



Dbriefs U presents:

# Business Tax Credits — Carrot or Stick?

**Gary Hecimovich, Deloitte Tax LLP**

**Jim Watts, Deloitte Tax LLP**

# Agenda

Introduction – Tax and public policy

Example – Energy tax credits (“going green”)

Types of credits

Credit mechanics

Case study – policy meets financial innovation

Career opportunities

# Introduction – Tax and public policy

- Congressional Budget and Impoundment Control Act of 1974 (the “Budget Act”)
- Normal income tax law vs. special income tax provisions
- Tax expenditures
  - “Revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.”
- Analogous to direct outlay
- Tax expenditures estimated for budgetary purposes
- Change in tax law as a means of accomplishing policy objectives

# Introduction – Tax and public policy (cont.)

## Federal policy

- Direct grants v. tax credits
- Examples:
  - Energy policy
  - Research and development
  - Domestic manufacturing
  - Community development
  - Short-term regional benefits
- President Bush
- President Obama

# Introduction – Tax and public policy (cont.)

## State policy

- Incentives to achieve local / regional results
- Environmental, charitable, social, economic policies
- Recent example:
  - Environmental - “going green”

# Example - Energy tax credits (going green)

## Federal Tax Credits

Credit Type	Credit amount	Credit period	Extended through
Energy credit (ITC) •Solar •Fuel cell •Others	30% or 10%	Investment based Placed in service	12/31/16
Renewable energy credit (PTC) •Wind •Biomass •Landfill gas •Hydropower •Others	2.1 (1.0) cents per kwh*  *adjusts annually for inflation	Production based 10 years	12/31/12 (wind) 12/31/13 (biomass and others)
Energy-Efficient Commercial Building Deduction	Up to \$1.80 per sq. ft.	Investment based	12/31/13
Energy-Efficient Appliance Credit	\$45 to \$250 various limitations	Per appliance	12/31/10
Energy-Efficient New Home	\$2,000	Per dwelling unit	12/31/09
Residential-Energy Efficient Property •Solar	30%	Investment based	12/31/16
Energy-Efficient Improvements to Existing Homes	30%; \$50 to \$300 limitations; \$1500 for 2009 and 2010	Investment based	12/31/10

# Example - Energy tax credits (going green)

## State Tax Credits

Credit Type	Credit Amount
Cincinnati, Ohio - Property Tax Abatement	Residential - 100% real property tax abatement for 15 years (new construction) or 10 years (existing renovations) max. value \$500,000. Commercial - 100% real property tax abatement for 15 years (new construction) or 12 years (existing building renovations).
Arizona - State sales tax exemption for retail sale of solar energy devices by contractors.	State portion of sales tax currently (5.6%).
Florida - State sales & use tax credit for fuel cells, biodiesel and ethanol cost incurred between July 1, 2006 – June 30, 2010.	75% of all capital operation, maintenance, and research and development costs incurred in connection with investment in hydrogen powered vehicles and hydrogen fueling stations (credit capped at 3 million). 75% of all capital operation maintenance, research and development costs incurred in connection with an investment in the production, storage, and distribution of biodiesel and ethanol in the state (credit capped at 6.5 million). This includes the cost of constructing and installing such technologies.

# Example - Energy tax credits (going green)

## New York green buildings credit

- Amount of credit varies by projects, but is capped at \$2 million per building
  - Green Whole-Building: Up to \$150/sq. ft. for base building and \$75/sq. ft. for tenant space aggregate cost
  - Green Base Building: Up to \$150/sq. ft. aggregate cost
  - Green Tenant Space: Up to \$75/sq. ft. aggregate cost
  - Fuel Cell: Up to \$1,000 per kilowatt
  - Photovoltaic Module: Up to \$3 per watt
  - Green Refrigerant: Up to 2% of the cost of air conditioning equipment using a non-ozone depleting refrigerant

### Hearst Tower – A recent example

“Diagrid” frame will contain roughly 20% less steel – saving approximately 2,000 tons of steel

Daylight sensors to control lighting and reduce energy use

Over 90% of structural steel contains recycled material

# Types of credits

- Location
- Eligible investment
- Workforce / job creation

# Types of credits - Location

- Federal
  - New Markets Tax Credit
  - Empowerment Zones and Renewal Communities
  - Gulf Opportunity (“GO”) Zone
  - New York Liberty Zone
  - Foreign Income
- State
  - Economic Enterprise Zones
    - Inner-city investment
    - Economically depressed areas
    - Technology zones

