

Court's Ruling Expanded Availability of Job Development Credits

Very few South Carolina appellate court cases deal with tax incentives intended to encourage state economic development. Thus, the recent South Carolina Court of Appeals decision in *Blackbaud, Inc. v. South Carolina Department of Revenue*, 688 SE2d 150 (S.C. Ct. App., 2010), may be of interest. At issue in the litigation was whether the taxpayer was entitled to claim job development credits for jobs created after a specified cut-off date.

General background—the job development credit. South Carolina's Enterprise Zone Act (S.C. Code title 12, ch. 10) contains an important "hard dollar" economic development incentive designed to promote the growth of manufacturing, research and development, technology-intensive, and other targeted businesses in the state. This incentive, referred to as the "job development credit" (JDC), allows businesses approved by the state's Coordinating Council for Economic Development (created under the Act) to claim a credit against their withholding tax liability on the quarterly state withholding tax returns. The JDC, codified in S.C. Code §12-10-80, is available to approved new or expanding businesses that make a qualifying capital investment and create a minimum number of new jobs in South Carolina.

Because they are credits against payroll withholdings—rather than income taxes—JDCs remain extremely valuable to businesses in today's tough economy. South Carolina was one of the first states to adopt a withholding tax credit as an economic development incentive and it has since been copied in many states.

South Carolina, also like many states, has attempted to deal with the rising revenue impact of its incentives during difficult budget times. The decision in *Blackbaud* deals with changes made to an incentive program to curtail its revenue impact.

Qualifying for the JDC. Generally, to qualify for the South Carolina job development credit a business must be located in the state and must meet all the following criteria:

- (1) The business must be involved primarily in qualifying activities, such as a manufacturing, tourism, processing, distribution, research and development, or technology-intensive endeavors.
- (2) The business must provide its full-time employees at the project site where the investment is made with a benefits package that includes health care.
- (3) The business must enter into a "revitalization agreement" with the Council.
- (4) The Council must determine that (a) the negotiated incentives are appropriate for the project, and (b) the total benefits of the proposed project exceed the total costs to the public.

Claiming the credits. As noted above, the JDC is a credit against employee withholding taxes. Typically, a business remits all South Carolina withholdings to the Department of Revenue as required under the law, and then claims a credit for allowable job development benefits when the business files its quarterly South Carolina withholding tax

return. The excess withholding resulting from the JDC is refunded to the business, which then must use the funds to cover the cost of qualifying expenditures.

To claim a job development credit for any quarter, the business must (1) be current with respect to all South Carolina state taxes; and (2) maintain, for the entire withholding quarter, the minimum employment and investment levels set forth in the revitalization agreement. A business may claim a JDC for up to 15 years, although the Council generally limits the term to ten years. The amount that may be claimed is generally a percentage of the "maximum allowable" job development credit based on (1) the "economic" designation of the county in which the project is located at the time the application is received by the Council, and (2) the gross wages paid to the employees at the project. The applicable percentages are as follows:

- 100% for a business in a "distressed" or "least developed" county.
- 85% for a business in an "under developed" county.
- 70% for a business in a "moderately developed" county.
- 55% for a business in a "developed" county.

The "maximum allowable" job development credit that may be claimed is calculated as a percentage of each new employee's "gross wages," which are defined as wages subject to withholding. The hourly gross wage figures are adjusted annually by an inflation factor determined by the State Budget and Control Board. For 2009, the hourly gross wages and related percentages are:

Gross Hourly Wage	Percentage for Maximum JDC
\$8.74 to \$11.64	2%
\$11.65 to \$14.55	3%
\$14.56 to \$21.84	4%
\$21.85 or more	5%

Taxpayers' use of refunded credits. The expenditure of funds received as a result of claiming a job development credit as authorized by the revitalization agreement are restricted, and include the following purposes:

- Training costs and related facilities.
- Acquiring, improving, or, in certain instances, leasing real estate.
- Making improvements to public and private utility systems, including water, sewer, electricity, natural gas, and telecommunications.
- Expenditures for fixed transportation facilities, including highway, rail, water, and air.
- Construction or improvements of real property and fixtures for the purpose of complying with environmental laws and regulations.

Council's standards. Summarized below are the Council's standards for businesses seeking to avail themselves of the job development credit.

- A business should apply for JDC benefits prior to the business's officially announcing its South Carolina location or expansion plan.
- The Council generally approves job development credit benefits for a maximum of ten years.
- Usually, a business must commit in writing to locate or expand in South Carolina within 30 days of its approval for benefits.

- With regard to employee health care, a business must pay at least 50% of the employee's premium for a comprehensive health plan that includes benefits equivalent to those provided under the Savings Plan of the State Health Plan made available to South Carolina state employees.
- The job development credit is available for the minimum number of jobs stated in the revitalization agreement, provided that those jobs are maintained. No credit may be claimed if the minimum job requirement is not maintained, and, as discussed below, under new rules the credit is not available for any jobs above the minimum set forth in the revitalization agreement.

