

Quick Takes

December 2007

Quick Takes: Credits/Schmedits!- How do I get incentives that mean something?

Recently I represented a Georgia community in a project that highlighted just how little value prospects place on tax credits under Georgia's BEST Program. Because it was in a lower "tier," this community had \$2.5 million more in job tax credits to offer the prospect than the competing Georgia community, plus offered 100% (instead of 50%, in the competing community) offset of job tax credits against Georgia income taxes. But the prospect's spreadsheet said it all - tax credits were set aside in a column whose caption read, in effect, "not meaningful."

Why was that? Well, thanks to H.B. 191, or "single factor apportionment", many companies like that prospect, that operate a multistate business, will pay little or no Georgia income tax. It is only when a company has substantial sales within Georgia that tax credits become usable, because only then will enough taxable income be allocated to Georgia for the credits to be needed. "Catch 22"- A company with in-state sales will have to pay property tax on its inventory for those sales, even if the community offers the "freoport" exemption, because freeport doesn't apply to inventory for in-state sales.

Yes, excess job tax credits can be carried forward for 10 years. But for a company that has immediate capital requirements and has operating costs to pay immediately, that's not much of an incentive. In tier 1 (least developed) Georgia communities, excess job tax credits can be applied against wage withholding. Now, that's an incentive! Allowing an employer to keep the employee's share of withheld wages is like a cash grant, and companies respond favorably to that.

But that ability to apply excess tax credits against wage withholding isn't available in the other three tiers of communities. And that's not all that is broken and needs fixing.

Here's what we need in order to restore competitiveness to Georgia's statutory incentives-

1. Tax Credits That Can Be “Monetized”. Tax credits should be freely transferable. If you can transfer credits, you can “monetize” them, by selling them. This produces the best incentive of all- cash! And best of all, the cash isn’t coming from the taxpayers, via state or community grants (note- any grant program has to be properly structured, of course). Rather, with monetization, the cash is coming from a profitable company that has both cash and tax liability. The profitable company would be paying some of its cash to another company, that has credits but needs cash. The profitable company would buy the seller’s credits in order to reduce the profitable company’s tax liability. It’s like “privatizing” grants! For example, the seller of the credits might be a prospect with a new business location in Georgia that isn’t going to be profitable for some time. The cash it raises from selling unneeded credits may be just what it takes to make that new business viable.

2. Flexible Tax Credits. If excess tax credits could be applied against wage withholding statewide, that would benefit every company in every community. Another “Catch 22”- If you’re an insurance company, you don’t earn job tax credits, and you couldn’t use them anyway (because of how the BEST statute is written, and because an insurance company pays a premium tax, instead of income tax). The State’s premium tax rate is 2.25%. In addition, the State collects the county and city premium taxes and disburses the proceeds to them. These local taxes are 1.00% of life, and accident and sickness, premiums, and 2.50% for property and casualty premiums. Some abatements and deductions figure into the effective rate of tax. However, a Report prepared a few years ago for the State Senate’s Study Committee on Insurance Economic Development determined that Georgia’s combined state and local tax premium rate was over twice the national average, being one of the highest in the country. The Report also determined that domiciling in Georgia usually places insurers at a competitive disadvantage when doing business in other states. Other states with a lower premium tax rate impose a retaliatory tax on policies sold there by a Georgia insurer. This brings their tax on those policies to the Georgia level, which is higher than the Georgia insurer’s competitors have to pay there. Other consequences of our premium tax structure, according to the Report, are that out-of-state insurers are not willing to locate their corporate headquarters in Georgia, and Georgia insurers are considering locating to other states (8 did so, largely because of our premium tax system, during the period covered by the Report). So, let’s make some changes. Let insurance companies earn tax credits and apply them against the State’s portion of their premium taxes (or, we could just abolish the State’s portion). And if they have excess tax credits, all taxpayers, including insurance companies, should be able to apply them against wage withholding, statewide.

3. “Two-Way” Port Credits. Georgia’s Department of Revenue (“DOR”) takes the position that the port traffic increase tax credit incentive (which can increase the job tax credit, for example, by \$1,250 per job) applies only to exports. One of our economic developers said recently, “It’s hard to imagine why container ships would come into Georgia ports empty, just to pick up exports.” That’s right, but DOR seems to be relying on the title of the bill that contained the original port traffic increase credit legislation and in one place had the word “exports”. A State Representative who

sponsored the original legislation had this comment on DOR's position: "It is an absurd interpretation of the statute." Rhetoric aside, we need to get back to the real intention behind the statute. The text of the bill itself, as well as the titles and text of amendments enacted by the General Assembly in subsequent years, refer to "port traffic." This should include both imports and exports. If Georgia doesn't understand why we have to encourage an active two way flow of commerce, with both imports and exports, we will lose port traffic to communities in states that do understand that, such as Charleston and Jacksonville.