# Types of credits – Eligible investment

- Federal
  - Research and development
  - Renewable and alternative energy
  - Low-income housing
  - Historic rehabilitation
- State
  - Targeted investment tax credits
    - Manufacturing property
    - Pollution control equipment
  - Research and development
  - Renewable and alternative energy

# Types of credits – Workforce/job creation

- Federal
  - Work Opportunity Tax Credit (WOTC)
  - Empowerment Zone and Renewal Community Employment Credits (EZEC/RCEC)
- State
  - Job training credits
    - Customized labor training
  - Job creation credits
    - Incremental growth
    - Enterprise zone employment

# Poll question #1

One of the community's largest employers recently relocated its operations to another state, leaving several hundreds of skilled workers unemployed in the area. Which of the following types of credits are most likely to be considered to remedy the unemployment situation?

- Location
- Eligible investment
- Workforce/job creation
- Location and workforce/job creation

# Poll answer #1

One of the community's largest employers recently relocated its operations to another state, leaving several hundreds of skilled workers unemployed in the area. Which of the following types of credits are most likely to be considered to remedy the unemployment situation?

- Location
- Eligible investment
- Workforce/job creation
- **Location and workforce/job creation**

# Credit mechanics

- Credits are taken after computing tax
  - More valuable than deductions
  - Results in permanent tax savings
  - Reduces effective tax rate for financial statement purposes
- Expenses upon which credits are computed must generally be reduced by the amount of the credit
  - Prevents complete “double dipping”

# Credit mechanics (cont.)

- Limitations are placed on:
  - Ability to utilize credits
  - Current year limitations
  - Carryforward and carryback limitations
  - Other limitations:
    - Alternative minimum tax
    - Passive activity losses
    - At-risk rules
- Ability to sell or transfer credits

# Credit mechanics (cont.)

- Special features and issues apply to certain credits:
  - Transferability
    - Creates a market for unused credits
      - Structured financing
  - (Non)refundability
    - May create a refund even when no tax is paid, or
    - May permit a credit only to the extent of a tax liability
- Audit trends
  - Heightened scrutiny (all states)
  - Recent California decision

# California Enterprise Zone

## Dicon Fiberoptics, Inc. v. Franchise Tax Board (FTB) (2nd App. Dist. May 7, 2009)

- On March 13, 2007, Dicon filed a suit for refund challenging the FTB's authority to audit documents supporting properly signed enterprise zone vouchers
- Case was dismissed and Dicon appealed
- The California Court of Appeals ruled that the FTB has legal authority to audit vouchers issued by local Enterprise Zone agencies that handle the voucher process
- The California Court of Appeals, however, provided significant new guidance for taxpayer's under FTB audit:
  - The Court held that a signed voucher is “prima facie” proof a worker is a “qualified employee.”
  - The Court further ruled that the FTB bears the burden of proof in rebutting the voucher's prima facie value as evidence that an employee is a “qualified worker.”
  - Further, the FTB may not rely on an employer's failure to produce documents establishing a worker's eligibility to the extent regulations governing the tax credit charge the enterprise zone, not the employer, with the obligation to maintain documents of workers' eligibility.

## Poll question #2

The government grants a non-refundable credit equal to 25% of qualified investment property purchased during the year. XYZ Co. bought \$400 of qualified property during 2008. XYZ Co. has \$75 in taxable income before consideration of tax credits. The tax rate in effect for 2008 is 20%. How much of a credit can XYZ Co. claim on its 2008 tax return?

