



Business credits and incentives: 15 programs you need to know about today

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Understanding credits and incentives

Trends in state and local incentives

- State and local economic development agencies are aggressively pursuing companies to expand in their jurisdiction
- More states privatizing the Economic Development Authority
- States pulling back on job retention tax credits
- Increasing scrutiny of incentives programs
- Expanded audit activity of tax incentives by taxing authorities
- Funding caps on incentives programs designed to minimize state budget impact

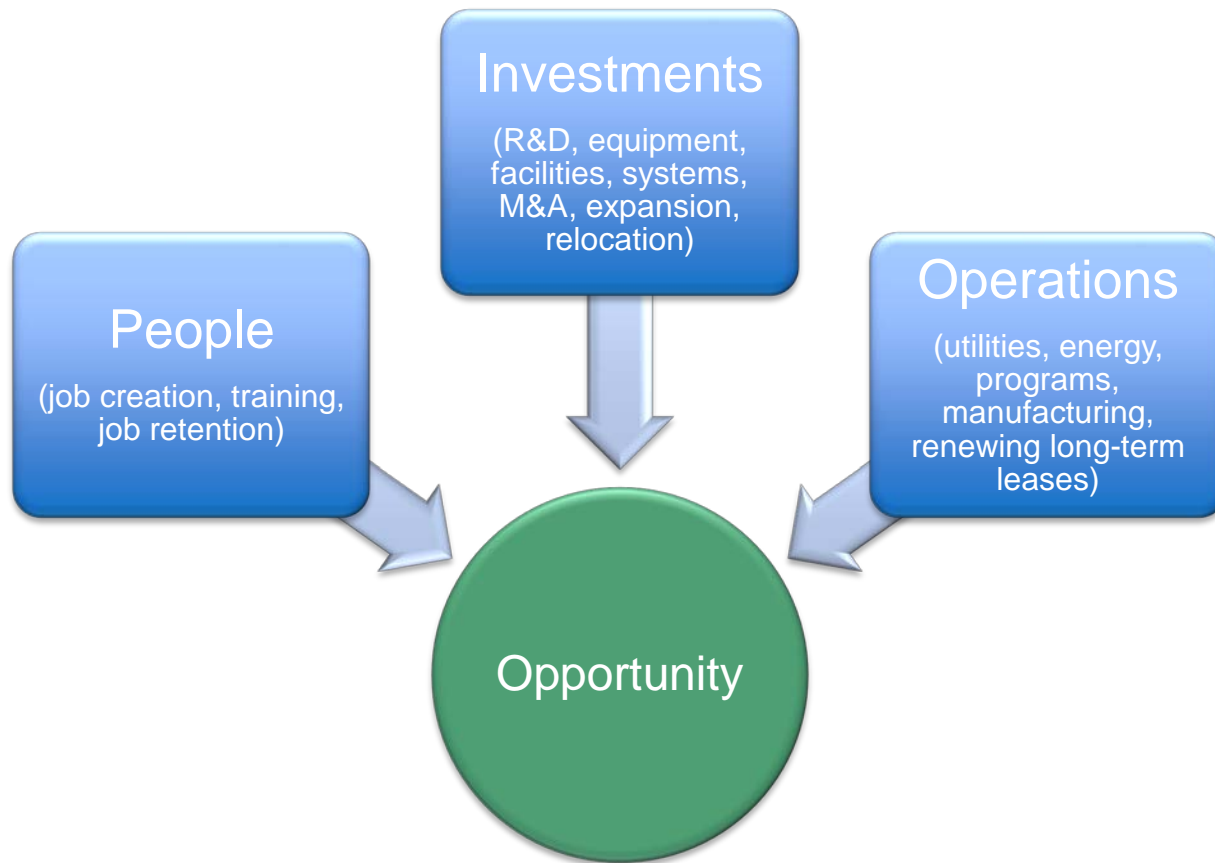
Trends in federal incentives

- Short-term stimulus incentives with rigorous application processes
 - ARRA section 1603 grant in lieu of tax credit for specified energy property
 - Section 48C advanced energy property manufacturing credit
 - Qualified therapeutic discovery projects credit
- Increased IRS audit challenges
 - R&D tax credit
 - Domestic production activities deductions
 - Economic substance of partnership and lease structures to monetize certain real estate and energy credits
- Potential 2014 expiration of several energy credits

