Federal Incentives in Schuyler County

Tax-Exempt Bond Transaction

Projects that generally qualify for tax-exempt bond financing (or refinancing in certain instances) are:

- a manufacturing facility within the meaning of § 144(a)(12)(C) of the Code;
- a facility for a 501(c)(3) charitable entity under § 145 of the Code; or
- an exempt facility under § 142 of the Code (e.g., airport, docks and wharfs, mass commuting facility, facilities for the furnishing of water, sewage facilities, solid waste disposal facilities, qualified residential rental projects, facilities for the local furnishing of electric energy or gas, local district heating or cooling facilities, hazardous waste facility, high-speed intercity rail facilities or environmental enhancements of hydroelectric facilities).

The company's first step is to complete an application for submission to the issuer (IDA or LDC). The application should specifically and completely describe the project and the types of benefits sought and include a commitment from the company to pay all costs incurred by the issuer in pursuing the transaction.

The application should also include a cost/benefit analysis. At the same time, the issuer representative should confer with counsel to determine if the project qualifies for a tax-exempt bond issue. If the project on its face appears to qualify, the issuer's bond counsel will send the company a detailed questionnaire to confirm that the project, as proposed, does in fact qualify for a tax-exempt bond issue.

Qualifications

Manufacturing Facilities

Definition. A manufacturing facility is one which is used in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of such property). The 1986 amendments to the Code expanded the definition of a manufacturing facility to include facilities which are "directly related and ancillary" to a manufacturing facility, if (i) such facilities are located on the same site as the manufacturing facility, and (ii) not more than 25% of the net proceeds of the bonds are used to provide for directly related and ancillary facilities.

These "directly related and ancillary facilities" include office and warehouse space. Ancillary activities must also be subordinate to and integral to the manufacturing process.

Volume Cap. Manufacturing facilities are subject to the statewide volume cap allocation. $10 Million Limitation (local test). The bond size is limited to $10 million per issue. This $10 million limitation includes the aggregate of:

(i) the principal amount of the bonds to be issued; and
(ii) (ii) prior outstanding bonds for the same company and its affiliates within the same municipality.

$20 Million Limitation (local test).

The following three items cannot exceed $20,000,000 in the aggregate:

(i) the principal amount of the bonds to be issued;

(ii) prior outstanding bonds for the same company and its affiliates within the same municipality;

(iii) the company's capital expenditures within the same municipality for a six-year period, looking three years back and three years forward from the date the bonds are to be issued.

$40 Million Limitation (nationwide test). Section 144(a)(10) of the Code provides that if the face amount of the bonds plus the aggregate face amount of all other small issue bonds of the company and its affiliates exceeds $40 million (determined at a national level), tax-exempt manufacturing bonds for the benefit of the company cannot be issued.

Limitation on Land Acquisition. Section 147(c) of the Code limits the amount of tax-exempt bond proceeds that can be used for land acquisition to 25% of such proceeds.

Acquisition of Existing Property.

Section 147(d) of the Code generally prohibits the use of tax-exempt bond proceeds for the acquisition of property (including equipment) unless the first use of such property is pursuant to such acquisition (i.e., "new" property). There is an exception to this general prohibition of acquisition of existing buildings (including equipment located therein as part of an integrated operation) if the rehabilitation cost of such building is at least 15% of the portion of the cost of acquisition of such property that is paid for out of bond proceeds. In the case of structures other than buildings, the rehabilitation costs must equal 100% of the purchase price paid with bond proceeds. For example, if a building is being acquired for $100,000 and all of such purchase price is paid for out of bond proceeds, at least $15,000 must be expended for the rehabilitation of such building before bond proceeds can be used. If the building includes equipment, the cost of replacing or upgrading such equipment can be counted toward satisfying this 15% requirement.

Federal Historic Rehabilitation Tax Credit (HRTC or HTC)

20% Credit

- The building must be a "certified historic structure" (listed on the National Register, or in a registered historic district and certified as contributing to the significance of the district).
- The cost of rehabilitation must exceed the greater of $5,000 or the building's adjusted basis.

