FINANCIAL OVERSIGHT & MANAGEMENT BOARD
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BY ELECTRONIC MAIL

December 28, 2022

Honorable Pedro Pierluisi Urrutia
Governor of Puerto Rico

Dear Governor Pierluisi Urrutia,

On December 8, 2022, the Oversight Board sent you a letter (the "Letter") conveying its serious concerns regarding Senate Bill 552 ("SB 552" or "the Bill"). We understand the Legislature has now sent the Bill to you for your review. We write to share the Oversight Board's recent determination regarding the Bill.

After consultation with its advisors, and for reasons set forth in the Letter and in the attached Resolution, the Oversight Board has determined SB 552 impairs or defeats the purposes of PROMESA. As such, PROMESA Section 108(a)(2) bars the Governor from signing the Bill into law and bars the Bill's implementation and enforcement. To the extent you disagree with the Oversight Board's determination, you may not simply disregard the bar in PROMESA Section 108(a)(2). Instead, you may seek judicial review of the Oversight Board's determination before signing SB 552 into law.

If you sign SB 552 into law, in violation of PROMESA Section 108(a)(2), PROMESA Sections 204(c) and 108(a)(2) will bar the Executive branch from implementing the law. Furthermore, if you enact the law in violation of PROMESA Section 108(a)(2), you will still be required to make a PROMESA Section 204(a) submission. In such a circumstance, the Oversight Board expects the submission will address the concerns set forth in the Letter and attached Resolution, particularly if the Section 204(a) certification concludes SB 552 is not significantly inconsistent with the Fiscal Plan, and indicate whether or not the Executive Branch intends to implement the law pending the successful completion of the Section 204(a) process.

The Oversight Board reserves all its rights, including those under PROMESA Sections 104(k), 108(a), and 204, to take such actions it deems appropriate, including seeking remedies to prevent implementation and enforcement of the Bill and sanctions for violation of PROMESA.

We look forward to continuing to work together for the benefit of the people of Puerto Rico.

Sincerely,

Jaime A. El Koury
General Counsel

Cc: Hon. José Luis Dalmau Santiago
Hon. Rafael Hernández Montañez
Hon. Omar Marrero Díaz

FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO

December 28, 2022

RESOLUTION REGARDING SENATE BILL 552

WHEREAS, on June 30, 2016, the federal Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA") was enacted;

WHEREAS, section 101 of PROMESA created the Financial Oversight and Management Board for Puerto Rico (the "Oversight Board") "to provide a method for [Puerto Rico] to achieve fiscal responsibility and access to the capital markets;"

WHEREAS, the Legislature for the Commonwealth of Puerto Rico (the "Legislature") has passed Senate Bill 552 ("SB 552" or the "Bill");

WHEREAS, SB 552, among other things, amends Act 60-2019, known as the "Puerto Rico Incentives Code" to increase the current cap on certain film industry tax incentives from $38 million to $100 million per year;

WHEREAS, the Bill grants AAFAF, the Department of Economic Development and Commerce, and the Office of Management and Budget the authority to identify and execute all possible actions to implement SB 552;

WHEREAS, the 2022 Certified Commonwealth Fiscal Plan (the "2022 Fiscal Plan") focuses on reforming the tax structure established in the Puerto Rico Incentives Code, including establishing a new standard "so that incentives are concentrated on those projects most likely to provide net economic benefits to the [C]ommonwealth;"

WHEREAS, the Fiscal Plan requires that "any tax reform or tax law initiative that the Government undertakes or pursues during a year within the 2022 Fiscal Plan period must be revenue neutral, that is, all tax reductions must be accompanied by specific, offsetting revenue measures of the same amount that are identified in the enabling legislation;"

WHEREAS, the 2022 Fiscal Plan requires regulations implementing tax incentives must be based on a published methodology demonstrating "at minimum they are revenue neutral;"

WHEREAS, the Oversight Board analyzed the economic effects of the Bill;

WHEREAS, the Bill would reduce Commonwealth revenues without identifying offsets in violation of the 2022 Fiscal Plan;

WHEREAS, the current tax incentives for film production in Puerto Rico are capped at $38 million and are not revenue neutral, costing the Commonwealth approximately $23 million annually;

WHEREAS, the Oversight Board's advisors estimate[1] that the increased cap (to $100 million) created by SB 552 would not be revenue neutral, and that any increased economic activity from the increased cap would be insufficient to offset the additional cost to the Commonwealth from the higher cap;