Benefits to your business

- A variety of programs exist at the federal, state and local levels to reward businesses for investing in growth
- Participation in credits and incentives programs may provide significant bottom line benefits including
 - Permanent tax savings
 - Reduced effective tax rate
 - Enhanced cash flow
 - Reduced start-up or operational costs
 - Increased shareholder value

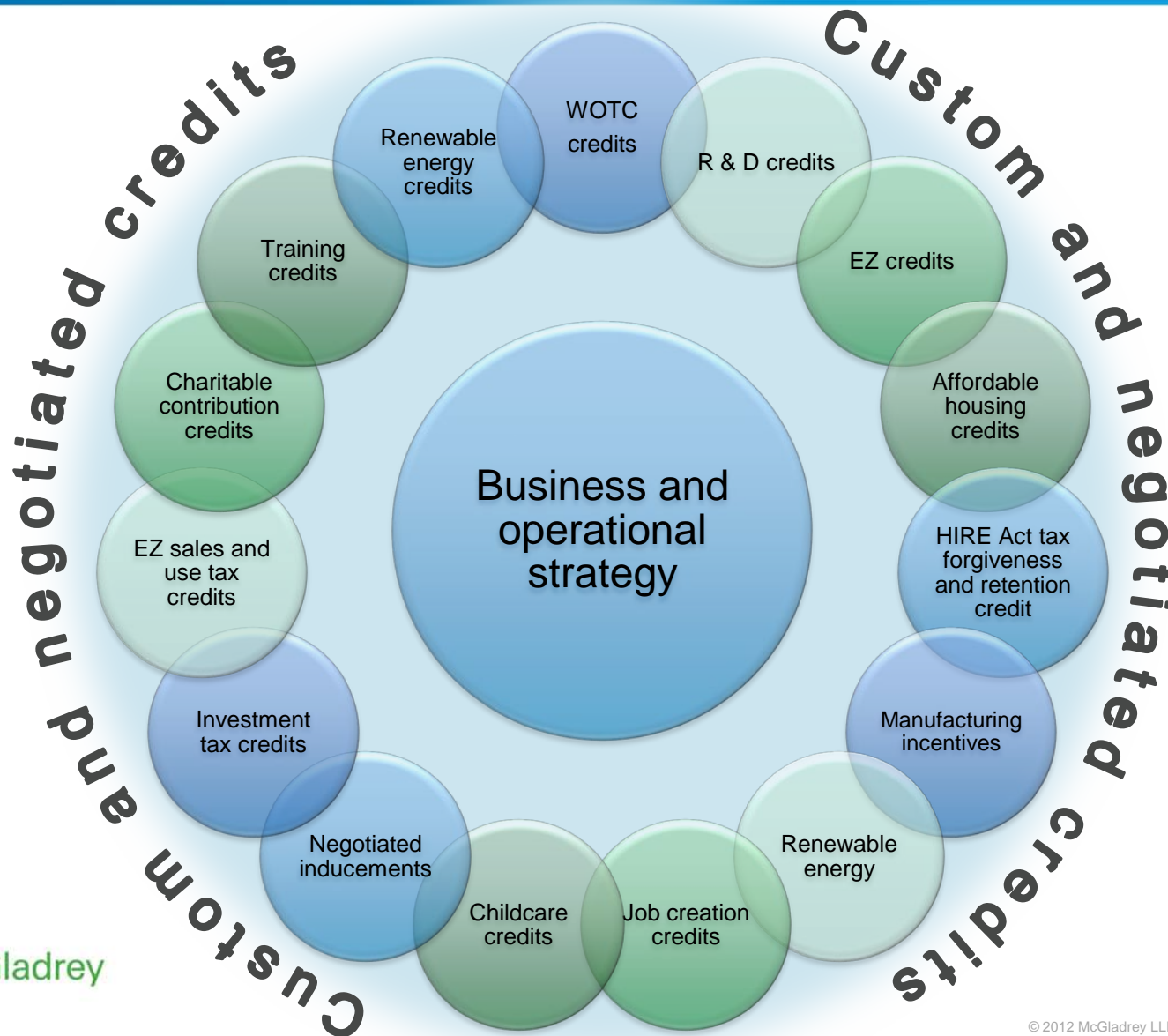
Three main business triggers



Types of incentives

- **Statutory**
 - Clear requirements, available to all qualifying companies
 - May require pre-approval or prior certification
 - Claimed on a tax return
 - Offset federal or state income and franchise tax liabilities
 - May offset sales and use, property or employment taxes
- **Discretionary/negotiated**
 - Must be secured or pre-approved in advance of qualifying activities taking place
 - Allowed by statute, benefits may range based on facts
 - Boundaries are less clear, allocated at the discretion of the controlling government agency
 - Can be customized to company's specific facts

Getting your share of the opportunity



**15 programs you need to know
about today**

Federal, state or local?

- All of the above
- Several programs approved at the federal level, administered at the state level
 - WOTC
 - EZ credits
- Similar triggers for multiple programs – people, investment, operations
- Piggybacking programs increases return on investment
- Leave no stone unturned

People

No. 1 – Training incentives

- Designed to encourage workforce development, including new skills training and transitional skills training
- Cash grants vs. in-kind services
 - Can apply towards incumbent workers or new employees
- Some states offer cash training grants and others offer in-kind services (training led by state trainers or community colleges)

Training incentives qualifiers

- Eligible training usually must increase employee skill level
