SALT BUZZ HF

Credits and Incentives Considerations for the Pandemic

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With many businesses struggling to stay afloat during the COVID-19 pandemic, especially due to stay-at-home and similar orders, the things that are upmost in business owners' and managers' minds are likely meeting cash flow needs and applying for federal loan or other rescue programs under recently enacted legislation. Next on the list may be the strategizing of the business's bounce back as the economy gradually returns to something approaching normal when the first – and hopefully last – wave of the virus recedes and people are cleared to go out again, and confident enough to spend money again. Those credits or incentives for which a business has an agreement in place or regularly qualifies may be much lower on the urgency list. However, there are good reasons to give these incentives some thought as we reach the pandemic's peak and begin to gain a view of the other side.

For one thing, if your business has an incentive agreement in place that requires you to reach or maintain an employment target, the question is, are you on track to meet or maintain that target as of the next reporting period? Moreover, even if the requirement is met, have you retained enough employees that the credit continues to calculate at the amount you budgeted? Some credits are based on those employees on the payroll as of a certain date, such as the end of the reporting period, while others are based on an average or total payroll over the course of the period. Thus, even temporary furloughs may impact the credit calculation, and may have a significant impact if they stretch past the measurement date. Now might be a good time to analyze your payroll in relation to your credit agreements.

As an example, many Ohio taxpayers have a Jobs Creation Tax Credit (JCTC) or, to a lesser extent, a Jobs Retention Tax Credit (JRTC) that was approved in the past and for which the taxpayer has an agreement in place with Ohio's Tax Credit Authority ("TCA"). These credits require a certain number of employees remain on the payroll and are calculated based on the total income tax revenue generated by the taxpayer in maintaining a paid workforce. There are two primary hazards at issue when the workforce is reduced. One is that the TCA has the right to require the taxpayer to pay the state back a portion of the credit previously granted, a provision commonly known as a "clawback." Under Ohio Revised Code § 122.17(K), the TCA may require such a clawback of the JCTC[1] if the taxpayer fails to substantially meet the job creation, payroll, or investment targets to which they agreed or if, after having met these agreements by the metric evaluation date, the taxpayer does not substantially maintain the number of new employees or payroll at a subsequent evaluation date, as reported on the taxpayer's annual compliance report. Such a clawback may also be imposed if the taxpayer declares bankruptcy and fails to maintain operations at the location of the project for which the credit was granted.

The second hazard involves the withholding adjustment factor ("WAF") that was devised in order to maintain credit levels subsequent to a decrease in Ohio's personal income tax rate, since such a decrease would otherwise reduce the calculated amount of credit.[2] The WAF, which is currently 12.806%, is multiplied by the taxpayer's reported income tax revenue and the product is added to the calculated credit amount. However, the taxpayer does not gain this valuable adjustment unless it has achieved one hundred percent (100%) of its new employment commitment, its new payroll commitment, and its investment commitment for the reporting period. While investment, once met, does not normally diminish later, employment numbers and total payroll fluctuate, and a decrease below what was initially promised in either will eliminate application of the WAF for that year. Thus, a taxpayer that does not satisfy one hundred percent (100%) of its employment, payroll, and investment commitments will not receive the WAF adjustment on the portion of the payroll that met the taxpayer's payroll commitment and qualifies for the credit. The taxpayer's credit would be limited to the actual tax on the payroll retained during the period without an adjustment. While the JCTC statute requires the TCA to "consider the effect of market conditions" on the taxpayer's project while determining whether and how much of a clawback to implement, it does not have a similar provision for the application of the WAF.

