of the following:

- create or maintain a minimum of 500 jobs within the first three years of full operation within the strategic development area; or
- invest a minimum of $45,000,000 in capital investment in the property located in the strategic development area within the first three full years of operation.

Similarities and Distinctions to the Keystone Opportunity Zone Program

The SDA program was modeled after the Commonwealth's Keystone Opportunity Zone (KOZ) program, created in 1998 by Act 92. After reviews of both acts creating the SDA and KOZ programs, the overall rationale for the creation of both programs is quite similar.

While the KOZ program does not have a jobs or capital investment requirement, both programs provide tax incentives for businesses that do create jobs and invest in key geographic areas of Pennsylvania. The legislation for both programs sets a maximum amount on the number of geographic areas to be created as well as their respective sizes in acreage. Prior to designation of an SDA or KOZ, approval at the local level must be granted from the political subdivisions involved. Further, to qualify for the tax incentives that both programs offer, businesses must agree to maintain their operations in Pennsylvania for a specified period of time. These requirements provide a more secure long-term capital investment and employment base in targeted areas around the Commonwealth.

One distinction between the SDA and KOZ programs is that, while businesses may, after approval, relocate to within a KOZ, Act 2006-151 does not provide for new businesses to relocate to an area designated as an SDA. As provided for in Act 151, the Governor's authority to designate an SDA expired after September 30, 2007, while the deadline for approval to be granted by the political subdivisions of the Governor's designated SDAs, expired December 31, 2007.[6] Act 151 does not provide for any further SDA designations after those dates.

[5] 72 P.S. §9913-C.
[6] 72 P.S. §9911-C.

For an area to be designated as a KOZ, the approval process must meet at least two of 12 criteria, with an additional 10 criteria to be considered. Designation of an SDA, by contrast, was targeted to retain specific businesses within the Commonwealth, as the areas designated were for businesses already established in the state. The corresponding resolutions and/or ordinances passed by the political subdivisions in regards to the Executive Orders issued by the Governor either specifically identify the business or the stated parcels of land lend themselves to the identity of the business for SDA designation.

Tax Exemptions Provided to Participants in the SDA Program

Act 2006-151 provides the following tax credits for approved participants operating within a strategic development area. While exemptions may be passed through to certain entities within the corporation, any credits granted are not sellable to another business. Further, Act 151 does not provide for any carry back or carry forward of any exemption granted from year to year. Any credit granted shall not exceed the taxpayer's tax liability.[7]

State Taxes, Sales and Use Tax, and Personal Income Tax. Act 151 provides that qualified businesses shall receive exemptions, deductions, abatements, or credits for state taxes imposed.[8] Businesses are entitled to an exemption from sales and use tax for sales at retail of services or tangible personal property, other than motor vehicles, for consumption and utilization at its facility in the SDA.[9] Further, individuals shall receive a personal income tax exemption for net income from the operation of a qualified business with business activity conducted within the SDA. Individuals may also receive exemptions for net income from the sale, exchange, or disposition of real property located within an SDA; rent received from property located in an SDA; dividends and interest received while a resident of an SDA; and income received from an estate or trust.[10]

Corporate Net Income Tax. On and after January 1, 2008, approved program participants are allowed to claim a corporate net income tax credit for business activity conducted directly by it and within the strategic development area.[11] The credit allowed shall not exceed the business's tax liability.

Capital Stock Franchise Tax. On and after January 1, 2008, approved program participants may claim a tax credit for liability attributable to capital employed within the strategic development area.[12] The credit allowed shall not exceed the business's tax liability.

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[7] 72 P.S. §9932-C.
[8] 72 P.S. §9921-C.
[9] 72 P.S. §9931-C.
[10] 72 P.S. §9932-C.
[11] 72 P.S. §9935-C.
[12] 72 P.S. §9936-C.

Strategic Development Area Tax Credits for Jobs. The Department of Revenue is authorized to approve, on an annual basis, up to $1,000,000 in Strategic Development Area Job Tax Credits. (The credit is available to insurance companies that are considered qualified businesses under the Act.) On and after January 1, 2008, insurance companies located within an SDA, may apply to the department for a job tax credit. Only new full-time jobs in companies, whose average monthly employment have increased over the prior 12-month calendar year and are created within the SDA, are eligible for a tax credit.

A Strategic Development Area Job *Creation* Tax Credit is available to railroad, truck, bus, pipeline, natural gas, or water companies located within an SDA. This tax credit may be applied for after new full-time jobs are created. Only new full-time jobs in companies, whose average monthly employment have increased over the prior 12-month calendar year and are created within the SDA, are eligible for the tax credit. The Department of Revenue is authorized to approve, on an annual basis, up to $1,000,000 in strategic development area job creation tax credits.

Local Taxes. For each political subdivision[13] with an SDA located within their geographic area, Act 2006-151 requires that they are to exempt, deduct, abate, or credit, local taxes in accordance with any ordinances or resolutions passed. The following is a general description of each type of local tax exemption provided within an SDA:

- Local Taxes: Every political subdivision in which a designated strategic development area is located shall exempt, deduct, abate, or credit local taxes.
- Real Property Tax: Political subdivisions shall abate 100 percent of real property taxation on the assessed valuation of deteriorated property.
- Local Earned Income and Net Profits Tax; Business Privilege Taxes: There is a general exemption for any tax on the privilege of engaging in any business or profession, measured by gross receipts or on a flat rate basis, earned income or net profits. These exemptions extend to:
  - business gross receipts for operations conducted by a qualified business within an SDA;
  - earned income received by a resident of an SDA; and
  - net profits of a qualified business by a resident or nonresident of an SDA for business activity conducted within an SDA.
- Mercantile License Tax: No person or qualified business in an SDA shall be required to pay any fee authorized pursuant to a mercantile license tax which provides in part revenue for school districts.

[13] 72 P.S. §9903-C. Political subdivision is defined as a county, city, borough, township, town, or school district with taxing jurisdiction in a defined geographic area within this Commonwealth.

- Local Sales and Use Tax: Qualified businesses shall be exempted from paying a city or county tax on the purchase price of retail sales for tangible personal property or services that are consumed or utilized within an SDA.

Authorized Amount of Tax Credit

The SDA program provides for a variety of tax exemptions, deductions, abatements, and credits from state and local taxes. Like the KOZ program, the tax exemptions offered by the state and political subdivisions do not have an annual statutory limit; however, the amount of exemptions received for corporate net income tax, capital stock and franchise tax, and personal income tax shall not exceed the taxpayer's tax liability. Act 2006-151 further provides that approved businesses may not carry back or carry forward any exemptions received from year to year.

The Legislature recently passed Act 2009-48, which reduced the amount of tax credits made available in several of the Commonwealth's tax credit programs. The exemptions, deductions, abatements, and credits offered by the SDA program, however, have not been limited by Act 48.

Annual Filing Requirements and Recapture Provisions

After admittance into the SDA program, DCED's program guidelines require that program participants submit, on an annual basis, a renewal application to maintain their eligibility. The application requires applicants to submit, among other items, the name of the real property owner, business, or resident; SDA address and mailing address; property tax parcel ID numbers, business type; job creation and capital investment amounts; and other tax filing information.

Act 2006-151 requires that each designated SDA submit to DCED an annual real property report by January 31 of each year. This report is to provide an account of all real property located within each SDA as well as the owners and addresses of the properties at any time during the preceding calendar year.[14] The act does not require, however, that DCED submit an annual report to the Legislature on the status and progress of the SDA program.

Act 151 provides certain recapture provision in the event that an approved business would relocate outside the SDA before the statutory occupancy requirement of five years was met. Should a qualified business located within an SDA that has received an exemption, deduction, abatement, or credit relocate outside of the area within three years of locating within it, the business shall refund 66 percent of all exemptions to the Commonwealth. Should a qualified business relocate outside

[14] 72 P.S. §9941-C

the area within three to five years of locating in it, it shall refund to the Commonwealth 33 percent of all exemptions granted. If the qualified business was located within a business operated by a non-profit organization to assist in the creation and development of a start-up business, no exemption, deduction, abatement or credit shall be refunded. The act further provides that DCED may waive or modify the recapture provisions if the business's relocation was due to circumstances beyond its control.[15]

Program Participants

The following businesses are the program participants and parent company involved in the SDA program. As stated previously, the Governor was permitted to designate only four SDAs in the Commonwealth. While there are four businesses receiving benefits from the program, there are a total of six businesses listed below. This is due to the involvement of a parent company (Westinghouse Electric Company, LLC) that is listed twice for two program participants. Exhibit 5 illustrates all businesses involved in the SDA program.

Findings

1. Companies located in Strategic Development Areas have reportedly retained over 1,500 jobs, created nearly 100 jobs and fostered a capital investment in the Commonwealth of over $242 million.

The Department of Community and Economic Development (DCED) provided our office with a copy of its Jobs and Capital Investment report for the SDA program. This data was collected by DCED and is current through December 2009. Act 151 requires businesses to create or maintain 500 jobs or invest $45,000,000 in capital in the property located within the SDA. Table 40 shows a breakdown of each participant's progress in the program, program requirements met, jobs retained, jobs created, and the capital investment amount for those approved businesses.

While not all businesses indicated below have met the full jobs or capital investment requirements of the program, Act 2006-151 provides that qualified businesses are allowed to meet their chosen requirement within the first three years of full operation in an SDA.[16]

[15] 72 P.S. §9952-C.
[16] 72 P.S. §9912-C.

