Credits and Incentives Update*

By Andi Brownell

Monetizing Tax Credits & Above the Line Savings Opportunities

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Tax credits are a key economic development tool that federal, state and local governments offer as an incentive to motivate and encourage certain corporate behavior such as job creation, capital investment or other behavior that will have a positive economic impact in the community. What do you do when your business has accrued significant amounts of tax credits but has limited or no income tax liability? Alternatively, what if your business has significant tax liability, but is not eligible for the existing statutory income tax credits? Are there other ways, beyond tax planning, to further reduce your company's effective tax rate? Taxpayers are frequently facing these issues and are searching for alternative ways to reduce tax liability and increase cash flow.

The term "monetizing tax credits" refers to receiving monetary value for underutilized tax credits that a taxpayer would otherwise be required to apply to its income tax return. This may be accomplished through several methods including, but not limited to, transferable tax credits, refundable tax credits, tax rebates and the application of tax credits against a non-income based tax, which results in the tax credits becoming an incentive that a taxpayer can use immediately. In addition, there are indirect tax incentives that bring opportunities for above the line savings.

Transferable Tax Credits

Transferable tax credits provide a mechanism through which an entity that has more tax credits than tax liability can sell the portion of tax credits it cannot use to a third-party. Transferability also allows entities that receive multiyear credits for capital projects to sell the tax credits and obtain the financing they need for future phases of a capital project. It is important to read the applicable law to determine if a tax credit

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is transferable and understand the requirements and limitations related to the transfer. Each tax credit that is transferable by statute may have a different set of rules. Issues that should be addressed when assessing the potential benefits related to transferring credits include:

- requirements related to the size and activity of business that may transfer a tax credit (e.g., "small businesses" as defined by number of employees or receipts, emerging technology or R&D activities);
- the number of times a credit may be transferred or sold;
- restrictions related to whether a partial credit can be transferred or if the credit cannot be bifurcated;
- minimum percentage of value that the credit can be sold for;
- federal and state tax treatment related to the potential gain on the sale of the credit;
- which party bears risk of economic loss or liability should the transferred credit be subject to recapture; and
- compliance requirements.

The most common transferable tax credits are related to low-income housing, historic preservation or rehabilitation, renewable energy or sustainability investments, entertainment and production activities, and research and development investment. While transferable tax credits may be a more recent concept in the credits and incentives arena, it is quickly becoming an important tool for states to have available. At least 20 states currently have one or more tax credits that are transferable and that can be sold to a third-party.

While some credits are not transferable to a third party, it may be possible to assign the tax credit to an affiliated entity. For example, Georgia allows taxpayers to assign a tax credit on an originally filed return to another taxpayer that is included in its federal consolidated group tax return. However, if a timely assignment is not made on the originally filed Georgia tax return, the credits can only be applied against the tax liability of the legal entity that generated the tax credits.[1]

Additionally, the Pennsylvania research and development tax credit (R&D credit) is available to businesses and individuals performing qualified research in Pennsylvania.[2] Of the total R&D credits issued by Pennsylvania annually, there is a portion allocated by the state that is reserved for small businesses that can be sold. Frequently, small businesses in the early stages of development are not yet profitable and do not have significant tax liability. These businesses have often not applied for the available R&D credits. With the R&D credit assignment program, technology businesses can now sell unused R&D credits on the open market to help advance and grow their business.

The R&D credits are issued or approved by the Pennsylvania Department of Revenue. Businesses that have not used all or part of their issued R&D credits within one year after the credits were approved may apply to the Pennsylvania Department of Community and Economic Development (DCED) for approval to assign their eligible R&D credits to another taxpayer that can then use the purchased credits to offset up to 75% of its own tax liability with the purchased credit. [3]

Finally, in New Jersey, the Technology Business Tax Certificate Transfer Program enables approved technology and biotechnology businesses with net operating losses (NOLs) to sell their unused NOLs and unused research and development tax credits for at least 80% of the value of the tax benefits to a profitable New Jersey corporate taxpayer that is not an affiliated business. This allows technology and biotechnology businesses with NOLs to turn their tax losses and credits into cash to finance growth and operations either as working capital or to fund research.[4]

Refundable Tax Credits

Certain tax credits are refundable to the taxpayer. The tax credit is first applied against the company's tax liability. If the amount of the credit is greater than the tax liability, the excess credit is treated as an overpayment of taxes and refunded to the taxpayer. Activities that qualify for refundable tax credits program vary and may be based on activities such as job creation, capital investment, payments of other taxes, or research and development.