WHEREAS, the SB 552 does not identify offsets from spending reductions and/or revenue increases to address the revenue shortfall of $38.1 million annually;

WHEREAS, by increasing tax incentives without demonstrating the incentive is revenue neutral, SB 552 is inconsistent with the 2022 Fiscal Plan's standards for tax incentives and requirements for revenue neutrality;

WHEREAS, by reducing Commonwealth revenues by $38 million without identifying offsetting savings or additional sources of revenues, SB 552 is inconsistent with the 2022 Fiscal Plan;

WHEREAS, by reducing Commonwealth revenues by $38 million without identifying offsetting savings or additional sources of revenues, SB 552 creates a significant risk that the Commonwealth's expenditures will exceed its revenues in Fiscal Year 2023;

WHEREAS, section 204(c) of PROMESA provides, among other things, the "Legislature shall not adopt a reprogramming, and no officer or employee of the territorial government may carry out any reprogramming, until the Oversight Board has provided the Legislature with an analysis that certifies such reprogramming will not be inconsistent with the Fiscal Plan and Budget;"

[1] The estimate relied upon is attached hereto at Exhibit A.

WHEREAS, SB 552 effectuates a reprogramming by increasing the Commonwealth tax incentives – which will reduce the Commonwealth's revenues – without identifying replacement funding sources or budgetary cuts to offset to offset the loss of revenues;

WHEREAS, neither the Legislature nor the Governor has requested the Oversight Board to approve a reprogramming in connection with SB 552;

WHEREAS, the Puerto Rico Senate approved SB 552 on June 25, 2022 and sent the approved text to the Puerto Rico House of Representatives for consideration;

WHEREAS, the Puerto Rico House of Representatives approved SB 552 with amendments on November 9, 2022;

WHEREAS, the Puerto Rico Senate and the Puerto Rico House of Representatives approved SB 552 as amended by the legislative conference committee on November 15, 2022, and arranged for the approved bill to be sent to the Governor of Puerto Rico for consideration;

WHEREAS, the Legislature violated PROMESA section 204(c)'s prohibition on adopting a reprogramming of funds without prior Oversight Board approval by passing SB 552;

WHEREAS, following consultation with the Oversight Board's legal and financial advisors, and extensive internal deliberation, the Oversight Board has determined it is necessary and appropriate to take such actions it considers necessary, consistent with its powers under PROMESA, to prevent the enactment and implementation of legislation violating the Commonwealth Fiscal Plan;

WHEREAS, for reasons discussed above and in the Oversight Board's correspondence with the Legislature and the Governor, the Oversight Board has determined SB 552 is inconsistent with the Commonwealth Fiscal Plan and, if enacted, SB 552 will impair or defeat PROMESA's purposes, including achieving fiscal responsibility, by increasing Commonwealth tax incentive expenditures without sufficient offsets in violation of express provisions of the Fiscal Plan;

WHEREAS, the Oversight Board has also determined that, if enacted, SB 552 impairs or defeats the purposes of PROMESA, including achieving fiscal responsibility and achieving a balanced budget, by passing additional tax incentives without ensuring revenue neutrality;

WHEREAS, for reasons discussed above and in the Oversight Board's correspondence with the Legislature and the Governor, the Oversight Board has determined SB 552 is inconsistent with the 2022 Fiscal Plan and, if enacted, SB 552 will impair or defeat PROMESA's purposes, including achieving fiscal responsibility, by granting AAFAF, the

Department of Economic Development and Commerce, and the Office of Management and Budget the authority to identify and execute all possible actions to implement the law without explaining what guardrails exist—if any—on this undefined power;

WHEREAS, the Oversight Board has also determined that SB 552 impairs or defeats the purposes of PROMESA, including achieving fiscal responsibility, by adopting a reprogramming without prior Oversight Board approval in violation of PROMESA section 204(c);

NOW, THEREFORE, IT IS HEREBY RESOLVED that the Oversight Board:

1. Advises the Governor that PROMESA section 108(a)(2) bars him from signing SB 552;
2. Advises the Governor that PROMESA section 108(a)(2) bars him from implementing and enforcing SB 552; and
3. Approves taking legal action, if it appears appropriate, against the Legislature, the Governor, and/or AAFAF pursuant to its authority under PROMESA sections 104(k), 108(a)(2), and 204 to prevent enforcement of the law and otherwise to enforce the bar in PROMESA sections 204(c) and 108(a)(2) against enactment and/or implementation of SB 552 and, if appropriate, to have it declared invalid and a nullity, among other remedies, if the Legislature and Governor violate PROMESA section 108(a)(2).

