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Location Lures

State and city tax breaks abound, but they shouldn't be the only consideration when locating a business

BY BOB VIOLINO

There seems to be no limit these days to what U.S. states and cities will do to lure businesses to their communities. Incentives recently dangled in front of companies include the $3 billion in tax breaks — amounting to $15,000 to $19,000 per job annually — that Wisconsin's governor has offered Foxconn to build a flat-screen plant in the Badger State. Suitors competing to be the host of a $5 billion second headquarters for Amazon have created elaborate videos, enlisted the help of CEOs of other major companies, and of course, offered huge tax incentives to attract the attention of the e-commerce giant.

"Different jurisdictions throughout the country are in the middle of an intense competition to lure businesses to their locales by offering generous financial incentives such as tax breaks," says Paul Laudicina, a partner and chairman of consulting firm A.T. Kearney's global business policy council. "The current competition to win Amazon's second headquarters is a compelling example."

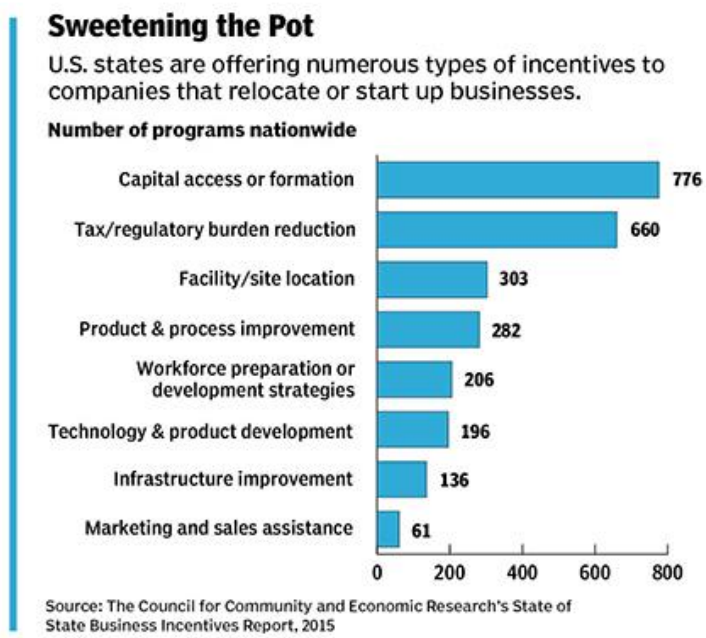
Finance chiefs, though, need to stay level-headed no matter how alluring the incentives may be — and, as with any major business decision, conduct their due diligence. For businesses that don't tread warily, the grass truly may not be greener on the other side.

"The bottom-line financial incentives municipalities offer will be easy to compare," says Scott Martinez, a former attorney for the city of Denver who is now a partner at the law firm Snell & Wilmer. "The best CFOs will reach deeper to the city's economic vitality and livability for its workers…. Does the city have access to quality health care, a housing market employees can afford, a commitment to infrastructure and education?"

Weighing Incentives

Tax relief is among the most widely used and effective tools that jurisdictions employ to lure companies, according to Laudicina. But as evidenced by the experiences of companies such as Amazon, General Electric, Aetna, and Caterpillar, global businesses are also attracted to large cities with a plethora of top talent, an abundance of research institutions, and good infrastructure.

"The most ideal incentives are those that make doing business simpler and less expensive," says Bert Young, CFO of Impartner, a provider of channel management technology. For most technology companies, the largest expense is payroll, so any incentives that reduce employee taxes, improve benefit costs, or offset real estate costs are helpful, he says. Among the vital things to look for is a city's commitment to arts and culture, Martinez adds.



"Cities tend to invest in arts and culture after their commitments to health, infrastructure, and education have already been met," he explains. "When you see a region with a commitment to funding an enlightened and entertaining cultural scene, it is an indicator that it's meeting the other obligations workers in a livable city would expect."

Paul Gevertzman, a partner at accounting firm Anchin, Block & Anchin, is an expert on tax incentive programs and chairs the firm's tax credits & incentives group. He recalls that one business client rejected an incentive-laden offer to move to New Jersey because "it was concerned that the workforce wouldn't move with it."

"It doesn't always make sense to chase the best offer," he says. "That client made the decision that it wasn't all dollars and cents and concluded it would be better off staying where it was."

Each of these investment incentive deals "is a unique animal, so there are no hard-and-fast rules to follow," Laudicina says. "In general, however, CFOs should weigh the financial incentives being offered with broader considerations about whether their workforce and infrastructure needs will be easily met in the locality."

Considerations about skills and workforce should most certainly be part of any decision, notes Alfredo De Zayas, a principal at accounting firm Morrison, Brown, Argiz & Farra. "In today's economy of knowledge-based products and services, a company's ability to hire, train, and retain highly talented [professionals] is crucial for business growth and sustainability," he says.

