Commonly Overlooked Tax Incentives for Business Owners, Part 1

Use government programs to lower tax bills while creating jobs and wealth

By Blake Christian

Key Takeaways:

- Taxpayers investing in their businesses should look carefully at these asset- and employee-based incentives which can significantly reduce federal and state tax liabilities and provide the business with enhanced cash flow for expansion or debt reduction, thereby generating more investable cash.
- Useful sites for federal and state credits include www.hud.gov and www.dsireusa.org. Googling "GoBiz" or "Enterprise Zone" will also provide information on certain state-level incentives.

Now is the time of year that many business owners are asking their financial advisors for help with tax planning for 2015 extensions, 2016 and beyond. As many CPAs are aware, there are a wide variety of federal and state tax credits and other incentives that are readily available but often overlooked by businesses and their tax advisors.

Federal, state and local tax incentives

While the vast majority of tax planning efforts are focused on the timing of taxable income and tax-deductible items (temporary or timing differences), there are literally hundreds of federal tax incentives (permanent differences) that encourage taxpayers to invest in certain equipment, hire certain types of employees, operate in certain regions or invest in certain industries.

Most of the federal incentives are statutorily defined, so taxpayers can easily access these credits and other incentives without negotiating with the federal government before becoming eligible. However, there are also a variety of grants and exemptions that may require applications or negotiations with federal agencies.

State and local incentives, however, fall into two general categories—"Pre-Qualification" programs and "Non-Pre-Qualification" programs.

For example, of the approximately 40 State Enterprise Programs, which vary in specific incentives (but which typically have hiring and equipment credits as core program benefits), roughly two-thirds are in prequalification states.

Preqqual States typically require taxpayers to apply to state agencies in advance of starting a business or prior to expanding their operations. They must also obtain approval to participate in the state program. Examples of prequal states include New York (Empire Program), Texas (Enterprise Zone) and California (Enterprise Program). Again, the majority of states require advance approval for their larger incentive programs.

Non-prequal states simply require taxpayers to meet certain statutory criteria to be eligible for the tax incentives or other financial incentives. In many cases, simply hiring employees in certain geographic regions or purchasing designated equipment (e.g., manufacturing or environmental). Florida, Utah and

Arizona are examples of states that offer certain incentives covering all or significant parts of their states. But many states do not.

In addition to these major state incentive programs, most states (and local jurisdictions) have a healthy variety of other statutory credits and exemptions. These benefits generally apply to corporations but occasionally extend to individual taxpayers via flow-through credits from LLCs, partnerships and S corps. In the current competitive environment for attracting and retaining businesses, states and municipalities are often open to negotiating short-term and long-term income/franchise tax holidays, property tax exemptions, sales tax rebates, low-interest loans, and even land and building transfers.

Since credits claimed often have an offsetting impact on depreciation or wage deductibility (to avoid double-dipping), the net, after-tax federal benefit can often be less than the after-tax benefit for similar credits at the state level.

The moral here is "A credit is a credit," but don't look down your nose at state- and local-level credits. Business owners and their advisors should explore all available federal, state and local incentives because they have significant value.

Federal business tax credits

Following are examples of various federal credits available for certain asset acquisitions and new hires.

As anticipated, at the end of 2015, Congress extended many of the of the previously expired tax incentive provisions, primarily the Research and Experimentation Credit, the Empowerment Zone Credit and the Work Opportunity Tax Credit (WOTC). In past years, extension of these credits had been retroactive to the beginning of the year and generally only extended a year at a time. However, with tax savvy Paul Ryan as the new Speaker of the House many of these incentives were made "permanent" (until a future Congress decides otherwise), with the exception of the WOTC Credit, which was only extended through 2019.

Research and Experimentation Credit

IRC Section 41 provides a relatively common credit, which is a general business tax credit for companies that are incurring R&D expenses in the United States. A taxpayer is entitled to a research credit for qualifying amounts (generally W-2 amounts paid to research-focused employees and/or for certain outsourced research) paid for or incurred during the tax year. . The credit is generally equal to 20 percent of the amount by which the qualified research expenses exceed a specific base amount, unless a simplified method is elected. Many states also have a similar credit.

Empowerment Zone Employment Credit

IRC Section 1396 provides an incentive to businesses that are located in distressed urban and rural areas in need of economic revitalization, known as empowerment zones (EZ). The credit is available to businesses located in an EZ hiring and retaining employees who also live in an EZ. Businesses are eligible for a wage credit of up to $3,000 per eligible employee. The credit amount can be as high as $3,000 (20 percent of the first $15,000) of wages paid to the employee.

Conclusion

Business owners and their advisors who take the time to dig into these incentives for their businesses will be pleasantly surprised by the wide variety of tax and economic benefits to which they are entitled. In Part

2 of this article, we will look closer at a number of other valuable, but often overlooked credits that business owners and their financial advisors should seriously consider.

About the Author

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