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## Credits & Incentives talk with Deloitte

### States Use Credits and Incentives to Attract Startups and Technology Companies

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## **States Use Credits and Incentives to Attract Startups and Technology Companies**

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Business headlines increasingly feature stories covering the rapid rise of technology startups and the related eye-popping IPOs. This press highlights recent technology industry growth at roughly three times the rate of the rest of the private sector, with each high-tech job creating 4.3 additional jobs throughout the rest of the economy.<sup>1</sup> Technology companies currently employ just under 6 million people in the United States with compensation at 98% more than the average for the private sector.<sup>2</sup> Facebook, Twitter, Instagram and Snapchat, unheard of around a decade ago, are now household names, while traditional service companies are being displaced by the sharing economy that has been encouraged by the likes of Uber, Airbnb, and Venmo.

The success and growth of the technology industry has not gone unnoticed by state legislatures, as the states recognize that these companies produce more vibrant communities by boosting job creation (including the trend among established technology companies to hire from local universities<sup>3</sup>), revenues, and intellectual capital. Consequently, the states have responded in a number of ways to attract technology businesses.

Through various credit, incentive and similar programs, states are working to create an environment that encourages technology businesses to open up shop within their borders, with the hope that the next Apple or Microsoft emerges as a taxpayer and job creator for the local population. These programs also seek to keep established startups from moving to other states as the competition to lure tech giants away from one state and into another heats up. Finally, in a nod toward the life-blood of startups, many states provide credits to the investors that fund the businesses at early growth stages.

In this column, we highlight some of the states with noteworthy programs focused on attracting and retaining technology companies and startups.

## **New York**

New York State is attracting new technology companies with its START-UP NY program, which allows eligible companies to operate in designated tax-free zones across the state. The program is not available to professional services firms, retailers, or real estate firms. Instead, it aims to attract medical science, technology, and manufacturing companies.

The tax-free zones waive business, corporate, sales, property, state and local taxes, as well as income tax for both companies and employees for ten years.<sup>4</sup> The program, which pairs businesses with local universities in an effort to provide a workforce for businesses located in the tax-free zones, currently has 55 participating businesses. Together, these 55 businesses have committed to "create more than 2,100 new jobs and invest over \$98 million across the state."<sup>5</sup>

In addition to START-UP NY, the state has also established a program to help spur "job creation and investment incentives [available] to firms in such targeted industries as biotechnology, pharmaceutical, high-tech, clean-technology, green technology, financial services, agriculture and manufacturing."<sup>6</sup> The program, dubbed the Excelsior Jobs Program, provides up to \$500 million in tax credits annually to eligible business entities.

The program includes four credits: a payroll credit that covers 6.85% of wages, an Investment Tax Credit ("ITC") valued at 2% of expenses, an income tax credit for up to 3% of research and development ("R&D") costs, and a special real property credit offered either to firms operating in strategically chosen areas or to firms in specific industries that are held to higher qualification standards.

Seventy-five percent of the Excelsior credits are made available to companies that meet certain job creation goals, while 25% of the credits are left to companies that are willing to invest \$10 into the state for every \$1 in credits.<sup>7</sup> Under this program, media website BuzzFeed was given a credit of \$4 million in exchange for the company's agreement to expand its offices in the state and create an additional 475 jobs.<sup>8</sup>

In a similar transaction, New York State has awarded \$5 million to Etsy, an online marketplace for craft goods, to stay in its current Brooklyn location and hire an additional 300 employees. The agreement also requires that Etsy make additional investments in the Hudson Valley region north of New York City.<sup>9</sup>

These incentives are offered as a means of attracting new businesses and encouraging established yet "highly mobile" technology companies to stay put and not relocate. While many companies are happy to stay in New York City, the incentives serve as an effective means for New York, both the city and the state as a whole, to compete with the allure of Silicon Valley's most invaluable asset: "the concentration of skilled tech workers."<sup>10</sup> In addition, in a move that is meant to address its shortage of qualified talent, New York City is providing \$100 million to the new Cornell NYC Tech School, with the hope that these new students will create their own startups, join existing startups, or join established technology companies in the city.<sup>11</sup>