To: Valerie Maldonado, Esq.
Senior Legislative & Regulatory Review Counsel
and
Ana Maria Santiago Ramirez, Esq.
Legislative & Regulatory Review Counsel
Financial Oversight & Management Board for Puerto Rico

Date: December 5, 2022

Memo on SB 552, amending Act 60-2019's sections on film tax credits[1], a revised version of a bill proposed in 2021.

The legislation increases the total amount of allowable film tax credits awarded annually from $38 million to $100 million. The legislation also expands the pool of companies eligible to receive a Green Energy incentive from DDEC.

SB 552's increase in the cap on film credits would result in a revenue loss of $38.1 million for the Commonwealth. Expanding the pool of companies eligible for a Green Energy grant has a negligible effect on the deficit.

Significant offsets from spending reductions or tax increases would be required to avoid violating the Fiscal Plan's requirement that tax changes not increase the deficit. SB 552 provides no revenue or spending offsets.

The revised version of SB 552 does not include the tax changes included in the original (2021) version. Because, while perhaps unintended by the drafters, those tax changes were likely to lower rather than raise tax revenue, **the revised version has a fiscal cost that is smaller in magnitude than that estimated for the original version** (which had an annual loss of $40.4 million)

A detailed fiscal note (2/18/2022) on the previous version of this legislation (SB 926) was provided.[2] The analysis contained in that note remains relevant to assessing the fiscal implication of this revised bill and is attached at the end of this note. The body of this memo identifies the differences between this version of the legislation and the previous version of the legislation and details how the fiscal implications depart from those previously identified**.**

Analysis of the SB 552 November 2022 version

Under current law, the film tax credit annual allocation is capped at $38 million. Under SB 552, the annual cap would be increased to $100 million, or by $62 million.

[1] The following two provisions are part of SB 552, but not related to creative industries
- Section 1020.07, A definition of energy storage systems
- Section 2071.01 (9a), Any business dedicated to the installation, operation, assembly, maintenance or sale of energy on a commercial scale from an Energy Storage System" added to Section 2071.01*. on "Companies Dedicated to Infrastructure and Green or Highly Efficient Energy".*

[2] This legislation has been referenced as both SB 926 in fall 2021 and SB 552 in Spring 2022. The fiscal note responses for SB 552 and SB 926 are identical.

The credit limit proposed in this legislation is more than 2.6 times that defined in Circular Letter 21-001, approved by FOMB in 2021.[3] The revised version of SB 552 contains no tax changes other than the increase in the film credit cap.

Fiscal impacts of SB 552 (November 2022 version)

Although this tax credit does not generate enough economic activity to cover its revenue cost, a portion of the $62 million increase in the credit cap is recouped by higher taxes paid on the direct and indirect economic activity stimulated by the credits. After accounting for these effects, the revised version of SB 552 is estimated to reduce revenues by $38.1 million, or about 61% of the increase in the credit cap.

The revenue loss of SB 552 is smaller in magnitude than the loss estimated for the previous version of SB 552 (a loss of $40.4 million annually) because the revised version drops a set of tax changes which, taken as a group, would have reduced revenue. While some of these provisions taken individually would have increased revenues to the Commonwealth, one, a sales tax exemption, would have lowered revenue significantly.

Table 1. Revenue Effect of SB 552 (November 2022)

Revenue Impact (relative to current law)	**($38.10)**

Comparing the original and the revised versions of SB 552

In the past, various versions of the film tax credit bill have been evaluated by FOMB. Table 2 compares the original and the revised versions of SB 552.

