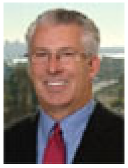

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Steering Tax Life on 'EZ' Street

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September 25, 2008
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Times are tough in many business communities and business owners across the country are more focused on looking at every opportunity to improve their bottom line. With combined federal and state burdens often in the 40 percent range, a material reduction in a company's tax rate can produce significant savings. If those savings can come in the form of a permanent tax savings (e.g. a tax credit or exclusion item versus a temporary difference, such as depreciation, income deferral, etc.), the economic gain to the business owners is enhanced.

The most abundant tax incentive programs throughout the country are the various Location Based Incentive Credits (LBIC) programs, which include state Enterprise Zone (EZ) programs (available in approximately 80 percent of the states and numerous federal LBIC programs available in virtually every state). These tax incentive programs were originally adopted in the U.K. to stimulate job growth in decaying "smokestack" regions throughout England. The U.S. government and a large number of states embraced the tax incentive concept in the early 1980s and today there are over 8,500 distinct LBIC zones throughout the U.S.

To summarize the widespread availability of these programs, following is a listing of the major programs and the number of programs (which can be revised weekly): 41 state Enterprise Zone (EZ) Programs; 40 federal Empowerment Zones (IRC Section 1396/ IRS Form 8844); 40 federal Renewal Communities (IRC Section 1400G and 1400H/ IRS Form 8844) and 20 federal Enterprise Communities (IRC Section 1391/IRS Form 8844) in over 39 states;, 408 federal Rural Renewal Counties (IRC Sections 51 and 52/Form 8850); 4,504 Indian Tribal Lands (IRC Section 1400E(a)(ii)/IRS Form 8844) and 149 Gulf Opportunity (GO) Zones (IRC Section 1400N and IRC Notice 2006-77). States with the most robust programs in terms of broad geographic coverage and/or credits per employee include: New York, North Carolina, Florida, Georgia, Michigan, Ohio, Illinois, Oklahoma, Louisiana, Mississippi, Arizona and California.

Nationally, over 20 percent of businesses have one or more locations that fall within an LBIC and of this eligible pool of businesses, less than 10 percent of these qualifying companies actually claim the benefits they are entitled to. As a result, CPAs, CFOs and tax directors have an excellent opportunity to dramatically increase shareholder value by taking advantage of the valuable tax incentives. Since the federal programs allow up to three years of amended return refunds and many states also allow retroactive benefit claims, immediate tax advantages can be secured along with favorable EPS impact.

The basic theory of Enterprise Zones and similar LBIC programs is that private employers will hire employees with various economic, physical or other challenges if the employers are provided with an adequate tax incentive. By shifting the burden of supporting these employee candidates from the state or local government to the private sector, government agencies can save significant monies and the impacted communities will generally see enhanced economic activities, including capital investment, job growth and increase in residential and commercial property values. Along with decreased unemployment rates, these communities typically see decreases in crime and increases in family incomes (see research results from Charles Swenson, CPA, PhD: http://marshallinside.usc.edu/ayse/EZ-2006-submission.pdf; http://www.hcd.ca.gov/fa/cdbg/ez/HCD_Final_Report.pdf).

These LBICs entitle businesses to hiring credits ranging from $500 per qualified employee to $14,000 per qualified employee. In addition to these highly valuable hiring credits, many state programs include equipment credits, grants, low interest loans and a variety of other tax breaks for businesses operating in economically challenged geographic regions. The federal Empowerment Zone and federal Renewal Community Zones programs have hiring tax credits ($3,000 and $1,500, respectively/annually) available for employees living and working in one of the zones. In addition, these programs include very valuable gain deferrals (via rollover) or full exclusions for certain appreciation on the sale of designated assets located within these tax incentive zones. See IRC Sections 1397B and 1400F, respectively.

A common underpinning of these LBIC programs is the requirement that any hiring credit or equipment credit claimed causes the taxpayer to add back the hiring credit (or reduce wage expense) to taxable income, as well as reduce the depreciable basis in the equipment by any tax credit claimed. This still leaves the taxpayer with a material tax savings; but due to the lower state tax rates, the net benefit from a state perspective is often much higher than the federal benefits in relative dollar terms.

Example: Assume a taxpayer in California has **Employee A**, who qualifies for a hiring credit under the California Enterprise Zone Program and generates a $3,000 employer hiring credit for the portion of calendar 2008 they worked. Also assume **Employee B** is a "qualified" employee under the federal Empowerment Zone Program and generates a $3,000 credit for the same employer. Assuming a 10 percent state tax rate and 30 percent federal tax rate (rounded/marginal), the after-tax savings for each employee, after adding back the credit or compensation deduction is as follows:

	CA	**Fed**
Tax Credit	$3,000	$3,000
Less Tax on credit/ wage add-back:	(300)	(900)
Net Tax Savings	$2,700	$2,100

The California tax credits may also result in incremental federal tax liability in cases where the taxpayer is not subject to AMT.

Since many state programs have relatively liberal definitions of which employees qualify for the hiring credit and the state credits are often larger for each qualifying employee, it is fairly common for employers to generate more state credits than federal credits. In some cases a business location may be in both a state and federal LBIC and the employer can claim dual credits on the same employee — although occasionally there are some scale-back of benefits in the statute.

Common qualifying criteria for employees include those who have been unemployed or threatened with layoff prior to getting hired, those receiving food stamps, welfare or other government assistance, military veterans and "ex-offenders."

While LBIC programs were originally designed to benefit manufacturing and processing employers with larger blue-collar workforces, most state and federal programs include both blue-collar and white-collar workforces and are accessible by virtually any industry other than gaming and in some states, retail establishments (which occasionally includes restaurants/fast-food establishments).

The federal credits and most state credits can be used to offset "regular" tax from both zone and non-zone taxable income; however, certain states such as California require taxpayers to apportion their California taxable income between zone and non-zone income based on apportionment factors (payroll and property, but not income) and limit credit utilization to the tax liability apportioned to zone activities.

In addition to these location-based credits, virtually any business can generate hiring credits for some portion (albeit often small) of their employee base through the Work Opportunity Tax Credit (WOTC) or Welfare-to-Work (WtW) programs, which can generate credits of up to $4,800 and $8,500 per qualified employee, respectively. The Small Business and Work Opportunity Tax Act of 2007 liberalized this program in terms of military "veteran" qualifiers, as well as now allowing the WOTC credits to offset both regular and Alternative Minimum Tax liabilities. See IRC Sections 51, 51A, 52 and IRS Form 8850.

Your clients will have operations in the vast majority of these LBIC regions. This offers you significant opportunities to assist them in identifying significant client tax savings on both a retroactive and prospective basis. To get started, you can utilize www.hud.gov to begin reviewing federal zones and state zones can generally be tracked down through the state or city Web sites.

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