5. Tax Credits for Call Centers and "Back Office" Operations. These business are threatened by proposed regulations that would use NAICS codes to change the definition of "business enterprise" for purposes of the job tax credit program. These changes would disqualify a number of businesses from earning job tax credits. Call centers and "back office" operations would be hit the hardest by these proposed changes. Consultants have already advised their call center clients to consider locations other than Georgia because of the proposed regulations, even though they are not yet effective. Among other businesses, ineligibility would also affect data centers, computer system design operations, and other computer services. Good news is the movement on this by the Georgia Department of Community Affairs ("DCA"). These proposed regulations were intended to be adopted by both DCA and DOR, so that the two Departments would be playing by the same rules. Most recently, DCA has extended its comment period on the new regulations until December 4, 2007, and has posted for comment revised proposed regulations that contain a number of remedial revisions. These include using more inclusive 4 or 5 digit NAICS codes (instead of more restrictive 6 digit NAICS codes) in some cases, as well as specifically addressing certain operations, call centers among them. Another positive development is that DCA now proposes to solely (instead of jointly with DOR) determine eligibility for the credits in cases where eligibility is unclear. As the agency originally chosen to administer the job tax credit program, I feel that DCA's views should be given great weight. Both DCA and DOR need to get on the same page with these proposed regulations, and for now that page needs to be DCA's new version.

6. More Options on "Freeport". Georgia needs to consider the possibility of granting the freeport inventory tax exemption statewide. The first step is for the State and our communities to study a phase-in of this incentive, taking into account the impact on local revenues in communities that have not yet implemented (or have not fully implemented) freeport. An alternative is to expand what communities can offer, so that inventory bound for in-state sale could benefit from freeport, by local option. We have lost distribution center projects already because this option is not available locally.

7. Exempt Development Authority Projects From Sales And Use Tax. A development authority is a public body, so projects for its own account (like building materials for a spec building) should certainly be exempt from sales and use tax. Unfortunately, that is not now the case, and this needs to be changed. But fixing that specific situation does not go far enough. Given the scarcity of Georgia statutory incentives with actual cash value, and the difficulty in obtaining changes on a piece-meal basis, we need to take the step of simply creating an exemption from the sales and use taxes for any property

(building materials, machinery and equipment, and other property) that is part of a development authority project. In order to carry out its Constitutional mission of “promoting the development of trade, commerce, industry and employment opportunities”, a development authority can finance the acquisition or construction, and equipping, of a facility for use by business or industry. When it does so and takes title to the project, the exemption from sales and use tax should apply to all of that property. In my view, that exemption should always eliminate the State’s portion of the sales and use tax, but would eliminate the community’s portion only if the community so elected.

Remember the question we led out with- “How do I get incentives that mean something?” Here’s the answer-
“Talk to your legislator.”

We need statutory changes to accomplish most of what’s needed. Let’s use the rest of this *Quick Takes* issue to provide some talking points for that conversation with your legislator.

In that conversation, keep in mind that we need to maintain our system of providing higher statutory incentives for less developed communities. The BEST program traditionally has allowed higher levels of tax credits for less developed communities. This policy can still be followed if credit monetization and wage withholding applicability are created and/or allowed statewide. For example, in the case of monetization, perhaps a company should be allowed to sell 100% of its tax credits earned in a tier 1 community, but only 25% of its credits earned in a tier 4 community. The overall value would have to be high enough to be viewed as an incentive, however, and perhaps a high level of transferability could be allowed in cases where a Georgia tier 4 community is competing against a city in another state for a project.

When we ask for these changes, are we asking for too much? I don’t think so. According to one consultant, at least 29 states permit some form of tax credit monetization. Georgia even has a version of this with its “Georgia Entertainment Industry Investment Act”. This Act follows the monetization model recommended above, by allowing film industry companies to earn credits that can be applied against wage withholding, with excess credits being transferable. Programs like this work. A recent *Wall Street Journal* article reported on how quickly Shreveport, Louisiana has become a “hot spot for the film industry”, and commented that, “State tax incentives- which began in 2002- are a big part of the draw. They now include transferable tax credits for motion-picture production in Louisiana and a return of about 40 cents in transferable tax credits for every dollar spent on film-related infrastructure projects approved by the state.”

As we consider expanding Georgia’s program, let’s take a look at how states do this. One consultant places cash incentives related to tax credits into one of three main categories

- Direct Refunds

Direct refund programs represent the majority of the monetary incentive programs available. This suggests that states and businesses favor the direct cash refunds of new employee payroll. The direct refund incentive is most commonly connected to employee withholdings tax and instead of remitting all the tax collected to the state, the company retains the awarded percentage of withholding as, in effect, a cash rebate. This is essentially what is available in Georgia's tier one communities with excess job tax credits.

- Refundable Tax Credits

Refundable credits are the second most commonly used monetary incentive with 12 states offering refundable tax credit programs. These can be credits based on job creation, credits based on R&D investments, and credits based on capital investment.

