MSNBC.com

Learning the Ropes: Seeking tax incentives is an arduous process, but help is available for interested companies

By John R. Karman III

Business First of Louisville

Updated: 8:00 p.m. ET April 30, 2006

David Dafoe was skeptical of the whole process.

The president and CEO of Pro-Liquitech LLC, a Louisville company that develops flavors and products for the beverage industry, had seen steady growth in his business over the course of 13 years and needed to expand his facility and add jobs.

But the investment, which he estimated at $1.2 million, was a daunting one for his small company. The idea of seeking tax incentives from the state to help offset the expenses associated with his plans didn't appeal to him either.

The concept seemed confusing and difficult and rife with red tape.

Dafoe had seen news reports of companies that received tax incentives from the state, but he didn't know how the process worked or what state and local resources were available to walk him through the system.

But as he and his associates began learning about Kentucky's incentive programs and worked with officials from the Kentucky Cabinet for Economic Development and Greater Louisville Inc., the metro chamber of commerce, he came to realize that applying for tax relief from the state would help him.

Dafoe hired Marty Snyder, a friend and associate with a history of experience as an entrepreneur, to find out about the process. Snyder contacted GLI and later worked with state economic development officials as Pro-Liquitech made plans to expand.

Last year, Dafoe filed an application with the state, which was reviewed by the Kentucky Economic

Development Finance Authority, the board within the cabinet that oversees the state's business incentive programs.

Company plans to expand, add jobs in West Louisville

In December, Pro-Liquitech received preliminary approval from KEDFA for up to $400,000 in state tax credits over 10 years. The company also received approval for $33,300 in tax rebates.

As a result, Dafoe plans to move his company headquarters from its current location in leased space at 10801 Electron Drive in Bluegrass Research and Industrial Park to a larger facility Pro-Liquitech is buying on South Eighth Street in West Louisville.

The company also plans to add 16 jobs to its current employment of 11.

Without the assistance from the state, Dafoe said, the moves wouldn't be possible.

"The numbers don't make sense until you start looking at incentives to help defray some of the costs," he explained.

Process can take months

Companies interested in pursuing state tax incentives to offset business expenses must go through a thorough review process before filing an application with the KEDFA board.

The process, which helps determine whether a company is eligible for incentives and which program is most appropriate, can take several weeks or several months, depending on the complexities of the proposal and the needs of the individual business.

Dafoe's company was granted state tax incentives under the Kentucky Industrial Development Act, a program in which companies that invest in new manufacturing projects or expand existing plants may qualify for tax credits.

To be eligible, companies must create at least 15 new full-time jobs, meet salary requirements and make a capital investment of at least $100,000 in land, buildings, fixtures and equipment.

Companies approved under KIDA, one of the state's most widely used programs, may receive up to a 100 percent credit against Kentucky income tax liability on taxable income generated by the project for up to 10 years.

Or a business may retain a job assessment fee of 3 percent of the gross wages of each employee whose job is created by the approved project and who is subject to Kentucky's individual income tax.

Pro-Liquitech's tax rebates were granted under another program, the Kentucky Enterprise Initiative Act.

KEIA was created to help attract new businesses or encourage the expansion of existing ones that are involved in technology, manufacturing or tourism activities.

The program allows companies to get a refund of the sales and use tax paid for construction materials, building fixtures and research and development equipment purchased for use on approved projects.

In addition to KIDA and KEIA, Kentucky offers a number of other incentive programs for businesses.

Eligible companies must add jobs, make investment to get benefits

Kentucky's current incentive programs, which are geared toward nonretail entities, were created in the late 1980s and early 1990s as a way to try to level the playing field with competing states and make it more attractive for new and existing businesses to locate or expand here.

The packages offered today are performance-based, meaning businesses must meet investment, hiring and salary thresholds stated in their applications to receive benefits, said Gene Strong, secretary of the state Economic Development Cabinet.

Prior to 1989, most of the state's incentive programs were cash-based, consisting of a variety of grants, bonds and forgivable loans, he said.

The way the programs work today is if a company invests here, hires workers, creates a tax liability and makes a profit, the incentives allow the business to offset business costs by keeping a portion of taxes it ordinarily would have to pay, Strong explained.

"If the company does perform, we feel like it makes sense for the state and the community to form a partnership with (it) long term," he said.

