Multistate Tax Update: December 10, 2015

David M. Kall | Thursday, December 10, 2015

Illinois: Governor revives two tax credit programs

In an effort to balance investment in the state with taxpayer benefits, Illinois Gov. Bruce Rauner has announced that he will be reviving two programs that had been suspended at the beginning of the fiscal year, which began on July 1. The first is the Economic Development for a Growing Economy (EDGE) tax credit program, and the other is the Film Tax Credit program.

As has been widely reported over the last several months, Illinois is facing a very difficult fiscal situation and is now approaching six months without a budget in place. In July we wrote that under these circumstances, Illinois cannot spend any money on programs that require an annual appropriation, including most state programs and services, like education, Medicaid, addiction, and child care services, the senior meal program, parks, museums, and casinos.

At the end of October, *The New York Times* described the situation as "the consequence of a long simmering ideological and political dispute" between the Republican governor and Democrats who control both chambers of the legislature. The paper, citing state comptroller's figures, reported that by the end of 2015, Illinois will have about $8.5 billion in unpaid bills, partly because of the expiration of a temporary increase in income tax.

The EDGE tax incentives are typically used to offer a special tax incentive that encourages companies to locate or expand operations in Illinois when a firm is actively considering a competing location in another state. The hope is that the incentives allow the company to reduce the costs of doing business in Illinois when compared with similar costs in other states. This is the tax incentive program that was used to lure ConAgra from Omaha to Chicago as part of its $300 million efficiency plan, which we described in October. That relocation was controversial because ConAgra's chief executive, Sean Connolly, claimed that the move to Chicago was "strictly about company strategy" he did not consider competitive pitches or incentive offers from Omaha.

Similarly, the *Chicago Tribune* criticized the EDGE program for handing out millions of dollars of tax breaks for corporations that eliminated jobs and became smaller, and for allowing companies to "reap lucrative rewards and then relocate to other states without penalty or repayment."

Gov. Rauner has taken what the administration characterizes as a more fiscally responsible approach to EDGE agreements by enacting certain policy changes, including the following:

1. No longer supporting "Special EDGE" agreements that only benefit certain companies that can afford lobbyists.
2. No longer providing tax credits for job retention, only for capital investment and net new job creation.
3. Requiring that tax credits can only be obtained for jobs created above a baseline of all existing employees located within the state, rather than just the baseline of employees located at the specific project location. In the past, a company that signed an EDGE agreement for an expansion project in a certain location only needed to maintain a requisite number of employees at that specific facility in order to meet its requirements. Laying off employees at a different facility in the state, or even closing it, would not have impacted its ability to continue receiving taxpayer funded benefits for the facility for which it was receiving the EDGE agreement.
4. Prohibiting more than one tax credit on the same facility. Previous administrations allowed multiple EDGE deals on jobs created at the same facility.
5. Focusing on marketing Illinois' assets, rather than leading with the tax incentives.

As for the Film Services Tax Credit, it was put in place in December 2008. It is scheduled to sunset in May 2021, and will be renewable in five-year increments after that.

The goal of the Tax Credit Act is to promote growth and job opportunities, and stimulate diversity in production hiring by attracting local vendors, union leaders, and filmmakers to the Illinois film industry. Like EDGE, this program was suspended when the new fiscal year started.

Benefits of the Film Services Tax Credit include the following:

1. 30 percent of the qualified Illinois Production Spending.
2. 30 percent credit on Illinois salaries up to $100,000 per worker.
3. Tax credit can be carried forward five years from when originally issued by Illinois Film Office.
4. Applicants will receive an additional 15 percent tax credit on salaries of individuals making at least $1,000 in total wages that live in an economically disadvantaged area (at least 13.8 percent unemployment).

Despite the governor's announcement, EDGE and film tax credits for new projects will not be certified or eligible for claim until lawmakers pass a budget for fiscal year 2016.

Massachusetts: Officials take action on daily fantasy sports contests

In our Nov. 5 *Multistate Tax Update*, we described how several states—like Massachusetts, Kansas, Florida, Washington, Nevada, Michigan, and California—are struggling to confront the regulation of Daily Fantasy Sports (DFS). The crux of the issue is whether DFS constitutes gambling such that it can be regulated and taxed like other kinds of gaming activities.

REGULATING DFS

In Massachusetts, there is little regulatory guidance, but the topic was on the agenda at the Massachusetts Gaming Commission's Oct. 29, 2015, public meeting. Now, just one month later, Massachusetts Attorney General Maura Healey has issued a draft regulation hoping to protect consumers who play DFS from unfair and deceptive acts and practices that may arise in the gaming process, and to protect the families of those players "to the extent that they may be affected by unfair and deceptive practices that lead to unaffordable losses."

The draft regulation, which applies to DFS operators doing business in the state, defines DFS as "[a]ny contest in which the offer or award of a Prize is connected to the statistical performance or finishing position of one or more individual participants in an underlying amateur or professional competition, but does not include offering or awarding a Prize to the winner of or participants in the underlying competition itself."

Any enterprise that does not collect compensation in connection with the contest, or in which no prize is awarded, no entry fee is collected, or the maximum prize is valued at no more than the lowest possible entry fee, is not considered to be DFS.

Additionally, under the terms of the draft regulation, DFS operators are obligated to comply with all tax laws, like those pertaining to withholdings and disclosures to tax authorities and to DFS consumers. In the on-boarding process and again at the time of award of any prize of more than $600, operators are required to disclose potential tax liabilities, along with penalties for failure to pay.