Exhibit 5

Businesses in the Strategic Development Areas Program

Business Name	Program Participant or Parent Company	Business Type	Strategic Development Area Address	County	SDA Benefits Term
Amgen USA, Inc.	Program Participant	Distribution	7175 Mill Road Fogelsville, PA 18051	Lehigh	11/20/07 – 11/20/22
Cardone Industries, Inc.	Program Participant	Manufacturing	5501 Whitaker Avenue Philadelphia, PA 19124	Philadelphia	12/21/07 – 12/21/22
Wells Real Estate Investment Trust II, Inc.	Program Participant	Other: Headquarters	1000 Cranberry Woods Drive Cranberry Woods, PA 16066	Butler	6/8/07 – 6/8/22
Westinghouse Electric Company, LLC	Parent Company	Other: Headquarters	1000 Cranberry Woods Drive Cranberry Woods, PA 16066	Butler	6/8/07 – 6/8/22
WesDyne International, LLC	Program Participant	Other: Headquarters	Interstate-70 Exit 54 Madison, PA 15663	Westmoreland	6/8/07 – 6/8/22
Westinghouse Electric Company, LLC	Parent Company	Other: Headquarters	1000 Cranberry Woods Drive Cranberry Woods, PA 16066	Butler	6/8/07 – 6/8/22

Source: DCED's Jobs and Capital Investment Report for the SDA program.

Based upon our telephone discussion with local tax assessor officials with Lehigh County, the SDA site on which Amgen USA, Inc. is to locate its facilities is not operational. Our office was informed that this site currently sits as "vacant and undeveloped land." The statutory three-year time period for Amgen to invest the required capital or employ the minimum number of jobs expires November 20, 2010. Using DCED's must current data, it is apparent Amgen may not meet the deadline.

Exhibit 6

DCED's SDA Jobs and Capital Investment Report

Business	SDA Benefits Term	Jobs or Capital Investment	Jobs Retained	Jobs Created	Capital Investment
Amgen USA, Inc.	11/20/07 – 11/20/22	Capital Investment	0	0	$4,700,000
Cardone Industries, Inc.	12/21/07- 12/21/22	Jobs	1,000	0	$592,917
Wells REIT II	6/8/07- 6/8/22	Capital Investment	0	0	$212,000,000
Westinghouse Electric Company, LLC	Parent company for Wells REIT II				
WesDyne International, LLC	6/8/07- 6/8/22	Jobs	0	0	Requirement met under parent company below
Westinghouse Electric Company, LLC	Parent company for WesDyne International, LLC		675	96	$25,000,000

Source: DCED's Jobs and Capital Investment Report for the SDA program.

2. Political subdivisions are exempting SDA participants from paying local taxes.

Act 2006-151 provides that political subdivisions which agree to host an SDA are to exempt, deduct, abate, or credit approved businesses from paying local taxes. Table 39 provides a year-by-year comparison of revenues which political subdivisions have foregone since the start of the SDA program to the most current data available. The table provides the program participant, corresponding political subdivisions, calendar year with applicable tax expenditure amount, and tax expenditure type.

As shown in Table 40, the political subdivisions in which an SDA is located have foregone significant revenue. Since the start of the SDA program, Cardone Industries, Inc. has received the highest tax exemption at a total of $5,169,120. From 2007 to 2010, the SDA program has resulted in applicable political subdivisions exempting an overall total of $12.1 million.

Table 40

SDA Political Subdivision Tax Expenditures

SDA Program Participant	Political Subdivision	Calendar Year 2007	Calendar Year 2008	Calendar Year 2009	Calendar Year 2010	Type of Expenditure
Wells REIT II, Inc.[a]	Seneca Valley School District	$0.00	$0.00	$197,265.20	$1,298,750.00	Real Estate Tax
	Township of Cranberry	0.00	0.00	88,719.00	142,242.78	
	County of Butler	0.00	0.00	197,265.20	315,587.64	
	Wells Totals:	**$0.00**	**$0.00**	**$483,249.40**	**$1,756,580.42**	
WesDyne International, LLC[b]	Yough School District	$198,755.39	$209,216.20	$209,216.20	$209,216.20[d]	Real Estate Tax
	Hempfield Area School District	34,950.57	35,818.59	35,818.59	35,818.59[d]	
	Township of Sewickley	0.00	34,740.72	34,740.72	34,740.72	
	County of Westmoreland	0.00	68,805.43	68,805.43	68,805.43	
	WesDyne Totals:	**$233,705.96**	**$348,580.94**	**$348,580.94**	**$348,580.94**	
Amgen USA, Inc.[e]	Parkland School District[c]	$0.00	FY 2008-09 $16,429.47	FY 2009-10 $16,665.00	FY 2010-11 $16,665.00[d]	Real Estate Tax
	Township of Upper Macungie	0.00	444.40	444.40	444.40	
	County of Lehigh	0.00	4,555.10	4,555.10	4,555.10	
	Amgen Totals:	**$0.00**	**$21,428.97**	**$21,664.50**	**$21,664.50**	
Cardone Industries, Inc.[g]	School District of Philadelphia	[f]	[f]	[f]	[f]	Real Estate Tax
	City of Philadelphia	[f]	[f]	[f]	[f]	
	County of Philadelphia	[f]	[f]	[f]	[f]	
	Cardone Totals:	**$0.00**	**$1,723,040.00**	**$1,723,040.00**	**$1,723,040.00**	
	Calendar Year Totals	**$467,411.92**	**$2,463,059.82**	**$3,430,029.68**	**$5,714,991.93**	
	Combined Overall Total (All Years)	**$12,075,493.35**				

[a]Source: Telephone discussion with Cranberry Township Property Tax office staff.
[b]Source: Telephone discussion with Westmoreland County Real Estate Tax Office staff.
[c] Parkland School District's tax exemption amounts were provided on a fiscal year basis.
[d] The school district's millage rates may increase in 2010 above the amount indicated.
[e]Source: Telephone discussion with Lehigh County Office of Assessment staff.
[f]The City of Philadelphia's Board of Revision of Taxes online search database does not provide tax assessment amounts by city, county, or school district; only aggregate tax assessment amounts were available.
[g]Source: City of Philadelphia's Board of Revision of Taxes online database, accessible via the Internet at http://brtweb.phila.gov/.

3. Annual reporting requirements are being met by businesses approved to receive benefits from the Strategic Development Areas program.

Act 2006-151 requires that every SDA submit to DCED an annual report by January 31 of each calendar year of all real property located in a designated SDA. This report is to include the owners and addresses of the real property, at any time, during the preceding calendar year. After a file review of each participant in the program, these required annual report documents were not found.

Our office held conversations with DCED staff to determine if the annual reporting requirement was being met by the approved businesses. While the statute for this real property report requirement does require an annual submission from each SDA to the department, the statute does not specify the format for these reports. We learned that, rather than require a separate and additional document from each business in the SDA program, the department relies on each business's annual renewal application, filed by December 31 of each year, to fulfill this requirement. At a meeting held in DCED's offices, department staff provided copies of renewal applications for the SDA participants.

Using the annual renewal applications, which contain the owners and addresses of the real property, the department creates its own internal annual real property report. Exhibit 7 provides the latest annual real property report available from the department, which is for the 2009 calendar year.

Exhibit 7

Strategic Development Area 2009 Annual Real Property Report

Property Owner	Address	County	Municipality	School District	SDA Term
Amgen USA, Inc.	7175 Mill Road	Lehigh	Upper Macungie Township	Parkland Area School District	11/20/07 – 11/20/22
Cardone Industries, Inc.	5501 Whitaker Avenue	Philadelphia	Philadelphia	Philadelphia	12/21/07 – 12/21/22
Wells REIT II	1000 Cranberry Woods Drive	Butler	Cranberry Township	Seneca Valley School District	6/8/07 – 6/8/22
CBS	I-70 Exit 54	Westmoreland	Sewickly and Hempfield Townships	Yough and Hempfield Area School Districts	6/8/07 – 6/8/22

Source: DCED's 2009 Annual Property Report.

4. The approval process for each SDA designation was completed as prescribed by the statute.

The step-by-step process, as provided by DCED, begins with the Governor's issuance of an executive order. All four executive orders, with their corresponding identification numbers, are indicated in Table 41. Each executive order states the township and/or county in which the SDA designation is proposed and the corresponding size of the site in acres. After the Governor's executive orders have been issued, DCED notifies the corresponding political subdivisions by letter, including the school districts, municipalities, and counties. Subsequently, DCED then submits an initial SDA annual application to the business occupying each proposed SDA site. Upon receipt of the completed applications, DCED then returns a commitment letter to each business, where each is to indicate the amount of jobs or capital investment to be made in the proposed SDA. When the executed commitment letters have been returned, reviewed, and processed by DCED, the applicant is approved for SDA benefits pending approval from the corresponding political subdivisions.

The Governor designated, by executive order, four areas in the Commonwealth as proposed SDA sites. SDA approval of those four sites was dependent upon the corresponding political subdivisions to grant their approval, by signed resolution or otherwise, before an official designation could be made. Exhibit 8 shows each executive order by number, date of issuance, political subdivisions involved, and their approval dates. The SDA approval process was completed successfully as each proposed SDA site, with the corresponding businesses, were approved for SDA designation and benefits. The approval dates below indicate the date when each SDA designation was completed and the occupying business began receiving SDA benefits.

5. Numerous attempts were made to contact approved participants of the Strategic Development Areas program yet met with little success.

LB&FC staff made several attempts via telephone, e-mail, and one attempt through a business's "Government Relations" contact section of its Internet homepage to reach program participants, yet had little success. One participant was reached by telephone; however, numerous attempts made for follow-up questions met with no success.

This limited availability to cross-reference program data provided by state agencies with data provided directly by program participants, making it difficult to verify program costs, results, and impacts. Also, program participants are not taking advantage of an opportunity to make suggestions and/or recommendations as to how the program may be improved.