Incentives one of many considerations for growing businesses

Strong stressed that the availability of incentives is only one consideration that a company should examine before planning to locate or expand in Kentucky or another state. Other factors for study can include the cost of property, availability of workers and education levels of the work force, highway accessibility and transportation options, labor environment and quality of life.

"We're very leery" of companies that immediately ask about incentives, Strong said. "That should not be the first question. There are lots of things that are more important.

"At the end of the day, a company will go where it can make the most money," he added. "That's where an incentive can play a role. An incentive does have the ability to lower the state-imposed cost of doing business. An incentive won't make a bad deal good. It can make a good deal better."

Process includes oversight by state cabinet, GLI

In Louisville, the application review process involves officials with GLI, Louisville-Jefferson County Metro Government and the state economic development cabinet.

Louisville Metro Government outsources many of its economic development activities to GLI through a partnership arrangement.

An extensive amount of background is gathered, and GLI and the cabinet evaluate the company by studying a number of criteria, including current and anticipated employment, investment and reasons for growth, according to Daryl Snyder, director of strategic relationships with the chamber.

Companies "may have predisposed ideas about what they want to do and what they think they need," Snyder said. "We seek first to understand. There are probably 25 factors that we look at, and then we rate them. Our agenda is to make Louisville an economic hot spot and to make this a prosperous community."

Typically, when a company comes to GLI with a project, chamber officials notify the cabinet, request a project manager and set up a meeting or conference call with the interested company.

As part of the review process, the company files a "pre-application" with GLI, where it plots out its plans for investment and hiring.

GLI's efforts were much appreciated, said Dafoe, of Pro-Liquitech.

He said he had allowed his chamber membership to lapse in recent years because he had been disappointed with the services he received. But his opinion changed after working with GLI on his expansion project, and he rejoined the chamber.

After studying a company's pre-application, GLI makes a recommendation on a project to Louisville Metro Mayor Jerry Abramson based on economic impact.

The mayor must sign a letter of support for any local project before it can be forwarded to Frankfort.

The city has a variety of incentives of its own, including participation with the state in another program, the Kentucky Jobs Development Act, said Bruce Traughber, secretary of Louisville Metro Government's Community Development Cabinet.

Under KJDA, Louisville Metro can provide up to 20 percent of the total credit by waiving up to 1 percent of its occupational tax for a project, he said.

Traughber said the city has become more aggressive in offering incentives. "We've had to be a lot more creative," he said. "Competition is much more intense than it's ever been before."

He also praised the relationship between the city and GLI, saying it has been much more effective since the merger of city and county governments in 2003.

Projects must meet criteria after receiving preliminary approval

If the mayor gives his blessing, a formal application is filed, along with a $500 non-refundable fee, with the economic development cabinet, which also reviews the project.

If that review is successful, the KEDFA board will consider the company's application for tax incentives. The seven-member body usually meets to consider projects on the last Thursday of each month in Frankfort.

KEDFA initially can either deny the project or grant preliminary approval for incentives. Preliminary approval is not a formal contract between the state and the company. That will come only if the business meets required hiring and investment criteria.

Upon receiving preliminary approval, the company receives a letter from the economic development cabinet that spells out the state's commitment. The company then must decide whether it will expand or locate in Kentucky.

If it chooses Kentucky, a public hearing is held in Frankfort, where company representatives describe their project and report on its progress.

At that time, competitor companies can raise any concerns they might have about the potential project, according to Roxann Fry, client solutions manager for GLI. That happens very rarely, she said.

"Part of the law for all of these programs is that any company receiving these benefits has to demonstrate no adverse effect to any other Kentucky employee or employer," she explained.

If there is no conflict, the company is eligible to go to the KEDFA board for final approval of its tax incentives. Usually, final approval is sought within one year of preliminary approval, although extensions can be granted by the board.

Following final approval, the company has up to a year in most cases to create at least 15 new Kentucky resident jobs. It is eligible to begin receiving its tax credits or wage assessments on a pro-rated basis as the jobs are added.

Since Kentucky's current programs were put into place in 1989, companies have been approved for $4.8 billion in incentives through Dec. 31, 2005, according to officials with the economic development cabinet. Only about $579 million -- or about 12 percent -- of those benefits have been realized by businesses.

Strong said people might be surprised by how infrequently companies make use of the tax incentive benefits for which they've been approved, but he believes that's a product of how much businesses must do to comply with the state's programs.

