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Transferable State Tax Credits and Incentives—An Important Element of Tax Planning

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In today's economic environment, credits and incentives are a valuable element of a company's tax planning approach. Typically, credits are statutory tax-based offsets that are used by federal, state and local governments to incentivize and encourage business activity that benefits the jurisdiction. For example, a statutory-based credit may provide that a manufacturing company purchasing at least $500,000 in machinery and equipment during a tax year in that state is eligible to claim a 3% tax credit on its state income tax return. A number of states are also utilizing discretionary credits that require taxpayers to apply and seek approval prior to engaging in the qualifying activities.

Incentives, typically discretionary in nature and requiring negotiation with a state or local government agency, are tax and/or financial offsets that jurisdictions use to entice business activity and investment,

particularly when a company is considering multiple jurisdictions for its capital or labor investment. Activities for which discretionary incentives may be available include job creation, skills-based training, investments in green technology and investments in capital equipment.

A taxing jurisdiction generally determines the amount of incentives to offer based on a variety of factors including the type of investment, the potential impact to the jurisdiction, and the needs of the area where the investment is projected to occur. For example, a jurisdiction may offer a taxpayer hiring 250 employees at an average wage of $20 per hour an employment grant worth $4,000 per new employee, provided the company also pays at least 65% of the health insurance premiums for those new hires.

Credits and incentives analysis

Companies seeking to reduce current or projected state tax liabilities will generally take two approaches to credits and incentives planning. The first is a liability-based approach, where companies review their largest state tax liabilities and then research to determine the potential tax credits and incentives that might be available in those particular jurisdictions. The company will then review the criteria for each credit or incentive to determine whether it might qualify for benefits and, if so, then apply for or claim the credit or incentive accordingly.

The second approach is an activity-based approach. Companies identify where they are engaging (or projected to engage) in activities that generally qualify for credits and incentives (e.g., increased hiring, expanding facilities, etc.) and analyze whether those states offer incentives that fit those activities. If so, then the taxpayers may seek to apply for or claim the credit or incentive accordingly.

While these two approaches are sufficient for many companies, some companies may have potential qualifying activities in states where minimal or no tax liability exists. Companies that find themselves in this situation should consider whether transferable credits are potentially available.

What are transferable credits?

Many states offer credits that can be transferred or sold to other taxpayers. These credits can then be used by the purchasing taxpayer ("transferee") to offset its current or future tax liability. The transferee does not typically need to engage in the type of qualifying activity that generated the credit. For example, a transferee engaged in retail activity may be able to use a purchased film credit to reduce its corporate income tax

liability. Transferrable credits may be offered for sale through online exchange websites, independent brokers that bring interested parties together, or through business-to-business relationships.

Depending on the credit and the state, transferrable credits can either be sold in full to one taxpayer or can be divided up and sold to multiple taxpayers. State-by-state provisions also determine whether a credit can be resold or reassigned by the transferee to another taxpayer and, if so, how many times. In some instances, transferrable credits may also be used to offset more than one type of tax.

For example, Pennsylvania's research and development credit can offset several different taxes and can be sold in whole or divided up and sold to multiple taxpayers. For illustrative purposes, this means that three different taxpayers could purchase part of a credit from the same transferor and could use it to offset three different taxes. One transferee could use the credit against its individual income tax liability, the second could apply it against its insurance premium tax liability and the third could apply it against its corporate income tax liability.

Practically speaking, transfer or assignment of credits is usually effectuated by a purchase agreement pursuant to which the purchaser/transferee agrees to pay a discounted price (e.g., $0.90/$1 of credit), which typically varies depending on the overall supply and demand for transferrable credits in the particular jurisdiction, the type of credit, whether it has been audited or certified by the state prior to the transfer, and the tax years for which the credits can be utilized. For the seller/transferor, the ability to sell credits (even at a discount) provides cash flow advantages in instances where a company may not otherwise be able to achieve a tax benefit from generated credits. For the purchaser/transferee, buying credits provides a company without qualifying activities the ability to use tax credits to offset its current and future tax liability.