Exhibit 8

Political Subdivisions' Approval Dates of SDA Designations

Program Participant	Executive Order	Date of Issuance	Political Subdivisions	Approval Date
Cardone Industries, Inc.	2006-10	December 22, 2006	School District of Philadelphia	December 19, 2007
			City of Philadelphia	December 21, 2007
Wells Real Estate Investment Trust II, Inc.	2007-01	April 24, 2007	Township of Cranberry	May 3, 2007
			Seneca Valley School District	May 7, 2007
			County of Butler	May 9, 2007
WesDyne International, LLC	2007-02	April 30, 2007	Yough School District	May 22, 2007
			Hempfield Area School District	June 5, 2007
			Township of Sewickley	June 4, 2007
			County of Westmoreland	June 7, 2007
Amgen USA, Inc.	2007-08	September 6, 2007	Parkland School District	November 20, 2007
			Township of Upper Macungie	October 4, 2007
			County of Lehigh	November 19, 2007

Source: Governor's Executive Orders and corresponding attachments.

6. To date, the annual cost of the Strategic Development Areas program to the Commonwealth has been minimal.

LB&FC staff made numerous attempts via an information request, phone calls, and e-mails to the Department of Revenue to identify the annual state tax credits awarded to the participants of the SDA program. Our office inquired as to the cost of the four tax credits identified by Act 2006-151, which are the Corporate Net Income Tax Credit, Capital Stock and Franchise Tax Credit, Strategic Development Areas Job Tax Credit and Strategic Development Areas Job Creation Tax Credit.

The department informed us that due to confidentiality provisions of the Fiscal Code, they are prohibited from distributing information in regards to the Corporate Net Income Tax Credit and Capital Stock and Franchise Tax Credit. The department did; however, inform us that no jobs have been created by companies under either the Strategic Development Areas job Tax Credit or the Strategic Development Areas Job Creation Tax Credit. To qualify for a Strategic Development Areas Job Tax Credit, the job must have been created with an insurance company located within an SDA. To qualify for a Strategic Development Areas Job Creation

Tax Credit, the job must have been created with a railroad, truck, bus, airline, pipeline, natural gas, or water transportation company located within an SDA. Because no jobs were created under any of the above-mentioned business types, no tax credits were claimed.

Through various e-mail exchanges with department staff, our office then inquired as to the aggregate annual cost of the SDA program. These inquiries did not ask for an itemized breakdown by individual program participant or by specific tax credit type; simply the total aggregated cost of the program by types of credits and exemptions taken. The Department of Revenue informed us that they are looking into the matter; however, are reluctant to release the total annual cost of the program. Because there are so few participants in this program, the department is concerned that the release of the program's total annual cost may lend itself to speculation aimed at estimating and identifying one individual program participant's tax benefits.

We later received a correspondence from the Department of Revenue stating that "upon further consideration and previous discussions entertained" between staff of both offices, the department was willing to provide the following information on the six participants in the SDA program. In regards to the Corporate Net Income Tax Credit, no qualified business within an SDA has claimed this credit. In regards to the Capital Stock and Franchise Tax Credit, the aggregate tax credit claimed by all qualified businesses within an SDA is $402. In regards to the two remaining tax credits, the Strategic Development Areas Job Tax Credit and the Strategic Development Areas Job Creation Tax Credit, the department's response remains unchanged from its previous official response. No jobs have been created under any of the qualified businesses mentioned above (which were an insurance, railroad, truck, bus, airline, pipeline, natural gas, or water transportation company) by businesses that could apply for either the Strategic Development Areas Job Tax Credit and the Strategic Development Areas Job Creation Tax Credit; therefore, no tax credits have been issued or claimed.

It should also be noted that, due to the newness of this program, little tax benefit information may yet be available. The approved SDA benefits term, as provided by DCED, for all businesses in the program began in mid- to late-2007. Approved program participants are afforded three years, from the beginning of their benefits term, in which to generate the required jobs or capital investment. A later review of this program may provide more tax credit information.

III. The Use of Tax Incentives in Public Sector Fiscal Policy[1]

Modern economic development intervention initiatives can be traced to the 1930s when the southern states began to use a variety of financial benefits, especially tax incentives, in an attempt to attract wealthy northern manufacturers to the economically depressed southern region.[2] Perhaps the first modern American attempt to develop a specific policy instrument to effect economic development was the issuance of industrial development bonds through Mississippi's 1936 Balance of Agriculture with Industry Program. These bonds are tax-exempt instruments and are backed by the revenue stream generated by the private project being financed.[3]

By the end of World War II, the southern states' initiatives had spread to the northeast and by the mid-century, had spread to most of the nation. Soon after, state officials, nationwide, began to believe that tax incentives were essential in order to be competitive with other states for corporate investment. During this time frame, state governments became increasingly well-organized, and nearly all states had created a government agency to oversee and promote their economic development programs.[4]

Another major addition to state economic development tools was the tax increment financing district, which was introduced in California in 1952. Since that time, at least 40 states have employed this technique to encourage economic growth.[5]

During the 1930s through the 1960s, different types of tax incentives were used, including tax abatements, tax credits, loan packaging, and infrastructure development in order to attract new business firms, especially manufacturing businesses. Even though through the 1980s and into the current time state governments expanded their efforts to include such programs and strategies as small business incubators, research-oriented industrial parks, and expanded government-financed loan programs, tax incentives remain a core economic development strategy. In terms of lost revenue, these incentives are perhaps the largest and costliest of all economic development programs.[6]

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[1] The discussion presented in this section of the report is based on information obtained from reports available through the EBSCO and HeinOnline databases.
[2] Matkin, David S. T. "Corporations, State Agencies, and the Management of State Corporate Income Tax Incentives." (M.P.A. diss., Brigham Young University, 2003): 24.
[3] Hultquist, Andy. "An Evaluation and Comparison of Geographically Targeted Economic Development Programs in Ohio and Piedmont, Italy." (Ph.D. diss., Ohio State University, 2007): 21.
[4] Matkin, at 24.
[5] Hultquist, at 22.
[6] Matkin, at 24-25.

The Commonwealth of Pennsylvania was no exception to this movement and the following two sections provide discussions of how tax credits emerged as tax incentives at both the federal level and in Pennsylvania. The third section discusses tax credits in general and how they relate to and affect a state's revenue system.

The Rise of Tax Credits at the Federal Level

At the end of World War II, the federal government instituted several policies to help rebuild and revitalize the cities across the nation. These federal policies provided assistance through veterans' assistance loans, federal housing administration loans, and home mortgage interest tax deductions all in an effort to help with the housing shortage. Then, in the mid-1960s, federal policies turned to focus on expanding jobs and income opportunities and to address other economic issues. By the 1970s, however, there was high unemployment and high inflation. Thus, it appeared that many of the federal and state programs instituted to address the poor economic conditions had failed, and a new strategy was needed. That new strategy focused on enterprise zones.[7]

The idea of enterprise zones was first conceived in Britain in 1977 by an economic planner as a way of revitalizing urban areas and reducing unemployment. In the United States, legislation embodying this concept was introduced in Congress in 1980. The proposal was subsequently enacted in 1987 as the Title VII Enterprise Zone Development Program, which sought to facilitate job creation and revitalize distressed urban and rural areas by providing businesses with various tax incentives. These tax incentives were to stimulate job creation and promote private investment in the most distressed areas by providing financial "carrots" to lower the costs of doing business for those companies willing to relocate to the enterprise zone.[8]

One of the earliest tax credits proposed was a tuition tax credit, which was introduced in Congress on fourteen different occasions between 1966 and 1983, each time without success. In 1983, President Reagan made the enactment of this credit a priority. However, due to concerns about the consequences of the proposal, such as causing a rise in overall tuition costs and a migration of students from public to private schools, the proposal was not enacted.[9]

Over the years, the federal government has instituted many different types of tax incentives including, for example, the research and development tax credit, job creation tax credit, and the earned income tax credit. Additionally, an investment credit was enacted to encourage the purchase of machinery and equipment;

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[7] Yekeson, Beverly Tete Goll. "The Impact of Tax Incentives on Job Creation and Capital Investment: A Case Study of Salisbury Enterprise Zone Program." (Master of City Research and Planning thesis, Morgan State University, 2004): 1.
[8] Yekeson, at 1-3.
[9] West, Edwin G. "The Real Costs of Tuition Tax Credits." *Public Choice*, Vol. 46, No. 1 (1985): 61-70, at 61.

excessive bad debt reserves for some financial institutions were allowed to encourage the growth of savings and loan associations and mutual savings banks; a charitable deduction was enacted and intended to foster philanthropy; the preferential tax treatment of qualified pension plans was established and intended to foster broad pension plan coverage; and the corporate surtax exemption was intended to foster small business growth.[10]

Pennsylvania

For much of the 19th and early 20th centuries, Pennsylvania's economy was "booming." Anthracite, or hard, coal from northeastern Pennsylvania fueled the industrial revolution and served as the nation's primary home heating source. Bituminous, or soft, coal from western Pennsylvania was an essential element that enabled Pittsburgh to be the leader in the nation's steel industry.[11]

In the early 1920s, however, Pennsylvania's economy began to decline. This decline is attributed to the faltering of the coal, railroad, and steel industries. In the 1930s, Pennsylvania's economic "boom" ended conclusively with the Depression, and, as two scholars note, in parts of Pennsylvania it has never returned.[12]

In the 1940s and 1950s, the economic distress in northeastern Pennsylvania continued to become even more severe as unemployment rates soared above 25 percent. This was a result of much of the nation converting away from relying on anthracite for its energy sources to more easily used supplies of oil and natural gas. Even today, the anthracite and bituminous industries continue to decline. In addition to declines in the coal industry, the railroad industry in Pennsylvania has greatly declined. It is reported that between 1974 and 1982, Pennsylvania railroads lost 25 percent of their employees.[13]

Other areas of Pennsylvania's economy have also suffered declines. For example, job losses continue in the clothing manufacturing and steel-making industries during the last decade. In northwestern Pennsylvania, the 19th century birthplace of the American oil industry, the current oil production accounts for only one one-thousandth of the nation's crude oil.[14]

In order to combat this long-established economic decline, Pennsylvania's state and local governments have attempted many different job creation and

