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# Unmined Gold for Your Clients: Location-Based Credits and Incentives

*By Charles Swenson*

Charles Swenson discusses state and federal location-based incentives and their value to tax practitioners and their clients.

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## Introduction

Location-Based Tax Incentives (LBTI) = Lower Effective Tax Rates, Enhanced Profits and Cash Flow, and Improved Market Share for tax practitioners and their clients. This simple formula can be a critical differentiator for both businesses and their CPAs and tax attorneys.

“Location, location, location” is the mantra of realtors since the beginning of time, and with just a little education, tax attorneys, CPAs and corporate CEOs, CFOs and tax directors can quickly recognize the ease and value of utilizing location-based tax reduction tools.

As reflected in the recent popular press, there is growing awareness by taxpayers that their cost of operations, effective tax rate, and earnings-per-share are dramatically impacted by where they operate. The unclaimed benefits in the LBTI market easily exceed billions of dollars. The highly competitive California incentive credits market has less than 10 percent of eligible businesses participating, and the participation level in most other states appears to be even lower.

LBTI services are currently being provided predominantly by local boutique (non-CPA) firms, or a single office of a CPA firm serving a specified incentive zone. National payroll companies and a few public companies are also servicing a small percentage of this market but focus almost exclusively on certain wage credits, leaving hundreds of millions of dollars in other benefits—such as equipment credits, tax holidays, property tax breaks, etc.

CPAs and consultants generally provide LBTI services at a premium rate per hour, or on a contingent fee basis when allowed under AICPA and state law,



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making it a highly profitable service and a low-risk arrangement for the ultimate client.

Why is the identification of and documentation of LBTIs so overlooked? Throughout the United States there are thousands of specific business areas, which can allow businesses operating there to enjoy a variety of lucrative tax benefits, in some cases paying little or no income, property or sales taxes. Currently, 39 states have state-level enterprise zone (EZ)-type programs, and virtually every state has one or more federal incentive programs (e.g., work opportunity tax credit (WOTC), Federal Tribal Lands, Renewal Community, Empowerment Zones, etc.).