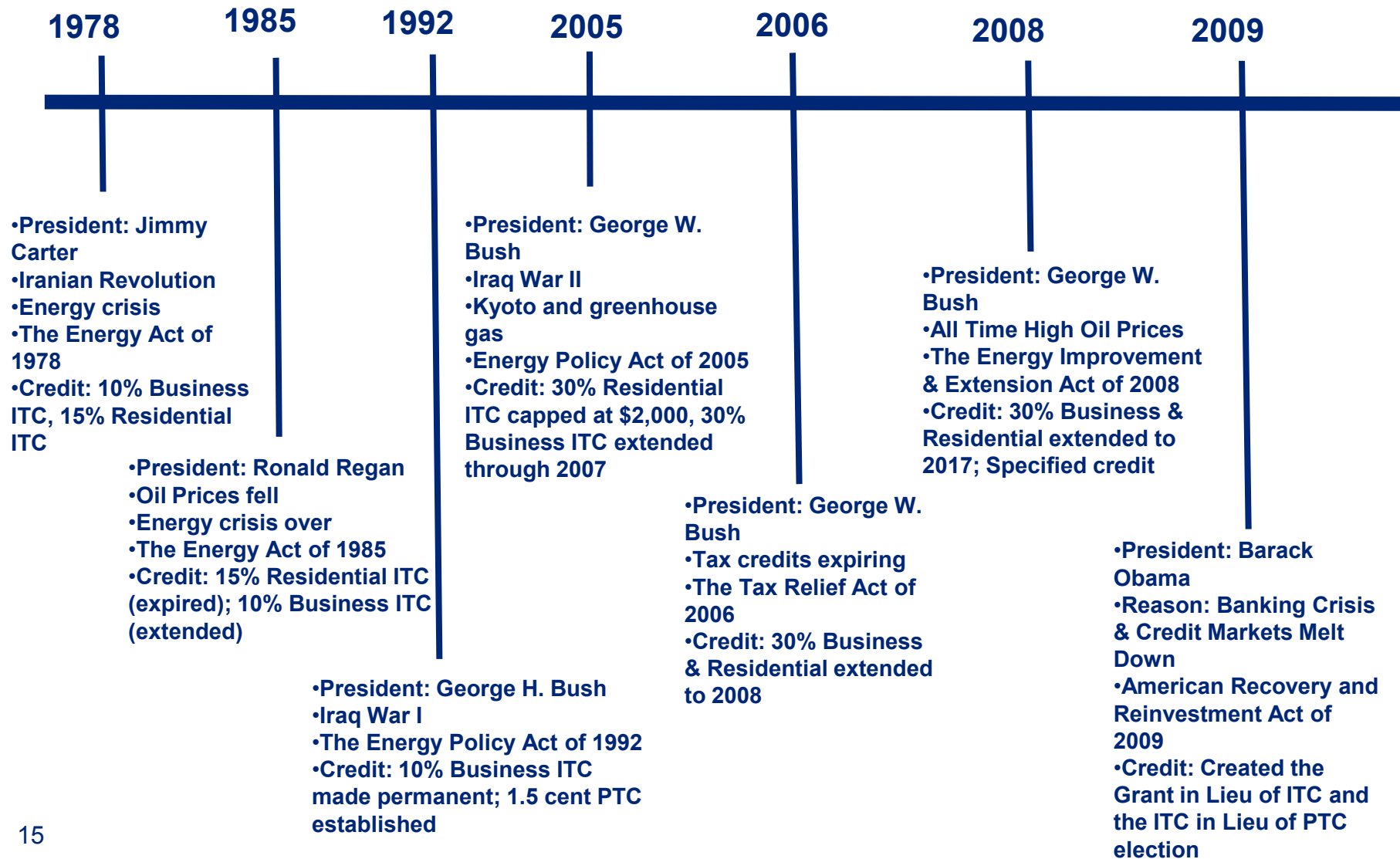
- \$0
- \$15
- \$60
- \$75
- \$100

# Poll answer #2

The government grants a non-refundable credit equal to 25% of qualified investment property purchased during the year. XYZ Co. bought \$400 of qualified property during 2006. XYZ Co. has \$75 in taxable income before consideration of tax credits. The tax rate in effect for 2006 is 20%. How much of a credit can XYZ Co. claim on its 2006 tax return?

- \$0 – Incorrect; non-refundable credits can be taken to the extent of the tax liability
- **\$15 – Correct**
  - $\$400 \times 25\% = \$100$  potential credit
  - $\$75 \times 20\% = \$15$  tax liability (limitation on non-refundable credit)
- \$20 – Incorrect; do not apply the tax rate to credits – credits are taken dollar for dollar against tax
- \$75 – Incorrect; credits are taken against the tax liability, not taxable income
- \$100 – Incorrect; non-refundable credits are limited to the tax liability