The *Blackbaud* decision. As noted above, *Blackbaud, Inc. v. South Carolina Department of Revenue* is one of very few South Carolina appellate court cases dealing with economic development tax incentives. At issue in *Blackbaud* was whether an administrative law court (ALC) erred in finding that the company was entitled to claim job development credits for jobs created after a specified cut-off date.

The South Carolina Enterprise Zone Act required qualifying businesses to enter into a revitalization agreement (RVA) with the Council. In addition, the Act gave the Council absolute discretion in deciding whether to enter into such an agreement. Furthermore, the Act allowed the Council and the qualifying business to negotiate the terms of the RVA. Although the terms of each individual RVA varied, every RVA uniformly required each business to create a minimum number of jobs and make a minimum capital investment by a certain date (the "cut-off" date) in order to claim job development credits.

Blackbaud, the largest software developer in the world for nonprofit organizations, moved its headquarters from New York to South Carolina in order to take advantage of the tax incentives provided by the Act. In October 1997, Blackbaud (one of the first companies to qualify for the incentive) entered into an RVA with the Council, agreeing to invest a minimum of \$29.6 million in the project and create 300 new jobs at its new facility in Charleston before the cut-off date of 10/22/02.

The "85/150" rule. The RVA also contained a significant provision commonly referred to as the "85/150 rule," one of many guidelines adopted by the Council to assist it in determining whether a business was eligible to receive job development credits. The 85/150 rule provided that "[o]nce it meets the Minimum Job Requirement, the Company may fall below the Minimum Job Requirement by 15 percent or exceed the Minimum Job Requirement by 50 percent and remain eligible to claim Job Development Credits."

Blackbaud met its minimum job and capital investment requirements on 9/30/01—more than a year before the cut-off date—and began claiming JDCs in October 2001. Although Blackbaud had agreed in the RVA to create only 300 new jobs, it took advantage of the 85/150 rule and created more jobs—and also claimed the related credits—during every quarter leading up to the cut-off date. In the last quarter before the cut-off date, Blackbaud claimed job development credits for 398 new jobs—its highest total up to that point. After the cut-off date, Blackbaud claimed job development credits in excess of 398 for every quarter from 1/1/03 through 12/31/05. Blackbaud, however, never violated the 85/150 rule by claiming job development credits in excess of 450 jobs (i.e., $300 \times 150\%$, the maximum allowed under that rule).

In 2004, the Council adopted new guidelines, including an amendment to the 85/150 rule, all designed to lower the revenue impact of the incentives program. The new rule applied only to "applications or RVAs pending as of February 1, 2004," and thus did not apply to Blackbaud. The amended version of the 85/150 rule added the following

language: "Jobs created in excess of the 'Minimum Job Requirement' shall be deemed to include only such 'New Jobs' as are created at the 'Project' prior to the 'Cut-off Date' as those terms are defined in the final RVA."

Following a July 2006 audit of Blackbaud's tax returns (the Department's first such audit since the cut-off date and the promulgation of the new guidelines), the Department concluded that Blackbaud had incorrectly calculated its job development credits. Specifically, the Department determined that the text of the initial 85/150 rule prevented the company from claiming job development credits in excess of those claimed at the time of the cut-off date, i.e., the 85/150 rule "burned off" at the cut-off date. Thus, the Department denied Blackbaud's claim for job development credits in excess of the 398 jobs claimed up to the cut-off date.

Appellate court agrees with broad interpretation of the rule. In affirming the ALC's ruling for the taxpayer, the South Carolina Court of Appeals noted that, with regard to the minimum job requirement and the 85/150 rule, Blackbaud's RVA provided the following: "Minimum Job Requirement means the minimum number of New Jobs the Company has agreed to create, prior to the Cut-Off Date, and maintain before claiming any Job Development Credits. *Once it meets the Minimum Job Requirement, the Company may fall below the Minimum Job Requirement by 15 percent or exceed the Minimum Job Requirement by 50 percent and remain eligible to claim Job Development Credits.*" (Emphasis added.)

The court found that the 85/150 rule allowed Blackbaud, after meeting the minimum job requirement, to continue claiming job development credits if it maintained at least 85% of that minimum requirement. Further, Blackbaud could exceed the minimum job requirement by 50% and still "remain eligible" to claim job development credits. Moreover, the Court found that, in contrast to the minimum job requirement, the 85/150 rule contained no timing limitation; rather, the rule did not reference the cut-off date at all. As a result, Blackbaud was entitled to claim all the job development credits in question.

Finally, the court agreed with the Department's contention that the plain language of the RVA did not support the ALC's finding that Blackbaud could take advantage of the 85/150 rule "for a five-year period commencing on the date the RVA received final approval by the Department of Commerce." As the court noted, the 85/150 rule contains *no timing limitation*. Thus, pursuant to the terms of the parties' agreement, Blackbaud is eligible to take advantage of the 85/150 rule for as long as the RVA remains in effect. Accordingly, the appellate court affirmed the ALC's decision as modified. []

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(The author served as Director of the S.C. Department of Revenue from 2003 to 2005 and 1995 to 1999, and he was co-counsel for the taxpayer in the case that is the subject of this article.)

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