QREs

HTC is equal to the 20% credit times the qualified rehabilitation expenditures (QREs). QREs are generally qualified "hard costs," and certain "soft costs" (construction period interest, architect fees, engineering fees, reasonable developer fees).

Depreciation

HTCs are available only if the taxpayer uses the straight-line method of depreciation (27.5 years for residential rental property and 39 years for nonresidential real property).

Tax-Exempt Use Prohibition

No HTC can be claimed with respect to any expenditure in connection with a rehabilitation which is allocable to the portion of such property which is "tax-exempt use property." "Tax-exempt use property" is nonresidential real property (which includes residential rental property) leased to a tax- exempt entity under a "Disqualified Lease," where a "Disqualified Lease" means any lease of more than 50% of the property to a tax-exempt entity, but only if:

- Part or all of the property was financed by tax-exempt bonds and the tax-exempt entity (or a related entity) participated in such financing; or
- The lease has a fixed or determinable price purchase or sale option (or equivalent thereof) which involves such entity (or a related entity); or
- The lease has a lease term in excess of 20 years; or
- The lease occurs after a sale (or other transfer) of the property by, or lease of the property from, the tax-exempt entity (or a related entity) and such property has been used by the tax-exempt entity (or a related entity) before such sale (or other transfer) or lease. HOWEVER, this rule shall not apply to any property which is leased within three months after the date such property is first used by the tax-exempt entity (or a related entity).
- Exception #1: If the property is rented and the rental income is subject to tax as unrelated business taxable income ("UBTI"), then the property shall not be treated as leased to a tax-exempt entity under a Disqualified Lease.

- Exception #2: A tax-exempt entity which makes an election under 168(h)((6)F)(ii) to be treated as a taxable entity shall not be treated as a tax-exempt entity, and any income recognized by the electing tax-exempt entity shall be treated as UBTI.

Application Process

- Part 1: Certifies to the historic significance of the building.
- Part 2: National Park Service ("NPS") determines the qualification of the proposed QRE work.
- Part 3: Submitted after the project is complete and certifies that the project is a "certified rehabilitation."

Claiming the Credit

The rehabilitation tax credit is available to the person(s) and/or the entity that holds title to the property, or to a master tenant to whom the federal HTC is passed under Internal Revenue Code regulations.

- Based on changes made in the tax law in 2018, the credit is taken over 5 years in equal 20% amounts. If the credit, or a portion of tax credit, cannot be used in the year placed in service, the excess can be carried back one year and forward for 20 years.
- Federal HTC is subject to alternative minimum tax and the passive activity rules

Recapture

HTCs are subject to recapture:

- If the building is sold, or ceases to be business-use property, during the 5-year period after placed in service, recapture occurs at a rate of 20% per year, including the year of recapture.
- If a partner sells all of her partnership interest, or if a partner's interest is reduced by 33.33% or more of what it was when the rehabilitated property was placed in service, the percent reduction is treated as a proportional disposition of the property.

Grants

- If a grant is taxable (developer has control over grant funds): the developer has basis; the HTC can be claimed on expenditures made with the grant funds.
- If the grant is not taxable (i.e., National Historic Preservation Act grants or developer has no grant control): developer has no basis; the HTC cannot be claimed on expenditures made with the grant funds.

- Grants received by corporate developers are considered tax-exempt contributions of capital by a non-shareholder: no eligible basis and no HTC can be claimed on expenditures made with the grant funds.

New Market Tax Credits

The New Market Tax Credit ("NMTC") Program was instituted as part of the Community Renewal Tax Relief Act of 2000. This Federal tax credit program is unique because unlike other low-income community tax programs that address purely housing issues, this tax credit is aimed at businesses. The NMTC Program is designed to bring new investment capital to low-income communities over a seven-year period. The source of capital is generated from lenders and private investors. The goal of the program is to provide a direct means to channel this investment capital to businesses in low-income communities. The primary incentive offered to investors is a credit against their federal income taxes equal to 39% over the seven-year investment period.