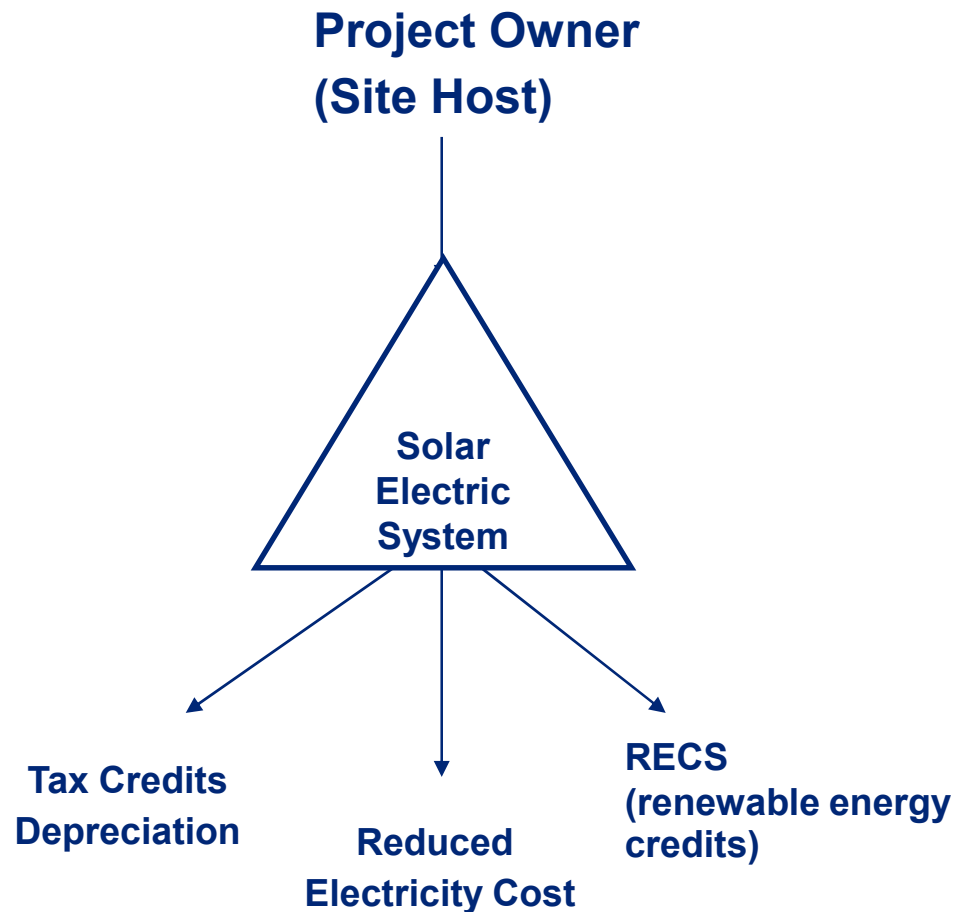
# Solar tax credit – Policy meets financial innovation



# Solar tax credit – Finance structures

## Owner/operator – The early days

### Example structure



### How it works

(1) Site Host finances purchase and installs Solar PV System based upon the strength of their balance sheet.

(2) Operate the system

### Benefits

Site Host:

- Electricity
- Federal ITC Credits
- Accelerated Depreciation
- RECS
- If available State incentives

