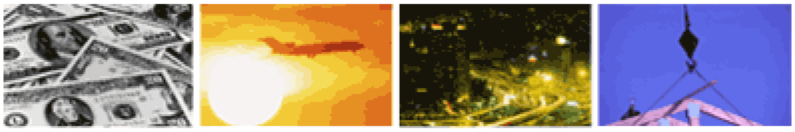

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Incentives: Part Of The Business Location Decision

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Incentives have always been the focus of a lot of attention in the site selection and economic development world. Recently, that attention has broadened to include the entire business community and even the general public with the results of the recent *Cuno vs. DaimlerChrysler* case in the 6^{th} U.S. Circuit Court of Appeals. One consistent characteristic of incentives is a general misunderstanding of the role they play in the business location decision. Incentives are a “normal” part of conducting business and are, or should be, addressed by all locating, expanding or contracting companies. Doing so properly is a challenge for companies. The challenge has become more difficult with a new level of uncertainty brought on by the recent court rulings.

Incentives: What Are They?

One misrepresentation sometimes seen in discussions about incentives is determining what an incentive is. It is important to make a distinction between location advantages, location assets and incentives. A useful definition for economic development incentives would be:

> Incentive: a deliberate policy or set of policies designed to make a location more attractive to particular investment decision makers.

This definition distinguishes incentives as policy actions as opposed to inherent location advantages. It also distinguishes between location assets as a result of general public investment and actions to attract specific industries or companies. For example, proximity to the Atlantic Coast is a potential location advantage; the Port of Baltimore is a location asset, and reduced port fees for a company in conjunction with a location or expansion in the area is an incentive.

Incentives As A Normal Part of Business

Companies are certainly familiar with incentives, both giving and receiving. Incentives have been a major and high profile element of doing business for U.S. automakers during the last several years. This is true in terms of providing incentives to customers as a competitive, but costly, tool, and receiving incentives from states and communities as an important and highly beneficial location element.

Although incentives are an expected part of every location decision, the site selection decision is a complex one for companies, involving a host of critical decision factors. Almost every component of a company (production, marketing, finance, legal, senior management, etc.) has an interest in a facility location decision. As a result, companies are faced with evaluating locations based on a wide range of often-conflicting factors, and almost certainly struggling with determining the relative importance of these factors.

One high-profile factor that is part of every location decision is incentives. For companies, or company project team members, who do not regularly conduct location decisions, understanding incentives is difficult. And properly managing the role of incentives in that decision process is even more difficult. Incentives can create an allure for a location that may distort the decision. It is the actual value of the incentive, not the marketing value of the incentive, which should be most important to companies. Taking it a bit further, it is the expected captured value of the incentive and ultimately the “after-incentives” analysis that should help determine the preferred location.

Companies will identify the available incentives at a competing location and assess the value of those incentives for their particular project. This is something that virtually every company will do as part of its sound due diligence. In practice, companies should do this on an ongoing basis to ensure they are capturing all qualifying incentives granted in support of a location or expansion decision.

Making Incentives Work For Companies

There are three critical characteristics to effective incentives for the company making a location decision:

1. Incentives must affect the decision

2. Incentives must differentiate one location from another

3. Incentives are generally more important later in the decision process

For an incentive to matter to a company, it must actually affect the project decision. High-impact property tax abatement or payment-in-lieu programs will have a major influence on large capital investment projects (manufacturing) but much less influence on small capital investment projects (office). Similarly, even a high-impact incentive must be able to be captured in order to influence a decision. Job creation credits can compute to high values, but without a corresponding state tax liability against which to use the credits, they will go unutilized.

For incentives to influence a company's location choice, they must differentiate locations. Often times neighboring states will have similar incentive programs that are important in that they create advantages relative to states in other regions and create value for the company, but do not distinguish between the competing, neighboring states. For this reason, custom incentive negotiations are often critical in making distinctions between locations.

At McCallum Sweeney Consulting, our approach to creating value for companies while helping to distinguish locations is to conduct custom incentive negotiations that focus on enhancing the strengths and mitigating the weaknesses of a location. This is best accomplished in the context of the total location decision and so enables the negotiations to focus on what is critically important *to that project for that company*.

If incentives are properly managed, the process results in incentives becoming more important during the life of the project. A general principle for companies to remember when dealing with incentives in a location decision is that projects drive incentives, incentives don't drive projects. Other, more critical, factors are more important early in the selection/elimination process; quite frankly, it would be difficult to properly assess incentives in all the communities under consideration at the beginning of a project. However, once the short list or finalists have been determined, a full assessment as well as focused negotiations can take place. At the end of a project, incentives have considerable impact on the final decision.

For site selectors, it is understood that incentives cannot make a bad location good. However, incentives can make a location more competitive and in the end distinguish one good location from another.

New Uncertainty for Incentives: 6th U.S. Circuit Court of Appeals And *Cuno v. DaimlerChrysler*

In the late 1990s, DaimlerChrysler sought to open a new assembly plant to produce the Jeep Liberty. It is understood that Ohio and Michigan were the two finalists for the new plant location. In 1998, DaimlerChrysler decided to construct a new assembly plant in Toledo, Ohio. In association with that decision, the company would receive approximately $280 million dollars in tax incentives. This new plant, which required DaimlerChrysler's investment of approximately $1.2 billion dollars, was expected to provide the region with several thousand new jobs. The incentive package included two tax incentives: a 10-year 100 percent property tax exemption, and an investment tax credit against the state corporate franchise tax. This new Jeep Liberty plant was an addition to DaimlerChrysler's existing presence in Ohio – the company already operated an assembly plant in Toledo at the time it decided to open the new plant.

A group of business owners and taxpayers in Toledo and Michigan filed suit challenging the incentive package awarded to DaimlerChrysler. A three-member panel of the 6th U.S. Circuit Court of Appeals reviewed the tax incentives offered by Ohio to DaimlerChrysler. The court upheld the personal property tax exemption. However, it held that the investment tax credit violated the federal "dormant" Commerce Clause. DaimlerChrysler petitioned the court for a rehearing where the full district court could hear the case, but that was denied. It is expected that the company will appeal to the U.S. Supreme Court.

While the decision of the court is complex, it appears that one critical element is the fact that the investment tax credit could be applied against tax liability that would have arisen without the investment. The court found that this created a discrimination based on location and so found it in violation of the Commerce Clause. The ruling made a distinction by finding the property by tax incentive valid; it was an abatement of new property placed in service the company and so would abate property taxes that would arise only with the investment.

While there is much to understand about this case, and this article does not purport to be legal advice, the case does point to increased uncertainty about many incentives. Many investment tax credit programs are of a similar nature to the Ohio program and so would be at risk of suffering a similar fate as Ohio's. Many of these programs are high impact, and many are tied to specific areas for development (distressed areas, etc.). So, this uncertainty is especially troubling for companies whose location decision may have been strongly influenced by the incentives. It is also troubling for public policy makers who may lose an important tool in bringing investment and jobs to distressed areas.

An incentive program that has gained increasing prominence over the past several years is the personal income tax capture program. Often called job development programs, these are high-impact programs that capture a portion of the personal income tax of new employees and divert it back to the company. These are complicated programs with many variations. Most limit the amount of the benefit to withholding amounts, although some do not limit it to the withholding of the new employees and so may have a *Cuno*–type issue. Some of the programs supply the benefit to companies via a cash rebate, which is probably *Cuno*-safe, but others may have benefit mechanisms that create *Cuno*-type issues.

The situation is that the case and expected appeal add a level of uncertainty to incentives, thereby adding to the difficulty of this factor in an already highly complex decision.

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