- Soft skills training (i.e., sales and marketing) usually not eligible
- State typically match 50% of the employee training and apply an overall cap on a per company basis
- Possible exceptions
 - Some states willing to accommodate proprietary (in-house) training and reimbursement as if in kind services

Training incentive example

Company	Manufacturing business in Louisiana
Situation	<ul style="list-style-type: none">• Seeking to upgrade employee skill set through internal and external training, including cross-training and computer-based equipment training.
Benefit	\$60,000 training grant approved

No. 2 – New job tax credits

- Jobs tax credits are credits that can be applied to state income tax to reduce an employer's income tax liability
- These credits are earned by certain types of businesses that create and sustain new jobs in a state
- Credit amounts range from \$500 to \$9,000 depending on the employee wages and where they locate in a state

New job tax credits qualifiers

- Advance application and state approval
- Competitive project in which the company is looking at more than one state to locate operations
- Cannot have hired employee before job tax credit approved
- Available to full time employee or full time equivalent
- Pay at least 150 percent of federal minimum wage

New job tax credits example

Company	Financial consulting firm in Illinois
Situation	<ul style="list-style-type: none">• Looking to locate a new company, including 15 net new jobs over two years, considering several states
Benefit	Illinois approved a \$700,000 EDGE credit over 10 years

No. 3 – Work Opportunity Tax Credit (WOTC)

- The Work Opportunity Tax Credit (WOTC) is a federal income tax benefit administered by the U.S. Department of Labor (DOL) for employers who hire individuals from specified target populations
- WOTC reduces a business's federal tax liability by up to \$9,600 *per eligible employee*
- Recently extended by the American Taxpayer Relief Act of 2012

