

McGUIREWOODS

# Winning The War Against Incentives

How To Build A Defensible Incentives Program

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# We Are All Part of the Problem – Recent Headlines

- “Amazon – End of Tax Break Means End to 1250 jobs”
- “Electrolux Gives Tennessee a Deadline”
- “Northrop Grumman competes VA, MD, DC for best deal”
- “Incentives: PBS vs. GE”
- “SC Tea Party Targets Incentives”
- “Obama and Tea Party Should Agree: End State Corporate Welfare”
- “Florida program gives \$423,000 incentive to cocaine dealer”

# Why Projects Go Bad

- Failure to perform a rigorous financial analysis of the company – pull a Dunn & Bradstreet, review 10-K
- Thinking your deal will be the next Google/Apple
- Deal entirely dependent upon short-term federal/state grants
- Your deal is at the tail end of the latest economic development fad
- If it sounds too good to be true, it probably is
- Lack of credible information about other sites under consideration
- Deal points “lost in translation”
- Deals are done for political reasons

# Incentives Defense Tactics Doomed to Fail

- “But look at all the jobs incentives have created!!”
- “Everyone else is doing it!”
- Secret meetings and unwritten policies
- Failing to do your homework on the prospect
- Surrendering your program to consultants
- Letting politics trump good business decisions
- Not learning from the mistakes of others

# Strategies to Undermine the Critics

- “Reform” policies to avoid
- Alternatives to incentives
- “Is that REALLY an incentive?”
- Rigorous return on investment analysis
- Written policies governing the use of incentives

# Consider the Alternatives

- Since the recession started in 2007, the federal government has spent \$520 BILLION on unemployment insurance payments. \$150 billion was spent in 2010 alone.
- Is it better to spend money supporting the unemployed or invest in permanent infrastructure and the intellectual capital of our people to put them back to work?
- Incentives are not just a US issue, countries around the world offer them. Why should we not?

# Policies to Avoid

- Surety bonds for incentives
- Making your economic development partner a “contractor” under state law
- Annual public hearings to request incentives
- A “we do what it takes” incentives program
- Broad based tax reductions - note, this is not what you think!

# “Is that REALLY an incentive?”

## 2007-2011 Incentives Spending by States – *New York Times*

New York	\$4.06 billion
Virginia	\$1.29 billion
Alabama	\$277 million
Michigan	\$6.65 billion
Kansas	\$1.01 billion
Arizona	\$1.47 billion
Washington	\$2.35 billion

# How Incentive Spending Was Calculated

- 45 states exempt machinery used in production and manufacturing activities. 5 don't – the 5 states that don't have a sales tax.
- A policy decision has been made that taxing production equipment is double taxation. Eliminating the deduction would increase cost of products to consumers.
- Many states exempt other inputs – agricultural feed, agricultural equipment, and other items involved in the production process.
- Some states maintain “specialty” tax exemptions, but they have a rational basis

# Sales Tax Exemptions By State

- New York \$269 million
- Virginia \$1.1 billion
- Alabama \$64.9 million
- Michigan \$120 million
- Kansas \$650 million
- Arizona \$147 million
- Washington \$865 million + \$160 million exemption on aircraft

# What the New York Times Did NOT Reveal

- Many of the items counted as “incentives” were merely tax policy decisions made by states.
- \$3.88 billion of the Michigan total and \$444 million of the Arizona total was because neither state taxes services. \$403 million of the Arizona total was an “exemption” on commercial leases.
- Private Activity Bonds have existed since income tax was created in 1914 and are thoroughly vetted by legal counsel and IRS

# Using ROI to your benefit

- Characterizes incentives as an investment
- Demonstrates to the public that decision to give incentives are not taken lightly
- Shows that incentives are a net gain to the community
- Helps you weed out bad deals
- Guides adjustments to tax and incentives policies to meet prospect needs

# Written Incentives Policies

- Outline what kind of jobs and investments a community wants
- Establish policies to guide your attraction and retention efforts
- Establish guidelines for incentives amounts
- Secure political and public approval for use of incentives
- May want to consider an “audit” of your incentives practices and programs

# Questions or Comments?

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