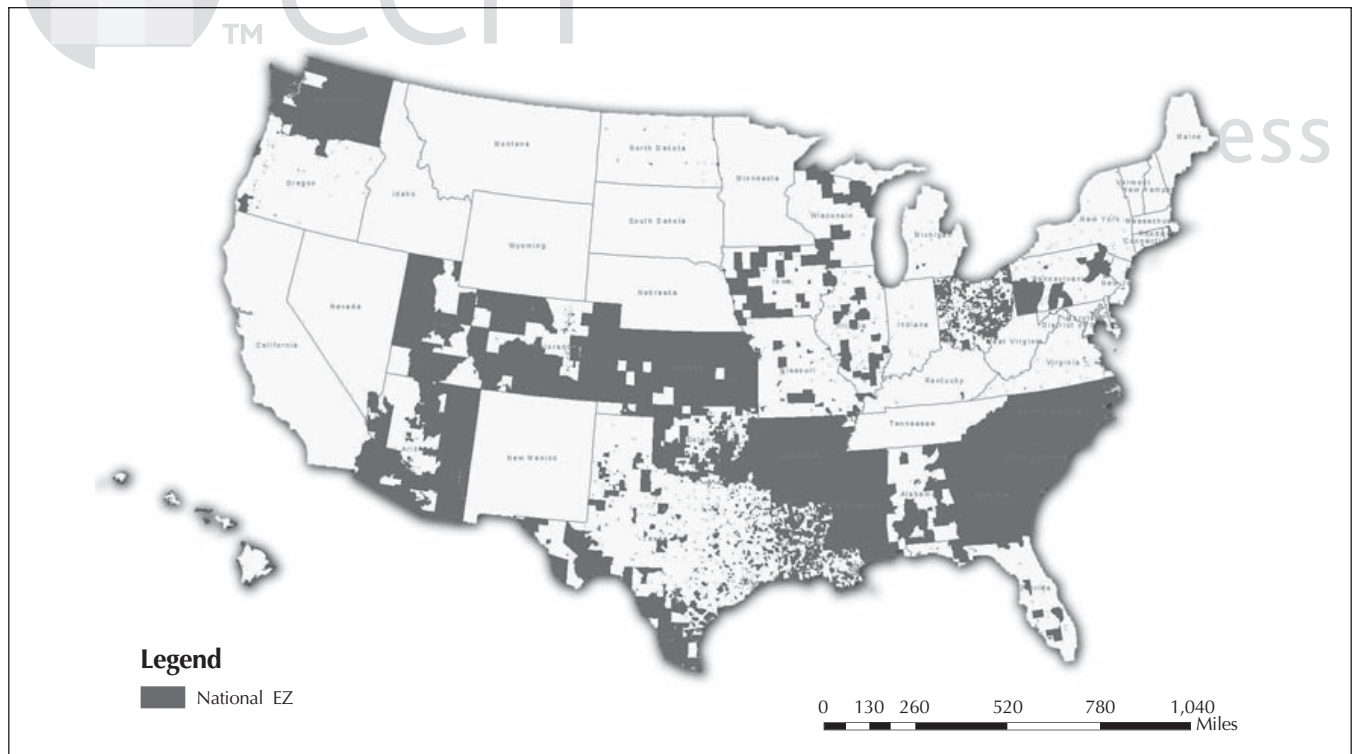
## State EZ Programs

Many EZs emerged starting in the early 1980s to encourage economic growth in areas which lag behind state expectations. These policies attempted to revive depressed urban areas by targeting tax breaks and other business incentives to specific geographic areas.<sup>1</sup> Although job creation is usually the explicit goal of these policies, policymakers often hope that the tax incentives aimed at encouraging businesses to relocate to (or to avoid leaving) these depressed areas will raise property values and expand the tax base. Various incentives are given for firms to

locate to or increase investment in such areas. The most prevalent incentives given are tax credits (on firms' state income tax returns) for increased hiring, increased investment in property and equipment, or as a percent of overall taxes.<sup>2</sup> Driven by the objective to create jobs, the majority of the states have labor-related tax credits. Other states have tax credits for both labor and capital, and three states have credits based on total taxes paid.<sup>3</sup>

The generosity of tax incentives for locating in an EZ varies widely across states. States also differ on the necessary qualifications for business to be eligible for tax credits. In California, establishments belonging to any SIC code may qualify for EZ credits, while in some other states, the activities are restricted to manufacturing, transportation and distribution centers. With respect to the labor-related tax credits, EZ policies in California are geared towards encouraging hiring of less-skilled individuals, even if they are not residents of an EZ, while in Indiana, firms are required to hire workers who are residents of EZs to be qualified for EZ credits.<sup>4</sup> In many states, minimum thresholds concerning unemployment rates, income, education levels, percent of vacant building, and decreases in population have to be met by local communities in order for them to be designated as an EZ.

Figure 1: National Enterprise Zones



Virtually all states approve individual EZs in a case-by-case manner, establishing individual EZ coordinators who validate credit eligibility requirements for firms within their EZs. Certain states also require an employer to increase its workforce or expand its facilities in order to be eligible for these credits. For the most part, states approve EZs on an individual basis and for a limited time.

Currently, 39 states have EZ programs as displayed in Figure 1. The annual tax benefits provided by these programs vary across states. California alone reports to have provided \$300 million in tax subsidies in 2003 to firms that located in the 39 EZ areas that existed in the state at that time. (There are currently 42 California EZs).

The geographic areas of EZs vary widely. For some states (Arkansas, Georgia, Mississippi and North Carolina), the entire state is effectively an EZ with benefits varying by the “tier” of each county. Other states, such as Michigan, may have EZ areas as small as a parcel of land.

As shown in Table 1, the types of benefits (hiring, machinery or general-profits income tax credits) vary significantly across states. A partial list of the amount of tax benefits is shown in Table 2.

