Certain State and Local Incentives will be Treated as Federal Taxable Income.

The new federal tax law makes some state and local incentives taxable, an important change sure to affect incentive policies across the country. Quarles & Brady LLP lays out what you need to know in this guest article.

Thousands of corporations throughout the United States receive various incentives from state and local governments. These incentives are aimed at fostering economic development and rewarding investment and job creation. Virtually every state offers economic incentives. And most corporations take advantage of them. The recently enacted Tax Cuts and Job Act will change the federal tax liability for many corporations receiving economic incentives.

The new law specifically states that certain incentives will be treated as taxable income for federal income tax purposes. The new law will affect corporations that receive incentives other than tax-related incentives, such as cash grants, land, low or no interest loans, or any direct transfer of property. The new law is likely to treat some government paid training and education programs as income as well.

It is clear that the Tax Cuts and Job Act will not affect the receipt of state and local tax incentives. Tax incentives remain the most common form of inducement and include a myriad of exemptions, deductions, and credits. State and local tax incentives do not give rise to federal taxable income under the new law. But in recent years state and local governments have begun shifting toward non-tax incentives. While large tax incentives get headlines, almost all location deals involve a non-tax contribution such as land, cash, or loans. It is the non-tax incentives that are potentially taxable under the new law. The new law will likely change the way incentive deals are negotiated. For example, it may be more advantageous to seek tax rather than non-tax incentives from state and local governments. State and local governments are likely to shift incentive offerings as a result. As importantly, the new law creates planning opportunities to avoid increased federal tax liabilities.

This provision is prospective; it applies only to incentives provided after the enactment date. However, payments made by state and local governments after the effective date are likely to be considered taxable regardless of when the incentive deal was signed.

David Brunori, Partner at Quarles & Brady, explains, “Those already receiving or contemplating non-tax incentives should consider the tax changes. And those governments handing out non-tax incentives may want to rethink their policies.”

Smart Incentives

Posted by Ellen Harpel | January 24, 2018