New Markets Tax Credit in a nutshell:

CDEs must use substantially all of the proceeds from QEIs to make QLICIs in QALICBs located in LICs.

CDEs:

A CDE is a Community Development Entity is any domestic, for-profit or not-for-profit corporation or partnership formed and certified as such by the Community Development Financial Institutions Fund ("CDFI"), which satisfies the following two tests:

- Primary Mission Test: The primary mission of the CDE must be to serve, or provide investment capital for, low-income communities ("LICs") or low-income persons ("LIPs").
- Accountability Test: The CDE must maintain accountability to residents of LICs within the CDE's chosen service area through their representation on CDE governing or advisory boards by having at least 20% of its members of its governing board or its advisory board(s) being persons who are representative of the LIC within its service area. Service areas can be local, statewide (or multi-states) or national.

QEIs

- A QEI is a Qualified Equity Investment in the form of a cash investment by a taxpayer for an equity interest in a CDE.
- Substantially all (85%) of the QEI must be used to make QLICIs within 12 months after the date the QEI is made (the "Substantially-All Test").

QLICIs:

A QLICI is a Qualified Low-Income Community Investment, which includes either a loan to or an equity investment in a QALICB. Invariably, it is a loan.

QALICBs:

A QALICB is a Qualified Active Low-Income Community Business which satisfies the following rules:

- Qualified business: any business enterprise except "Excluded Businesses":
    - The "sin businesses" (applicable also to tenant businesses): country clubs, golf courses, massage parlors, hot tub facility, suntan facility, racetracks, gambling facili-ties (including casinos) and liquor stores;
    - Businesses holding intangibles for sale or license;
    - Projects which are wholly residential rental real estate projects (but mixed-use projects are allowed as long as the residential component does not exceed 80% of overall revenues (80/20 test)).
- Active business:
    - The CDE must reasonably expect the business will generate revenues within three years after the QLICI is made.
- Low-Income Community business:
- To be a QALICB, the business must also satisfy the following five LIC tests:
    - Gross income test (at least 50% revenue generated in the LIC).
    - Tangible property test (at least 40% of asset use is in the LIC).
    - Services test (at least 40% of employee services performed in the LIC). If no employees, satisfied by 85% of property usage.
    - Collectibles (no more than 5% of QALICB assets are collectibles). Non-qualified financial property (NQFP) (less than 5% of QALICB's property is attributable to NQFP (essentially, cash and equivalents).

Low-Income Community (LIC):

A low-income community ("LIC") is any population census tract that:

- has a poverty rate of at least 20%; or
- if the tract is located outside of a metropolitan area, the median family income ("MFI") does not exceed 80% of statewide median family income; or
- if the tract is located within a metropolitan area, the MFI does not exceed 80% of the greater of, (i) statewide median family income, or (ii) the metropolitan median family income.

Claiming the NMTC

- The NMTC is 39% times the QEI, taken over 7 years (5% in years 1-3 and 6% in years 4-7).
- Tax basis is reduced by the amount of the NMTC taken with respect to a QEI.
- If a recapture event occurs during the seven-year compliance period, the tax credit is recaptured back to year one.

- A recapture event occurs when: (i) the CDE ceases to be a qualified CDE; (ii) the proceeds of the QEI cease to remain QLICIs; or (iii) there is redemption of the QEI investment without a reinvestment.

Opportunity Zone

On December 22, 2017, the Qualified Opportunity Zones ("QOZ"s) program was enacted as part of the Tax Cuts and Jobs Act ("TCJA"). On October 19, 2019 the IRS issued proposed regulations that provide guidance relating to the QOZ program, along with a related revenue ruling and Form 8996.