Significant equipment credits, property tax breaks and other benefits can result in annual benefits in the tens of thousands to the millions for some taxpayers. Location-based credit consulting is an important service differentiator for tax directors and CPAs in public practice. CPAs can increase services to existing clients by providing EZ consulting services. By being able to provide EZ consulting to their corporations/clients, tax directors and CPAs can increase their reputation and impact on after-tax earnings.

In this author’s experience, less than 10 percent of state EZ and federal zone benefits are being claimed on a national level. So, there is a substantial untapped market for these services. Consultants can sometimes “zero out” tax liabilities for clients’ taxes in many states and dramatically reduce federal taxes. For example, states like Hawaii, Michigan, New York and Pennsylvania offer virtually tax-free status to firms locating in EZs. Such benefits extend to income, property and sales/use taxes. These services should also be carefully evaluated when a taxpayer is being audited by the federal or state tax authorities, since the credits can often offset all, or a significant portion of, any tax increases imposed by the auditors.

**Table 1: Enterprise Zone Starting Dates and Types of Tax Credits by State**

State	Starting Year	Payroll/Property Credit
Alaska	N/A	No/no
Alabama	1987	Yes/no
Arizona	1990	Yes/no
Arkansas	1993	Yes/no
California	1986	Yes/no
Colorado	1986	Yes/yes
Connecticut	1990	No/yes*
Delaware	1984	Yes/yes
Florida	1995	Yes/no
Georgia	1994	Yes/no
Hawaii	1994	No/yes*
Idaho	N/A	no/no
Illinois	1983	Yes/yes
Indiana	1983	Yes/no
Iowa	1994	Yes/no
Kansas	1990	Yes/no
Kentucky	1983	Yes/no
Louisiana	1981	Yes/no
Maine	2004	No/no*
Maryland	1992	Yes/no
Massachusetts	1987	No/yes
Michigan	1985	No/yes*
Minnesota	1985	Yes/no
Mississippi	1989	Yes/no
Missouri	1986	Yes/no
Montana	N/A	No/no
Nebraska	1994	Yes/yes
Nevada	N/A	N/A-no tax
New Hampshire	N/A	No/no
New Jersey	1988	Yes/no
New Mexico	2001	Yes/no
New York	1994	Yes/yes
North Carolina	1997	Yes/no
North Dakota	N/A	No/no
Ohio	1983	Yes/no
Oklahoma	1983	Yes/yes
Oregon	1985	Yes/no
Pennsylvania	2001	Yes/no*
Rhode Island	1992	Yes/no
South Carolina	1994	Yes/no
South Dakota	N/A	N/A-no tax
Tennessee	N/A	No/no
Texas	1995	Yes/yes
Utah	1997	Yes/no
Vermont	N/A	No/no
Washington	N/A	N/A-no inc. tax
West Virginia	1984	No/yes
Wisconsin	1989	Yes/no
Wyoming	N/A	N/A-no tax

\* indicates profits credit

**Note:** Pennsylvania and Minnesota changed to profits-based credits after 2000. Most of Kentucky’s EZs expired before 2004.

**Table 2: Enterprise Zone Benefits  
Types of Tax Credits by State**

State	Partial List of Potential Tax Benefits
Alabama	80% general tax credit
Arizona	\$3,000 hiring credit, lower property tax
California	\$32,000 employee hiring credit
Colorado	3% investment credit, hiring credit
Connecticut	50% general tax credit, property tax abatements
Delaware	Hiring and investment credits
Florida	Hiring credits, property tax credits, sales/use tax credits
Georgia	\$3,500 employee credit, property tax exemptions
Hawaii	80% general tax credit
Illinois	Hiring and investment credits
Indiana	Hiring credits
Maryland	\$9,000 employee hiring credits
Maine	Income tax, sales/use tax exemptions
Massachusetts	5% investment credit
Michigan	Income, property tax exemption
Minnesota	\$900 employee credit, sales/use and property tax breaks
Missouri	Hiring, general income tax credits
Nebraska	Hiring, investment credits
New Jersey	Hiring, investment credits
New York	Hiring credits; income, sales/use, property tax exemptions
North Carolina	\$12,500 employee hiring credit, investment credits
Oklahoma	Hiring, investment credits
Pennsylvania	Income, sales/use, property tax waivers
Rhode Island	\$15,000 employee hiring credit
Utah	Hiring, investment credits
Virginia	Hiring credits, tax abatements