WOTC qualifiers

- Eligible employees must be certified and claims filed within 28 days of hiring date
- Targeted groups
 - Long-term family assistance recipients
 - Qualified recipients of Temporary Assistance for Needy Families (TANF)
 - Qualified veterans
 - Qualified ex-felons
 - Designated community residents (i.e., federal empowerment zones and rural renewal counties)
 - Vocational rehabilitation referrals
 - Summer youth employees
 - Supplemental Nutrition Assistance Program (SNAP) recipients
 - Supplemental Security Income (SSI) recipients
 - Individuals displaced by Hurricane Katrina*

*qualifying hire period ended Aug. 28, 2007

WOTC example

Company	Illinois service company
Situation	<ul style="list-style-type: none">• Under the WOTC retroactive screening that ended March 2013 the company screened 88 new hires• 18 percent (16 employees) qualified for credit
Benefit	Estimated tax credit is \$38,000, plus program in place to capture new qualified hires as they are employed

No. 4 - Empowerment Zone Employment Credit

- The Empowerment Zone (EZ) Employment Credit is a renewable credit that provides businesses with an incentive to hire individuals who both live and work in an empowerment zone
 - Exception: individuals who work in the DC Zone may live anywhere in the District of Columbia.
- Credit is equal to 20 percent of the qualified zone wages (including training and education expenses treated as qualified zone wages)
 - Limited to \$15,000 per employee **each calendar year**

EZ Credit qualifiers

- Any employee who meets **both** of the following tests:
 - Performs substantially all of the services for the employer within an empowerment zone in the employer's trade or business, and
 - Has his or her principal residence within that empowerment zone while performing these services
- Both full-time and part-time employees may qualify
- Minimum 90-day employment required, except when:
 - Employee is terminated because of misconduct, as determined by applicable state unemployment law
 - Employee becomes disabled before the 90th day
 - If the disability ends before the 90th day, the employer must offer to reemploy the former employee

EZ credit example

Company	Restaurant business headquartered in Ohio, with locations in multiple states
Situation	<ul style="list-style-type: none">•Despite having operations in target employment areas, no existing or prior EZ credit process had been executed•Opportunity for reverse audit with three year lookback
Benefit	\$250,000 annual credit awarded (retroactive and forward going) based on 10 EZ locations and more than 100 eligible employees

No. 5 – State enterprise zone (EZ) credits

- EZs are areas that have been designated as financially distressed and disadvantaged
 - Typically, a zone is comprised of several municipalities
- Primary goals of EZ programs
 - Increase business investment
 - Encourage job creation
 - Sustain community self-sufficiency
- Core benefits of enterprise zones are tax credits for
 - Capital investments
 - Research and development
 - Job creation and retention

State EZ credits qualifiers

- The exact rules and details for these incentive packages vary from state to state
 - Additional county and municipal regulations often apply
- Benefits may be tiered
 - Best credits go to companies that do business in communities or regions that are the most economically distressed

State EZ credit example

Company	Assembly company in Indiana
Situation	<ul style="list-style-type: none">• Looking to establish a new location for business operations and seeking to maximize capital investment in facilities• Open to various location solutions
Benefit	\$90,000 state tax credit, based on 60 qualified hires

Investments

No. 6 – Research and development (R&D) tax credits

- Credit available to companies that:
 - Engage in qualified research activities in the US
 - Incur expenses to perform the research
 - Wages paid to R&D employees
 - Supplies used in conducting research
 - 65 percent of payments to outside contractors
 - Currently pay regular US federal income taxes
 - Pass-through entities must look to owner's tax situation for credit utilization
- Credit formula results in net credit of 4.5 percent to 6.5 percent qualified research expenses annually
- Many states piggyback on the federal R&D credit

R&D tax credit qualifiers

- Qualified research activities defined
 - Undertake process of experimentation by
 - Relying on principles of physical or biological science, engineering or computer science to
 - Resolve uncertainty regarding capability, method or appropriate design in order to
 - Develop new or improved function, performance, reliability or quality of a “business component”
 - product, process, software, invention, formula or technique
- Documentation is key to sustaining claimed credits