Georgia allows emerging companies that are new to Georgia to apply a R&D credit amount to offset their payroll withholding once all other tax liability has been exhausted for their first five years.[5]

The Michigan Business Tax Act also provides a refundable credit for personal property taxes paid on certain classified property levied after December 31, 2007. The credit is equal to 35% of the amount paid for property taxes on eligible personal property in the tax year. If the amount of the credit exceeds

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the tax liability of the taxpayer for the tax year, that excess is refunded.[6]

Additionally, in Kansas, any taxpayer may claim an income or privilege tax credit for personal property tax paid on commercial and industrial machinery and equipment. The credit is equal to 25% of the property tax levied for property tax year 2007 and all later years that are paid on a timely basis on specific commercial and industrial machinery and equipment. The amount of credit that exceeds the tax liability for a taxable year is refunded to the taxpayer.[7]

The Louisiana inventory tax credit can be applied against any Louisiana income or corporation franchise tax for ad valorem tax paid to political subdivisions on inventory held by manufacturers, distributors, and retailers. Inventory taxes paid and credits claimed in excess of a taxpayers' state tax liability are paid to taxpayers as a refundable credit.[8]

Finally, New York taxpayers that were certified in an Empire Zone prior to the program's expiration on June 30, 2010, and meet the definition of a Qualified Empire Zone Enterprises ("QEZE") may claim a tax credit against business or income tax based upon eligible real property taxes paid in the Empire Zone. The amount of the QEZE credit for real property taxes paid is also based upon the percentage increase in the average employment of the business in the current tax year over a test year average. Any amount of the QEZE credit for real property taxes not deductible in the current tax year may be refunded without interest or applied as an overpayment against the tax liability for the next tax year.[9]

The term "monetizing tax credits" refers to receiving monetary value for underutilized tax credits that a taxpayer would otherwise be required to apply to its income tax return. This may be accomplished through several methods including, but not limited to, transferable tax credits, refundable tax credits, tax rebates and the application of tax credits against a non-income based tax, which results in the tax credits becoming an incentive that a taxpayer can use immediately.

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Tax Refunds/Rebates

Another method of monetizing tax credits and offering above-the-line incentives is through direct tax refunds or rebates. In lieu of remitting all tax collected to the state, a company may be approved to retain a portion of the tax collected as a cash rebate or the state may offer a company a direct refund of taxes once the company meets an incentive program requirements. For example, the Arkansas Tax Back program is a sales and use tax refund program for the eligible companies creating jobs and investing in Arkansas.

The Tax Back program provides sales and use tax refunds on the purchase of building materials and machinery and equipment to qualifying businesses that create new jobs as a result of construction, expansion, or facility modernization projects in Arkansas. This incentive program is available to all eligible businesses that meet the qualifications for investment and payroll thresholds for the tier in which it locates or expands and are approved for benefits by the Department of Economic Development. The approval is contingent upon receipt of a complete application and a local endorsement resolution for the city and/or county which authorizes the refund of its local taxes to the eligible company. To qualify, the eligible business must invest at least $100,000 and meet the eligibility criteria of the Advantage Arkansas or the create rebate job creation incentive program.[10]

Employee withholding tax incentives are also common incentive programs that can be monetized. The South Carolina job development credit is a discretionary incentive available to approved new or expanding businesses making a qualifying investment and creating a minimum number of new jobs in South Carolina. If approved for the program by the South Carolina Coordinating Council for Economic Development, a company may receive credits against employee withholding tax. A business remits all South Carolina withholding taxes to the Department of Revenue as required under the withholding laws in Chapter 8 of Title 12 and claims a credit for the amount of allowable job development benefits when it files the quarterly South Carolina withholding tax return. The withholding overpayment resulting from the job development credit is refunded to the business and must be used to pay for or reimburse the cost of qualifying project expenditures.[11]

Indirect Tax Incentives

Indirect tax incentives such as sales and use tax credits and exemptions and property tax exemptions are also valuable tools.