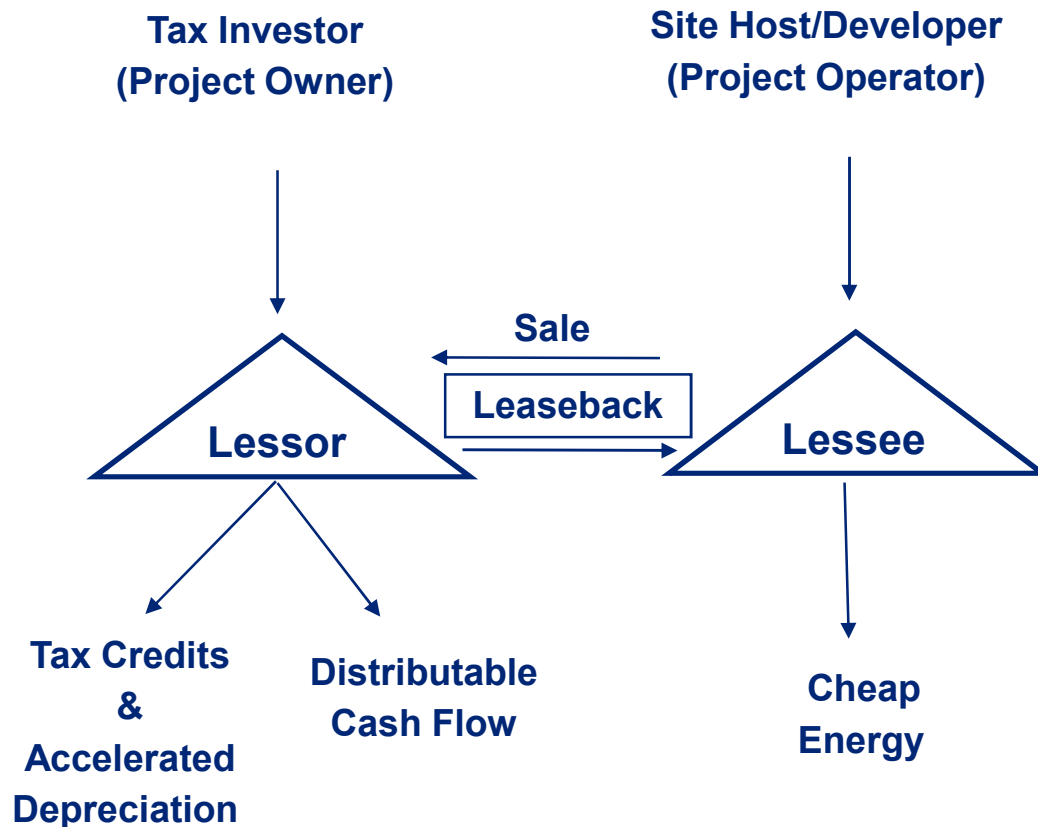
### Potential issues

- Site Host can not use the credits
- Site Host needs to have a strong balance sheet to take on the debt
- Developing & running a PV system may be a distraction from Site Host core business

# Solar tax credit – Finance structures

## Sale leaseback – Credit increased to 30%

### Example structure



### How it works

- (1) Site Host purchases & installs of a Solar PV System
- (2) Sell the system to a Tax Investor who leases the system back to the site host with annual lease payments equal to energy savings

### Benefits

Tax Investor:

- Tax Credits
- Accelerated Depreciation
- Small amount of cash flow

Site Host:

- Reduced electricity cost
- No up front cash to finance system
- Potential to purchase system at end of lease term

### Potential issues

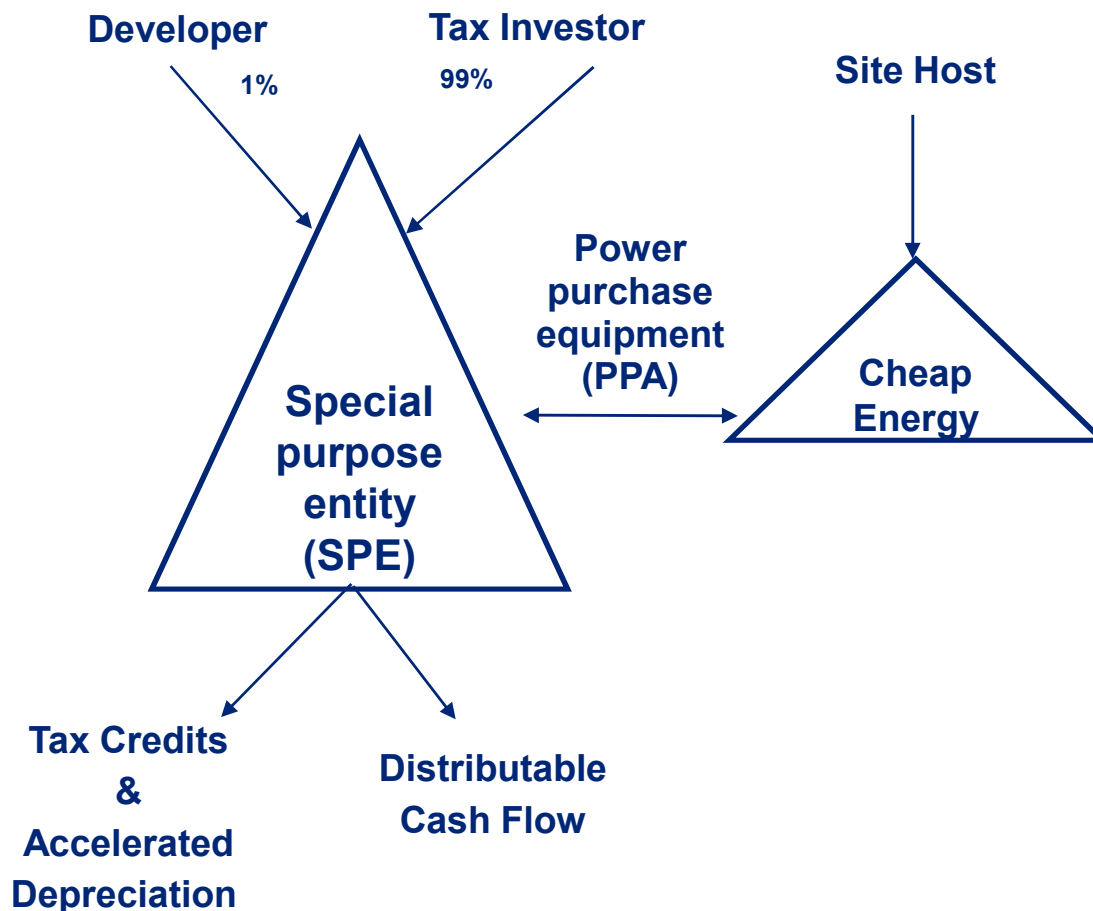
- Site host still has to develop and maintain the system
- Higher structuring cost
- Site Host will typically guarantee the tax benefits to the Tax Investor