Capital Gains Deferral and Gain Exclusion

The QOZ program created new incentives intended to encourage development and investment in designated low-income communities. Significant federal income tax benefits are available to taxpayers who invest in businesses located within designated QOZs, and such benefits essentially fall into three categories: (i) temporary deferral of capital gains; (ii) permanent exclusion of a portion of deferred gains for fund investments held for five to seven years; and (iii) permanent exclusion of post-acquisition gains. Deferral is available for qualifying capital gains, with special rules applicable to §1256 contracts, and excluding gains from straddle transactions. Individual taxpayers, in addition to corporations, partnerships, REITs, RICs, trusts and estates are all eligible to defer gain.

Under the QOZ tax regime, eligible capital gains are deferred if such gains are reinvested, within 180 days after being recognized, in a Qualified Opportunity Fund ("QOF"). Individuals who are deferring gains received from a pass-through entity (such as a partnership or S-corporation) may start the 180-day period for investing the gain at the end of the entity's year or on the day of the sale or exchange creating the gain. Eligible gains are deferred from inclusion in gross income until the first of the following dates: (i) the date the investment is sold or liquidated; or (ii) December 31, 2026. When this recognition event occurs, the capital gains owed by the investor may be reduced by 10% if the QOF investment is held for five years and by an additional 5% if such investment is held for seven years. In addition, post-acquisition gains on investments held in QOFs are excluded from a taxpayer's gross income entirely, if held for a period of at least 10 years.

Gain Deferral Example – An example of the capital gains deferment and savings can be found below: If an investor has $40 million in capital gains from a sale, the investor can defer recognition of the $40 million in capital gains if the $40 million is invested in a QOF within 180 days of the sale. When the investment is made, the basis will be $0. However, if the investment is maintained in the QOF for five (5) years, the investment will receive an increase of its basis equal to $4 million (10% of the original investment). If the investment is maintained for an additional two (2) years, the investment's basis will increase to $6 million (15% of the original investment). On the recognition event, the investor will recognize capital gains on $34 million, instead of the original $40 million. If the investment is maintained for 10 or more years, the basis of the investment becomes its fair market value on the day it is sold. If the investment has grown over the 10 years it was maintained in the Fund, say to $50 million, the investor will not recognize any additional capital gains when the investment is sold. When the investment is sold for $50 million after 10 years, the investor would have only recognized capital gains on $34 million of the investment (the amount paid on the recognition event).

Qualified Opportunity Funds

A QOF is a corporation or partnership organized for the purpose of investing in Qualified Opportunity Zone Property ("QOZP") (as such term is defined below) and holds at least 90% of its assets in such property. The 90% test is based on the average of the percentage of QOZP held by the QOF on the last day of the first six-month period of the fund's tax year and on the last day of the fund's tax year.

If a QOF has an applicable financial statement as defined in Prop. Treas. Reg. §1.475(a)-4(h), then the value of its assets for purposes of the 90% asset test is the value reported on such applicable financial statement for the relevant reporting period. For QOF's without an applicable financial statement, the appropriate value is the cost of the assets. For purposes of applying the 90% test, and as discussed in further detail below, a safe harbor rule applies to working capital. A QOF will be penalized for each month it fails to hold at least 90% of its assets in QOZP.

IRS Form 8996, Qualified Opportunity Fund, should be used by a corporation or partnership to self-certify as a QOF and for annual reporting purposes. Form 8996 is attached to the corporate or partnership federal return by the due date of such returns, including any extensions. During the year an entity first certifies itself as a QOF, it must identify the first tax year that the entity wants to be a QOF and may identify the first month of that tax year that the corporation or partnership wants to be a QOF. If the starting month is not specified, then the first month of the tax year is treated as the month in which QOF status starts. If a partnership or corporation becomes a QOF in the seventh or later month of taxable year, only the QOF's assets on the last day of the tax year will count for purposes of the 90% asset test.

Notably, any investment made in the potential eligible QOF prior such entity's first month as a QOF does not qualify for the capital gains deferral benefits afforded by the program. Notwithstanding the foregoing, a pre-existing entity may certify as a QOF, but the entity must satisfy all QOZ program46 requirements, including the requirement that QOZP must be acquired after December 31, 2017.

