COVID-19 Job Losses – Are Your Incentive Awards at Risk?

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As businesses continue to grapple with how to best navigate the economic climate following the COVID-19 pandemic, it is important to consider how these changes could affect your previously awarded state tax incentives.

Many states offer extensive tax programs to incentivize new and expanding businesses. These programs can provide a variety of tax benefits from state income and payroll tax credits for businesses in certain industries such as manufacturing and energy production, to sales and use tax refunds for construction materials and building fixtures. In order to qualify for these programs, virtually every state requires not only minimum capital expenditures, but also increased or maintained employee headcounts and wage levels.

Virtually all states are alike, so let's look at Kentucky for an example.

The Kentucky Cabinet for Economic Development (KCED) offers the Kentucky Business Investment Program (KBI) to incentivize most industries in the state. This program allows businesses engaged in manufacturing, agribusiness, headquarters operations, alternative fuel, gasification, or renewable energy production, to name a few, to receive tax credits up to 100% of corporate income tax or limited liability entity tax and/or wage assessment incentives up to 4-5%, depending on local participation, on each employee's taxable wages. In order to receive and maintain this incentive, the eligible business must not only incur a minimum of $100,000 in costs, but it must also create and maintain an annual average of at least 10 new full-time hires, 90% of which must receive a minimum hourly wage and employee benefits. Once approved for the incentive program, project improvements are completed, and the eligible business executes a Tax Incentive Agreement with KCED to begin receiving benefits, the business must still file annual reports with KCED. Within 30 days of fiscal-year end, the business must confirm compliance with KCED in order to continue receiving benefits.

This is just an example of one incentive program in one state, but it also showcases how measures taken to prevent the spread of

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COVID-19, such as business closures and lay-offs, could affect businesses applying for and receiving tax incentives.

In Kentucky, for businesses that have received preliminary approval, but have not yet activated their incentives, the standard language of the required Memorandum of Agreement (MOA) between KCED and the eligible business provides guidance for changing circumstances. The MOA provides that the Company is to notify the Kentucky Economic Development Finance Authority (KEDFA) in writing describing any material changes to the Incentive Program Application. The MOA defines material changes to be the identity of the company, the location of the project, or a reduction in job and hourly wage targets. It further provides that the company and KEDFA will consult to determine if these changes affect the company's incentive award. Thus, if a business has received preliminary KEDFA approval, but due to COVID-19 will be unable to meet the requirements of the MOA (or any other agreement with KCED), it should promptly notify KEDFA of this change.

If a company has already entered into a Tax Incentive Agreement and is required to maintain a job or wage count on an annual basis, as with the KBI program or a similar Kentucky incentive program, Kentucky Reinvestment Act (KRA) requires 85% job retention and a $2.5 million investment. It is important for businesses to review the Agreement's specific language on meeting those requirements and termination of incentives. For example, many KBI Agreements recite that if a business can achieve 90% of its job or wage target, its incentive will not be reduced. But, if the business is unable to achieve 90% compliance, its award will be reduced to the percentage amount it was able to maintain. Not unlike the MOA discussed above, these Agreements also require notification in writing to KEDFA upon "changed circumstances." Changed circumstances often noted in KBI Agreements include if the company transfers interests or disposes of the land in which the project is located, or the business "ceases or fundamentally alters" its operations. Notification of wage base erosion and job loss should be noted as well. Remedies that are available to KCED upon failure to comply with the terms of the Agreement include incentive suspension, termination, and/or recovery.

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It is important for businesses to consider how COVID-19 may affect previously awarded or future tax incentives, and proactively discuss these issues with counsel and respective state authorities. The best practice is prompt notice of changed circumstances.

For more information on how the coronavirus has affected taxpayers, visit Tax Law Defined.

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a Coronavirus Response Team. Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

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