

STATE TAX INCENTIVES NEWSLETTER

Issue 2, January 2000

SAM HOWELL AND CECIL KRAMER JOIN NPJP

Samuel W. Howell, IV has joined Nexsen Pruet Jacobs Pollard & Robinson as Special Counsel in its Charleston office, practicing in the areas of economic development, public finance, state and local government law and corporate finance. He received his undergraduate degree from Sewanee, where he was a Georgia M. Wilkins Scholar, and his law degree from the University of South Carolina. He has been on the Board and currently serves as Chairman of the State Election Commission. He also serves as Charleston County Attorney.

Cecil C. Kramer has joined Nexsen Pruet Jacobs & Pollard, LLP, as an associate. Mr. Kramer will concentrate his practice on economic development, international, and public finance law. Mr. Kramer is a native of Duesseldorf, Germany. He received a Juris Doctor degree from the University of Freiburg and a LL.M. degree from the University of Georgia School of Law.

INCENTIVES UNDER FIRE

Notwithstanding that the unemployment rate in South Carolina increased more than any other state in the nation last year, economic development incentives have come under increasing attack.

A. Media

The *Baltimore Sun*, ABC News, op-ed editorials in *The State* and the left wing advocacy publication *The Point* (Columbia, SC) have all run lengthy articles in the past year which have been heavily critical of South Carolina's incentives program. In response, Department of Commerce Director Charlie Way has submitted a very effective op-ed piece which is being published in various papers around the state.

B. Litigation

Local school districts and the South Carolina School Board Association have been very active on both the litigation and legislative fronts. Last year, Barnwell School District 45 filed suit against Barnwell County Council and obtained an *ex parte* Order prohibiting the Council from sharing fees from a Multi-County Business Park with another school district in Barnwell County. In February of this year, the Horry County School District filed suit against Horry County Council seeking to enjoin the creation of a large multi- county business park in that county.

C. Legislative

Although still in draft form at the time this newsletter goes to press, the South Carolina School Board Association has retained a team of six prestigious economists and drafted legislation which it intends to have introduced in the General Assembly in early March. In its draft form the legislation will contain the following: *Fee-in-Lieu* – require copies of all fee agreements to be filed with local school districts; *Multi-County Business Parks* – excludes residential, retail and commercial property; and fees from the Park must be distributed pro-rata to each taxing entity in accordance with their

millage; *Special Source Credits* - Special Source Credits and Bonds will be capped at 20% of the tax revenue, and school districts must annually consent to any special source credits granted by County Council.

ENTERPRISE ZONE UPDATE

By: Burnet R. Maybank III

A. Enterprise Zone Program Changes

Several administrative changes were made to the Enterprise Zone program in calendar year 1999. These include: (1) in order to comply with changes made to the FOIA, the Revitalization Agreement now provides that the Coordinating Council will disclose upon request by a member of the public any Revitalization Agreement executed after June 12, 1998 except for those portions clearly designated by the applicant as confidential, proprietary information; (2) a company may not claim retraining credits on the same employee for which it claims Job Development Credits; (3) withholdings may only be claimed beginning the quarter subsequent to the Council's approving the company's documentation that the minimum jobs and capital investment have been met; (4) once approved a project will maintain the county classification in effect at the time of approval, regardless of subsequent changes in the classification; (5) when exercising its discretion in reviewing a project, the Council will compare the average hourly wage of the new job to the average per capita income in the relevant county; (6) reimbursement for retraining costs will be limited to those costs incurred in the current year; and (7) a *final* Revitalization Agreement must be fully executed by the Coordinating Council and the Company within 18 months of the effective date of the company's preliminary Revitalization Agreement (the previous limit was five years.) Based on information received from the Coordinating Council staff, the primary reason for the new 18 month guideline is to put the staff and the Department of Revenue in a better position to understand (and project) the impact of the Enterprise Program. The guideline does not create any added hurdles to the program because, after 18 months, most companies are able to project their minimum capital investment and job numbers accurately and, arguably, should be finalizing RVAs within that time period. Additionally, companies with large, phased projects that cannot accurately project minimum capital investment and job numbers within 18 months will simply be required to notify the Coordinating Council staff of the inability to comply with the guideline, the reasons for that inability, and the proposed date to finalize their RVAs. That way, the staff will have an updated status and get a better handle on the program. The guideline still allows a company five years to get the jobs and investment projected in the final RVA in place.

