Have Your Clients Taken All the Credits They Deserve? Better Look Again

Over 80 percent of location-based tax credits are overlooked by taxpayers, tax preparers and CPAs. Some of these credits are large enough to eliminate your clients' tax liabilities.

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After the Tax Reform Act of 1984, the federal and most state tax codes became very restrictive in allowing taxpayers to reduce corporate and individual income taxes permanently or temporarily. While significant hours and dollars are expended annually by taxpayers and their CPAs in developing tax deferral strategies, the most underutilized and most impacted area for *permanent* federal and state tax savings relates to Location-Based Incentive Credits (LBICs).

There are more than 7,500 distinct state and federal LBIC regions throughout the country. Surprisingly, less than 20 percent of eligible businesses claim these lucrative tax breaks. The National Tax Credit Group, LLC has conducted hundreds of client LBIC studies and found that less than 10 percent of the clients had claimed any state tax credits — and among those who had, they generally under-reported their state credits by over 50 percent. Less than 10 percent of the clients had claimed any federal LBICs.

Statistics available through 2005 for one California Enterprise Zone city reveals that out of 7,500 businesses in the city, only 300 or so businesses claimed the benefits (i.e. less than 5 percent). *CPA Tax Insider* readers can view related information in *Do Enterprise Zones Work?* (PDF) (a working paper from the Marshall School of Business, University of Southern California), which documents the extent and usage of EZs across all states over the last 20 years.

Low Program Utilization

Businesses will often get lured to another state or foreign country in order to reduce their tax rate, only to later find out that they had been passing up federal and/or state credits, which would have negated the need to relocate.

Part of the reason for low program utilization lies in the limited federal and state funds to promote these programs. The other reason is that many CPAs and other tax preparers are either unaware of the programs, believe they are too complex to administer, or believe that the programs do not apply to their client base. Several state programs, including Georgia, and Arkansas cover the entire state. With 39 state programs, over 4,500 Tribal Lands and over 100 other federal LBIC regions, 15 percent to 20 percent of businesses are eligible for one or more of these LBICs. Since these specified regions focus on business districts, there are higher than average concentrations of eligible businesses in LBICs. Statistics provided to the authors from CCH indicate that more than 30 percent of business addresses screened by the CCH Web-based product were in one or more state or federal tax zones.

Related Tax Savings

The amount of tax savings are often in the tens of thousands to hundreds of thousands annually — even for single location middle-market companies. Certain states such as California, and larger employers in federal zones can often generate credits in the $100,000 to $1,000,000-plus range annually.

Most state programs are designed to primarily assist manufacturers, processors and those businesses employing blue-collar workforces. However, most federal programs and many states, including California, have no restrictions (other than gambling operations), on the types of industries that can claim these benefits. Approximately one-third of the 39 state programs, however, place limits on benefits available to retail businesses. Also many state programs are also geared towards those businesses purchasing business equipment, or expanding their facilities and workforce.

How Much Money Are We Talking About?

While benefits can be found in almost every state, the most beneficial state programs (in terms of geographic boundaries and/ or benefits per employee) include: Arizona, California, Florida, Georgia and New York

LBICs include the following incentive hiring credits and other benefits associated with operating in any one of over 7,500 distinct incentive "zones":

Federal Incentives	Maximum Hiring Credit	Number of Zones	Form Number
Empowerment Zone	$3,000/yr. per employee	41	IRS Form 8844
Renewal Community	$1,500/yr. per employee	39	IRS Form 8844
Indian Tribal Lands	$4,000/yr. per employee	4476	IRS Form 8845
Gulf Opportunity (GO) Zone	$2,400 per employee	132	IRS Form 8850
Free-Trade Zone	Deferred Customs Duty	612	

State Incentives	Maximum Credit	Number of States
Enterprise/ Misc. Zones	$500 - $11,700/ yr. per ee	39
Other Common Benefits	Equipment Credits/ Bidding	
	Preferences/ Tax Holiday/	
	Property Tax Breaks/ etc.	Varies by State

In addition to allowing credits for employees who live on designated areas near the qualifying business location, most state programs also include military veterans as "qualified" employees.

Therefore, employers located in certain state zones can obtain hiring credits by giving priority to certain enlisted men and woman. Ex-Offenders, a euphemism for those men and women who have spent time in prison, are also generally given hiring priority via employer credits under state programs. Parolees represent a growing segment of the potential workforce and the state and federal cost of incarcerating repeat offenders is costly; on average, direct costs of incarceration per prisoner are over $23,000 per year, and with average prison sentences of over four years average incarceration costs per prisoner can approach $100,000. Therefore, giving employers a tax credit equal to a fraction of such cost produces a pretty good return on investment for the government and taxpayer — provided the Ex-Offender successfully transitions back into society.

The process for documenting these benefits is fairly straightforward. Generally the CPA or taxpayer simply:

- confirms that their business location is located in a specified zone,
- confirms that certain employees working at the location either live in specified areas, or meet other "qualification" criteria (*e.g.*, veteran, ex-offender, previously unemployed, etc.)
- calculates the credit, which is a percentage of wages, a per-capita credit or based on the number of months worked,
- complete federal or state tax forms — generally one or two pages.

Employers and CPAs can set up manual or computerized systems to allow the employer to screen the employees before they are hired in order to streamline the documentation process and maximize the hiring credits. CCH, and its affiliate National Tax Credit Group, LLC has also developed a number of Web-based tools, which can assist in maximizing the identification of eligible employees and credits.

C Corps retain and utilize the credits at the entity level, while S Corps, LLCs and partnerships pass the credits out to the active equity owners, who can then offset all or a portion of their personal tax obligations. IRC 469 will limit the utilization of the credits in those instances where the investor is a passive investor.

It is recommended that the CPA charge separately for this project out from the annual tax return preparation since it does require incremental hours, but generally the benefits far outweigh the cost in most situations.

All of the above-referenced credits result in permanent tax benefits and can have a dramatic impact on a taxpayer's effective tax rate. While, the credits cannot generally reduce Alternative Minimum Tax (AMT), certain states allow full AMT offset, and unused credits can generally be carried over for 20 years for federal purposes and in some states, the credits never expire. This tax rate reduction results in enhanced cash flow, lower labor costs, lower after-tax capital expenditures and enhanced business valuations. Amended returns for three years or more, (if the statute has been extended due to audit, etc.) are allowed for federal purposes and certain states also allow amended return refunds.

CCH has a great Web-based tool that identifies all of these credits and provides forms and instructions. You can visit their site for details.

Hot Off the Presses!

On Friday, May 25, 2007, President Bush signed into law H.R. 2206, the "US Troop Readiness, Veterans' Care, Katrina Recovery and Iraq Accountability Appropriations Act of 2007." This law includes a 44 month of extension of the Work Opportunity Tax Credit (WOTC) through August 31, 2011 and a number of important program enhancements. A significant enhancement is the addition of high risk youths hired if they are from a "rural renewal county" as being eligible for the Federal Work Opportunity Tax Credit (WOTC) credit, which is up to $2,400 per year per eligible employee.

Conclusion

Ultimately, by claiming these above-mentioned tax incentives, the business owners are rewarded for their hiring practices and are often much more competitive in terms of operating cost reductions. The long term impact of the business owners' action also generally improves the lives of the employees as well as the communities in which the business operates.

Once business owners and their CPAs understand the financial and social impact of these programs, they do tend to alter their hiring practices and also tend to expand their facilities and workforce within the LBICs.

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