Court case makes future of programs uncertain

Kentucky's business incentive programs have both supporters and detractors, and the issue of using tax credits as a tool for attracting and retaining companies is the subject of debate across the country.

Many critics believe companies will make their relocation or expansion decisions independent of incentives.

Currently, the topic of tax incentives is being examined by the U.S. Supreme Court, which is hearing a case regarding a program in Ohio.

At issue are incentives given by the state to DaimlerChrysler Corp. to build a Jeep plant in Toledo. A three-judge panel of the 6th Circuit Court of Appeals ruled in 2004 that the Ohio incentive program is unconstitutional. It found that the program encourages in-state investment over investment elsewhere and violates the U.S. Constitution's prohibition against commerce policies that hinder free trade.

The Supreme Court has been asked to overturn the ruling, which could set precedents for challenges to similar tax-credit programs administered in Kentucky, Tennessee and Michigan, which also are part of the 6th Circuit.

Strong, of the state economic development cabinet, is hopeful that the ruling will be overturned. Even if it is not, he is confident that most of Kentucky's programs would not be affected because they are "well-designed" and don't take existing money out of the state's coffers.

Strong also made a case for the merits of the programs in the state.

Since 1989, 1,062 companies have received final approval for tax incentives. Those companies have created 125,943 jobs and made investments totaling $15 billion.

"It's very naive" to think incentives don't work, Strong said. "That's a staggering return on investment."

Selected Kentucky business incentives: Kentucky Jobs Development Act (KJDA) provides tax incentives to new or expanding service and technology-based companies that earn at least 75 percent of their revenues from outside the state, employ at least 15 new full-time Kentucky residents and meet salary requirements.

This tax-credit program enables the company to recoup 50 percent of annual occupancy costs of a facility for up to 10 years and 50 percent of eligible startup cost expenditures up to $20,000 per job created.

Benefits include a 100 percent credit against the state corporate income tax arising from the project and the retention of up to 5 percent of the gross wages of the new employment generated by the project as a credit against state and local occupational taxes. Kentucky Industrial Development Act (KIDA) provides tax incentives to new or expanding manufacturing operations that invest at least $100,000 in a facility, employ at least 15 new full-time Kentucky residents and meet salary requirements.

The business can recoup up to 100 percent of annual debt service costs for up to 10 years for the financing of land, buildings, site development, building fixtures and equipment associated with the project. Eligible equipment is limited to $10,000 in credits per new job created.

Benefits include a 100 percent waiver of state corporate income tax liability or the retention of 3 percent of gross wages of the new employment generated by the project as a credit against state occupational taxes. Kentucky Enterprise Initiative Act (KEIA) provides sales tax refunds to any business entity that establishes a new or expanded service or technology, manufacturing or tourism attraction activity in Kentucky.

The program must involve a minimum investment of $100,000 if located in a preference zone (formerly known as an enterprise zone) and $500,000 if located outside a preference zone.

Eligible investment costs include expenditures for research and development

equipment, construction materials, building fixtures, and land and facility acquisition. A company is eligible to receive a refund of the sales and use tax on those expenditures during the life of the project. Kentucky Rural Economic Development Act (KREDA) provides tax credits for new and expanding manufacturing projects that create at least 15 new full-time jobs in economically distressed Kentucky counties.

Companies must make a capital investment of at least $100,000 in land, buildings, fixtures and equipment.

Benefits include up to 100 percent credit against the Kentucky income tax liability on taxable income generated by the project for up to 15 years. A company also may collect a job assessment fee of 4 percent of the gross wages of each employee whose job is created by the approved project and who is subject to Kentucky's individual income tax. Kentucky Economic Opportunity Zone (KEOZ) focuses on development of areas with high unemployment and poverty levels.

Eligible companies include new or expanded manufacturing, service or technology industries, which must invest at least $100,000 in the project and create at least 10 new full-time jobs for residents of the zone.

Benefits include up to 100 percent credit against the Kentucky income tax liability on taxable income generated by the project for up to 10 years. The company also may collect a job assessment fee of up to 5 percent of the gross wages of each employee whose job is created by the approved project and who is subject to Kentucky income taxes.

The state also offers a variety of grants and investment credits for training, direct-loan programs for small companies and other tax breaks for businesses. For more information, visit the Kentucky Cabinet for Economic Development Web site at www.thinkkentucky.com.

© 2006 Business First of Louisville

© 2006 MSNBC.com

URL: http://msnbc.msn.com/id/12571860/