Insights

Articles November 18, 2011

Don't miss out on valuable facility review tax credits

Many businesses overlook significant tax credit and incentive savings that offer tax reductions, refunds, and other payouts related to investments in their facilities.

Numerous US, foreign, state, and local governmental entities offer tax credits or incentives to businesses to encourage development, create jobs, promote research, save energy, or otherwise boost the recovering economy.

Companies should be aware of what credits and incentives exist — and how to obtain them.

To fully utilize the credits and incentives available, companies must evaluate their costs and activities and thoroughly understand the pre- and post-tax consequences. This can be challenging if they lack the appropriate internal resources. As a result, sizeable dollars in credits and incentives go unused every year.

Outsourcing the review process can help companies capitalize on the available international, federal, state, or local tax credits and incentives. It could result in significant savings and potentially increase profitability.

Tax credits and incentives

Incentives are offered for different reasons. Some target specific industries or encourage capital investments in economically disadvantaged areas. Some are created to increase employee skill sets or reward job creation and retention. Others are aimed at encouraging a desired activity, e.g., research and development (R&D), "green energy," and exporting.

Credits and incentives come in numerous forms and include:

- Cash payments, refunds, and rebates
- Tax credits or abatements
- Preferential tax treatment (sometimes called the "super" deduction), accelerated depreciation, etc.
- Opportunities related to financing, such as forgivable loans, loan guarantees, "below market" interest rate loans, in-kind benefits or grants, and other subsidies

Incentives typically can be statutory, negotiated, or both.

Statutory incentives satisfy governmental statutory or administrative definitions and/or filing requirements. They do not normally require pre-approval from a government agency, as long as a company meets specific requirements. They are most commonly are awarded as tax credits, accelerated depreciation, or exemptions.

Some common statutory incentives include:

- **International capital investment, economic development, and/or R&D incentives —** typically include credits and incentives for: investment in a certain country or region, encouraging a company to transfer its operations; adding new manufacturing or packaging capabilities, or enhancing its information technology
- **Certain federal incentives and credits, such as the federal Research Tax Credit (RTC) —** which provides a reduction in tax liability or a tax refund — designed for technology developers, domestic manufacturers, and others who invest in software, process improvements, and new products
- **Incentives that offset the cost of using "green" building-related products and materials —** such as the Energy Efficient Commercial Building Deduction, commonly called the Commercial Building Deduction or 179D deduction — included in Internal Revenue Code Section 179D, the provision gives an immediate tax deduction for expenses that boost the energy efficiency of a new or remodeled building
- **State tax credits** for creating new jobs or sales and use tax exemptions for manufacturing equipment

Negotiated incentives typically must be approved in advance by a unit of government. They are often subject to annual caps or appropriation limits.

The various incentives often must be negotiated with multiple levels of government or agencies. The incentives could include nontax incentives such as grants or infrastructure improvements. Negotiated incentives normally require a binding contract with the government agency that is offering the incentive.

Some commonly negotiated incentives include:

- Discretionary grants
- Low-cost land or lease rates
- Employee training monies
- Employee recruiting and screening assistance
- Access to technical resources
- Infrastructure improvements, e.g., roads, parking lots
- Utility rate reductions
- Tax increment financing (TIF)
- State business development loans, such as a state energy loan program
- Other "characteristic-based" loans that might include environmental, small business, and minority loans
- State and federal bonding programs, such as industrial revenue bonds
- Accelerated deductions or tax credits on energy-efficient components

What events trigger opportunities to seek out credits and incentives?

Various events and expenditures can make a company eligible for credits and incentives. Situations that could potentially qualify a company for tax incentive- or credit-related savings include:

- New construction
- Remodeling or retrofitting existing facilities
- Rehabilitation of an old or historic structure
- Moving
- Lease renewal or leasehold improvement investments
- Transferring equipment or employees from another facility
- Acquiring a business or undergoing a merger
- Job creation and/or retention
- Training needs, including costs and requirements
- International expansion

Facility-related opportunities

Considerable tax credits and incentives are often available for a company's facility-related expenditures. However, companies need to conduct a comprehensive review of the estimated costs associated with facility enhancement or construction. This can be challenging for organizations that lack the personnel with the time and/or expertise to maximize the benefits.

The federal tax incentives associated with building or renovating a facility include:

- Cost segregation to accelerate depreciation and prevent a company from "pre-paying" taxes, involves segregating the capitalized cost into appropriate depreciable lives, typically moving certain costs from 39-year lives into 15-, 7-, and 5-year lives
- Energy incentives, including renewable energy opportunities, qualified energy projects (Section 48C), and energy-efficient commercial building deductions (Section 179D)
- The research tax credit (Section 41) that includes a current deduction of certain building expansion design and engineering costs (Section 174), created to stimulate investment in R&D, science, and engineering in the US; most states offer a corresponding research tax credit
- Federal New Markets Tax Credits to encourage commercial investment in low-income communities (defined by census tract data)
- The Domestic Production Activities Deduction (IRS Section 199), which allows companies to take a 3 percent deduction for qualified US-based business activities
- Federal wage tax credit incentives such as the Work Opportunity Tax Credit, offering up to $2,400 for each new hire from one of nine groups that have historically faced difficulty gaining employment
- Capital gain exclusion for the sale of certain assets, which, for example, can allow a company to avoid including any qualified capital gain from the sale of an asset that's considered a renewable community business asset that was acquired between 2001-2010 and held for a minimum of 5 years
- Building usage and performance-related incentives: By assessing the operating cost of a building over its predicted years of use — including initial capital expenses, operating costs, repair needs, and other expenditures — a company can find out if it should upgrade or include additional energy-efficient elements to qualify for credits such as the Energy Efficient Building Deduction, offered to new and existing buildings that undergo lighting/electrical upgrades and other improvements to reduce energy use