B. Upcoming RVA Deadline

Companies that entered into a Revitalization Agreement with the Coordinating Council more than four years ago should be aware of an important looming deadline. After the EZ application is approved and the initial or preliminary Revitalization Agreement is executed, the company has a maximum of five years to complete the final Revitalization Agreement ("RVA"). (Effective December 16, 1999, the Company has 18 months to enter in to the final Agreement, although it may apply for a waiver of such 18-month period.) The company cannot claim the credits until the company has finalized the application and preliminary RVA. Once the Final RVA is executed, the

company must provide proof of its compliance with its projected minimum capital investment and minimum job requirements as set forth in the final RVA to the Coordinating Council. If the Coordinating Council is satisfied with the certification, it will notify the company (and the Department of Revenue) of the certification date to begin claiming the Job Development Credits. The company will begin claiming the credit on a quarterly basis with the Department of Revenue.

C. Indexed Wage Figures

A company entering into an RVA with the Coordinating Council has to comply with certain wage levels to obtain withholding credits. The Coordinating Council has set those numbers for 2000 as follows (percentage of withholding to correspond with following wage levels in calendar year 2000):

2%	\$6.74 - \$8.98/hr
3%	\$8.99 - \$11.23/hr
4%	\$11.24 - \$16.85/hr
5%	\$16.86/hr and over

Mr. Maybank served as the first Chairman of the Enterprise Zone Committee of the Coordinating Council, and was the lead co-author and lobbyist of the enabling legislation.

LEGISLATIVE UPDATE

In his State of the State Speech, Governor Hodges called for the establishment of a small business venture capital fund as well as the creation of a Cabinet-level Secretary of Technology position. Governor Hodges's Executive Budget for fiscal year 2000 proposed more than \$8.5 million in technology-related projects.

Although it is still early in the legislative session as we go to press, several incentive bills are in the hopper. The only one to be actually introduced is a bill by Senator Hugh Leathermen to allow leased employees to qualify for Job Tax Credits. Representative Alf Robinson will introduce legislation to authorize counties to allow a taxpayer to utilize an alternative fee-in-lieu procedure in the event that the method under which it initially executed a fee-in-lieu was ruled unconstitutional. (This legislation would provide a boost to the Simplified Fee method.)

The Department of Commerce and House Republicans led by Ways & Means Chairman Bobby Harrell and Lt. Governor Bob Peeler are poised to have legislation introduced to provide incentives to certain high-tech employers. The legislation does this in several ways. First, it provides a sales tax exemption (versus the current \$300 cap) for purchases of qualifying R & D equipment. Second, it eliminates the "separate facility" requirement for R & D Operations found in the current sales and property tax incentive. Third, it replaces the current "*exclusively* used in R & D operations" requirement with the federal "*primarily* used" standard. Lastly, it expands the list of employers which qualify for the Job Tax Credit and the Job Development Credit to include certain high-tech employers like software publishers. (As stated below, call or write for a copy of a NPJP White Paper on State & Federal R & D Tax Incentives.)

The Department of Commerce is also working on a bill which will provide technical corrections and simplification of a variety of the tax incentives.

Lastly, as stated above, the South Carolina School District Association intends to have legislation introduced which will affect Multi-County Business Parks and Special Source Credits.

FEE IN LIEU OF TAXES UPDATE

The minimum investment level to qualify for a FILOT arrangement under the Streamlined and Simplified FILOT Act has been lowered from five to one million dollars for counties that have an average annual unemployment rate of at least twice the state average during each of the last two completed calendar years. In 1999, the counties that qualified for the one million dollar investment level included:

Chester, Marion, Georgetown, Marlboro, Lee, and Williamsburg

CORPORATE INCOME TAX MORATORIUM

South Carolina law grants a ten year moratorium on corporate income taxes for qualifying taxpayers in certain counties with high unemployment or low per capita income. The Department of Revenue recently certified the following counties for calendar year 1999:

Allendale, Marion, Chester, Marlboro, Georgetown, Williamsburg, and Lee.

1999 DOR POLICY DOCUMENTS

In our last issue, we summarized the 1999 Legislative Session as it pertained to state tax incentives. This article lists the relevant DOR Policy documents issued in 1999:

A. Administrative

Interest Rate for Tax Liabilities related to DISC and Foreign Trade Receipts - (IL 99-3)

B. Income Tax

Corporate Headquarters Credit - (RR-99-11 and IL 99-1); Motion Picture Project Credits (RR-99-10); Job Tax Credit (RR 99-5, IL 99-2, RR-11, IL 99-1).

C. License Taxes

Utility Tax Credit (RR 99-6).

INCENTIVES UPDATES BY E-MAIL

E-mail Burnie Maybank (BMaybank@NPJP.com) to receive future editions of this publication, as well as timely updates of incentive topics, by e-mail.

