

Incentive agreement compliance strategies and COVID-19

Overview

The COVID-19 global pandemic continues to change our economic environment which may significantly affect businesses with an economic development incentive agreement. These agreements often cover a wide range of discretionary incentives, including tax and non-tax related benefits. While facing unprecedented challenges, businesses with an economic development incentive agreement should proactively review, and perhaps seek to modify, an incentive agreement with the respective state and local jurisdiction. Failing to meet incentive agreement milestones may risk breach, default, and potential claw back of an incentive already granted. A number of options may exist for taxpayers to consider to proactively mitigate an unforeseen result.

This Tax Alert summarizes some of the taxpayer considerations.

Incentive Agreements

State and local jurisdictions may offer a variety of economic incentives. Some incentives may be discretionary, and some may be statutory. Statutory credits are typically statute-based tax offsets that businesses that engage in an activity (e.g. manufacturing or research and development) could qualify for. Discretionary incentives, on the other hand, are typically available only at the discretion of a jurisdiction and generally require negotiation and an economic development agreement.

Economic development agreements generally contain the incentive(s) that are being offered, value of the incentive(s), and the requirements a company must meet to obtain or monetize the incentive(s). To satisfy the terms of an agreement, a company may, for example, need to meet annual target milestones for increased hiring and/or retaining employees, increased investment in machinery and equipment, real estate, etc. Further, a company likely will need to prepare compliance filings over a multi-year period to detail progress towards or meeting the milestones.

Companies typically negotiate these agreements to help offset the cost of future growth. The economic consequences of the COVID-19 global pandemic, however, may have changed the dynamic for some companies' short and long-term plans. Where an economic development incentive agreement has been negotiated, companies should consider a review of the agreement, the milestones committed to, and whether the agreement provides for modification or revision. By strategically and proactively managing the incentive compliance process, a company may retain a significant amount of the economic incentive or mitigate a significant amount of the economic risk.

Exposure and Potential Opportunity

State and local jurisdictions are in the early stages of dealing with the effects of the COVID-19 pandemic on compliance with economic development incentive agreements. Initially, states have moved to extend deadlines for compliance filings or milestone completion. For example, in Indiana, the Governor signed Executive Order 20-23 which extends deadlines for property tax abatement incentive filings, and in Oklahoma, the Governor signed Senate Bill 1075, which provides that that recipients of the Quality Jobs Program incentive that fail to meet their payroll requirements from April 1 through June 30, 2021, will continue to receive their incentive payments. Given the general lack of guidance from state and local jurisdictions and the fluidity of the economic situation, we believe it is important to consider three steps:

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- 1) Examine current incentive agreements to determine exposure and risk that a company may face if it is unable to meet or is in breach of current, past, or future agreement milestones;
- 2) Work with the company's legal counsel to determine if there is an opportunity under the terms of the agreement to modify or revise the obligations; and
- 3) To the extent a company may have already received some incremental benefit in prior tax years, examine whether a claw back of the incentive can be mitigated.

Economic development incentive agreements generally have milestones, that is to say, periodic or annual requirements that must be met for the incentive to be claimed. Examples may be a specified number of net new hires or a specified amount of increased capital spend or increased rent. In some agreements, those requirements are through a certain fixed date (or dates) and in some a company may have a term or set number of years to meet the milestones. Either way, failure to meet the milestone may mean a company cannot claim the incentive or may owe the state or local jurisdiction any incentive already received.

Once the agreement has been reviewed for milestones, the terms of the agreement will likely control the extent of the opportunity to modify or revise the agreement. Specifically, as to non-compliance or breach, it is important to work with the company's legal counsel to determine if the agreement contains a "force majeure," "market conditions," or "claw back" provisions. These provisions address what may happen if performance under an agreement becomes delayed or impossible due to forces outside a party's control. Companies should work with their legal counsel to evaluate their contracts' terms.

A force majeure clause or a "market conditions" clause are common contract clauses that may excuse a party to a contract from an obligation based upon conditions outside of their control. The determination of the meaning of and/or applicability of these clauses is a legal determination which should be discussed with legal counsel. If such a clause is contained in an incentive agreement, it may provide an avenue for strategic and proactive discussions with state or local jurisdictions regarding compliance with the agreement. Indeed, given the broad nature of government shutdowns, even if the agreement does not contain one of these clauses an economic development agency may be open to discussions regarding compliance.

Finally, some economic development incentive agreements may contain claw back provisions. A claw back is a provision that allows for an incentive already received to be taken or owed back to the jurisdiction that provided the incentive. Generally, a breach due to non-compliance may trigger a claw back provision. For a company facing challenges from the business downturn, triggering a claw back and having to repay an already received incentive to a state or local jurisdiction could create significant internal issues. Even if compliance with milestone requirements, is not an issue now, strategically and proactively working with an economic development agency to address a claw back situation may assist in achieving a reasonable accommodation or a mutually beneficial result in the future.

Considerations

Our current economic situation is unprecedented and there is no "road-map" or historical model to navigate compliance with economic development incentive agreements in this environment. However, developing a strategy for reviewing current, past, and future incentive agreement compliance and, if needed, proactively engaging in discussions with the relevant economic development agency may provide a path forward for companies facing uncertainty.

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