Beyond these topics, the draft regulation covers several others, like the prohibition of minors, compliance with data security rules, restrictions on advertising, and protections for gambling addicts.

The Office of the Attorney General has issued a Notice of Public Hearing informing the public that it will hold the hearing and accept oral and written comments on Tuesday, Jan. 12, 2016.

TAX RULES CHANGES

Technical Information Release 15-14, issued by the Massachusetts Department of Revenue on Nov. 20, 2015, describes changes to the personal income tax calculation, income tax withholding, and income reporting rules with respect to wagering income. The release does not address DFS specifically, but points out that the state allows a new deduction "for losses from wagering transactions that were incurred at a licensed gaming establishment, or a racing meeting licensee or simulcasting licensee, only to the extent of the gains from such transactions."

In addition, the release explains the increase in the threshold for personal income tax withholding on certain game winnings, and the revised requirements for determining if the winner owes unpaid taxes or child support.

Finally, the release notes that the described changes do not affect income calculation, withholding, or reporting rules for lottery winnings.

Michigan: Agreement with Fiat helps stabilize the budget

BACKGROUND

A December 2015 report by Pew Charitable Trusts, Reducing Budget Risks, considered the unpredictable nature of specific state tax incentive programs. The cost of some of these programs has increased "by tens or hundreds of millions of dollars," requiring lawmakers to make tough choices between increasing taxes and cutting spending in order to keep their budgets balanced.

Opining that "these problems are not inevitable," the report's authors attributed the instability to the increasing costs of economic development tax incentives, which, theoretically, encourage business growth and job creation. But these incentives also decrease corporate tax revenues.

Pew's researchers came up with two strategies that can help states accomplish their economic development and job growth goals without "budgetary surprises." First, states should gather high quality data on the costs of incentives by forecasting and monitoring costs, and share this information with the relevant stakeholders.

Second, states should design incentives in ways that reduce fiscal risk, such as the following:

1. Capping how much programs can cost each year.
2. Controlling the timing of incentive redemptions.
3. Requiring lawmakers to pay for incentives through budget appropriations.
4. Restricting the ability of companies to redeem more in credits than they owe in taxes.
5. Linking incentives to company performance.
6. Requiring businesses to provide advance notice of program participation.

MICHIGAN

The Pew report used Michigan as an example of how these incentives can cause budget challenges. It reported that when Gov. Rick Snyder signed the fiscal year 2015 budget, lawmakers thought projected revenues would cover spending. However, within four months, they discovered that the budget would actually be out of balance by millions of dollars.

This was due largely to the tax incentive program within the Michigan Economic Growth Authority (MEGA) Board, which was created in 1995 and rolled into the Michigan Strategic Fund (MSF) in 2012. MEGA was authorized to promote economic growth and job creation, which it did, in part, by amending certain business tax credits. In a press release, House Democratic Leader Tim Greimel (D-Auburn Hills) explained that MEGA had gotten "out-of-control," and that it would devour up to $9.4 billion of state revenue over the next 20 years. But because of the structure of the tax credits, it was impossible to predict the amounts and timing of these credits. Consequently, corporate recipients were asked to renegotiate their MEGA agreements in a way that would allow the state to plan more effectively.

One result of these renegotiations is the deal that Michigan and Fiat Chrysler Automobiles (FCA) came to, through MSF, which promises to help stabilize the state's budget, as numerous outlets reported just before Thanksgiving.

Ultimately, FCA consented to claim no more than $1.9 billion of tax credits during the life of the agreement, which will now end two years earlier, in 2029 rather than 2031. Ford Motor Company and Michigan reached a similar arrangement in June, under which Ford went along with a $2.3 billion cap on its tax breaks; Ford also committed to making an additional investment of $3.1 billion, noted *The Detroit News* at the time. The paper put Michigan's long-term tax liability at $9.3 billion but growing.

The actual amount of FCA's credit was originally estimated to be $1.3 billion. The *Detroit Free Press* pointed out that even though the compromise increased the credit amount, which is based on the value of the jobs saved with increased wages, the certainty and the mandate that FCA invest $1 billion by 2029, will "prevent blowing a hole in future state budgets."

The Pew report described how Michigan came to find itself in such a dire situation:

> "Many of the credits causing fiscal challenges were authorized in 2010 as part of long-term deals with distressed automakers, without protections to limit the program's cost. The state badly underestimated the number of jobs the companies would create and the salaries they would pay because of flawed wage growth assumptions that state officials had used and the surprisingly strong recovery of the auto industry. Since the companies were paying more in wages to their workers, they earned more tax credits.

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According to the report, Louisiana faced a similar circumstance when it implemented a tax exemption for horizontal natural gas drilling in 1994. Once energy companies discovered large deposits of natural gas in 2008, they began to drill regularly, increasing both economic activity and costs to the state, from $285,000 in fiscal year 2007 to $239 million in fiscal year 2010. In contrast is New York's brownfields clean up project, which was also extremely expensive but did not produce any of the hoped for economic development benefits.

In the end, Gov. Snyder's press release touted Michigan's agreement with FCA as "an essential step in helping us better manage our state budget, while finding common ground that will ensure the company will continue to invest and create jobs in our state for years to come."

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Team member bio