R&D tax credit example

Company	Generic drug company
Situation	<ul style="list-style-type: none">• Generic drug development is often challenged by the IRS in situations where the company is merely reverse engineering a patented drug.• R&D study qualified the research at this company based on their business model of successfully challenging patents with same bioequivalence but formulation that produced better, more efficient drug delivery to the body and fewer side effects
Benefit	\$6,000,000 federal R&D credit over four year period

No. 7 – State investment tax credits

- Offered by many states to encourage capital investments
- Help companies offset the cost of purchasing new capital equipment
- Credit typically equals one to 10 percent of the total investment
- Typically earned in the year the capital is placed in service or over one to five years
- Unused credits may be carried forward for a period of years (usually five to 20 years)

State investment tax credit qualifiers

- States usually apply this tax credit to buildings and tangible personal property acquired by purchase, with a useful life of four years or more and used in
 - Manufacturing, processing, assembling
 - Agriculture, farming, horticulture, viticulture, and commercial fishing
 - Refining, mining, extracting
 - Qualified film production
 - Waste treatment and pollution control
 - Research and development
- An application might be required prior to purchasing any equipment

State investment tax credit example

Company	Manufacturer in New York
Situation	<ul style="list-style-type: none">• Making a significant capital investment in existing and new equipment for their New York operations• Equipment would not require new jobs and may actually reduce jobs
Benefit	A five percent non-refundable tax credit totaling \$2,500,000 in the year the property was placed in service

No. 8 - State and local benefits for capital expansion

- Most states and localities provide capital investment incentives
- While the incentive is provided for capital investment, the amount of jobs the company commits to will often determine amount of capital investment incentives a company receives
- These incentives range from tax credits to cash grants

State and local benefits for capital expansion qualifiers

- State and local incentives have a major factor test and require companies to show there is “out of state” competition
- The incentives require an application and ultimately approval by the state and local authorities
 - Approval must be received prior to any announcements, ground breaking, or hiring

State and local benefits for capital expansion example

Company	Service business with plans to expand
Situation	<ul style="list-style-type: none">• Deciding between Ohio and North Carolina• Plan to invest \$15,000,000 in a new building and add 100 new jobs at an average wage of \$40,000• Competing incentive packages secured
Benefit	State and local benefits valued at \$3,200,000 Ohio job creation tax credit 65 percent for 10 years Ohio Training Grant Ohio Rapid Outreach Grant Local job creation credit – 50 percent for 5 years Enterprise Zone – 10 year, 75 percent real property tax abatement

No. 9 – New markets tax credits (NMTC)

- The NMTC program provides for a 39 percent tax credit over a seven year period
 - Five percent in years one through three
 - Six percent in years four through seven
- Enacted in 2000 to infuse investment dollars in low-income communities where access to capital is generally more difficult to obtain
- The tax credits are monetized by an investor who can use the credit