Table 2. Increasing the film tax credit: two versions of SB 552

	SB 552 (Spring 2022)/ SB 926 (Fall, 2021)	**SB 552 (November 2022)**
Tax provisions	Raises the film tax credit annual limit from $38 million to $100 million Raises the tax rate on income earned by firms receiving the credit from 4% to 10%.	Raises the film tax credit annual limit from $38 million to $100 million Not included

[3] In addition, this circular letter contains language requiring that credits allocated in a year, whether used in that year, are counted toward the annual cap in that year in their entirety. That is, no credit can be granted for a future year and a credit not used in one year cannot be shifted to the following year's cap. Specifically, the language reads as follows: "Film Tax Credits will only be issued by official Decree and each Film Tax Credit Decree will state a specific maximum dollar value limit (enumerated in dollars) of Film Tax Credits for which the film project and applicant would be eligible upon satisfaction of the terms of the Decree. The full value of the eligible dollar limit of Film Tax Credits identified in each Degree will be charged against the annual credit cap for the year in which the Degree is granted, reducing the available cap on a dollar for dollar basis, irrespective of if the Film Tax Credit is used in the current fiscal year, or any future fiscal year. The sum of all Film Tax Credits issued by Decree in a fiscal year shall not exceed the annual budget cap for that fiscal year."

	Reduces the exemptions on property taxes from 75% to 50%.	Not included
	Reduces the (total cap on the) refundable portion of tax credit by 25%, from $40 million to $30 million.	Not included
	Exempts sales and use tax on business purchases currently taxed at the combined commonwealth and municipal rate of 11.5%.	Not included
	The Bill also diverts from using the ROI methodology developed by DDEC and, without introducing a new calculation method, suggests taking into account intangible costs and benefits.	Not included
	Not included	The Secretary of the DDEC will distribute the tax credits fairly and equitably among all eligible film projects through regulations or circular letters, which must guarantee no less than 10% of the total incentive for local productions and documentaries, with the objective of maintaining and promoting investment and job creation in all representative sectors of the Puerto Rican film industry, as well as promoting the growth of the Puerto Rican film industry and the best interests of the Country

Estimated impact	~$40.40 million annual loss	~ $38.10 million annual loss
Provisions on green energy (not related to creative industries)	No	Yes

Green Energy Grants

SB 552 also expands the pool of companies eligible for a Green or Highly Efficient Energy grant from DDEC without increasing the total funding available for the program. The legislation defines an Energy Storage System as an "interconnected system with an aggregate capacity of at least one (1) megawatt (MW) for the absorption and storage of energy generated at a given time to be used later according to the need of the resource". The legislation provides that companies with such a storage system are eligible to receive a grant from DDEC as defined in Act 60-2019. While the legislation does not create a new grant program, by expanding an existing program, more companies will qualify. This is likely to have adverse effects for the PREPA customer base and revenues.

The fiscal note on the previous version of SB 926, provided on 2.18.2022.

PS 926 Fiscal
Note_DELIVERED Fel

Fiscal note on P.S. 926

Initial review/completed review

Date taken in: 02-03-2021

[x] Preliminary Review [X] Full Fiscal Review

Date Completed: 10-6-2021 Date Completed: 02-18-2022

Is the Act in compliance with the Fiscal Plan? Y/N

Total fiscal impact: ~$40.4 million loss annually

- **Overall Commonwealth** ~ $40.4 million annual loss
- **General fund:** $40.4 million loss annually (estimated using projects in current pipeline)
- **Local/CRIM/Municipalities:** Non-zero revenue increase (unable to estimate due to data limitations)

The credit limit proposed in this legislation is $100 million, more than 2.5 times that defined in the Circular Letter. While PS 926 contemplates some tax increases to offset the $62 million increase in authorized credits, this analysis finds that these would be insufficient to bring the bill into conformity with the Fiscal Plan. In total, PS 926 reflects a fiscal loss to the Commonwealth of $63.7 million. Existing policy results in a $23.3 million loss, such that PS 926 produces an additional incremental loss of $40.4 million above this amount.

Detailed data for supporting the fiscal impact assessment can be found at the end of this Note.

Summary:

PS 926 major provisions include the following:

1. Raises the film tax credit annual limit from $38 million to $100 million, increasing the budget cap to 263% of its previous amount.
2. Raises the tax rate on income earned by firms receiving the credit from 4% to 10%.
3. Reduces the exemptions on property taxes from 75% to 50%.
4. Reduces the (total cap on the) refundable portion of tax credit by 25%, from $40 million to $30 million.
5. Exempts sales and use tax on business purchases that are currently taxed at the combined commonwealth and municipal rate of 11.5%.

The Bill also diverts from using the ROI methodology developed by DDEC and, without introducing a new method of calculation, suggests taking into account intangible costs and benefits.