## **San Francisco**

Even San Francisco, which has overtaken Silicon Valley as the epicenter for technology start-ups, has resorted to incentives as a means of remaining attractive to the technology industry. The city has long imposed a 1.5% tax on payroll, including stock options.<sup>12</sup> To encourage Twitter to build its new headquarters in San Francisco, the city enacted the "Central Market" exemption that effectively froze Twitter's payroll tax liability at 2010 levels for up to eight years.<sup>13</sup> The exemption also applied to other companies that either were already located in or agreed to relocate to the Central Market area, which had suffered from blight and high commercial vacancy.

While the city initially lost tax revenue on the deal, Twitter ended up building its headquarters in the Central Market neighborhood, which spurred the area's revival. More technology companies have moved into the area since 2011, resulting in a gain of over \$7 million in payroll tax revenue for the neighborhood.<sup>14</sup> This form of local incentive illustrates how targeted tax incentives can attract desirable companies into an area, turning an initial loss into a resounding win for a local community.

## Louisiana

In the wake of Katrina, Louisiana has worked to transform itself into a hub of innovation and has adopted a wide array of tax policies to attract business. While the state's film industry, now only smaller than Los Angeles and New York, is a large recipient of state credits, technology startups are also sought by Louisiana.<sup>15</sup>

Specifically, the state offers a generous credit of up to 40% for R&D expenditures against income and corporation franchise taxes due, and a 35% credit for in-state wages for digital interactive media and software development.<sup>16</sup> This credit for digital media has been touted as "the strongest of its kind in the nation" by Louisiana Economic Development.<sup>17</sup> In addition to credits, the state has helped create the Louisiana Technology Park, which provides office space to high-tech startups as well as benefits that include access to the Louisiana Technology Fund, business planning, accounting training, "angel" investors, and venture capitalists.<sup>18</sup>

As a result of these programs, the state has begun to attract an array of digital media startups, especially video game developers. Electronic Arts, a giant in the video game industry, set up shop in the state when it paired with Louisiana State University to create a Digital Arts graduate degree program and a quality assurance center for testing games before they go to market.<sup>19</sup> That Louisiana was vying for this opportunity with Romania illustrates the competitive edge that these incentives can provide on a global scale.<sup>20</sup>

As in the case of San Francisco reaping future rewards after providing credits for Twitter, Louisiana's emphasis on bringing in technology business has attracted other larger and more established technology companies.

New York, California and Louisiana are by no means the only states looking to attract technology companies, with a host of states, including Wisconsin, Missouri, and New Mexico, also offering incentives to technology businesses.

## Venture capital incentives

Many states also offer incentives to the investors that fund the early stage ventures that states are courting. These angel and venture capital investors are offered substantial tax credits to provide funding

at the earliest stages of a company's development.

Louisiana offers a 35% credit against the investor's income and corporation franchise tax on investment to eligible companies, though the program is capped at \$5 million annually, and investors are limited to \$1 million in investment per business per year (and \$2 million per business over the life of the program) <sup>21</sup>

Connecticut offers a 25% credit against state income tax to angel investors for investments of \$25,000 - \$1,000,000. <sup>22</sup>

As of December 15, 2014, Kentucky became the latest state to announce an angel investor credit against individual income tax, and is offering credits of up to 50% in counties with the highest unemployment rates (and 40% credits elsewhere) for investments into tech, advanced manufacturing, and other hard-science related fields. Total credits are limited to \$3 million annually. <sup>23</sup>

## **Conclusion**

With states looking for ways to increase jobs and boost revenues, it is not surprising that many are setting up programs to create an atmosphere that encourages local business innovation. Investing in early-stage companies can be risky, but the amount of revenue that states must forego to help such new companies is low in comparison to the potential upside. This combination of potentially unlimited upside and relatively low cost makes creating these programs an alluring prospect to any state.