- Monetized Tax Credits

Monetized credits are the most contemporary of cash incentive programs, and the least used of the three cash incentive categories. Tax benefits are sold to entities that have a corporate state tax liability for a discounted price, then the buyer applies the face value of the credit toward their state income tax liability. Monetized tax credits involve policy issues related to controlling a secondary tax credit market. (Some controls exist now in Georgia under the Georgia Entertainment Industry Investment Act.)

And speaking of tax credits, beyond coming up with regulations that we can live with, what we really need is a legislative rewrite and modernization of the BEST program to bring it into the 21st Century (and by the way, to make the monetization and other changes that are needed!). Among other things, a modernized BEST program should provide, in a clear fashion, appropriate incentives for all of the strategic industries identified by the Governor's Commission for a New Georgia.

Legislation could also expressly overturn DOR's position on the port traffic increase credit. However, litigation, rather than legislation, may be what does so, since Georgia Power Company is now in court with DOR over DOR's position.

The other changes in our incentives are needed just so we can play "catch up" with our competing states.

Alabama has offered statewide freeport for some time. HB 124, introduced in the 2007 Session of the Georgia General Assembly, would have responded to our need to be competitive, by calling a statewide referendum to exempt all businesses from paying either state or local property tax on inventory. The Bill did not pass, but carries over into this year's Session.

Likewise, sales and use tax exemptions for a project's building materials have long been available in Alabama, and in Mississippi, for example. If all property financed and owned by a Georgia development authority were exempted by new legislation from sales and use tax, we would level that playing field. Moreover, that exemption could be used so that it would no longer be necessary to pursue the "integrated plant theory" of sales and use tax exemption. HB 237 would have adopted that theory by exempting from the sales and use tax all machinery and equipment that is necessary and integral to the manufacturing process. That Bill also did not pass the General Assembly in 2007, but also carries over to the 2008 Session.

What do you think? If you have feedback, on these or any other topics, please let me hear from you.

Meanwhile, look at these pages on my website, danmcrae.info, for some more information on these issues.

Go to the *Quick Takes* page, for more on-

Meaningful Incentives; see the 2007-2008 Legislative Agenda for the Georgia Economic Developers Association ("GEDA").

Job Tax Credits; see the revised DCA regulations related to its December 4, 2007 public hearing, and the notice of the hearing.

Port Traffic Increase Credits; see Pleadings filed in Georgia Power's lawsuit against DOR.

"Freeport" Inventory Tax Exemption; see the February 2004 *Quick Takes* issue- "Incentives That Matter: Would You Like Freeport With That?".

Sales and Use Tax Exemption for Development Authority Projects; see the draft of a bill entitled "Development Authority Projects Assistance Act of 2008", that I prepared for purposes of further discussing this proposed new incentive.

Go to the "White Papers" page, for more on-

HB 191, and single factor apportionment; see the 2005 White Paper- "Georgia

Becomes a Tax Haven for Investors and Employers".

And, of course, all of the standard references are available on the "White Papers" page, such as- January 2007 - "Introduction to Taxable Floaters"; August 2006 - "Bond FAQ's"; July 2006 - "Bonds for Title"; July 2006 - "Financing Projects for Non-Profits"; and March 2006 - "Monetizing Property Tax Abatement".

The "Current Bond Rates" page at danmcræe.info is updated weekly. This week's version is what you see below.

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General note: This issue of *Quick Takes* is a quick-reference guide for economic developers, participants in the real estate and financial industries, company executives and managers, and their advisors. The information in this issue is general in nature. Various points that could be important in a particular case have been condensed or omitted in the interest of readability. Specific professional advice should be obtained before this information is applied to any particular case. Any tax information or written tax advice contained herein (including any attachments) is not intended to be and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. (The foregoing legend has been affixed pursuant to U.S. Treasury Regulations governing tax practice.)

| CURRENT BOND RATES | |
|-----------------------------|------------------------|
| EFFECTIVE NOVEMBER 23, 2007 | |
| | Interest Rates: |
| tax-exempt- | floating: 3.72% |
| | fixed: 3.71% |

taxable-

floating: 4.85%

fixed: 4.92%

General notes:

1. Rates are posted weekly. These rates are for the effective date indicated above, or as otherwise indicated. For intra-week rates, Contact Dan.
2. These are interest rates on revenue bonds that are variable rate demand bonds; i.e., floating. These can be synthetically fixed via interest rate swaps, as noted below.
3. Tax-exempt rates are for industrial development revenue bonds (IDB's") that are subject to the AMT and are 7 day general market quotes.
4. Taxable rates are for taxable IDB's or for taxable "corporate bonds".
5. Fixed rates are for 10 year terms via swaps.
6. All rates are market extracted and approximations, and are not guaranteed.
7. These rates do not reflect all-in costs; e.g., annual letter of credit fees are not included.

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