The FOMB approval of Circular Letter 21-01 was predicated on maintaining a $38 million annual film tax credit cap present in existing legislation. The Circular Letter was meant to be temporary and to only be in effect until regulations are established within the Act 60 framework. At the time of the review of 21-01, it was determined that the budget cap would be considered separate from other forms of tax incentives, given the specific legislative specification of the credit limit.

Assumptions and interpretation of provisions:

NA

Stated reasons for change:

To increase tax credits awarded to the film industry with the aim of increasing economic and tourism activity on the island.

Identification of Potential Effects/Implications:

Increasing the cap on film credits would not be a revenue neutral proposal. Significant offsets from either spending reductions or tax increases would be required to avoid violating the Fiscal Plan.

Industry representatives have stated the film credit requires annual subsidies to maintain the industry, and for that reason can never be entirely self-sufficient. That is, if the subsidies were to cease or be reduced, so to would be film industry activity in the CW. The Puerto Rican Treasury Department will annually need to dedicate funds to maintain current levels of film production. This requirement is inconsistent with an economic development objective of facilitating self-sustaining economic activity.

The benefits of the credit flow to a select number of firms and locations around the island and subsidize an affluent industry. On the other hand, taxpayers from all locations of the CW contribute tax dollars to pay for the credits.

Other economic impacts (short and long term):

Independent studies on film credits have repeatedly shown that the credits do not pay for themselves and do little to support long term economic growth. A 2019 National Bureau of Economic Analysis paper found that while film activity increases after incentives are adopted, this does not result in meaningful increases in employment, wages, or firms in the film industry or its related industries.[1] A 2016 paper in the American Review of Public Administration suggested that most of the incentives included under these programs had little to no sustained impact on employment or wage growth, and that none of the incentives affected motion picture industry GSP or concentration[2]. The finding is not surprising, given the temporary nature of the activity associated with the incentives. Additionally, the author stated that:

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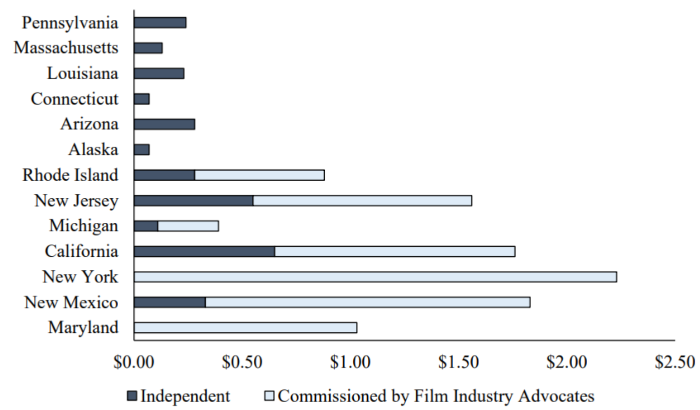
[1] Button, Patrick, "Do Tax Incentives Affect Business Location and Economic Development? Evidence from State Film Incentives". NBER Working Paper 25963 (2019).

[2] Thom, Michael. "Lights, camera, but no action? Tax and economic development lessons from state motion picture incentive programs." *The American Review of Public Administration* 48.1 (2018): 33-51

"…economic development institutions must solicit multiple cost-benefit analyses before acting on incentive proposals. It is imperative that parties with no conflict of interest conduct those evaluations and that agencies avoid venue-shopping for favorable outcomes."

Studies conducted by state government analytic offices overwhelmingly confirm these results and have quite different findings than those that are film industry funded. Figure one shows a comparison of ROIs found by independent state legislatures and those that were industry funded. Interestingly, even within the same state, studies have large discrepancies regarding the benefits of the film credits. Only studies funded by the film industry have a positive ROI

Figure 1. Comparison of the return on investment of film production incentives as estimated by independent entities and film industry advocates



Source: State Legislative, Economic Development, and Treasury Departments; Department of Legislative Services

Exhibit 1.6 shows the ROI and the cost per job of incentives in various states, as calculated by independent state agencies. Most states have an ROI of under 50 cents, while the cost per job varies significantly among the states, ranging from a low of $8,519 in New Mexico to a high of $128,575 in Massachusetts.

Upon examination of the literature for this assessment there were no findings from academic research papers that suggest a positive return on investment for film credits or a substantial increase to permanent employment across states that enact them.

Suggested policy changes to improve fiscal implications:

These findings do not support adoption of the Bill in its current form.