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[10] Surrey, Stanley S. "Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures." *Harvard Law Review*, Vol. 83, No. 4 (February 1970): 705-738, at 711.
[11] Argall, David G. "A Policy Analysis of the First Six Years of Pennsylvania's Keystone Opportunity Zone Program, 1988-2004: Enlightened Economic Development or Corporate Welfare?" (Ph.D. thesis, Pennsylvania State University, 2006): 20-21.
[12] Argall, at 21.
[13] Argall, at 21-23.
[14] Argall, at 26.

retention strategies through the decades. For example, in the early 1930s, Governor Pinchot put unemployed laborers to work in road-building crews. Governor Earle, in the mid-to-late-1930s utilized federal dollars to begin a public works program by building dams, government buildings and schools, bridges, parks, and the Pennsylvania Turnpike.[15]

In the late 1940s, Governor Duff sought to improve economic and environmental conditions by constructing sewage treatment plants and desilting dams to improve water quality. In the mid-to-late-1950s, Governor Leader worked with the legislature to create the Pennsylvania Industrial Development Corporation, which remains in place today, offering low-interest loans to encourage businesses to invest in distressed areas of the state.[16]

Governor Lawrence had pursued statewide initiatives against air pollution and in transforming riverside slums into parks in order to encourage business leaders to reinvest in Pennsylvania's cities. Governors Scranton and Shafer expanded on Governor Lawrence's efforts in this regard. During the late 1960s and early 1970s, these two governors ended legal exemptions that had previously permitted the coal industry to pollute waterways and took additional steps to increase the enforcement of anti-pollution laws.[17]

Governor Shapp, in the 1970s, was successful in negotiating a financial incentive package that lured Volkswagen to establish its first American production facility in western Pennsylvania. Into the 1980s, Governor Thornburgh increased the amount of funding available for the construction and reconstruction of Pennsylvania's highways and bridges, which was a critical component of the state's economic infrastructure. Governor Casey expanded on these efforts, and developed PENNVEST to provide funding to local communities to improve their water and wastewater infrastructures for industrial and residential uses.[18]

One of the earliest tax credits established in Pennsylvania, which is still in use today, is the Neighborhood Assistance Tax Credit, which was enacted by Act 1967-292 to encourage private businesses to provide funding to support education, job training, crime prevention, community services, and physical improvement projects in impoverished neighborhoods.

Another early tax credit was the Malt Beverage Tax Credit, which was authorized in 1974 in an amendment to the Tax Reform Code of 1971. This credit granted a limited tax subsidy for capital improvements made by small brewers for an "emergency" period, which was set as January 1, 1974, through December 31,

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[15] Argall, at 33.
[16] Argall, at 33-34.
[17] Argall, at 34.
[18] Argall, at 34-35.

1976. The credit was extended to December 31, 2008, at which time the tax credit expired.

Some of the more recently enacted tax credits include: Act 2006-65 created the Organ and Bone Marrow Donor Tax Credit, which authorizes every business firm providing paid leaves of absences to employees for the specific purpose of organ or bone marrow donation to qualify for a tax credit; Act 1997-7 created the Research and Development Tax Credit to encourage taxpayers to increase research and development expenditures in the Commonwealth in order to enhance economic growth; Act 2001-4 created the Educational Improvement Tax Credit program, which authorizes credits to business firms making a contribution—a donation of cash, personal property, or services—to a scholarship organization, an educational improvement organization, and/or a pre-kindergarten scholarship organization.

Tax Credits and the Tax System

The primary purpose of any tax system is to raise revenue to cover the costs of public expenditures. A tax system must not only provide for current spending, but also be capable of meeting the future revenue needs of the government.[19] The National Conference of State Legislatures, in its report *Principles of a High-Quality State Revenue System*, proposed four broad concepts of sound tax policy:

- A tax system should have stability, certainty, and sufficiency.
- A tax system should be equitable.
- A tax system should be easily and economically administered.
- A tax system should ensure accountability.[20]

As part of the tax system, government entities offer incentive programs in hopes of creating jobs and spurring economic growth. These government entities, including the federal and state governments, use many types of tax incentives, for example, direct grants, loans, interest subsidies, guarantees of loan repayment or interest payments, insurance on investments, and tax credits.

A "tax credit" is a direct dollar-for-dollar reduction of an individual's or business's tax liability. This can be compared to deductions and exemptions, which only reduce the amount of income that is taxable. In other words, tax credits reduce the actual amount of tax owed. The concept behind tax incentives is premised on the belief that the entity receiving the tax credit will eventually contribute more revenue to the governmental entity than it cost to grant the incentives.[21]

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[19] Brunori, David. "Principles of Tax Policy and Targeted Tax Incentives." *State and Local Government Review*, Vol. 29, No. 1 (Winter 1997): 50-61, at 52.
[20] *Principles of a High-Quality State Revenue System*, National Conference of State Legislatures, July 2007.
[21] Brunori, at 53.

The purpose of a tax credit is to provide monetary assistance or benefits through the tax laws so as to make certain actions financially attractive to taxpayers and to thereby induce them to take that action. Whatever the purpose of the economic benefit involved, e.g., to make an expensive activity less costly, to reduce its risk, or to increase the rate of after-tax profit, the incentive effect is the desired effect.[22]

For policy makers, the advantages to enacting a tax credit are many. For example, the tax credit program can go into effect immediately upon enactment. Additionally, tax credits promote private decision-making rather than government-centered decision-making. Another advantage seen with tax credits is the assumption that statutorily-enacted tax incentive programs need little, to no, additional administrative support because state revenue departments already collect, manage, and audit corporate tax returns.[23]

There are also disadvantages to tax credits. For example, tax incentives typically result in reductions in available revenue for the governmental entity. Further, tax incentives, particularly tax credits, are usually available to only the largest and most profitable companies who are in a position to take advantage of the credits. Smaller companies are not as likely to be able to take advantage of the credits because they do not have as much tax liability.

There are many varying tax credits available, including, for example, for job creation, job training, educational expenses, investments in low income housing, machinery and equipment purchases, and research and development. As with all these types of credits, the direct purpose is to provide monetary assistance or benefit through the tax laws.[24]

Like other policies a government may put forth, a tax credit is considered to be effective if its overall benefits outweigh its overall costs. In other words, the potential benefits of the credit, such as encouraging economic growth, must be weighed against the effect the credit has on the economy because it takes revenue away from the government.[25]

Over the past several years, states have increasingly used tax incentives such as tax credits to persuade companies to relocate to or remain in the state. Businesses use tax incentives not only to minimize tax liability, they also use incentives to minimize development costs. Although there are tax incentives available to business firms in general, state governments have been using targeted tax incentives more and more frequently. Targeted tax incentives are those that provide

[22] Surrey, at 713.
[23] Matkin, at 3-4.
[24] Surrey, at 713.
[25] Surrey, at 713.

preferential treatment to a limited number of taxpayers or businesses or are negotiated with one entity in particular. Generally, such incentives offer special tax treatment in return for some specified business activity in the state and often include property tax abatements, sales and use tax exemptions, job and investment credits, and accelerated depreciation deductions. One example of a targeted tax incentive is the "Mercedes-Benz" law in Alabama, which was enacted to entice the German automaker. Similarly, legislation in Nebraska provides corporate income tax credits to any company employing 250 new workers and investing at least $100 million. This law was enacted in 1996 on behalf of Union Pacific Railroad, which was considering expanding its headquarters in Omaha.[26]

Effectiveness of Tax Credits

Although the effects of state tax policy on economic development have been studied, there has been no specific research, either by scholars or by state policy analysts, on the long-term effects of tax incentives generally on state economies.[27] In general, scholars suggest that tax incentives have had mixed results, and tend to benefit persons and businesses in high tax brackets most and are difficult to administer.[28]

Another type of tax incentive, the job creation tax credit, is thought by some scholars to be ineffective. For example, one scholar commented that "experience with these tax credits show that businesses cannot be bribed to hire people….and that companies will game the system, wasting taxpayers' money." Another commenter noted that it is hard to determine if the business would have hired the employee anyway without a tax credit offering. One scholar suggested that a better approach might be a "payroll tax holiday" where, for a temporary period, the government would cover the employer and employee contributions to Social Security, Medicare, and unemployment insurance on behalf of new hires. Such a plan would immediately lower the cost of hiring a worker by about 7.5 percent and would also temporarily increase a worker's take-home pay by an additional 7.5 percent.[29]

As noted above, some states are utilizing tax incentives targeted to specific companies to encourage them to locate in that state. Scholars question the efficacy of such a program. For example, one commenter noted that there is no evidence that targeted tax incentives generate additional revenue for state government. For states, such as Alabama in the example described above, the prospect of recovering the lost tax revenue is uncertain. Given the large dollar amounts involved and the added infrastructure costs, targeted tax incentives could actually cost the state money in the long run. With this type of incentive, the states are essentially

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[26] Brunori, at 50-51.
[27] Brunori, at 54.
[28] Brunori, at 55-56.
[29] Stokes, Bruce. "Do Tax Credits Create Jobs?" *National Journal*, December 12, 2009.

borrowing against future revenue to finance immediate job growth. The end result, however may be a budget deficit.[30]

A legal review article compared tax incentives, such as tax credits, to direct tax expenditures, such as grants and loans. The writer of this article pointed out that, in many cases, tax credits are rarely examined as part of a state's budgeting process. He also noted that the impact of tax credits is difficult to ascertain and control because it is difficult to predict how many credits will be claimed. This is especially true for those tax credit programs which contain no limit as to the magnitude of credits that can be claimed. In contrast, direct expenditures are typically reviewed annually, and the impact of such direct expenditures can be clearly seen as part of the annual budgeting process. Further, this scholar suggested that, overall, the use of tax incentives greatly decreases the ability of a government to maintain control over the management of its priorities. He suggested that tax incentives such as tax credits should be viewed as an expenditure of funds. If this view is taken, the government will be able to better set its priorities and work through its budgetary process to enable these priorities to become reality.[31]

[30] Brunori, at 55.
[31] Surrey, at 734-738.

