

A close-up photograph of a glass filled with a vibrant green liquid, likely juice. The glass is partially submerged in water, and a dynamic splash of water is captured mid-air, cascading over the rim of the glass. The background is a soft, out-of-focus light blue, suggesting a bright, airy environment. The overall composition is clean and fresh, with a focus on the textures of the liquid and the glass.

August 2015

Credits & Incentives talk with Deloitte

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Governor Used Economic
Development to Create a
New Virginia Economy

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Journal of Multistate Taxation and Incentives (Thomson Reuters/Tax & Accounting)

Volume 25, Number 5, August 2015

CREDITS & INCENTIVES TALK WITH DELOITTE

A Roadmap of How One Governor Used Economic Development to Create a New Virginia Economy

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Last October, I had lunch with Virginia Gov. Terence McAuliffe and a team of his closest economic development advisers. What impressed me most about Virginia's new governor was how open-minded he was about confronting the legacy economic challenges he inherited. Gov. McAuliffe was focused on more than just winning jobs from other states in the union. His approaches form a comprehensive, long-term strategy to turn his state into a modern-day leader in global economic development.

His proactive approach to economic development may serve as a possible model for other states to attract a diverse pool of private sector employers, reinforce infrastructure assets and align education and skills of local workers to match the needs of businesses. But it's far from a sure win. Several obstacles—including state budget cuts, partisanship, critical constituents and term limitations—potentially stand in the way of the plan's success.

Facing legacy challenges

Defense is one of Virginia's largest industrial sectors, and the Commonwealth is the top recipient of U.S. Department of Defense (DOD) contracts. With 5,000 defense companies in Virginia facing DOD-announced spending reductions of more than \$300 billion in the next five years or so, Virginia stands to

lose many high-paying jobs. Gov. McAuliffe's priority is to grow and diversify the state economy to reduce dependency on the federal government.

Regional differences within the state in terms of prosperity and levels of educational attainment also present challenges. Nearly 12% of Virginians still live below the federal poverty level, even though Virginia consistently ranks among the top 10 states for per capita personal income.¹

Agriculture and forestry remain vital to Virginia's economy today. But farm commodities-such as cattle, grains, tobacco and cotton-won't make Virginia a powerhouse in an advanced global marketplace.

Devising a game plan

Where others might see insurmountable challenges, Gov. McAuliffe seeks solutions that require decisive action to enhance Virginia's fiscal resilience and foster economic growth. The New Virginia Economy strategic plan is aimed at establishing a diverse economic infrastructure critical in the 21st century. His overarching goal is to improve the average standard of living and build an economy that's "diverse, cutting-edge and attractive to the world."² He plans to achieve that goal by leveraging Virginia's existing assets: its robust education system, wealth of natural resources and extensive transportation system.

During a speech in New York to launch a Virginia advertising section in the 2014 Forbes 400 magazine issue, Steve Forbes referred to Gov. McAuliffe as "the Derek Jeter of economic development."³

Much as Jeter would inspire his teammates to perform, the governor has charged Virginia to, "Take risks. Be bold. We cannot hope to accomplish great things if we are not willing to take chances. Our economy demands it, and the future of the Commonwealth depends on it."⁴ The first part of the governor's bold plan is to attract businesses with the Commonwealth's pro-business policies and some direct financial incentives.

Creating a business-friendly state

As a former businessman, Gov. McAuliffe understands the challenges of building and growing a successful business. He has seen first-hand how creating jobs can have a positive effect in the local community. This insight drives him to make Virginia an increasingly business-friendly state.

One of Virginia's competitive advantages is its profit-friendly business environment.⁵ The state's corporate income tax rate has been just 6% since 1972, compared to a national median of 6.5%. In addition, its unemployment tax rates and workers compensation costs are among the lowest in the nation.

While building the New Virginia Economy, Gov. McAuliffe felt that businesses might need an extra nudge—namely financial incentives—to persuade them to relocate to or reinvest in Virginia. Here's a summary of some popular grant and income tax incentive programs that the state supports:

Governor's Opportunity Fund (GOF) grant:⁶ As of July 1, 2015, this program will be called the Commonwealth Opportunity Fund. The governor makes these discretionary grants to secure a company's location or expansion in Virginia. GOF grants are typically given to local governments to allocate in ways that benefit the investor, such as extending public utilities, grading and paving sites, or installing high-speed or broadband Internet access.

Recognizing the value these "deal closing" grants bring to recruiting new businesses, Gov. McAuliffe has pressed the state legislature to increase the GOF grant program and provide more discretionary control, which would make Virginia more competitive against other states, as well as offshore locales.