Possible ways to improve it are the

- Introduction of a strong ROI and CBA element in the Bill in line with the Act 60 requirement (and Regulation No. 9248), where film productions have to compete with other projects.
- Instead of transferable credits that are typically sold at 90% of their value, a 90% refundable credit would result in the same effect for the CW, but with simpler administration.
- Reducing the incentive for hiring local labor relative to non-local would reduce the revenue loss associated with this incentive program.

Maintain the credit cap at $38 million to reduce losses. At $100 million, the cap would be above that imposed by most other states. When considered as a share of GNP the Puerto Rico cap would be high compared to that offered in the states. For instance, the cap in New Jersey is $75 million. While not all states (Georgia and Illinois) have a cap, most states cap this credit at an amount less than $100 million.

Fiscal impact summary tables:

The fiscal impact of increasing the film tax credit cap was calculated by estimating the net change in taxes collected using the recapture rate developed in the FOMB report titled *Film Credit Economic and Fiscal Impact Study*. For details on the methodology see Appendix 1 and the accompanying report embedded in the appendix.

In total, the increase in the film credit, increase in business income tax rate and exemption of the SUT will result in a $40.4 million loss to the Commonwealth.

- Data for these estimates was provided by DDEC and represents the current pipeline of projects waiting to receive a film credit. The projects in the "pipeline" requested credits are worth $96 million. Thus, there are sufficient projects to reach the cap of $100 million. Data used for these estimates was the credit amount for residents and non-residents. It is not clear which projects would be selected under the $38 million cap. For the purposes of the estimate, it was assumed the projects selected would have the same ratio of non-resident credit to resident credit as the projects in the pipeline. This is a stylized assumption and may not hold when the film projects are selected.

Assumptions for the estimates are as follows:

- To generate the fiscal and economic impact of increasing the cap on the film credit, we rely on the recapture rates for the resident and non-resident portion of the tax credits from the FOMB report *Film Credit Economic and Fiscal Impact Study*. The original recapture rates from this report are presented in Appendix Table 1 for *current law* non-resident and residents.

- The recapture rates used to estimate the fiscal effects of PS 926 are shown in Table 1. While the resident and nonresident recapture rates match those from the report, the total recapture rates presented below in Table 1 differ from the total rates presented in the report for two reasons. The recapture rates presented in the report reflect the mix of resident and nonresident credits in the FY20-FY22 data. The recapture rate used to estimate PS 926 reflects the mix of resident and nonresident credits from the stock of current film credit applications and are, therefore, more specifically reflective of the current pipeline.[3] Furthermore, the recapture rates used to estimate this note are adjusted to incorporate the sales and use tax exemption and the increase in business income taxes contained in the proposal.[4] The recapture rates presented in the report represent current law, rather than the proposal.

- The methodology to construct the recapture rate for PS 926 to account for the increase in the business income tax and the SUT exemption for business purchases is modified as follows:

[3] Due to differences in the mix of resident and nonresident credits awarded each year, the total multiplier and consequently the economic/fiscal impact of this credit will vary each year. In years with a higher nonresident share of credits awarded, the revenue loss to the CW would be lower compared to years in which there was a lower nonresident share.

[4] The recapture rate for PS 926 drops because of the estimated opportunity costs. Film credit employees that would have been working in the next best available job if there were no film credit are assumed to have been working for businesses that do not have a business-to-business sales tax exemption.

- To determine the impact of increasing the business income tax rate from 4% to 10%, we adjust the original IMPLAN model results from the report to incorporate this new tax rate on income and recompute the resulting tax effect.
- We eliminate the sales tax revenue from the original model presented in the report to determine the effect of exempting sales and use tax for business purchases as provided under PS 926.

- Due to data limitations, the analysis is not able to estimate the revenue effect associated with the property tax exoneration decrease in PS 926. This provision is highly unlikely to raise substantial revenue. Furthermore, as this revenue would accrue to local governments, it would not affect CW tax collections.
- As stated above, PS 926 reduces the refundable portion of the credit from $40 million to $30 million. Although we did not model this explicitly, it is likely that this modification would have little to no impact on the revenue loss to the CW. Credits may be sold so it is unlikely that would go unused. Thus, we expect this provision to have little to no impact on the cost of the overall incentive to the CW but may reduce the incentives received by some projects.
- It is important to note that the recapture rate is dependent on the mix of resident and nonresident credits awarded each year. Projects from FY20 to FY22 had a significantly lower share of non-resident credit as a proportion of total film credits compared to the projects in the current pipeline. If future projects were more like the previous three fiscal years compared to the current pipeline, the recapture rate of the film credits would be lower, and the loss to the CW would be larger.