IV. Appendices

APPENDIX A

THE GENERAL ASSEMBLY OF PENNSYLVANIA

SENATE RESOLUTION

No. 20 Session of 2009

INTRODUCED BY PIPPY, FERLO, FONTANA, WOZNIAK, ALLOWAY, STOUT, FOLMER, ORIE, RAFFERTY, LEACH, BROWNE, O'PAKE, WAUGH, SCARNATI AND EARLL, FEBRUARY 6, 2009

SENATOR BROWNE, FINANCE, AS AMENDED, FEBRUARY 10, 2009

A RESOLUTION

Directing the Legislative Budget and Finance Committee to determine the impact of Pennsylvania's tax credit programs on the Commonwealth's economy, job market and State and local tax revenues.

WHEREAS, The Commonwealth of Pennsylvania has enacted at least 18 different tax credit programs that apply to businesses and other taxpayers; and

WHEREAS, These tax credit programs vary in size, scope and purpose; and

WHEREAS, Taken together, the Commonwealth's tax credit programs total approximately $350 million annually; and

WHEREAS, Information on the effectiveness of the Commonwealth's tax credit programs in achieving their respective goals and objectives is important information for the General Assembly to consider; therefore be it

RESOLVED, That the Legislative Budget and Finance Committee conduct a study to determine the effect of the Commonwealth's tax credit programs on the Commonwealth's economy, job market and State and local tax revenues; and be it further

Appendix A (Continued)

RESOLVED, That the Legislative Budget and Finance Committee study include an assessment of the:

(1) neighborhood assistance programs (Article XIX-A of the Tax Reform Code of 1971);

(2) employment incentive payments (Article XIX-A of the Tax Reform Code of 1971);

(3) Homeowner's Emergency Mortgage Assistance Fund (Article IV-C of the Housing Finance Agency Law);

(4) job creation tax credit (Article XVIII-B of the Tax Reform Code of 1971);

(5) research and development tax credit (Article XVII-B of the Tax Reform Code of 1971);

(6) keystone opportunity zone (Act 92 of October 6, 1998;

(7) coal waste removal and ultraclean fuels tax credit (Article XVIII-A of the Tax Reform Code of 1971);

(8) educational improvement tax credit (Article XX-B of the Public School Code of 1949, as amended);

(9) keystone innovation zone (Act 12 of February 12, 2004);

(10) FILM PRODUCTION TAX CREDIT (ARTICLE XVII-C OF THE TAX REFORM CODE OF 1971, AS AMENDED);

(11) first class cities economic development district (Act 226 of December 1, 2004);

(12) organ and bone marrow donor tax credit (Act 65 of July 2, 2006);

(13) strategic development areas (Act 151 of November 20, 2006);

(14) resource enhancement and protection tax credit (Article XVII-E of the Tax Reform Code of 1971);

(15) life and health insurance guaranty association credit (Article XVII of the Insurance Company Law of 1921);

(16) property and causality guaranty association tax credit (Article IX of the Tax Reform Code of 1971);

(17) emergency tax credit (Article XX of the Tax Reform Code of 1971);

(18) call center credit (Article II of the Tax Reform Code of 1971);

and be it further

RESOLVED, That the Legislative Budget and Finance Committee determine the extent to which each of the above-listed programs have clearly defined goals and objectives and whether the Commonwealth collects the information necessary to assess whether those goals and objectives are being achieved; and be it further

RESOLVED, That the Legislative Budget and Finance Committee report all findings to the Senate no later than one year from the passage of this resolution.

APPENDIX B

Neighborhood Assistance Programs in Other States

State	Who Is Eligible for Credit	Amount of Tax Credit	Total Individual Credit Amount	Total Annual Credits	Miscellaneous
Connecticut	Business firms that make cash investments in qualifying community programs conducted by tax exempt or municipal agencies.	100 percent of cash invested in energy conservation projects. 60 percent for investments in neighborhood assistance, job training, education, community services, crime prevention, construction or rehabilitation of housing for low and moderate income families, open space acquisition, child care services, employment and training programs for handicapped or for those over 50 years old, education and training for TANF families, and any other program that serves a group of individuals where at least 75 percent of individuals are at an income up to 150 percent of poverty level. 40 percent for contributions made to alcoholism prevention and treatment programs.	$75,000 or $50,000 for investments in child care services.	$5 million, of which $3 million is set aside for energy conservation, job training, and programs serving low-income persons.	Total charitable contributions must meet or exceed prior year's contribution to be eligible for credit. This does not apply to contributions to open space acquisition funds. Minimum contribution is $250. Organizations conducting a program eligible for funding are limited to receiving $150,000 in aggregate per year.
Delaware	Individuals and businesses who offer neighborhood assistance directly and who contribute to neighborhood organizations to benefit families with low to moderate income or to benefit impoverished areas.	-50 percent	$100,000	$500,000	Creditors are awarded on a first-come, first-awarded basis. If credit award results in exceeding $500,000, the excess is carried over to the next fiscal year and is given priority for award.

Appendix B (Continued)

State	Who Is Eligible for Credit	Amount of Tax Credit	Total Individual Credit Amount	Total Annual Credits	Miscellaneous
Florida	Any business firm that makes community contributions to a community action program, a non-profit community-based development organization that provides housing or increases entrepreneurial and job-development opportunities for low-income or very low-income persons, a neighborhood housing services corporation, a local housing authority, community redevelopment agency, Florida Industrial Development Corporation, historic preservation organization, regional workforce board, units of state or local government, a 501(c)(3) community-based organization, an enterprise zone development agency, or a direct support organization.	50 Percent	$200,000	$10.5 million for projects that provide home ownership for low income or very low-income households and $3.5 million for all other projects.	For FY 08-09 only, the $10.5 million was increased to $13 million. Except for construction or rehabilitation housing, all projects must be in an enterprise zone or Front Porch Florida Community in order to be eligible.
Kansas	Businesses that make contributions to community services such as social services provided to low income persons for food, employment, housing, health care, emergency assistance, education, and crime prevention.	50 percent, or 70 percent for contributions made by businesses in rural communities (population less than 15,000)	Up to 100 percent of tax liability.	$4,130,000	Minimum contribution is $250.
Illinois	Corporations who make donations to a qualified program in a target area for job training creation or expansion, and counseling, youth day care centers, housing programs for seniors, youth recreation, alcohol and drug abuse prevention, mental health counseling, domestic violence shelters, and other programs deemed as qualified programs.	50 percent			Must donate at least $10,000 to a qualified program. Tax credit is applied to property taxes.

Appendix B (Continued)

State	Who Is Eligible for Credit	Amount of Tax Credit	Total Individual Credit Amount	Total Annual Credits	Miscellaneous
Maryland	Individuals[a] and business entities making contributions to an approved project conducted by a non-profit in a priority funding area.	50 percent	$250,000 or tax liability amount, whichever is less.	Determined yearly by Department of Housing and Community Development.	Minimum contribution is $500 in goods, money, and real property. The total contributions for all approved projects may not exceed $2 million annually.
Nebraska	Individuals, business firms, insurance companies, and financial institutions making contributions to community services in a community development area.	40 percent	Maximum credit is as allowed by Department of Economic Development.	$350,000	Community services include employment training, human services, medical services, physical facility and neighborhood development services, recreation, education, and crime prevention. Community development area is one that has been designated as an area of chronic economic distress, and has unemployment rate that exceeds the statewide average; per capita income below the statewide average, or a population loss based on the federal census.
New Jersey	Any business firm or individual operating a business who makes contributions to a project in an eligible neighborhood.	100 percent	$1 million or total tax due	$10 million	Eligible neighborhood means an area having a neighborhood preservation and revitalization plan and eligible under the Special Municipal Aid Act or the Comprehensive Educational Improvement and Financing Act.

Appendix B (Continued)

State	Who Is Eligible for Credit	Amount of Tax Credit	Total Individual Credit Amount	Total Annual Credits	Miscellaneous
Pennsylvania	Any business firm engaging or contributing to a neighborhood organization that provides neighborhood assistance, comprehensive service projects job training, education community services, or crime prevention in an impoverished area or private company that makes qualified investments to rehabilitate, expand, or improve buildings or land in impoverished areas designed as enterprise zones.	55 percent of total annual contributions or 25 percent of qualified investments; or 75 percent of total contributions or 35 percent of qualified investments where activities are special program priorities. 75 percent for comprehensive service projects with 5-year commitments or 80 percent for 6-years or longer commitments.	$500,000 for less than 4 projects or $1,250,000 for 4 or more projects.	$18 million $2 million is designated for pass-through entities.	Banks and similar entities are not eligible for the credit.
Virginia	Individuals or businesses who contribute to neighborhood organizations that provide education assistance for impoverished people, community services, housing assistance, or job training.	40 percent	Minimum credit to be given is $400, maximum is $175,000 for businesses. For individuals or married couples, the minimum credit is $500, maximum is $50,000.	$4.9 million for education-related contributions, and $7 million for all other contributions.	At least 50 percent of persons served by organizations must be impoverished and at least 50 percent of expenditures must be for scholastic instruction. Impoverished means annual income not in excess of 180 percent of the poverty guidelines for education proposals and 150 percent for all other proposals. Community services means any type of counseling, emergency assistance, medical care, provision of basic necessities, and services intended to minimize poverty. Each organization is eligible to receive up to $500,000 for education-related proposals, and $500,000 for all other proposals.

