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Credits and Incentives: Important Tools for Economic Growth

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Finance and tax professionals are increasingly cognizant of the potential value of state and local credits and incentives as lucrative offsets to project, operating, or tax costs. A December 2012 series in *The New York Times* suggested that state and local governments provide more than $80 billion worth of credits and incentives to businesses annually. Generally speaking, these programs encompass tax, financial, or operational benefits offered by government agencies or other interested parties to companies in order to encourage desirable activity – such as new investment, job creation, or research and development (R&D) – in a particular area or to attract or retain such activity that might otherwise be taken elsewhere. The availability and size of credits and incentives can make a significant impact on business decisions, particularly on those that involve whether, where, how, and when investment and workforce-related activities take place.

Programs fall into two general categories: tax credits and incentives.

Tax credits are offsets to income tax liabilities claimed on returns. Credits are often statutory, or “as-of-right,” which means they are available for businesses based on their having undertaken qualifying activities, identified via statute, during the tax year. Traditionally, negotiation or prequalification isn’t required, and occasionally some credits are retroactively available. These features, however, are changing in many states because of recent fiscal difficulties. States are recognizing that the broad availability of uncapped, retroactive, “as-of-right” credits can have a significant impact on tax revenues.

Incentives, on the other hand, are a much broader genre. They can take many forms, ranging from income, sales, or property tax relief, to direct grants, utility discounts, or contributions of land. Further, the availability and scale of such programs is usually dependent upon a business’s facts and circumstances. Incentives tend to be awarded at the discretion of state and local officials, in which case they are considered negotiable. Sometimes a business seeking incentives or tax credits must prequalify by filing an application or certification in advance of a deadline. Virtually all incentives represent an abatement or deferral of a prospective liability. They are usually based on revenues or economic impacts expected to be generated by a particular activity.

Credit and Incentive Programs

Although there is no known all-inclusive, centralized database of programs, estimates range from 1,900 to more than 3,000 separate credit and incentive programs offered by state and local-level governmental entities. Here are some of the general categories of these programs.

Income Tax Credits and Other Attributes – In addition to credits, states provide other means of reducing income tax liabilities. Rhode Island, for instance, will reduce the corporate tax rate for companies that create a certain number of new jobs. New Jersey allows start-up technology companies to sell unusable tax attributes – such as net operating losses and research and development (R&D) credits – to other companies in exchange for cash. Many states, responding to taxpayer complaints that credits may not be fully "realizable" since the amount of the credit a company generates might exceed its income tax liabilities, allow unusable credits to be refunded, sold, or transferred to a related entity.

Property Tax Incentives – Many communities provide mechanisms for the abatement of incremental property tax liabilities associated with newly constructed or substantially refurbished facilities. A variety of methodologies are used, depending on the applicable state law, ranging from direct abatement to complex sale/leaseback arrangements involving local development authorities.

Sales Tax Incentives – Certain expenditures, such as manufacturing equipment, are exempt from sales taxes in many states. However, some items that would otherwise be taxable may qualify for abatement through negotiation or location in designated economic "zones." New Jersey, for example, provides exemptions for construction materials installed within Urban Enterprise Zones. New York provides a de facto exemption through a short-term sale/leaseback transaction with a development agency.

Direct Grants and Forgivable
Loans – The most popular of all incentives are the direct cash payments made to offset project, infrastructure, training, or other costs. Such incentives have been used with increasing frequency in recent years by Texas, Utah, Virginia, and other states to close deals with relocating or expanding businesses. Loan forgiveness is another popular tool, subject to a company's compliance with employment, investment, or other commitments.

Utility Discounts and Other Incentives – States and utility companies may provide discounted utility supply or delivery. In some cases, utilities will provide grants or fund-required improvements to utility-related infrastructure.

Contributions of Land, Infra-structure, and Services – State and local governments may provide support in the form of land, infrastructure, and services. Infrastructure could include things such as traffic lights, utility hookups, or road or rail improvements, and services might be something like employee screening.

Project Facilitation – Projects are often burdened by "red tape" in the form of zoning, permitting, and other regulatory delays and fees. "Streamlining" or "fast-tracking" these processes, or a reduction or waiver of fees, is viewed as a significant inducement by some.

Green and Sustainability Incentives – Various states offer incentives for environmentally friendly, or "green," investments in the form of income tax credits, property tax abatements, grants, and more.

A Pennsylvania Perspective

Pennsylvania, like most states, has a representative collection of incentive programs designed to encourage economic development in the state. A list of available programs is available at the Department of Community & Economic Development website.1 Some of the most popular are listed below.

PA First – Gov. Tom Corbett (R) implemented PA First in 2011, combining several previous incentives. The program provides direct grants and loans for projects involving job creation and capital investment.

Keystone Opportunity Zones (KOZ)/Keystone Opportunity Expansion Zones (KOEZ) – Businesses locating and creating jobs in designated geographic areas may operate essentially free from state and local taxes under the KOZ/KOEZ programs. Qualifying companies are broadly exempt from state and local income, sales and use, property, and other taxes. This type of program may generate material tax savings and can be a primary factor in determining a business location.

Tax Credits – Pennsylvania offers dozens of tax credits for qualifying activities. Some examples are as follows:

- A job-creation tax credit of up to $1,000 per job to approved businesses that agree to create employment: Companies must expand their work- force by 25 jobs (or 20 percent) within three years. Twenty-five percent of the credits approved annually must be awarded to businesses with less than 100 workers.
- R&D tax credits for businesses qualifying for the federal R&D credit and making R&D investments in Pennsylvania: Eligible companies may apply for approval to sell and assign their unused R&D tax credits.
- Other credits are available for "Educational Improvement" (for businesses contributing to scholarship and educational improvement organizations), film production, historic preservation, and many other enterprises.

Local Incentives – Dozens of municipalities around the state offer incentives, many of which are property tax relief on real property improvements. Philadelphia offers its own version of a job-creation tax credit against the city's Business Income & Receipts Tax (recently increased to $5,000 per job), along with property tax incentive programs.

Many business activities and initiatives can qualify for government assistance in the form of credits and incentives, both in Pennsylvania and elsewhere. Such programs can make a significant difference in the economics of a particular investment or project, and those programs should be taken into consideration as a critical element of business planning. These opportunities should be identified at an early stage, before capital investments are made, a lease is signed, or hiring of new employees occurs. Many states require applications to be submitted before a project starts to ensure proper investment of government funds, as opposed to funding a project that is already complete or substantially under way.

Companies should consider putting a process in place to try to ensure that appropriate credits and incentives are captured when the company engages in the desired activities, such as job creation or capital investment. One method is to form a team of tax, finance, legal, operational, real estate, and human resources professionals, ideally along with a CPA who has expertise as a state and local tax credit and incentive specialist.

1 www.newpa.com/business/financial-incentives

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