**Note:** In addition to the above, Arkansas, Iowa, Kansas, Louisiana, North Dakota, Ohio, Oregon, South Carolina, Texas and Washington have lucrative EZ programs.

## Similar Federal Tax Zones

Starting in the 1990s, the federal government also designated special zones. These zones include Empowerment Zones (EMPZs), Renewal Communities (RCs) and Tribal Areas. Companies locating in these zones can receive tax credits (taken on their federal income tax returns) for hiring residents of the areas. EMPZs have such a credit (\$3,000 per EMPZ resident per year), and also have increased Internal Revenue Code Sec. 179 expensing (an additional \$35,000

per year). Both RCs and EMPZs provide employers a WOTC of up to \$2,400 for hiring 18- to 24-year-olds who live in the zones. Finally, both EMPZs and RCs allow states to issue tax-exempt bonds to finance certain investments in these areas. There are EMPZs and RCs in more than half the states. The annual tax benefits provided by these programs are estimated to be \$1.21 billion in 2006.<sup>5</sup>

## Lending Institutions

Banks enjoy special tax breaks in three states. In California and Illinois, interest income on qualifying interest from borrowers in EZs are excludable from taxation. Similarly, in Indiana, there is a five percent state tax credit for qualifying gross interest to borrowers in EZs.

## California Example

A manufacturer is located in both a California EZ and a federal Empowerment Zone. Forty of its 100 employees reside in the EZ and the EMPZ. Assuming each employee works a full year, meets other criteria, and earns \$40,000 per year, the California hiring credits total almost \$1.24 million over five years, and the federal hiring credits total \$600,000 over five years. The manufacturer is also eligible for credits on its California return for sales taxes paid on manufacturing equipment.

## Getting Started: Obtaining Tax Benefits for Your Clients

Practitioners can go to their state's EZ program and the state's revenue department Web pages to find locations of the state's EZ program, benefits and forms. For example, information on California EZs can be found at [www.caez.org](http://www.caez.org). Information on the federal zones can be found at [www.hud.us.gov](http://www.hud.us.gov).

## Conclusion

State EZ and federal hiring credits are a lucrative addition to a practitioner's skill set. Providing such services can bring added value to existing clients and serve as a market differentiator for practitioners seeking new clients.

ENDNOTES

<sup>1</sup> Exceptions are Arkansas, Georgia, Kansas, North Carolina and South Carolina where the entire state is an EZ. Counties in these states are given EZ status in proportion to lack of economic activity.

<sup>2</sup> Other incentives include property tax abatements, sales/use tax exclusions, workforce training grants and others. These benefits are less common, and are often given as a result of special negotiations. Accordingly, they are not discussed further in this article.

<sup>3</sup> A summary of these benefits, by type, and the starting date for EZs across states are shown in Tables 1 and 2.

<sup>4</sup> Qualified employees in California were required to fall under one of the following categories before 1997: Receiving services under the federal Job Training Partnership Act (JTPA); eligible to be a voluntary or mandatory registrant under the Greater Avenues for Independence (GAIN) Act, or eligible, as determined by the California Employment

Development Department, under the federal Targeted Jobs Tax Credit Program. In Indiana, a “qualified employee” is one who lives in the enterprise zone, works 50 percent of his or her time in the enterprise zone, and has at least 90 percent of his or her services directly related to the employer’s facility in the enterprise zone.

<sup>5</sup> *Projected Tax Expenditures Budget, 2004-2010*, Tax Policy Center (2004). The Tax Policy Center is a joint organization of the Urban Institute and the Brookings Institute.

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