Appendix B (Continued)

State	Who Is Eligible for Credit	Amount of Tax Credit	Total Individual Credit Amount	Total Annual Credits	Miscellaneous
West Virginia	Eligible taxpayers, e.g., entities who pay business taxes or personal income taxes, who make contributions to a qualified charitable organization.	50 percent	$100,000	$2,500,000	Community services means counseling, emergency assistance or medical care, recreation, economic development assistance, and community technical assistance, crime prevention, job training, and education to economically disadvantaged. Economically disadvantaged means 125 percent of federal statewide poverty rate. Minimum contribution is $500, maximum contribution is $200,000.

[a]This took effect January 1, 2009, and is applicable to tax years beginning after December 31, 2009. Prior to this, only businesses were permitted to claim the credit.

Source: Developed by the LB&FC staff from a review of legislation establishing neighborhood assistance programs in other selected states.

REV-545CT (4-10)PC

BUREAU OF CORPORATION TAXES
PO BOX 280703
HARRISBURG PA 17128-0703

PENNSYLVANIA RESEARCH AND DEVELOPMENT TAX CREDIT 2010 APPLICATION

pennsylvania DEPARTMENT OF REVENUE

(SEE INSTRUCTIONS ON PAGES 3 AND 4 BEFORE COMPLETING.)

ENTITY NAME	ACCOUNT ID (BOX NUMBER/SSN)	EIN
STREET ADDRESS	DUE DATE: SEPTEMBER 15, 2010	
	DEPARTMENT USE ONLY POST MARK DATE:	
CITY OR TOWN, STATE AND ZIP CODE		

☐ **CHECK BOX IF A SMALL BUSINESS**
IF CLAIM IS AS A SMALL BUSINESS WITH TOTAL ASSETS OF LESS THAN $5 MILLION AT THE BEGINNING OR END OF THE YEAR, SUBMIT A BALANCE SHEET REFLECTING TOTAL ASSETS.
ENTER ENTITY TYPE (SEE INSTRUCTIONS ON PAGE 3) ______________ **KOZ - (SEE SCHEDULE ON PAGE 2)**

DRAFT

CALCULATION OF CREDIT

1. Pennsylvania qualified research and development (R&D) expenditures (Complete Page 2):

Tax Year Beginning MM/DD/YYYY	Tax Year Ending MM/DD/YYYY	Actual		Use Whole Dollars Annualized
__/__/____	__/__/____	$________	1.	$________

2. 50 percent of Line 1 .... 2. $________

3. Prior years' Pennsylvania R&D expenditures (See instructions on Page 3):

	Tax Year Beginning MM/DD/YYYY	Tax Year Ending MM/DD/YYYY	Actual	Annualized
A.	__/__/____	__/__/____	$________	A. $________
B.	__/__/____	__/__/____	$________	B. $________
C.	__/__/____	__/__/____	$________	C. $________
D.	__/__/____	__/__/____	$________	D. $________

4. Total of prior years' annualized Pennsylvania R&D expenditures (Sum of A, B, C and D) .... 4. $________

5. Average of prior years' Pennsylvania R&D expenditures
   (Line 4 divided by number of base years in Line 3 with R&D expenditures) .... 5. $________

6. Line 1 minus the greater of Line 2 or Line 5 .... 6. $________

7. Tentative Pennsylvania R&D credit (Line 6 x 0.1 or 0.2 for large or small company, respectively) .... 7. $________

SIGNATURE AND VERIFICATION

Under penalties of perjury, I declare I have examined this return, including any accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct and complete. THIS FORM MUST BE SIGNED BY A CORPORATE OFFICER.

SIGNATURE OF OFFICER OF COMPANY		FAX NUMBER ( )	DATE
PRINT OFFICER'S NAME	TITLE	TELEPHONE NUMBER ( )	E-MAIL ADDRESS
NAME OF PREPARER		PREPARER'S ADDRESS	
TELEPHONE NUMBER ( )	PREPARER'S EIN OR SSN / DATE	CITY OR TOWN, STATE AND ZIP CODE	

Breakdown of R&D Expenditures by Location

PART I

		Column 1	Column 2	Column 3	Column 4
Line 1	Federal R&D Expense			$	100%
	PA Location:	PA Qualified Expenditure	PA Expenditure Located in KOZ	Total Expenditure	% of Federal Expense (% of Line 1, Column 3)
Line 2	A	$	$	$	%
Line 3	B	$	$	$	%
Line 4	C	$	$	$	%
Line 5	D	$	$	$	%
Line 6	E	$	$	$	%
Line 7	Non PA Expenditures			$	%
Line 8	Total	$		$	100%

PART II

	Address	City	ZIP Code
A.			
B.			
C.			
D.			
E.			

PART III

	Contact Name	Telephone Number	Fax Number	E-mail Address
A.				
B.				
C.				
D.				
E.				

Instructions:
Line 1, Column 3 – Federal R&D Expense, Schedule X, Line X, for tax periods beginning XX/XX/XX.

PENNSYLVANIA RESEARCH AND DEVELOPMENT TAX CREDIT APPLICATION INSTRUCTIONS
PER ACT 7 of 1997, ACT 46 of 2003 and ACT 116 of 2006

To claim the PA Research and Development (R&D) Tax Credit, a taxpayer must have qualified Pennsylvania R&D expenses in the current tax year (Line 1) and in at least one preceding tax year (Line 3). **NOTE: If PA R&D expenditures were incurred in a Keystone Opportunity Zone (KOZ), the taxpayer is not entitled to an R&D credit.**

For purposes of the PA R&D Tax Credit, a taxpayer is an entity subject to PA personal income tax, PA corporate net income tax or PA capital stock/foreign franchise tax.

Qualified R&D expenses include research expenses incurred for qualified research and development conducted within Pennsylvania, as defined in Section 41 (B) of the Internal Revenue Code of 1986.

Application for a PA R&D Tax Credit for PA R&D expenses incurred in the year ending in 2009 must be submitted by Sept. 15, 2010. A 52/53 week filer whose year ends in the first week of January will be considered a calendar year filer.

The department will notify applicants by Dec. 15, 2010, of PA R&D Tax Credit approval. A taxpayer may apply the approved credit against his/her PA personal income tax, PA corporate net income tax, or PA capital stock/foreign franchise tax liability for the tax year in which the credit is approved. The amount of credit applied to any tax liability cannot exceed 50 percent of such liability for that taxable year (the 50 percent limitation is eliminated for tax years beginning in 2005 and after). Any unused credit may be carried over to no more than the 15 succeeding taxable years. A taxpayer is not entitled to carry back, obtain a refund of or assign unused PA R&D Tax Credits (for awards made Dec. 15, 2002 and prior).

Effective for awards made Dec. 15, 2003, and after, the taxpayer can apply to the PA Department of Community and Economic Development (DCED) to sell or assign a PA R&D credit if there has been no claim of allowance filed within one year from the date the Department of Revenue approved the credit. Effective for awards made Dec. 15, 2009, and after, the taxpayer no longer has to wait one year before selling or assigning the credit. However, they can not sell or assign the credit until the tax return with the Dec. 15 award date has been filed.

To apply, visit www.newpa.com or contact DCED at 717-787-7120, 1-800-379-7448 or 400 North St., 4th Fl., Keystone Building, Harrisburg PA 17120-0225. The purchaser or assignee must use the credit in the taxable year in which the purchase or assignment is made, and the credit cannot exceed 75 percent of the tax liability for the taxable year. The purchaser or assignee may not carry over, carry forward, carry back or obtain a refund of the credit.

Effective for awards made Dec. 15, 2006, and after, pass-through entities include limited liability companies and partnerships, thus the credit can be transferred (passed-through) in writing to shareholders, members or partners in their proportionate share. The shareholder, member or partner must use the credit in the taxable year in which the transfer is made. R&D credits cannot be used against employer withholding taxes. Also effective for awards made Dec. 15, 2006, and after, the tentative credit on Line 7 is equal to 10 percent for large companies and 20 percent for small companies.

ENTITY TYPE: Complete the Entity Type on the front of this form by selecting one of the following categories:

Individual, LLC, LLP, S corporation, C corporation, Sole proprietorship

If any tax years on application Line 1 or Lines 3A, 3B, 3C or 3D represents a period of less than a full year, (other than for full year 52/53 week filers), the amount(s) of PA R&D expenses must be annualized.

Example: Tax year beginning Jan. 1, 2007 and ending July 31, 2007

$$\text{Annualized amount} = \$1{,}000{,}000 \times \frac{365^*}{212} = \underline{\$1{,}721{,}698}$$

*Use 366 for leap years that include 29 days in February.

If the taxpayer has two or more consecutive short periods that equal one full tax year, the short periods should be combined as a single tax year on Line 3 of the application.

Instructions for Line 3 (A, B, C, or D) on Page 1:

If any prior year PA expenditure has been changed for a specific year(s) as reported on this PA R&D application, you must provide a detailed explanation for each change and complete Page 2 for each change.

NOTE: ATTACH ALL ADDITIONAL INFORMATION USED TO DETERMINE THE CREDIT INCLUDING FEDERAL FORM 6765, BALANCE SHEETS FOR A SMALL BUSINESS AND ANY APPLICABLE PARTNERSHIP INFORMATION (PERCENTAGE OWNED, ETC.). THIS INFORMATION IS REQUIRED EVEN IF ZERO CREDIT IS CLAIMED ON LINE 7 OF THE APPLICATION.

Instructions for Page 2, Breakdown of R&D Expenditures by Location

PART I

Line 1:

Column 3 – List the Total Qualified Research Expenses from Section A, Section B, or Section C of FF 6765.

Line 2: Location A

Column 1 – List PA-qualified R&D expenditures for that location.
Column 2 – List PA expenditures located in a KOZ.
Column 3 – List total PA expenditures (sum of Columns 1 and 2).
Column 4 – List percent of federal expense (Line 1, Column 3).

Lines 3 through 6 should be completed for additional PA locations (if more than five locations, duplicate Page 2).

Line 7:

Column 3 – List total Non-PA R&D expenditures.
Column 4 – List percent of federal expense (Line 1, Column 3).