Panel 1 of Table 1 below shows the fiscal effect of the credit if the modifications in PS 926 were adopted. Panel 2 of Table 1 shows the fiscal effect under current law. Panel 3 shows the net effect of adopting the provisions of PS 926. As can be seen from the table, the nonresident credit is fully funded through the withholding tax on nonresident workers and does not result in a negative impact to the CW.

Table 1. Annual Fiscal Impact of PS 926

Fiscal effect of tax credit under PS 926	Resident	Non-Resident	Total
Credit	$80.0	$16.4	$96.4
Recapture rate	5%	175%	33.9%
Taxes Collected	$4.0	$28.7	$32.7
Fiscal Impact	**-$76.0**	**$12.3**	**-$63.7**

Fiscal effect of tax credit under Current Law	Resident	Non-Resident	Total
Credit (estimated)	$31.5	$6.5	$38.0
Recapture rate	11%	175%	38.6%
Taxes Collected	$3.4	$11.3	$14.7
Fiscal Impact	**-$28.2**	**$4.8**	**-$23.3**

Net Fiscal effect of PS 926	Resident	Non-Resident	Total
Fiscal Impact	**-$47.8**	**$7.4**	**-$40.4**

Appendix 1.

The results of the FOMB Fiscal Impact study find that the net recapture rate of the film credit **from FY20 through FY2022** was 30%. The recapture rate is calculated as the total amount of credits granted over the study period less the taxes received from economic activity spurred by the credit and the opportunity costs.

This implies that for the for the total $165 million investment by the film industry over the FY20-FY22 period, the Treasury lost $108 million. This equates to the Treasury spending $85,477 per net film-industry job gained in Puerto Rico.

Table A1. Puerto Rico Film tax credit recapture rate, ($ in millions)

	PR Resident[5] Investment	PR Non-Resident Investment + Visitor Spending*	Total
Panel 1: Economic impact of credit subsidized film projects			
Total output	$409.7	$133.6	$543.3
Less: Local film production	$95.8	--	$95.8
Less opportunity costs	$171.3	--	$171.3
Net economic impact	**$142.6**	**$133.6**	**$276.2**
Panel 2: Fiscal impact of credit subsidized film projects			
Total credits	$146.6	$18.4	$165.0
Taxes recovered from economic activity	$33.9	$32.2	$66.1
Less: opportunity costs	$16.8	--	$16.8
Net taxes recovered from economic activity	$17.1	$32.2	$49.3
% of total credits	**11.7%**	**174.8%**	**29.9%**

To estimate the economic activity associated with the film tax credit and any additional indirect and induced economic activity associated with the direct film tax investment, an IMPLAN model for Puerto Rico is used.[6] For more detail on the methodology, see the accompanying FOMB report, titled *Film Credit Economic and Fiscal Impact Study*.

The direct, indirect, and induced flows estimated in the economic impact calculations were used to estimate the additional revenue generated from the film activity. The fiscal effects are generated from three main sources, income and sales tax collections associated with the earnings from workers, business tax receipts, and hotel tax receipts.

The opportunity cost analysis estimates the alternative scenario of factor resource engagement in the absence of the tax credit. Inclusion of this part of the analysis is critical. To assume that all film production activity exists as a result of the incentive and that resources used in support of film production have no second-best alternative use overstates the impact of the incentive. The FOMB analysis assumes that all workers in the film industry have a transferrable skillset such that if employment in the film industry (NAICS 512) did not exist, they would be employed in other industries within the information sector (NAICS 51), subject to formal and informal labor force participation and unemployment. The economic opportunity wage cost was estimated for all workers, subject to the formal labor force participation rate,

[5] Bona-Fide resident of Puerto Rico must live in Puerto Rico 183 days out of the year and have a primary residence on the island (among other stipulations)

[6] The model uses 2019 data for Puerto Rico.

that were hired through direct resident investment and the indirect and induced workers that gained employment. The fiscal effects of the direct, indirect, and induced economic effects were estimated in a manner similar to the gross tax impacts.

Finally, the net effect of the above impacts is calculated as the difference between the total economic and fiscal impacts and the opportunity cost.

The report referenced throughout the document can accessed through the embedded link below.

Film Credit Economic
Cost Benefit Analysis_(