Copyright © 2009 Deloitte Development LLC. All rights reserved.

# Solar tax credit – Finance structures

## Power Purchase Structure (PPA)

### Example structure



#### How it works:

- (1) Site owner leases their roof to the Developer
- (2) Developer builds & operates the Solar PV System.
- (3) PV system is placed in a Special Purpose Entity (SPE) which the Developer owns 1% and a Tax Investor owns 99%. The equity from the Tax Investor is used to finance the system/
- (4) SPE enters into PPA with Site Host

#### Benefits:

##### Tax Investor:

- Tax Credits
- Accelerated Depreciation
- Small amount of cash flow

##### Developer:

- Development fee upfront
- Annual fee for maintenance of system

##### Site Host:

- Reduced electricity cost
- No up front cash to finance system
- Potential to purchase system at end of lease term

#### Potential issues:

- Higher structuring cost
- 3<sup>rd</sup> party developer could have issues if site is foreclosed upon
- Developer will typically guarantee the tax benefits to the tax investor

# Career opportunities

- Jobs and career paths
  - Tax credit syndication industry
  - In-house staff credits and incentives focus
  - Accounting or law firm
  - Boutique firms
- Locations
- Benefits
- Projects

## Poll question #3

Which of the following factors would be the most likely to attract you to pursue a career involving tax credits and incentives?

- Compensation and job benefits
- Impact of my work on society
- Ability to influence business decisions
- Variety of opportunities and career paths
- All of the above

# Poll answer #3

Which of the following factors would be the most likely to attract you to pursue a career involving tax credits and incentives?

- Compensation and job benefits
- Impact of my work on society
- Ability to influence business decisions
- Variety of opportunities and career paths
- **All of the above**

# So why do business tax credits matter?

- Credits play an important role in public and tax policy at both federal and state levels;
- Companies value them, and seek advice and counsel in how to calculate and claim them;
- Working in this tax area is an opportunity to play a positive role in a timely socio-economic area:
- It's fun

# Contact info

Gary Hecimovich

202-879-4936

[ghecimovich@deloitte.com](mailto:ghecimovich@deloitte.com)

Jim Watts

214-840-7548

[jimwatts@deloitte.com](mailto:jimwatts@deloitte.com)

**Deloitte.**

# Dbriefs U

Tax webcast series for students

Log in and learn more at

[www.deloitte.com/us/dbriefsu](http://www.deloitte.com/us/dbriefsu)

This presentation contains general information only and is based on the experiences and research of Deloitte practitioners. Deloitte is not, by means of this presentation, rendering business, financial, investment, or other professional advice or services. This presentation is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte, its affiliates, and related entities shall not be responsible for any loss sustained by any person who relies on this presentation.

Recorded on June 29, 2009.

**Deloitte.**