Businesses that Do Not Qualify

QOF investments cannot include the operation of a private or commercial golf course, country club, massage parlor, hot tub facility; suntan facility, racetrack, gambling, or a store whose principal business is the sale of alcohol for consumption off-premises.

Dates to Remember

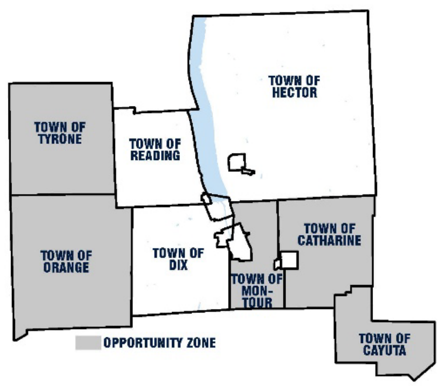
December 31, 2019 – date by which an investor must invest in a QOF in order to meet the seven-year holding period to defer up to 15% of qualifying capital gains;

December 31, 2021 – date by which an investor must invest in a QOF in order to meet the five-year holding period to defer up to 10% of qualifying capital gains;

December 31, 2026 – mandatory gain recognition date;

December 31, 2028 – designations of all QOZs not in existence expire; last date to invest and receive a 100% exemption from tax on gain on a QOF interest; and

December 31, 2047 – last date a taxpayer may make a basis step-up election



EB-5 Foreign Investment

Two main objectives of the fifth employment-based preference (EB-5) visa foreign investor program are:

(i) to encourage foreign investments into a U.S. commercial enterprise and
(ii) to create American jobs. By making a qualified investment (either $500,000 or $1.0 million depending on the specifics of the investment area) and under other terms, a qualified foreign investor can receive a permanent visa for themselves, their spouse and unmarried children under 21 years old.

EB-5 investments can be made directly by an individual or through a designated Regional Center. A Regional Center is a private enterprise or corporation or a regional government agency with a targeted investment program within a defined geographic area. The Regional Center can pool individual investments and invest in particular projects. In contrast to individual EB-5 investments, Regional Center projects can receive credit for indirect as well as direct job creation. Currently, in New York state, there are twenty-four (24) Regional Centers, each servicing different geographic areas in NYS and different approved North America Industry Classification Systems (NAICS)/industries. Further detail and contact information for each regional center can be found at https://www.uscis.gov/working-united-states/permanent-workers/employment-based-immigration-fifth-preference-eb-5/immigrant-investor-regional-centers

To the business owner/developer, EB-5 funding is often a lower cost form of capital than alternatives because investor demand for return on their investment is often lower for EB-5 capital than other sources of capital. In addition, securing EB-5 capital increases the overall liquidity of a business project which, in turn, reduces the costs of acquiring capital from other sources.

If an investor decides to invest through a Regional Center, they are relieved of both the need to manage the business and of the job creation requirement; instead the Regional Center runs the project and is held responsible for creating 10 (either direct or indirect) jobs per investor over two years. The foreign investor would not have to play an active role in the business, nor would they have to have any direct role in managing the investment. The investor receives conditional permanent resident status (a “green card”) during the investment phase, and then applies for full unconditional status upon proof that the investment was made and at least 10 jobs were created.

Each Regional Center has their specific targeted investment areas. For example, some Centers are solely interested in Retail investments/tourism-related projects or manufacturing. Other Centers are only interested in real-estate related projects. The EB-5 program presents a potentially significant source of alternative investment for certain American businesses.

In addition to the EB-5 programs, foreign investors in U.S. enterprises have been accommodated under the E visa “Treaty Investor” program and the L-1 “Intracompany Transferee” option, neither of which require the investor to meet a minimum investment or job creation threshold.