Who should consider selling transferable credits?

- Companies that are not paying tax in a state because they are operating at a loss, have NOL carryforwards or that have other non-transferrable credits that are otherwise offsetting their tax liability (e.g., research and development credits).
- Start-up companies for which no taxable income is expected for some time, but that are making significant investments of capital and labor.

Who should consider purchasing transferable credits?

- Companies with significant tax liabilities in states for which little or no qualifying activity is anticipated.
- Profitable companies with a significant customer base in single-sales-factor apportionment states but minimal property or payroll in those states.

- Companies undergoing transactions or acquisitions that are projected to trigger increased state tax liabilities.

What types of transferrable credits exist?

Many states offer low-income housing credits, historic property rehabilitation credits, brownfield credits, alternative energy credits, and film credits that may be transferred or assigned by the real estate or film ventures that generated such credits. In addition, transferrable or assignable research and development, job creation and capital investment credits are available to a broad range of taxpayers, as noted below.

Research and development: Examples of states with transferrable research and development credits include the following:

- Arkansas: In-House Research by Targeted Business Income Tax Credit[1]
- North Dakota: Research Expense Credit[2]
- New Jersey: Research and Development Tax Credit[3]
- Pennsylvania: Research and Development Tax Credit[4]

Job creation: Other examples of states with transferrable credits are those listed below, which provide companies that are expanding/hiring with the opportunity to monetize their job creation credits through transfer.

- Florida: Capital Investment Credit[5]
- Arkansas: Targeted Business Payroll Income Tax Credit[6]
- Missouri: Quality Jobs Act[7] and New and Expanded Business Facility Credit[8]
- New Jersey: Grow New Jersey Assistance Program Credit[9]
- New Mexico: Rural Job Tax Credit[10]

Capital investment: For those companies acquiring new facilities, expanding existing facilities or investing in new capital equipment, the following are examples of states offering transferable credits for capital investment.

- Florida: Capital Investment Tax Credit[11]
- Idaho: Broadband Equipment Investment Credit[12]
- Missouri: New and Expanded Business Facility Credit[13]
- New Jersey: Urban Transit Hub Tax Credit[14] and Economic Redevelopment and Growth (ERG) Credit[15]

Survey of transferrable credits in Georgia, New Jersey and Pennsylvania

Georgia has a myriad of transferable credits, and allows most of its credits to be transferred between related entities. Additionally, it offers several credits that can be transferred to unrelated taxpayers, including the Tax Credit for Film, Video, or Digital Production in State;[16] the Tax Credit for Donation of Real Property;[17] and the Tax Credit for the Rehabilitation of Historic Structures.[18] These credits can be offset against the Georgia corporate income tax and the individual income tax and can be split up and sold/assigned to multiple related or unrelated parties. The statutes applicable to these Georgia credits generally do not allow a transferee to resell or transfer the credits to unrelated parties.

New Jersey offers at least eight transferable credits including the Business Retention and Relocation Assistance Grant (BRRAG);[19] the Grow New Jersey Assistance Program Credit;[20] the Film Production Tax Credit;[21] the Urban Transit Hub Tax Credit;[22] the Research and Development Tax Credit Program;[23] the Economic Redevelopment and Growth (ERG) Program[24] and the Digital Media Tax Credit Program.[25] In addition, legislation signed by New Jersey's Governor Christie on January 11, 2016, allowed taxpayers to convert their approved cash grants under the Business Employment Incentive Program (BEIP) to refundable tax credits, which can then be sold or assigned.[26]

New Jersey's transferable credits can generally be divided among multiple transferees and can be re-sold by the original transferee and subsequent transferees multiple times. The converted BEIP credits, however, cannot be re-sold. It should be noted that the BRRAG expired on September 18, 2013, while the Digital Media Tax Credit and Film Production Tax Credits both expired on July 1, 2015.[27] Under these three programs, no new credits can be generated; however, these credits may still be available for purchase or sale.