"One of the fundamental pillars for building a new Virginia economy is a world-class business environment," said Gov. McAuliffe. "That environment must include a diverse toolbox of financial and tax incentives for business expansion and attraction."

Virginia Investment Partnership (VIP) grant:⁷ This discretionary performance incentive grant targets manufacturers that have operated in Virginia for at least three years and have invested at least \$25 million per year in research and development while maintaining stable employment levels. Approximately \$13.3 million in VIP grants had been approved as of April 1, 2015.

Major Eligible Employer (MEE) grant:⁸ This discretionary performance incentive grant may be awarded to major employers that make a capital investment of at least \$100 million and create at least 1,000 new jobs. If a company's average pay is at least twice the local prevailing average wage, the company may qualify for the grant program for creating as few as 400 jobs.

Virginia Economic Development Incentive Grant (VEDIG):⁹ This grant program is available to companies that invest in new employment opportunities by locating significant headquarters, administrative or service sector operations in Virginia. A company locating in a metropolitan area with a population of at least 300,000 must meet the following eligibility requirements:

- Create 400 new full-time jobs and pay average salaries at least 1.5 times the local prevailing average wage (or create 300 new full-time jobs with average salaries at least twice the local prevailing average wage); and
- Invest at least \$5 million total or \$6,500 per job (whichever is greater).

Slightly different requirements apply in less populated parts of Virginia. As of April 1, 2015, approximately \$9 million in VEDIG grants had been approved.

The Port of Virginia Economic and Infrastructure Development (POV) grant:¹⁰ This program provides grants to incentivize companies to locate new maritime-related employment centers or expand existing centers in specified localities to encourage and facilitate the growth of the Port of Virginia in accordance with criteria established by legislation.

Port Volume Increase Tax Credit/International Trade Facility Tax Credit:¹¹ Qualifying agricultural, manufacturing, and mineral and gas entities that use port facilities and increase port cargo volume by at least 5% may be eligible to claim a state income tax credit. It is generally equal to \$50 for each 20-foot equivalent unit of roll-on/roll-off cargo or 16 net tons of non-containerized cargo above the base-year port cargo volume.

Major Business Facility Job Tax Credit:¹² Qualifying companies may receive a \$1,000 state income tax credit for each full-time job created above prescribed thresholds after a new facility opens or an existing operation expands. Some jobs-such as seasonal, temporary, and building and grounds maintenance positions-don't qualify for the credit. For jobs on the payroll for less than a full calendar year, the credit is prorated.

Adding enterprise zones to the mix

Virginia has created a number of enterprise zones-areas designated by the state and local governments as targets for business development and expansion. The state offers the following financial incentives associated with its enterprise zones:

Enterprise Zone Job Creation grants:¹³ Qualified businesses in an enterprise zone may be eligible for cash grants for permanent net new jobs created over a four-job threshold. Positions must offer health benefits and meet certain wage thresholds. A business can receive grants for a maximum of 350 jobs

annually above the four-job threshold, and it may qualify for additional five-year grant periods with further job creation.

Jobs with pay rates below the federal minimum wage, those without health care benefits, and positions in retail, personal service or food and beverage service are specifically excluded from this program.

Businesses that receive this grant are not eligible for the Major Business Facility Job Tax Credit for the same jobs.

Enterprise Zone Real Property Investment grant:¹⁴ Qualified investors in industrial, commercial or mixed use real property located within an enterprise zone may be eligible for a cash grant. To qualify, investors must spend at least \$100,000 on rehabilitation or expansion projects or at least \$500,000 on new construction projects.

In addition to enterprise zones, Virginia currently has established six foreign trade zones. Benefits of operating in foreign trade zones include deferring U.S. custom duties on imported goods until the goods enter the U.S. market and allowing businesses to store goods within the foreign trade zone for an unlimited period.

Making Virginia employee friendly

In addition to the significant incentives made available to organizations that locate or grow their operations in Virginia, the state also offers tax credits to make it an employee-friendly state where individuals will want to work. It has done so by offering tax credits to organizations for putting programs in place that will benefit employees. Examples include:

Worker Retraining Tax Credit:¹⁵ This credit may be claimed against income, franchise or premiums taxes by employers that provide qualifying retraining for their employees through noncredit classes approved by the Virginia Department of Business Assistance or through an apprenticeship agreement approved by the Virginia Apprenticeship Council. The basic credit is equal to 30% of expenditures paid or incurred by the taxpayer during the tax year for eligible worker retraining. But it's limited to up to \$200 annually per student if the course work is incurred at a private school or \$300 per qualified employee with retraining in a science, technology, engineering, arts or math discipline.