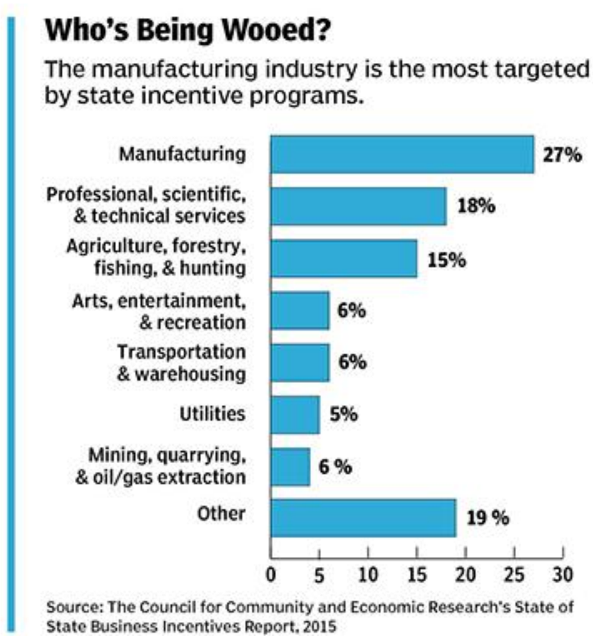
Cities that expect to lure businesses must be able to provide a steady flow of talent. Martinez cites the case of a corporate client that was seeking to relocate a large satellite office. The company, he says, partnered with a large city's economic development department and a university to fast-track apprenticeships and provide employment tax relief for apprentices.

One of the biggest concerns for growing technology companies is not having a large enough pool of qualified candidates to hire for hard-to-fill positions, Impartner CFO Young explains. “Software engineers and sales and customer support professionals are key to the growth and success of the business,” he says. “We need to relocate to an area we know has a large enough talent pool to support our continued expansion.”

Cash In Hand

Even as they are looking to maintain a skilled workforce, companies want to keep the cost of doing business as low as possible, De Zayas says. When relocating a company to another state or city, he explains, finance officers need to think about deals in which financial incentives include not only breaks on taxes, but also grants for research and development, training, and education; bonuses awarded to the most innovative employees; cash incentives to fund projects; and subsidies for housing, moving expenses, and other costs.

“Companies should emphasize upfront cash incentives from the government,” De Zayas says. “During the investment phase of moving to a different state, companies will be incurring a lot of costs and expenses and not [booking] enough revenues. Thus, cash incentives are [more] preferable during the early stages — the first few years — than state and local tax credits. Tax credits are useful once the company becomes profitable.”



The financial health of a city is another consideration. “You want to make sure that those cities have the funds and financial health to come through on their financial commitments to the company,” De Zayas notes. “The company’s decision-makers need to think about the state’s infrastructure, economy, quality of life, technology, education, business friendliness, access to capital, and cost of living.”

Shifting Sentiment

No matter how diligent CFOs may be, though, there is one variable they certainly can’t control. As professional sports franchises have found in trying to move their team to a new location, political winds can change overnight. Governments may change their policies or back out of commitments.

"Politics is always risky," says Snell & Wilmer's Martinez. "The only thing we know for certain is that there will be another election with new candidates. Forward-thinking companies get to know their politicians and their potential successors early on and discuss how the incentives impact their business, their employees, and the people in the city."

He adds: "The art of politics is personal. A personal relationship between company management and the person filling a political seat is the difference between having a conversation about the importance of an incentive and finding your company's incentives on the chopping block."

An example of an unexpected turn because of politics comes from the Business Employment Incentive Program in New Jersey, Gevertzman says. "I have clients who were promised benefits and who did all they were supposed to do, but the legislature didn't allocate the funds and the state didn't pay." After three or four years of not receiving the money, the companies converted from grants to tax credits paid out over a period of years. "So, it took five years to get what [they] were offered three years ago," Gevertzman says.

Changes in government administrations can always lead to changes in policy, which is a risk for businesses, Laudicina says. "And in our populist-charged political environment, tax concessions to companies may be an easy target," he adds.

To mitigate the risk of new politicians changing previous commitments, companies should build broad, cross-party support in both state legislatures and city councils to ensure the continuation of pro-business policies, Laudicina explains. "And they should act as good corporate citizens in the community once their business is set up," he says.

Companies that take discretionary incentives to relocate but then leave [the new area] after a few years can face political backlash in the form of clawback provisions. "That's part of the political situation, leading to more and more accountability for these programs," Gevertzman says. He predicts that state and city governments will be demanding on a regular basis that companies show they did what they promised to do.

Chicago, Boston, and Albuquerque, among other cities, have clawback provisions, Laudicina says. At the federal level, President Donald Trump has threatened retaliatory action against companies that have accepted tax incentives and later moved jobs abroad.

But there's little doubt states and cities will continue to leave no stone unturned in their courtship of companies. As Gevertzman says, "States are really hungry for money—and that's going to get worse."