NPJP WHITE PAPERS AVAILABLE

NPJP White Papers are available on (1) State and Federal Research & Development Tax Incentives; and (2) Post Closing Issues. Call, write, or e-mail Burnet Maybank for a copy.

NPJP CO-SPONSORS ECONOMIC DEVELOPMENT INCENTIVES SEMINAR IN MARCH

NPJP is co-sponsoring with the Charleston Metro Chamber of Commerce a seminar on tax incentives which will be held on March 23rd in Charleston. Call (843-805-3065) or fax (843-723-4853) or e-mail Becky Vaughan (bvaughn@charlestonchamber.org) at the Metro Chamber to register.

INVESTMENT TAX PRIMER

A. General

The ITC credit is based upon “economic impact zone qualified manufacturing and productive equipment property.” This definition includes any property:

- (a) which is used as an integral part of manufacturing or production, or used as an integral part of extraction of or furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services in the economic impact zone;
- (b) which is tangible property to which Section 168 of the Internal Revenue Code applies;
- (c) which is Section 1245 property (as defined in Section 1245(a)(3) of the Internal Revenue Code); and
- (d)(i) the construction, reconstruction, or erection of which is completed by the taxpayer in the economic impact zone; or
- (ii) which is acquired by the taxpayer if the original use of such property commences with the taxpayer inside the economic impact zone.

There are accordingly four requirements. The property must: (1) be used as an integral part of manufacturing; (2) included in Section 168 of the IRC; (3) included in Section 1245 of the IRC; and (4) constructed or erected in an economic impact zone.

B. Integral Test

To qualify under the federal ITC, the property must also be an “integral part” of the taxpayer’s qualifying trade or business. Property is not an integral part of the specified operations if it is merely incidental and not essential to their completeness. Thus, in one case construing the federal ITC, the court held that a concrete driveway installed over gasoline storage tanks did not constitute qualifying property. Pavements, parking lots, inherently permanent advertising displays or outdoor lighting facilities, and swimming pools may not constitute integral parts, depending upon their use. However, blast furnaces, oil and gas pipelines, railroad tracks and signals, telephone poles, broadcasting towers, fences used to contain livestock, and oil derricks have been found to be integral parts.

C. Section 168 Test

Section 168 of the IRC deals with Accelerated Cost Recovery depreciation.

Real property (except land) is depreciable under this section if the property (1) is used in a trade or business; (2) has an exhaustible useful life that can be determined with reasonable accuracy; and (3) is not inventory, stock in trade, or held for investment.

D. Section 1245 Test

Section 1245 property is defined as (1) any property which is property of a character subject to the allowance for depreciation provided in Section 167 *and* is either, (2) personal property; or (3) other property (*not including a building or its structural components*), but only if such other property is tangible and is used as an integral part of manufacturing. (Emphasis added).

Section 167 is the general depreciation statute and it applies to buildings (not including land) used in a business.

The second requirement of Section 1245, requires the property to be personal (as opposed to real property or fixtures). In Rev. Rul. 68-50 the IRS held that large conventional type structures housing machinery and equipment in breaker and coal plants from which the machinery and equipment may be removed without replacing the structures were “buildings” and thus not Section 1245 property.

The Regulations to Section 1245 incorporate the definition of “tangible personal property” found in the federal Investment Tax Credit Act.

The House Committee Report to the original ITC legislation states that the meaning of tangible personal property was not intended to be narrowly defined or limited to any local law definition. Thus, assets accessory to a trade or business could qualify as tangible personal property even though classified as fixtures under state law; and assets of a mechanical nature, even though located outside a building, such as gasoline pumps, may qualify for the credit. In this regard, the term “building” was given its commonly accepted meaning, *i.e.*, a structure or edifice enclosing a space within its walls and usually covered by a roof whereby the structure improves the land, and provides shelter or housing for work, office, display, or sales space.

The essential issue, then, in classifying a particular asset as tangible personal property is whether it can be distinguished from real property. If some attachment to real property exists, the resolution of the issue hinges on the nature of the asset’s inherent permanency to the real property.

E. Qualifying Counties

Counties qualifying for the Economic Impact Zone Act are: Aiken, Allendale, Bamberg, Barnwell, Beaufort, Berkeley, Calhoun, Charleston, Clarendon, Colleton, Dillon, Dorchester, Edgefield, Florence, Georgetown, Greenwood, Hampton, Horry, Jasper, Lexington, Marion, McCormick, Newberry, Orangeburg, Richland, Saluda, and Williamsburg.

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