Telework Expenses Tax Credit:¹⁶ Individual and corporate employers that offer their employees an opportunity to telecommute can receive an income tax credit up to \$1,200 for eligible telework expenses

for each participating employee. The credit is capped at \$50,000 per employer for each calendar year that ends during the taxable year.

This credit is for eligible telecommuting expenses pursuant to a telecommuting agreement or to allow the employer to conduct a telecommuting assessment. Credits for telecommuting assessment expenses can be claimed only once by an employer and equal the costs of preparing the assessment, which may not exceed \$20,000. An employer may not claim another Virginia income tax credit on the jobs, wages or other expenses for the same employee for whom it is claiming the Telework Expenses Tax Credit.

Thinking beyond direct financial incentives

Financial incentive programs may serve as "carrots" for private sector employers that are driven by delivering results and lowering costs in a competitive global economy. But state investment in developing indirect incentives-such as a diverse, skilled workforce and world-class transportation, communication and energy infrastructures-could trump direct financial incentives over the long run, persuading businesses to stay in Virginia and provide jobs and tax dollars for years to come.

In the next issue, I'll explore the indirect incentives that make Virginia a premier business destination. In addition, a real-world example will demonstrate how building the new economic approaches is helping to transform Virginia's old-school economy into a global powerhouse while teaching some lessons about the effectiveness of various incentive programs. Through its successes and failures, Virginia is providing a roadmap for states to follow in order to enhance the return on economic development costs.

¹ *Virginia Performs: Economy*, Council on Virginia's Future website, <http://vaperforms.virginia.gov/indicators/economy/summary.php>.

² *New Virginia Economy*, Governor Terence McAuliffe website, <https://governor.virginia.gov/media/3501/new-virginia-economy-12052014.pdf>.

³ *Gov. McAuliffe and Steve Forbes host celebration of release of Virginia section in 2014 Forbes 400*, Augusta Free Press, <http://augustafreepress.com/gov-mcauliffe-steve-forbes-host-celebration-release-virginia-section-2014-forbes-400/>.

⁴ *New Virginia Economy*, Governor Terence McAuliffe website, <https://governor.virginia.gov/media/3501/new-virginia-economy-12052014.pdf>.

⁵ *Fast Facts: Virginia is the Best State for Business*, Virginia Economic Development Partnership website, <http://www.yesvirginia.org/AssetRich/FastFacts>.

⁶ *Virginia Guide to Business Incentives 2014-2015*, p.19, Virginia Economic Development Partnership website, <http://www.yesvirginia.org/ProBusiness/BusinessIncentives>.

⁷ *Virginia Guide to Business Incentives 2014-2015*, p.20, Virginia Economic Development Partnership website, <http://www.yesvirginia.org/ProBusiness/BusinessIncentives>.

⁸ *Virginia Guide to Business Incentives 2014-2015*, p.20, Virginia Economic Development Partnership website, <http://www.yesvirginia.org/ProBusiness/BusinessIncentives>.

⁹ *Virginia Guide to Business Incentives 2014-2015*, p.21, Virginia Economic Development Partnership website, <http://www.yesvirginia.org/ProBusiness/BusinessIncentives>.

¹⁰ The Port of Virginia website, <http://www.portofvirginia.com/stewardship/economic-development/ed-infrastructure-grant-program>.

¹¹ *Virginia Guide to Business Incentives 2014-2015*, p.4, Virginia Economic Development Partnership website, <http://www.yesvirginia.org/ProBusiness/BusinessIncentives>.

¹² *Virginia Guide to Business Incentives 2014-2015*, p.2, Virginia Economic Development Partnership website, <http://www.yesvirginia.org/ProBusiness/BusinessIncentives>.

¹³ *Virginia Guide to Business Incentives 2014-2015*, p.7, Virginia Economic Development Partnership website, <http://www.yesvirginia.org/ProBusiness/BusinessIncentives>.

¹⁴ *Virginia Guide to Business Incentives 2014-2015*, p.7, Virginia Economic Development Partnership website, <http://www.yesvirginia.org/ProBusiness/BusinessIncentives>.

¹⁵ *Virginia Guide to Business Incentives 2014-2015*, p.3, Virginia Economic Development Partnership website, <http://www.yesvirginia.org/ProBusiness/BusinessIncentives>.

¹⁶ Commonwealth of Virginia website, <http://www.teleworkva.org/teleworkTaxCredit/index.aspx>.