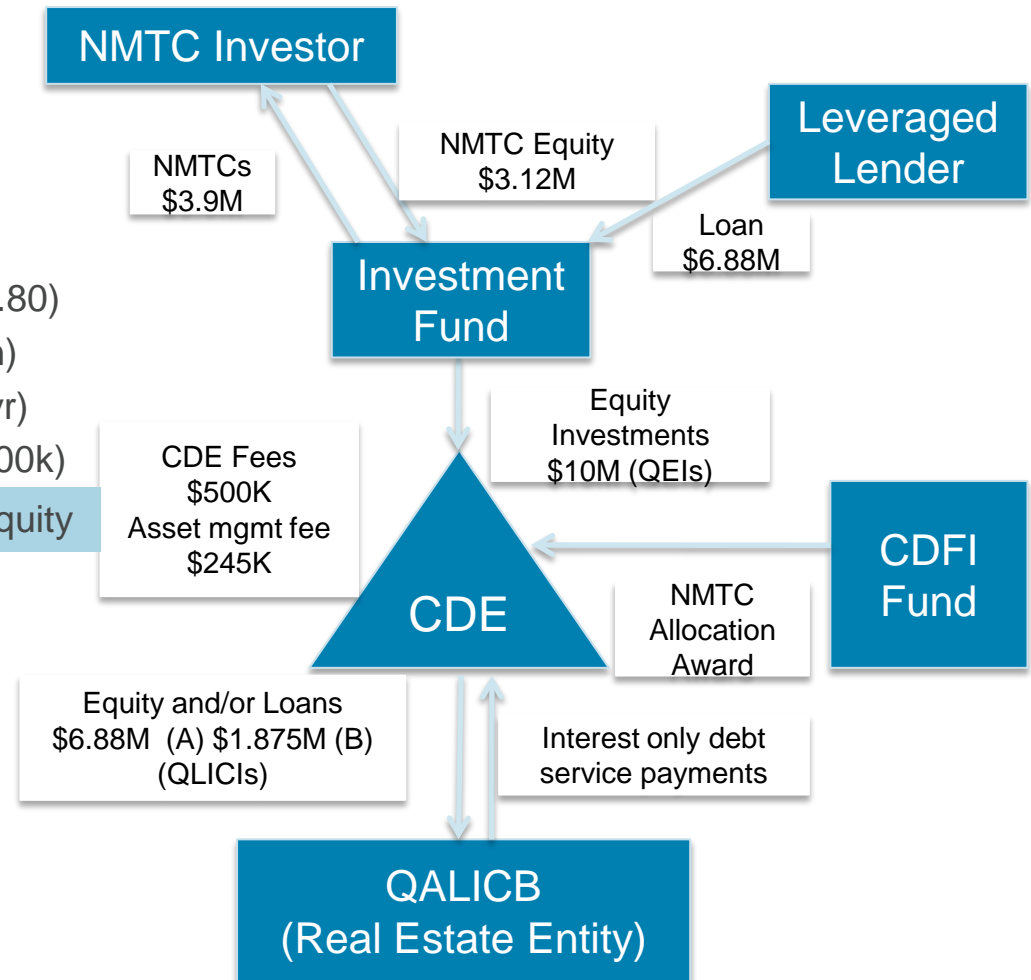
NMTC qualifications and applicability

- Close the funding gap in real estate projects (developer)
 - commercial, mixed-use, or community facilities
- Acquire, rehabilitate or expand facilities (operating business)
 - Owner-occupied retail facilities
 - Industrial or manufacturing facilities
 - Warehouses and storage facilities
 - Community facilities
- Expand operations (operating business)
 - Equity investments
 - Fixed asset loans (equipment, furniture, machinery)
 - Working capital loans to cover operating expenses
- Boost the benefit
 - Can be “twinned” with historic rehabilitation (HTC) and other tax credit equity
 - Certain states have comparable NMTCs and HTCs creating additional equity for projects

NMTC leverage example

- \$10M Allocation NMTC Project
- \$3.9M NMTCs
- \$3.12M in gross NMTC equity (\$.80)
- Less: CDE fees (5% of allocation)
- Less: annual CDE fees (\$35k a yr)
- Less: Transaction costs (avg. \$500k)
- Equals approx. \$1.875M in net equity

Note: Leveraged loan needs to be repaid



No. 10 – Rehabilitation tax credits

- The Rehabilitation tax credit provides an incentive and cost reduction to save older buildings
- Offered to companies planning to move to or expand a currently occupied older building
 - Substantial rehab required
- These tax credits are often monetized by an investor who can better use them if credit too large for owner

Rehabilitation tax credit qualifiers

- Rehab of nonresidential structure placed in service before 1936 – 10% credit based on QREs
- Rehab of certified historic structure regardless of use and age – 20% credit based on QREs
- Qualified rehab expenditures (QREs)
 - most direct, indirect and soft construction costs
 - excluding enlargements, site improvements or anything else outside the existing building envelope
- Special rules for tax exempt users
- Depreciable base may be reduced by credit
- Owner must hold for five years to avoid recapture