As showcased by San Francisco's success with its payroll tax program and Louisiana's comprehensive tax credit program for tech companies, the initial draw of incentives can be enough to bring the first wave of businesses. However, it was not until the initial benefits of these programs were realized that the true rewards became evident.

In San Francisco, Twitter's decision to stay in a relatively undesirable neighborhood led to a parade of other successful startups and tech companies following in its wake.

Likewise, Louisiana's tax program has attracted many startups hoping to become the next success story. The program has even resulted in one of the largest video game companies in the world moving some of its operations to the state and partnering with a local university. On top of these successes, other large tech companies wanting to invest in Louisiana have indicated their intention to follow, bringing more jobs and increased revenues to the local economy.

New York City is already a startup hub, but the statewide START-UP NY and Excelsior programs aim to foster similar communities in other regions of the state that will fuel job growth and increased revenue. Whether these programs yield the desired success stories will only be known in time, but they are already doing a good job of retaining established startups.

When entrepreneurs decide where to establish their businesses, they do not do so in a vacuum. Instead, they consider a variety of options such as geography, infrastructure and culture. They will also consider the extent to which they are entering a successful market. These considerations will fuel the type of businesses a state can attract.

With these other factors in mind, an ambitious tax program that encourages a healthy startup environment may be a useful tool in tipping the scale in a state's favor. As such, any state with aspirations of creating a vibrant community for new businesses should consider the strength of its incentives programs, not only in light of the size of credits being offered but also the business infrastructure and other services that exist in a given locale.

Businesses flock to other successful businesses, and the sooner states act to implement plans to incentivize tech startups, the more time the community has to grow in a desired area. While these businesses are highly mobile, the stronger the community that is created, the more reasons a company has to stay put.

<sup>1</sup> Dominic Rushe, The Guardian, "Technology sector found to be growing faster than rest of US economy," Dec. 6, 2012, <http://www.theguardian.com/business/2012/dec/06/technology-sector-growing-faster-economy>.

<sup>2</sup> TechAmerica Foundation, "Tech Industry Employment Grows in 2012," <http://www.techamericafoundation.org/tech-industry-employment-grows-in-2012>.

<sup>3</sup> Joanna Pearlstein, Wired, "The Schools Where Apple, Google, and Facebook Get Their Recruits," May 22, 2014, <http://www.wired.com/2014/05/alumni-network-2/>.

<sup>4</sup> "What is START-UP NY?" <http://startup.ny.gov/Business-Growth>.

<sup>5</sup> "Governor Cuomo Announces 13 More Businesses Will Create More than 260 New Jobs in New York

State under START-UP NY," Dec. 29, 2014, <http://startup.ny.gov/news#/ajax/nojs/936>.

<sup>6</sup> Excelsior Jobs Program, [http://esd.ny.gov/\\_private/BusinessPrograms/Data/Excelsior/ExcelsiorJobsProgramOverview02282014.pdf](http://esd.ny.gov/_private/BusinessPrograms/Data/Excelsior/ExcelsiorJobsProgramOverview02282014.pdf).

<sup>7</sup> *Id.*

<sup>8</sup> Nicole Levy, Capital New York, "Buzzfeed gets \$4M tax credit to expand (and stay) in New York," Dec. 18, 2014, <http://www.capitalnewyork.com/article/media/2014/12/8558868/buzzfeed-gets-4-m-tax-credit-expand-and-stay-new-york>.

<sup>9</sup> Laura Kusisto and Josh Dawsey, Wall Street Journal, "Scrutiny on New York State Tax Breaks for Tech Firms," Dec. 23, 2014, <http://www.wsj.com/articles/scrutiny-on-new-york-state-tax-breaks-for-tech-firms-1419389929>.