Foreign Trade Zones

Foreign-Trade Zones ("FTZ"), sometimes referred to as "Free-Trade Zones" or "Free Zones," are geographic areas administered by the Foreign-Trade Zones Board (FTZB) under the U.S. Department of Commerce and under the supervision of the U.S. Customs and Border Protection ("CBP") that, once activated, are considered outside CBP territory. These zones allow both domestic and foreign merchandise to receive the same Customs treatment as if it were outside the commerce of the United States (US). The primary benefits to using an FTZ are related to duties/tariffs, processing fees, and certain regulatory requirements for products entering the United States.

Authority for establishing these facilities is granted by the Foreign-Trade Zones Board under the Foreign-Trade Zones Act of 1934, as amended (19 U.S.C. 81a-81u). The Foreign-Trade Zones Act is administered through two sets of regulations, the FTZ Regulations (15 CFR Part 400) and CBP Regulations (19 CFR Part 146).

Program Benefits

FTZs help businesses lower the cost of international transactions. Three of the most notable duty- related benefits of a FTZ include duty deferral, duty inversion (when the duty rate of the overall completed good is lower than the duty rate of its parts), and duty elimination.

1. **Duty Deferral**

In general, payment of duties and excise taxes on foreign merchandise admitted to a zone will be deferred until the goods are admitted from the FTZ and into U.S. Customs territory. Merchandise may be manufactured or changed in condition while in the zone, subject to prior approval from the FTZ Board. Manufacturing or processing may substantially lower the duties paid on merchandise that enters U.S. commerce. In addition, merchandise or materials may be permanently stored, destroyed, or exported, eliminating, in most cases, the need to pay duties and excise taxes. Companies may also import its equipment into its FTZ and defer duty until the equipment is used in production. This allows companies to defer duty on the imported equipment when installation and training may take a significant amount of time.

2. **Duty Inversion**

Duty inversion or inverted tariff results when the duty rate for the finished item is lower than the duty rate of its parts. If the item is manufactured within a FTZ, U.S. importers can take advantage of the inverted duty/tariff and keep the manufacturing within the U.S. The use of inverted tariff is predominantly used by the electronics, automotive, chemical, petroleum, pharmaceutical and aerospace manufacturing industries. The benefit allows manufacturers to produce a final product at a lower duty rate than the imported components whereby the imported components are no longer considered to be in their original form and subject to the higher duty rate; duty is paid at the lower rate of the final product.

3. **Duty Elimination**

Foreign-Trade Zone users can eliminate U.S. duty altogether on items that are ultimately exported from the FTZ to locations outside of the United States. The U.S. benefits from the value added to the imported product through production or manufacturing. Duty is also eliminated on product that is destroyed or scrap, and does not have a secondary market in the United States. Scrap or waste that is exported also benefits from duty elimination in the same way that any export for a FTZ does.

4. **Logistical Benefits**

Logistical benefits are another benefit of operating within a FTZ. Merchandise processing fees are reduced since zone users can file a single customs entry and pay a single fee per week rather than multiple entries (and multiple fees) during the course of the week. Those fees are capped at $485 per week and can result in significant savings for importers of high value or high-volume shipments.

Foreign-Trade Zone users may also import product into zone locations which may not have met certain regulatory requirements. Product may be awaiting approval, may be subject to relabeling, or may require alterations to meet certain regulatory standards in order to be admitted into the United States. This benefit may be helpful to a company awaiting a regulatory approval but wants to have the product ready for market. The company can ship the unapproved inventory into a FTZ until approval is given to admit the product into the United States.

In most instances, imports subject to quota may be retained within a Foreign-Trade Zone once a quota has been reached allowing zone users access to potentially discounted inputs and the ability to admit merchandise as soon as a new quota year starts. Additionally, except for certain textiles, inputs subject to quota may be manipulated or manufactured while in the zone into a product not subject to a quota.

Other benefits of a FTZ include improved cash flow and inventory management, elimination of duties rejected or defective parts, automated recordkeeping and document storage, and lessened U.S. regulatory agency requirements for re-export. FTZ warehouses also offer certain advantages over bonded warehouses including the ability to place both foreign and domestic merchandise in the FTZ warehouse and no time limitations for FTZ merchandise. In New York state, there are 16 active FTZ projects.