Line 8:

Column 1 – Total PA-qualified R&D expenditures (this amount should match "Actual" amount on Line 1 of Page 1).
Column 3 – Total R&D expenditures everywhere.

PART II

List address for each location (A, B, etc.).

PART III

List contact's name, telephone number, FAX number and e-mail address for each location (A, B, etc.).

Please visit www.revenue.state.pa.us for further information. Questions regarding completion of the application and the calculation of the credit may be directed to 717-783-6031, Option 7, then Option 2.

Send completed, signed applications to:

Bureau of Corporation Taxes
PO Box 280703
Harrisburg PA 17128-0703

APPENDIX D

Responses to This Report

RECEIVED JUL 9 2010

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT
HARRISBURG, PA 17120

OFFICE OF SECRETARY

July 9, 2010

Philip R. Durgin, Executive Director
Legislative Budget and Finance Committee
400 Finance Building
613 North Street
Harrisburg, PA 17105-8737

Dear Mr. Durgin:

Thank you for allowing us the opportunity to review the draft report entitled *Pennsylvania's Tax Credit Programs* prepared by the Legislative Budget and Finance Committee (LBFC) pursuant to Senate Resolution 2009-20 and House Resolution 2009-127. In your letter, dated June 18, 2010, you indicate that the Department of Community and Economic Development (DCED) is invited to provide written comments on the report. In response to your invitation, this letter addresses LBFC's recommendations about the two tax credit programs administered by DCED.

Educational Improvement Tax Credit program (EITC)

Recommendation: We recommend that, rather than randomly selecting businesses to receive the full amount of the requested tax credits, DCED should pro-rate, for all businesses that submit their applications by a certain date, the annual EIO credits available.
The EITC law prescribes that tax credits shall be made available on a first come, first serve basis.* This method is therefore not only statutorily required, it is the fairest and provides the most stable funding stream for organizations. Denied applications are placed on a waiting list and have an opportunity to be funded later in the year as funds become available.

Recommendation: Although we acknowledge that the departments have conversed on this particular issue, we recommend the EITC program establish an EITC Advisory Board that would be comprised of staff from DCED, PDE, and a representative sampling of all program participants.
From the inception of the program, DCED has consulted with the Department of Revenue, Department of Education, REACH Foundation, PA School Boards Association, local districts and individual scholarship organizations. We intend to continue to seek guidance from a wide range of stakeholders and do not see the need for an EITC Advisory Board.

Recommendation: We recommend DCED seek a formal legal opinion from the Office of General Counsel as to the appropriateness of its interpretation of the requirement that 80 percent of an EIO's annual receipts be contributed to a public school as grants.
DCED's interpretation is that the law permits Educational Improvement Organizations to offer innovative educational programs by provision of direct grants to public school districts, by providing direct services to public school students, and by bringing in third party vendors to provide such programming to public school students. A recent meeting with the PDE confirmed our views. However, we will seek an opinion on the issue.

*LB&FC Note: The final report has been changed to direct this recommendation to the General Assembly.

We recommend DCED reconstitute its program monitoring unit and review and follow-up on the monitoring reports submitted by EIOs to ensure the EIO programs are being implemented as described and approved in the program applications.

1. Even as it scaled back the monitoring division that existed within the business assistance area, DCED was creating a centralized monitoring and reporting function in its financial management center. This group offers program managers throughout the agency guidance, oversight and uniform approaches to performance and financial monitoring. While the division's initial focus has been large state grant contracts and those Recovery Act programs considered to pose the highest risk, its scope is expected to expand in the future.
2. In addition, business assistance staff (and program staff throughout the department), have continued monitoring grants, loans and tax credits even without program level units dedicated solely to monitoring work. DCED will, however, rebuild a monitoring presence solely within business assistance, in order to increase the visibility of and focus on monitoring activities.

We recommend DCED begin the process of converting the EITC program into electronic files that SOs, PKSOs, EIOs and donating businesses access on-line.
DCED will begin the process of converting the paper-based application process to an online procedure. The implementation schedule cannot be fully determined at this time as it will depend on available resources.

Job Creation Tax Credit program

Recommendation:
a. We recommend that DCED complete a comprehensive file review of companies participating in the program with start dates within the past five years to ascertain what pieces of information are missing from participants' files and take the necessary resulting actions, including rescinding the tax credits, if not already done so, for noncompliance with program requirements.
DCED will perform this review and has already taken or intends to take the following corrective actions:

1. In addition to the checklist used by analysts when reviewing an application, a checklist verifying the presence of the application and commitment letter must be completed and initialed by both the analyst and supervisor.
2. A similar checklist will be developed when a certificate is issued confirming the presence of an Attachment A and resulting certificate, if any is present.
3. DCED will rename Attachment A as "Employment Affidavit" in order to differentiate between application and monitoring as well as to better define the purpose of the report.
4. Ensure that the base number of jobs is always collected so that only those jobs created after the start date of the contract are counted as new jobs.
5. A check box will be added in order to document that a municipality losing jobs transferred for which JCTC was awarded has been afforded an opportunity to comment prior to a decision on JCTC by DCED.

b. We further recommend that DCED should begin to ask program participants to submit a statement five years after they have first redeemed their tax credits (or from their start date, please see footnote 9) verifying that they still maintain existing operations and operations related to the tax credit in Pennsylvania.
Prior to sending a JCTC file to archives and immediately following the fifth anniversary of a project's start date, DCED will verify and document the fact that a business is still operating in Pennsylvania.

Recommendations: We recommend that DCED conduct follow-up inquiries on a random or targeted sample of JCTC current and future program participants to help ensure the integrity of the job growth and wage data being reported.
DCED has found self-reporting by companies of employment data to be efficient and largely consistent with other methods. In the early days of the JCTC, DCED performed random site visits to companies earning JCTC. While self-reporting has been demonstrated to be accurate, the department will implement random site visits over the next several years to supplement monitoring and ensure that taxpayers are being adequately protected.

Recommendation: Until such time as the program statute is amended to allow it, DCED should stop the practice of awarding JCTC tax credit above the $1,000 per new job created above a company's base amount.
DCED believes that the authors of the JCTC statute intended the $1,000 per job credit to be provided on a multiple basis to select companies offered such incentives by the Governor's Action Team. It was seen as necessary in order to compete with other states for business retention, expansion and attraction.

Recommendations:
a. Because so many of the tax credits are rescinded prior to certificates being issued (a total of 67.4 percent of total commitments from program years FY1999-2000 to FY2009-2010 were rescinded prior to certificates being issued), we recommend that the Department of Revenue not post JCTC tax credits to a specific company's ledger until such time as a tax credit certificate is actually issued by DCED.
b. In addition, we recommend that DCED and DOR regularly compare and reconcile their job creation tax credit amounts available for issuance, recapture and reissuance, but at least once a year prior to the start of the next program year.
While DCED was unaware of the process at the Department of Revenue, the Department agrees that reconciliation of records is absolutely necessary and will convene a meeting with Revenue to ascertain what informational needs are being unmet in either direction and promptly implement the necessary remedial actions.

Neighborhood Assistance Tax Credit Program (NAP)

Recommendation: We recommend the department proceed with its plans to implement a new performance monitoring report for NAP recipients, and that this information be used when awarding tax credits in subsequent years.

1. The new performance reports are in place and are being used during the 2010 application period. The reports and process will continue to be refined to ensure that measurable and accurate information is captured.
2. The guidelines for the NPP and EZP were updated in June 2010 to require additional outcome measures, from project inception, projected outcomes and actual outcomes. The Department will continue to update the guidelines for other components of the program.
3. Unfortunately, the additional outcome measures for a particular year contained in the new performance reports will not be included in the annual legislative report for that year, which is due October 1. Due to our contracting process, the final outcomes and results of the year's activities are not reported until October 15, as the activity period of the contracts ends on September 30 of the award year.

Recommendation: We recommend the Department of Community and Economic Development consider the amount of the NAP tax credit to be used for administrative overhead costs as one of the criteria when awarding tax credits to NAP participants.

1. DCED is in agreement. While not a part of the guidelines, the official review process includes administrative overhead costs compared to service delivery costs and administrative overhead costs were scrutinized closely during the team reviews of all applications during the 2009 application period.
2. The NAP application review sheet has been modified to require the identification of the amount and percentage of administrative costs as a part of the overall project budget.

Recommendation: We recommend that as the economy improves, DCED consider reinstituting a more balanced approach between economic and community development programs and projects when awarding tax credits.

The focus of the Neighborhood Partnership Program is community revitalization through long term, community partnerships. Thus, the vast majority of tax credits have benefited communities. Prior to fiscal year 2009 when economic conditions were much better, we had a broader diversity of projects. Such diversity is now limited due to the reductions in available tax credits, but DCED believes that it will be restored when the economy improves.

Again, I would like to thank you for the opportunity to offer the Department's input on this draft report. If you have any further questions, please feel free to contact me at (717) 720-1355.

Sincerely,

Austin J. Burke,
Secretary

RECEIVED JUL 15 2010

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF REVENUE
HARRISBURG, PENNSYLVANIA
17128-1100

THE SECRETARY

(717) 783-3680

July 9, 2010

Philip R. Durgin, Executive Director
Legislative Budget and Finance Committee
400 Finance Building
613 North Street
Harrisburg, PA 17105-8737

Dear Mr. Durgin:

Thank you for giving the Department of Revenue (DoR) an opportunity to review the draft report, entitled *Pennsylvania's Tax Credit Programs,* prepared by the Legislative Budget and Finance Committee (LBFC) in response to SR 2009-20 and HR 2009-127. This letter is in response to your letter dated June 18, 2010, in which you indicate that DoR is invited to provide written comments to the draft report.