Rehabilitation tax credit example

Company	Office building owner
Situation	<ul style="list-style-type: none">• Need more space beyond existing facility's capacity and needs to move• Considering leasing or buying a certified historic building for \$800,000• Rehabilitation of the building would require an additional investment of \$1,500,000
Benefit	\$300,000 tax credit possible, assuming all expenses qualify

Operations

No. 11 – Energy investment credit (ITC)

- The energy investment credit is available to companies that construct or acquire and place in service qualified investment property
 - Solar
 - Geothermal
 - Fuel cell power plant
 - Microturbine power plant
 - Combined heat and power system
 - Wind turbine of 100 kw or less
 - Geothermal heat pump cooling system
- May be eligible for federal tax credit of 10 percent to 30 percent of qualified cost basis

Energy ITC qualifiers

- Tangible personal property subject to depreciation (not real property)
- Integrated part of qualified facility
 - Includes generation but not transmission equipment
- Depreciable basis reduced by 50 percent of credit
- Owner must hold for five years to avoid recapture
- Owner may elect to pass credit through to qualified lessee within first 90 days
- Must be paying tax to utilize credit
 - Developer can transfer credit to tax equity investor through partnership flip or lease structure – many traps for the unwary

ITC example

Company	Solar energy developer and commercial bank
Situation	<ul style="list-style-type: none">• Developer constructs \$10,000,000 solar farm• Developer is a start up with not enough taxable income to use tax credits• Commercial bank has appetite for credits to reduce tax liability• Developer and bank set up partnership flip structure
Benefit	Bank receives 99% of \$3,000,000 energy ITC plus accelerated depreciation on \$8,500,000 over five years Developer receives project financing

No. 12– Renewable electricity production (PTC)

- May be eligible for federal tax credit (PTC) of .75¢ or 1.5¢ per kwh, adjusted for inflation
- Credit is based on annual production for 10 years
- Credit can reduce alternative minimum tax for first four years
- Can elect ITC in lieu of PTC

PTC qualifiers

- This credit is available to companies that produce and sell electricity from a qualified facility
 - Wind turbine of more than 100 kw
 - Biomass (open loop or closed loop)
 - Geothermal
 - Landfill gas
 - Trash combustion
 - Hydropower
 - Marine and hydrokinetic power
 - Refined coal (credit = \$4.375 per ton)
 - Steel industry fuel (credit = \$2.00 per barrel of oil equivalent)
- Construction must begin before credit expiration date of Jan. 1, 2014

PTC example

Company	Wind energy developer
Situation	<ul style="list-style-type: none">•\$1,000,000 wind turbine placed in service•Produces 1,200,000 kwh of electricity annually
Benefit	<p>\$252,000 total credits over 10 years (\$25,500 production tax credit per year)</p> <p>or</p> <p>May elect ITC and receive \$300,000 credit when property placed in service.</p>

No. 13 – Making commercial buildings energy efficient (179D)

- A special incentive available to
 - Companies that acquire “green” commercial buildings
 - Companies that make energy efficient improvements to commercial buildings they own
 - Firms that design energy efficient government buildings
 - Government entity has to award the incentive to the designer
 - Often issues with multiple designers vying for award
 - Government entity often tries to negotiate price concessions in exchange for incentive award
- The federal tax incentive is special deduction under section 179D
 - Available in year energy efficient property is installed
 - Taken before depreciation computed (basis reduced by deduction before depreciation)
- Certain states may also have green building incentives

179D Qualifiers

- Maximum deduction is \$1.80 per square foot
 - Applies to energy efficient commercial building property in the U.S.
 - Installed as part of interior lighting systems, HVAC and hot water systems or building envelope
 - Requires 50 percent energy cost reduction as compared to 2001 ASHRAE energy standards
- Partial deduction of 60¢ per square foot
 - 25 percent for interior lighting systems
 - 15 percent for HVAC and hot water systems
 - 10 percent for building envelope