State and local tax opportunities and incentives include:

- Property tax-related savings and incentives, such as tax increment financing, which encourages development in underperforming or economically challenged enterprise zone areas, and tax abatement, offering companies a tax reduction or exemption that allows them to invest in other areas, such as capital equipment
- Adjusting what companies pay when they either sell, lease, or rent property or obtaining a refund if they've overpaid
- Tax credit or exemption for the purchase of qualified manufacturing machinery
- Training grants that provide funds to pay a portion of the training wages for new employees and fund educational opportunities for workers to learn specific skills such as green building principles
- State research tax credits (Massachusetts offers one for manufacturers and R&D companies in the state to offset research expenses; Iowa's research credit is refundable, offering companies a monetary payment if their credit surpasses their tax liability)
- Utility rate reductions, which offer discounts for small businesses, refunds for sales tax paid on electricity and natural gas, and other savings

The credits and incentives listed above are an example of what is typically available across multiple industries, including construction and real estate, manufacturing and distribution, agriculture, services, and government contractor work.

Depending on a company's location, international credits and incentives may also be available. Many foreign jurisdictions offer targeted economic and technical incentives that are similar to the US incentives; they are statutory or negotiated and include tax credits, refunds, or rebates, "super" deductions, and cash incentives that are directly deposited to a bank account.

International credits and incentives are given to promote:

- **Enhancements to information technology.** China provides a nonrefundable deduction for technology development-related expenses.
- **Transferring operations.** Credits are also available for making a capital investment, such as the addition of new manufacturing, assembly, packaging, or service capabilities, in certain countries or regions.
- **Generating jobs.** Brazil, for example, offers cash incentives for job creation and IT development.
- **R&D improvements.** Japan provides an incremental tax credit for R&D work.

Qualifying for credits and incentives

To increase the chance of obtaining valuable credits and incentives, it is crucial to compile solid data and information about the scope of the investment and the number of jobs it will create. Companies also need to develop a compelling story about their work and the benefits a project will provide.

The following actions should be considered before applying for a tax credit or incentive:

- Analyze state and local tax impacts for potential sites
- Conduct thorough research to learn about available tax credits and incentives; identify points of contact with state, regional, and local officials
- Determine who the company's "quarterback" will be to ensure there is a consistent source to deal with officials
- Plan meetings with state and local officials at one or more sites; tour available sites and evaluate the options offered to determine whether to lease, buy, or build
- Request a preliminary credits and incentives proposal — in advance of a site visit, if possible
- Carefully prepare the application and gather the requested financial and operational data
- Complete any second round of information requests on a timely basis
- Anticipate how to address potential roadblocks, such as questions about recent job reductions or environmental issues
- Lock in the credits and incentives package through contracts and final applications; ask for a thorough review by outside or corporate legal counsel before signing on the dotted line
- Be sure all ongoing compliance requirements that are included in the final contract are understood and can be met, such as an annual certification of added or retained jobs

A thorough review leads to valuable savings

Identifying — and taking advantage of — every tax credit and incentive opportunity isn't a simple task.

Successfully applying for a credit or incentive requires a thorough understanding of the available savings opportunities. The application process also involves conducting an exhaustive audit of company operations; careful planning to ensure targeted building, R&D, and other expansion efforts; and meticulous documentation — essential undertakings that need to either be completed internally or by partnering with a professional accounting, tax, assurance, and consulting firm.

The tax credit and incentive process requires time and effort. However, using local, state, federal, and international tax credits and incentives can save companies a considerable amount of money — and, in turn, help them vastly increase their profitability.

Avoiding credits and incentives application process pitfalls

Allow adequate lead time to develop the business case for available credits and incentives. Make sure all information is correct and current.

Keep information private. It is also important to avoid any potential premature public disclosure, such as a press release, that might diminish negotiating capabilities.

Prepare creditable estimates. Have business data ready for economic development agencies.

Identify an internal point person for negotiations. Be sure the company and point person are prepared for public hearings, and be aware of relevant legal issues, such as zoning.

Meet the deadlines for submitting applications and other documents. Avoid the deal coming to a halt when the required disclosure of business or owner financial statements aren't available.

Don't get caught by surprise. A company's negotiating power is stronger if credit and incentive offers from other jurisdictions are in hand.

Read everything. Carefully analyze the final agreements and understand the company's commitment.

Be aware of "clawback" provisions. They can require repayment of credits and incentives benefits if the agreed upon conditions — e.g., jobs created — are not met.

And finally, fulfill all the compliance requirements. Complete all paperwork.

Share:

Tags: *No tags found.*

Insight Types

- Articles
- Case Studies
- Videos
- Webinars
- Whitepapers

You might be interested in:

- Agribusiness
- Banking
- Food and Beverage
- Manufacturing and Distribution
- Retail
- Cost Segregation
- Tax Credits and Incentives
- New Markets Tax Credits

Have a question for one of our specialists?
Contact us

More Insights Like This

New IRS guidance changes structuring of historic rehabilitation tax credits