Even apart from the potential for a clawback or the non-application of the WAF, if the size of a payroll credit was calculated in a previous quarter, this calculation needs to be reevaluated

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1 Similar provisions apply to the JRTC under Ohio Revised Code § 122.17(J)

2 For the JCTC, the WAF is codified at Ohio Revised Code § 122.17(S); for the JRTC, at § 122.171(O)

if it was based on payroll that has declined dramatically. For instance, assume a taxpayer, as of December 31, 2019, was expecting a 2020 JCTC of $1,000,000 based on its expected payroll during calendar year 2020 and budgeted for this amount. Without any review, a receivable may have been accrued on the company's financial statements based on the budgeted amount. However, if a major furlough or series of layoffs at the project location were needed in response to pandemic conditions, both the budget and the accrual would need to be adjusted downward based on actual payroll during the period. Therefore, it is important to calculate the impact of workforce reductions on payroll credits as budgets are reconsidered and accruals recorded. Other types of incentives, such as TIFs and CRAs, may also be tied to employment and investment goals, so businesses with these incentive agreements should consider whether recent events may impact these agreements as well.

It may be reasonable to expect relief from the jurisdictions, whether state or local, that provide the incentives you've been using. However, there are multiple factors to keep in mind. For one, if credit relief requires legislative action, it is possible the legislature or local governing body is not in session and will not be in session in time to provide this relief. Numerous state legislatures ended their session early due to the COVID-19 pandemic, while others had already finished or will end their sessions for the summer without taking action. Even where the legislature or other body is able to meet, they have conflicting interests, making the results hard to predict with certainty. While all jurisdictions wish to see their local economies recover as quickly as possible, they also have higher than usual fiscal needs as a result of the pandemic: unemployment is at an all-time high in many jurisdictions, while there have been many emergency expenditures for such things as medical supplies and equipment. At the same time, most states assisted taxpayers by allowing a deferral of their various tax payments, creating both a budgetary issue given the timing of receipts after the states' fiscal year end, and a cash flow issue as the payments are not only delayed, but in many cases will not come in at all due to business bankruptcies.[3] State and local jurisdictions may not be able to provide much relief when it comes to incentives.

On the other hand, these jurisdictions have every reason to want to help businesses recover, as this is the only way to achieve fiscal stability. Therefore, if the jurisdiction can afford it, we may see some of the following forms of relief:

- Continued deferrals of filing due dates, especially if the due date falls before the end of stay-at-home or similar orders.
- New offerings for small businesses to encourage investment or (re)hiring.
- Waivers of jobs requirements built into current credit programs where the business can prove it was impacted by work-from-home or similar orders.

Therefore, it is an important time to track state and local developments to be aware of what the governing bodies and administrative agencies are considering, and to participate in the process if it makes a difference to your business.

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3 Federation of Tax Administrators, https://www.taxadmin.org/covid19-federal-impact, last visited Apr. 27, 2020.

Other actions to consider include reviewing your compliance requirements for those incentives you're currently committed to, even if compliance is not due for some time. Will you be in compliance based on your headcount projections? If it appears likely you will not be complying, it is never too soon to reach out to the economic development officer or other contact person at the jurisdiction and discuss your situation. Proactivity may help to avoid a costly clawback that might otherwise be imposed. For businesses with Ohio incentives in place, however, we do expect that a global policy may be put in place at the administrative level to prevent remedial action where employment targets have been met in all years except 2020. Regarding the WAF, though, legislative action is required to allow any exceptions to the statutory requirement of one hundred percent (100%) compliance before the adjustment may be applied.

The Ohio Legislature is planning to return to Columbus in the very near future to pass some much needed legislative priorities, mainly to resolve budget shortfalls (declining tax revenues, coupled with additional spending) as a result of the Coronavirus and for the need to get our economy up and running again. It is anticipated there could be a $2 billion+ deficit, so state agencies are looking at implementing twenty percent (20%) cuts across the board to help offset some of the losses and the Legislature is looking at tapping the "rainy day fund" to help as well. We expect legislators to develop a series of recovery tax credits, grants, loans and other programs when they return.

If you have specific concerns about your company's credits and incentives or similar agreements in Ohio and would like assistance in negotiating with the taxing authorities or participating in the legislative process, please contact Tom Zaino, Rich Bitonte, Derek Heyman or any other ZHF professional.

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