<sup>10</sup> *Id.*

<sup>11</sup> New York City Mayor's Office Press Release, "Mayor Bloomberg, Cornell President Skorton and Technion President Lavie Announce Historic Partnership to Build a New Applied Sciences Campus on Roosevelt Island," Dec. 19, 2011, [http://www.nyc.gov/portal/site/nycgov/menuitem.c0935b9a57bb4ef3daf2f1c701c789a0/index.jsp?pageID=mayor\\_press\\_release&catID=1194&doc\\_name=http://www.nyc.gov/html/om/html/2011b/pr444-11.html&cc=unused1978&rc=1194&ndi=1](http://www.nyc.gov/portal/site/nycgov/menuitem.c0935b9a57bb4ef3daf2f1c701c789a0/index.jsp?pageID=mayor_press_release&catID=1194&doc_name=http://www.nyc.gov/html/om/html/2011b/pr444-11.html&cc=unused1978&rc=1194&ndi=1); Ruth Reader, VentureBeat, "Here's why Cornell Tech is so important to building NYC's startup ecosystem," Dec. 3, 2014, <http://venturebeat.com/2014/12/03/david-tisch-explains-why-cornell-tech-is-integral-to-building-nycs-ecosystem/>.

<sup>12</sup> San Francisco Payroll Expense Ordinance Section 902.1.

<sup>13</sup> San Francisco Payroll Expense Ordinance Section 906.3.



<sup>14</sup> Alison Vekshin, Bloomberg, "Twitter Tax Deal Boosts San Francisco Revenue \$7 Million," Oct. 28, 2014, <http://www.bloomberg.com/news/2014-10-27/twitter-tax-deal-boosts-san-francisco-revenue-7-million.html>.

<sup>15</sup> Anita Hamilton, Time, "How Louisiana is Luring Startups," March 30, 2012, [http://content.time.com/time/specials/packages/article/0,28804,2094921\\_2094923\\_2110624,00.html](http://content.time.com/time/specials/packages/article/0,28804,2094921_2094923_2110624,00.html).

<sup>16</sup> Louisiana Economic Development, Research and Development Tax Credit, <http://www.opportunitylouisiana.com/page/research-and-development-tax-credit>; Louisiana Economic Development, Digital Interactive Media and Software Development Incentive, <http://www.opportunitylouisiana.com/page/digital-interactive-media-and-software-development-incentive>.

<sup>17</sup> Louisiana Economic Development, Digital Interactive Media and Software Development Incentive, <http://www.opportunitylouisiana.com/page/digital-interactive-media-and-software-development-incentive>.

<sup>18</sup> Louisiana Technology Park, Benefits, <http://www.latechpark.com/what-we-offer/benefits>.

<sup>19</sup> John Gaudiosi, Fortune, "Louisiana tax incentives attract videogame companies," March 25, 2014, <http://fortune.com/2014/03/25/louisiana-tax-incentives-attract-videogame-companies/>.

<sup>20</sup> *Id.*

<sup>21</sup> Louisiana Economic Development, Angel Investor Tax Credit, <http://www.opportunitylouisiana.com/page/angel-investor-tax-credit>.

<sup>22</sup> Connecticut Innovations, <http://ctinnovations.com/angels>.

<sup>23</sup> Kentucky Cabinet for Economic Development, Press Release, Dec. 15, 2014, [http://www.thinkkentucky.com/newsroom/NewsPage.aspx?x=12152014\\_Angel\\_Tax\\_Credit.html](http://www.thinkkentucky.com/newsroom/NewsPage.aspx?x=12152014_Angel_Tax_Credit.html); Factsheet, Kentucky Angel Investment Act Program, [http://thinkkentucky.com/KYEDC/pdfs/Angel\\_Fact\\_Sheet.pdf?12092014](http://thinkkentucky.com/KYEDC/pdfs/Angel_Fact_Sheet.pdf?12092014).