We take note of your objection to the Department's stance regarding the release of confidential taxpayer data to LBFC for the purpose of preparing this report. Please be aware that the Department's duty to protect taxpayer data is based on more than the Department's own interpretation of the Fiscal Code. Although certain credit information with respect to particular tax credit programs can be disclosed pursuant to specific statutory authority, the Office of Attorney General has opined by official opinion that "the official purposes" exception of Section 731 of the Fiscal Code is applicable only for the administration, collection, or enforcement of a Commonwealth tax. See, Op. Att'y Gen. 90-1 (1990). Since the LBFC does not engage in those functions, it is clear that the DoR is not legally authorized to release certain tax credit to LBCF under that exception.

Nevertheless, we fully appreciate the value of public review of tax credit programs and have never objected to legislation waiving the confidentiality restrictions on tax credit data. Consequently, we agree with your Overall Recommendation 2 on page S-7.

In section II.A., *Call Center Tax Credit,* 2. Recommendation on page 12 provides "the statute should be amended to require that an annual report be published so that information about the program is more transparent and information pertaining to the benefit of the tax credit can be determined." DoR will investigate the possibility of making changes to the application in order to capture data relevant to job retention or creation. DoR will publish such information as it is authorized to do by statute.

In section II.C., *Educational Improvement Tax Credit*, Background and Overview on page 15 provides at the third paragraph that "a pass-through entity, however, may transfer part or all of an unused tax credit to shareholders, members or partners (proportionately), who must immediately claim the credit in the taxable year in which it is made." In accordance with Act 48-2009, the tax credit can be transferred to the shareholders, members or partners in the taxable year in which the contribution is made *or in the taxable year immediately following the year in which the contribution is made.* *

In section II.C., *Educational Improvement Tax Credit*, on page 35, the first paragraph of Findings 11 references the "now phased-out capital stock and franchise tax." If needed for clarity, it is noted that the capital stock and franchise tax is not yet phased-out. The tax will expire for taxable years beginning after December 31, 2013.*

In section II.G., *Job Creation Tax Credit*, 4. Recommendation a. on page 72 recommends that "Revenue not post JCTC tax credit to a specific company's ledger until such time as a tax credit certificate is actually issued by DCED." DoR does not post the credit until after a credit certificate is issued by DCED and after a claim has been made for the credit by the taxpayer.

In section II.G., *Job Creation Tax Credit*, 4. Recommendation b. on page 72 recommends that "DCED and DOR regularly compare and reconcile their job creation tax credit amounts available for issuance, recapture and reissuance[.]" DoR agrees with this Recommendation 4, which suggests a more frequent reconciliation of data maintained by DoR and DCED. However, DoR believes the figures reported in Table 21 are incomplete. The "Difference" in "Credits Issued Total" is due to three certificates that have been issued but which have yet to be presented to DoR. DoR believes that the majority of the "Difference" in "Recapture Total" is due to credits that were never issued by DCED. The figures DoR provided to LBFC show $791,000 in credits that have not been issued that LBFC failed to consider in compiling the "Department of Revenue" "Recapture Total" in Table 21. Instead of $4,932,000, that Recapture Total should reflect $5,723,000.

In section II.K., *Pennsylvania Insurance Guaranty Association Tax Credits*, 3. Recommendation on page 110 recommends that "Revenue should annually provide a report of which insurance companies have taken the tax credit to the Pennsylvania Insurance Department" to prevent members who raised premiums as a result of an assessment from receiving a tax credit for payment of the assessment. The proposed release of the tax credit information by DoR to the Insurance Department would be unrelated to tax administration, collection, or enforcement. Such a release would, therefore, be for a reason unrelated to the official purposes exception to Section 731 of the Fiscal Code.

In section II.L., *Research and Development Tax Credit*, 1. Recommendation on page 121 recommends that "Revenue revise the current research and development application to clarify for

*LB&FC Note: The final report has been changed to incorporate this information.

which tax year expenses are to be submitted." DoR agrees with this recommendation and will enhance the form or instruction materials.

In section II.L., *Research and Development Tax Credit*, 2. Recommendation on page 122 recommends "Revenue provide clarification on the application and accompanying instructions as to what is considered to be an acceptable qualified research expense, rather than merely referring to the federal statute." The Pennsylvania Research and Development Tax Credit Law provides that "[q]ualified research expense [is] as defined in section 41(b) of the Internal Revenue Code of 1986[.]" DoR is hesitant to redefine and possibly alter meanings or interpretations of federal terms.

In section II.L., *Research and Development Tax Credit*, 3. Recommendation a. on page 124 provides "Revenue should match the data reported to the IRS on the Federal Form 6765 to the data reported on the Pennsylvania Research and Development tax credit application to provide reasonable assurance that the businesses applying for the Pennsylvania tax credit have incurred legitimate research expenses and that the relative amounts claimed are appropriate." This is part of DoR current process. DoR requires a copy of the Federal Form 6765 that was filed with the IRS (or would have been filed with the IRS for members of a consolidated group) as part of the review of every application. In addition, DoR does receive information directly from the IRS on audits of Pennsylvania corporations and the DoR looks for changes made by the IRS to the federal credit.

In section II.L., *Research and Development Tax Credit*, 3. Recommendation b. on page 124 recommends that "the department conduct (or contract to perform) audits of some or all businesses that receive substantial research and development tax credits." See response to *Research and Development Tax Credit*, 3. Recommendation a. (immediately prior paragraph). The DoR does audit research and development tax credits claimed on returns that are selected for audit.

In section II.L., *Research and Development Tax Credit*, 5. Recommendation on page 126 recommends that "Revenue revise the Research and Development application to require that an applicant indicate whether any of research and development activities they are claiming as expenses on the application were performed by a third party and, if so, to provide the identifying information of the contractor and where the third-party research was conducted." Federal Form 6765, lines 8 and 27, require an entity to report a percentage of the amounts paid for third party research. DoR will add a field to the Research and Development application to ask for contractor information when the Federal Form 6765 shows third party research expenses.

Again, I would like to thank you for the opportunity to comment on this draft report. I look forward to working with you and your staff as needed on clarifying any information or details with respect to, and adequately presenting the administration of, Pennsylvania's tax credit programs.

Sincerely,

C. Daniel Hassell

C. Daniel Hassell
Secretary of Revenue

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COMMONWEALTH OF PENNSYLVANIA

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
RUSSELL C. REDDING

July 7, 2010

Philip R. Durgin
Executive Director
Legislative Budget & Finance Committee
Room 400 Finance Building
613 North Street
Harrisburg, PA 17105-8737

Dear Mr. Durgin:

I have received the section of the confidential draft of the Legislative Budget and Finance Committee report entitled *Pennsylvania's Tax Credit Programs* pertaining to the Resource Enhancement and Protection (REAP) Program, and appreciate the opportunity to provide written comment on the draft for inclusion in the final report.

In the three years since the creation of the program in July of 2007, REAP has proven to be an important tool in Pennsylvania's commitment to conservation. By allowing farmers and businesses to earn state tax credits in exchange for Best Management Practices (BMPs) implemented on their farms, the REAP program has had a tremendous impact from both a financial and environmental standpoint.

I am pleased that the Committee's overall review of this program confirms the true benefits the REAP program has had for our state's agriculture industry and for our environment.

I wish to comment on the final item in the "Findings and Recommendation" section, on page 143 of the draft report.

The fifth finding states "The Conservation Commission does not provide all required information to the General Assembly or make it available as a matter of public record." I respectfully maintain that this finding is inaccurate.

As noted in the draft report, the State Conservation Commission (Commission) is required by statute to provide certain information to the General Assembly via an annual report, and to the public in accordance with the laws applicable to public information and public records.

Section 1710-E of Act 55 of 2007 states the following:

SECTION 1710-E. REPORT AND PUBLIC INFORMATION.

(A) General Rule – The Commission, in consultation with the Department, shall annually report to the General Assembly on the Resource Enhancement and Protection Tax Credit Program as follows:

(1) The number of projects and the dollar amount of tax credits granted under the program in the aggregate, by best management practice and per project.
(2) The types, locations and costs of projects
(3) The estimated benefits of the projects including pollution reduction.

(B) Identity – the identity of each taxpayer utilizing a Resource Enhancement and Protection tax credit under this article, and the amount of credits approved and utilized by each taxpayer shall be made available annually within a year of when the credits were granted and shall constitute a public record, notwithstanding any law providing for the confidentiality of tax records. This information regarding taxpayer use of Resource Enhancement and Protection tax credits shall be made available in accordance with the laws applicable to public information and public records generally, and need not be included in the annual report to the General Assembly.

The draft Committee report states that the Commission's annual report to the General Assembly does not meet statutory requirements, since the report does not list each individual "project." The Commission interprets the statutory language in Section (A) as a requirement to report in the aggregate, since Section (B) separately addresses individual taxpayer (applicant) information. Part of the difference in interpretation comes from the use of the word "project," which is not defined in the statute. In simple terms, each individual Best Management Practice (BMP) which receives a REAP tax credit is a "project." The REAP annual report provides all required information on all BMPs which have received tax credits.

Second, the report states *"...initially, we had an issue with getting complete information from the Commission."* The Commission strongly disagrees with this statement. It is correct that the Commission initially only provided the Legislative Budget and Finance Committee with names and county locations for each applicant. The reason that only this particular information was provided was because this is the information that was originally requested. When names and addresses were requested in a follow-up request, the information was promptly provided.

The REAP administrator spent a considerable amount of time replying to the Committee analyst's requests for information, both via a detailed briefing binder provided to the staff at the beginning of the review, and through dozens of follow-up phone conversations and emails. The Committee analyst also spent several hours physically reviewing paper files, and had unlimited access to all REAP records and files. The State Conservation Commission does indeed provide all public records regarding the REAP program in compliance with the Commonwealth's Right to Know Law.

Again, thank you for the opportunity to provide comments. Please let us know if any additional information is needed to finalize the report.

Sincerely,

Russell C. Redding