The Florida community contribution tax credit program allows qualifying taxpayers a 50% credit against Florida corporate income tax, insurance premium tax, or a sales tax refund for donation to local community development projects. The donation may also be deducted from federal taxable income. A five-year carry forward provision is available for any unused portion of the corporate income tax credit (sales tax refunds are available for up to three years after the first application). The annual amount of credit granted is limited to $200,000 per taxpayer.[12]

The InvestArk program is a sales and use tax credit program available to businesses established in Arkansas for at least two years that invest $5 million or more in plant or equipment for new construction, expansion or modernization. The business must be approved for the program prior to beginning construction or incurring eligible project costs. The business must obtain a direct-pay sales and use tax permit from the state. All project expenditures must be incurred within four years of the project eligibility date. The sales and use tax credit earned under the InvestArk program is based upon a percentage of eligible project cost. The percentage of credit that may be authorized is equal to .5% above the state sales and use tax rate in effect at the time a financial incentive agreement is signed. Currently, the percentage that may be earned as credit is 6.5% of eligible project expenditures.

The credit may be used to offset up to 50% of the business' sales and use tax liability on taxable purchases. The credit is earned in the year the eligible expenditure is made and can be applied against the business' state direct-pay sales and use tax liability in the year following the year of expenditure. If the entire credit cannot be used, the remainder may be carried forward for five years.[13]

Additionally, numerous states and local jurisdictions provide sales tax exemptions and/or property tax exemptions on purchases of specific items used by a qualifying business, including manufacturing equipment, material handling equipment, building materials, the purchase of electrical energy or other fuel used in manufacturing, research and development equipment, pollution control equipment, etc. Often these exemptions are available by statute or regulation and may be claimed by completing and submitting a registration form, an application for exemption, or a similar document to the applicable state or local taxing jurisdiction.

Offering taxpayers the ability to monetize tax credits through transferable tax credits, refundable tax credits, tax rebates, and indirect tax credits and exemptions can stimulate economic activities while simultaneously helping businesses decrease their tax liability and increase cash flow so they can continue to grow and prosper.

Summary

As taxpayers develop expansion and relocation plans, they include numerous criteria in their decision making process. Tax credits and incentives often play an important role in this analysis. While a state and/or local community's incentive offer may look great at first glance, it is important to evaluate the usability of these programs. Frequently, a taxpayer may only benefit from a minimal amount of the incentives available due to a low income tax liability or other statutory requirements. Offering taxpayers the ability to monetize tax credits through transferable tax credits, refundable tax credits, tax rebates, and indirect tax credits and exemptions can stimulate economic activities while simultaneously helping businesses decrease their tax liability and increase cash flow so they can continue to grow and prosper.

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Endnotes

* The views expressed in this article are those of the authors and do not necessarily reflect the views of any organization or firm with which the authors are associated.

1 Ga. Code. Ann. §48-7-42.

2 Policy Statement §9.17, Research and Development Tax Credit Implementation Issues (December 31, 1996).

3 Pennsylvania Department of Community & Economic Development – Research & Development Tax Credit Assignment Program Guidelines.

4 N.J. Admin. Code tit. 19, §31-12.1 (2010).

5 Ga. Code. Ann. §48-7-40.12.

6 Mich. Comp. Laws §208.1413(1)(a), (3).

7 Kan. Stat. Ann. §79-32,206.

8 La. Rev. Stat. Ann. 47:6006.

9 New York General Municipal Law, Article 18-B.

10 Ark. Code. Ann. §15-4-2706(d).

11 S.C. Code Ann. §12-1080 (general provision).

12 Fla. Stat. §624.5105.

13 Ark. Code. Ann. §26-52-701 et. seq.

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