179 example

Company	Big box retailer
Situation	<ul style="list-style-type: none">• Making substantial energy improvements to a 100,000 square foot distribution center• Achieves 50 percent energy cost reduction compared to 2001 baseline building
Benefit	Section 179D deduction of \$180,000

No. 14 – Utility incentives

- Most utilities offer energy incentive programs to help offset energy costs
- Prescriptive incentives
 - Cover everything from lighting to commercial kitchen equipment
- Custom programs
 - Cover up to some percentage of a project's incremental costs

Utility incentive qualifiers

- Pre-approval is usually required for all incentives, including any submission through the custom options
- Programs usually cover a percentage of the project – up to 50 percent – or a fixed dollar amount
- Prescriptive program benefits based on the efficiency and capacity of equipment, and cannot exceed set dollar amount per facility per year

Utility incentive example

Company	Manufacturer in Tennessee
Situation	<ul style="list-style-type: none">• Company was expanding and installing energy efficient equipment• Worked with Tennessee Valley Authority and received the Valley Investment Initiative incentive• Also received a Small Manufacturing annual rider reduction
Benefit	\$1,600,000 total incentive over five years

No. 15 – Domestic production activities deduction (DPAD)

- This federal tax deduction is designed to encourage production activity in the United States
- The DPAD is equal to the lesser of:
 - Nine percent of qualified production activity income (QPAI)
 - Nine percent of taxable income before the DPAD
 - 50 percent of W-2 wages attributable to domestic production
- Complex analysis required to determine domestic production activities and the income and expenses attributable to production activities in order to calculate QPAI

DPAD qualifiers

- Available to companies that :
 - Manufacture tangible personal property
 - Grow crops or timber
 - Mine natural resources
 - Develop software
 - Record music or produce films
 - Produce electricity, natural gas or water
 - Construct or substantially renovate real property
 - Perform engineering or architectural services

DPAD example

Company	Manufacturer of health foods
Situation	Company utilized more advantageous method to allocate cost of sales and other expenses to domestic production gross receipts
Benefit	Increased DPAD by \$1,800,000 and received tax refund of \$630,000

Additional considerations

Sales tax agreements

- Sales tax sharing agreements
 - Usually offered to retailers
 - Discretionary incentive negotiated at the local level
 - Assumes that the company generates a large amount of local sales tax
 - Cities can use this as an inducement to have the company expand in the city
 - Agreement structured where as the city will provide to the company annual rebate of sales tax collected
 - Usually 10 percent to 50 percent rebate

Monetizing state tax credits

- State tax credits can be of no value to a company without income tax liability
- Many states are making transferrable tax credits available
- Allow qualified companies that owe no tax to monetize their credits by selling them on the open market
- Benefit to the state
 - Cash paid to qualifying companies for transferrable credits does not come from state coffers
- Benefit to participating companies
 - Gain some value from credits that may otherwise be wasted
 - Apply discounted credits without meeting qualifying criteria

Strategies for credits and incentives success

Best practices

- Start early - more options exist when planning is still open
- Research continually to stay aware of programs
- Know the qualifiers and understand the commitment
- Establish a process or partner with someone who can provide a process
- Develop a media response – significant credits are newsworthy

Common pitfalls

- Process started too late
- Lack of awareness – not all opportunities are widely publicized
- Inaccurate or incomplete documentation
- Overpromises on investments or jobs – potential for missed goals
- Failure to timely and accurately comply with reporting and maintenance procedures
- Premature announcements invalidate eligibility
- Assumption of ineligibility

Key take aways

- There are hundreds of opportunities out there
- Staying aware and having a good process takes time but pays dividends
- Every business should consider credit and incentives as part of overall strategy – especially around strategic activities
- Start planning early to gain the greatest overall benefit

Thank you

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