Pennsylvania offers at least seven transferable credits, all of which are currently active with no upcoming sunset provisions. These are the Keystone Innovation Zone Tax Credit (KIZ);[28] the Keystone Special Development Zone (KSDZ) Program;[29] the Film Production Tax Credit;[30] the Neighborhood Assistance Program Tax Credit;[31] the Research and Development Tax Credit;[32] the Resource Enhancement and Protection (REAP) Credit;[33] and the Historic Rehabilitation Credit.[34] With the exception of the Historic Rehabilitation Credit, all the credits can be divided and sold to multiple transferees.

Pennsylvania does not allow any of its transferable credits to be transferred again or sold by the transferees after the initial transfer or purchase. The credits can all offset the corporate net income tax and personal

income tax, with some available to offset other taxes such as the bank and trust company shares tax, insurance premiums tax, capital stock-franchise tax, mutual thrift institutions tax, gross receipts tax and title insurance company shares tax.

It should be noted that legislation enacted in July 2016 modified, expanded, and, in some cases, added credits for Pennsylvania tax purposes.[35]

Conclusion

Companies should analyze transferable credits as part of a holistic approach to managing their current and future tax liabilities balancing potential tax benefits against cash flow needs that could be addressed by selling transferable credits. Companies should consult with their tax advisors for planning considerations in these areas given their specific needs and set of facts.

[1] Ark. Code Ann. § 15-4-2708(c)(2).

[2] N.D. Cent. Code § 57-38-30.5.8.

[3] N.J. Stat. Ann. § 34.1B-7.42.a.a.

[4] 72 Pa. Stat. Ann. § 8704-B(d).

[5] Fla. Stat. Ann. § 220.191(2)(c).

[6] Ark. Code Ann. § 15-4-2709.

[7] Mo. Rev. Stat. § 620.1881.9.

[8] Mo. Rev. Stat. § 135.110.14.

[9] N.J. Stat. Ann. § 34.1B-248.

[10] N.M. Stat. Ann. § 7-2E-1.1.F.

[11] Fla. Stat. Ann. § 220.191(2)(c).

[12] Idaho Code Ann. § 63-3029I(9).

[13] Mo. Rev. Stat. § 135.110.14.

[14] N.J. Stat. Ann. § 34.1B-209.1.

[15] N.J. Stat. Ann. § 52.27D-489f(4).

[16] Ga. Code Ann. § 48-7-40.26(g).

[17] Ga. Code Ann. § 48-7-29.12(d.1).

[18] Ga. Code Ann. § 48-7-29.8(e)(2).

[19] N.J. Stat. Ann. § 34.1B-120.2.

[20] N.J. Stat. Ann. § 34.1B-248.

[21] N.J. Stat. Ann. § 54.10A-5.39.d.

[22] N.J. Stat. Ann. § 34.1B-209.1.

[23] N.J. Stat. Ann. § 34.1B-7.42.a.a.

[24] N.J. Stat. Ann. § 52.27D-489f(4).

[25] N.J. Stat. Ann. § 54.10A-5.39.d.

[26] N.J. Pub. L. 2015, ch. 194.

[27] N.J. Stat. Ann. § 34.1B-114.b; N.J. Stat. Ann. § 54.10A-5.39.

[28] 72 Pa. Stat. Ann. § 8906-F(g).

[29] Keystone Special Development Zone Program Guidelines, August 2016, http://dced.pa.gov/download/keystone-special-development-zone-guidelines-2016/?wpdmdl=65702.

[30] 72 Pa. Stat. Ann. § 8705-D(e).

[31] 72 Pa. Stat. Ann. § 8904-A(d).

[32] 72 Pa. Stat. Ann. § 8704-B(d).

[33] 72 Pa. Stat. Ann. § 8703-E(d).

[34] 72 Pa. Stat. Ann. § 8705-H(d).

[35] P.A. P.L. 526, No. 84.

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