Evaluating State Business Tax Credits

Jennifer Weiner, Policy Analyst
New England Public Policy Center
Federal Reserve Bank of Boston

Connecticut Voices for Children
9th Annual State Budget Forum
Hartford, Connecticut
January 26, 2010

FEDERAL RESERVE BANK OF BOSTON™

New England Public Policy Center
at the Federal Reserve Bank of Boston

What are business tax credits?

- A common economic development tool.
- Preferences in the tax code meant to encourage some type of business activity that would not have occurred—or would have occurred to a lesser degree—without the credit.
- Allow a business to reduce its tax liability dollar-for-dollar.
- Potential benefits include expanded economic activity; potential costs include forgone tax revenue. Both are difficult to measure because we cannot observe the "counterfactual."

Example: Connecticut film tax credit

- Eligibility criteria
  - ➢ Minimum expenditures of $100,000
  - ➢ At least 50% of principal photography days in-state
- Production companies must submit to application process, but essentially an entitlement
- No caps on individual or aggregate credits

Example: Connecticut film tax credit

- Credit rate varies from 10 to 30% based on size of production
- Only in-state expenses and compensation for star talent up to $20 million per production qualify for credit
- Transferable, 3-year carry-forward

Evaluations of tax credits

- Important to try to understand the effectiveness and cost-effectiveness of tax credits
- Evaluating these things can be challenging
  - Lack of data
  - Necessity of assumptions
- Stakeholders should avoid the temptation to take the results of evaluations at “face value” without a closer examination

Examining tax credit evaluations: One key question

- **Are the study's assumptions and methodologies transparent?**
  - An analyst's decisions may be justifiable, but it is difficult to know without transparency
  - Allows us to better assess the reasonableness and relevance of the findings

Tax credit evaluations: A framework

- Does the credit induce the targeted activity?
  - What actually happened with the credit in place versus what would have happened without the credit (the "counterfactual")
- What is the credit's overall economic impact?
  - Direct effects
  - Indirect effects (positive and negative)

Tax credit evaluations: A framework

- What is the credit's fiscal impact?
  - ➢ Changes in state revenues and spending resulting from the credit
- Is the credit cost-effective?
  - ➢ Relative to a standard threshold (e.g. HUD's $35,000 per permanent job)
  - ➢ Relative to other policies

Differences in assumptions and methodologies can impact study findings.

Summary of Selected Film Credit Evaluations Released in 2008 and 2008

	CT	MA	NM		NY
Study information:					
Author(s)	DECD	DOR	P&P	E&Y	E&Y
Model used	REMI	REMI	IMPLAN	IMPLAN	IMPLAN
Does the study adjust for…					
Non-induced productions?	No	Yes	No	No	No
Salaries to non-residents?	Yes	Yes	No	No	No
Balanced-budgets?	Yes	Yes	No	No	No
Key findings:					
State revenue per credit $	$0.07	$0.16	$0.14	$0.94	$1.13
Approx. net cost per job	$33,400	$38,200	$13,400	$300	($1,200)

DECD = Department of Economic & Community Development
DOR = Department of Revenue

P&P = Popp & Peach
E&Y = Ernst & Young

But differences across states matter too.

- Estimation issues aside, the impact of a tax credit in one state might differ from the impact of a similar credit elsewhere, due to differences in:
  - Credit design
  - State economies
  - Tax systems
- Therefore, one should not automatically assume that the estimated impacts for one state would apply to another—even if the study is well-conducted.

Evaluating business tax credits vis-à-vis other tax policy goals

Tax policy goal	In general, do business tax credits support or undermine this goal?
Equity	**Unclear**; depends on who bears burden of taxes
Neutrality	**Undermine**; by their nature tax credits are a means of using the tax code to influence economic behavior
Simplicity	**Undermine**; tends to make tax code more administratively burdensome for firms and states
Transparency	**Undermine**; harder to tell which taxpayers are paying taxes and how much they are paying
Adequacy	**Unclear**; depends on whether tax credits generate a net revenue loss and desired level and mix of public services
Competitiveness	**Unclear**; depends on whether a state's relative level and mix of taxes and public services is attractive to firms

Concluding thoughts

- As data improve, more high-quality studies may emerge, allowing for sounder conclusions.
- Policymakers and other stakeholders need to understand the strengths and weaknesses of existing studies when using them to inform the debate.
- It is also important to consider the larger picture—including how business tax credits mesh with other tax policy goals and who is benefiting and how—when determining the role of film and other business tax credits in economic development policy.