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# Tax Incentives: The New York Urban Job Incentive Program


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# CURRENT LEGISLATION

## TAX INCENTIVES: THE NEW YORK STATE URBAN JOB INCENTIVE PROGRAM

In the nation's urban poverty areas thousands of people are either unemployed or are working at jobs below their capacities.[1] While certain psychological and institutional causes have over decades created and sustained this state of unemployment, at the moment two major curative approaches are recommended with special force. The first is the governmental inducement of industrial and commercial location in the urban poverty areas. Such location would have immediate impact on the affected area by large-scale creation of job opportunities. Another related policy tending toward the same result is the encouragement of commercial and industrial expansion by enterprises already located in urban areas. But either of these responses by industry will not alleviate unemployment if the jobs offered are not within the capabilities of the local inhabitants. Hence, the second major line of attack upon urban unemployment and underemployment is the establishment of training programs for local residents. An efficient training program should retrain and help to reemploy those whose previous jobs have been made obsolete by automation. It should enable people to qualify for certain industries and to advance to more demanding and rewarding jobs. By moving people up the industrial work ladder, training programs should create job openings at the bottom for those presently unable to qualify for any kind of employment.[2]

Private industry, unaided by government support, will not produce the needed programs. The fact that the problems of unemployment and underemployment continue to exist on a large scale is ample evidence that training programs in industry are inadequate. It is unrealistic to believe that industry itself would take substantial steps at great expense to seek change in the employment pattern prevalent in many areas. It has done little in the past and cannot be expected to change now, unless it were to find that the establishment of training programs would be economically feasible, if not profitable.

It is the purpose of this comment, using the federal experience as a background, to consider the advantages and disadvantages of various state approaches designed to attract businesses into the urban area and to conduct training programs enabling residents to qualify for the new jobs made available. The comment will then give consideration to a recent New York statute establishing the New York State Urban Job Incentive Program, which, through tax incentives, attempts to alleviate the problems both of attracting industry and of establishing training programs. The program will be evalu-

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1 In the first quarter of 1968, big city poverty areas had an unemployment rate of 7% while the national rate was only 3.8%. Task Force in Occupational Training in Industry, A Government Commitment to Occupational Training in Industry 20, 25 (Aug. 1968) [hereinafter cited as Task Force].

2 Id. at 12.

ated in terms of the strengths and weaknesses of alternative approaches attempted at state and federal levels.

## I. Federal Programs

The principal mechanism used by the federal government to encourage businesses to expand their operation is the 7 percent investment credit on corporate income taxes.[3] This provision, however, does not address itself specifically to urban problems. While government loans are available to some businesses,[4] these too fail to emphasize urban problems.

In search of new approaches to the nation's training needs, the *1967 President's Manpower Report to the Congress* instructed that a Task Force on Occupational Training in Industry be established.[5] The Task Force considered three methods to establish training programs: credits against the federal income tax, a levy-grant system, and direct payments to industries establishing an acceptable training program. It decided against a general tax credit based on training expenses because such a device could not effectively emphasize the specific areas, like the urban areas, demanding special attention.[6] While some value always lies in the creation of training programs even in areas with a low unemployment rate, the Task Force felt that government aid by way of tax credits was not the best means to cope with the pressing problems afflicting specific areas of the nation.[7]

The second method considered by the Task Force was a levy-grant system under which industrial training boards are established and are made responsible for all forms of training in all occupations within an industry.[8] The boards assess a levy upon all companies of an industry, based upon a percentage of an employer's total payroll, and then distribute these funds to those companies conducting acceptable training programs. The British have employed this system with some success, since it allows industries to formulate their own training programs and does not greatly alter the existing tax system.[9] However, the Task Force concluded that classification of American industries would be extremely difficult and could make the training programs less effective for individual trainees.[10]

The Task Force finally recommended that the most effective development of training programs was available through direct federal payments to industries incurring training expenses.[11] By this method, the government could easily concentrate on those areas which it desired to aid financially.

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3 Int. Rev. Code of 1954, § 46.

4 E.g., 13 C.F.R. §§ 122.1-.25 (1968).

5 See Task Force at ii.

6 Id. at 79.

7 But the Task Force failed to consider a more limited type of tax credit which could be designed to help those areas most in need of training programs. While its criticisms are valid with regard to a general tax credit, they do not apply to a system of credits for particular locations only.

8 Task Force at 81-82.

9 Id.

10 Id. at 82.

11 Id. at 83-87.

## II. State Methods to Attract Businesses

On the state level, several methods presently exist for the attraction of industries into urban locations. Many states have established development credit corporations which sell stock as a means of raising capital.[12] These corporations then lend funds to businesses unable to obtain money in the private sector.[13] Other states have set up industrial finance authorities which provide state funds or credit to local development corporations which in turn give assistance to new industries.[14] A third method employed by states is to allow local governments to issue bonds to help the financing of industrial locations.[15] These bonds are either revenue bonds which must be amortized from funds from the industrial project or general obligation bonds for which tax revenue must be used for amortization if revenue from the project is insufficient.[16] Finally, states may offer tax concessions to attract businesses to urban locations.[17] Usually, a state will allow municipalities to grant new businesses an exemption from local taxes for a certain number of years, although a few states even provide exemptions from certain state taxes.[18]

In effect, the development credit corporation, the industrial finance authority and the local bond issues are variations of direct payments to businesses locating in a certain area. While most of the funds must eventually be paid back, these companies are receiving funds which they either could not have acquired in the open market or for which they would have had to pay a much higher rate of interest. Tax concessions, on the other hand, involve a totally different concept. They do not provide for a tight control on the amount of funds expended. A tax concession requires a new business to pay its initial costs for such items as land, construction and equipment; but the state or municipality then aids the enterprise by tax concessions reducing operating expenses. Each of the above plans attempts to attract businesses to certain locations so that the area's tax base will be broadened. None makes a direct attempt to alleviate unemployment problems in the particular area. Thus, implementation of any one of the four methods in an urban area would not, by itself, eliminate unemployment; for, as the Task Force concluded, training must constitute an integral part of any attack on the problem of unemployment.

## III. State Methods to Establish Training Programs

Several methods are available by which states may develop adequate and efficient training programs. First, a state could itself establish and operate training programs. However, this method is subject to many drawbacks. Facilities would have to be acquired or existing facilities would have to be renovated so that they could be used efficiently. Personnel would have to be

12 New York State Department of Commerce, The Use of Public Funds or Credit in Industrial Locations 2 (June 1968).

13 Id. As of March 15, 1968, 24 states had such development credit corporations. Id.

14 Id. As of March 15, 1968, 19 states had active authorities. Id.

15 Id. at 3.

16 Id. As of March 15, 1968, 38 states allowed governments to issue bonds. Id.

17 Id. As of March 15, 1968, 12 states granted some kind of tax relief. Id.

18 Id.

hired to operate the program. Finally, and most importantly, the training to be given simply could not be as realistic or efficient as the training provided by a company engaged in the particular business. Private companies will know exactly what skills need development and will have experienced personnel to serve as instructors. A second approach would be to establish training programs solely through the initiative of private industry. But this is really no approach at all since it is essentially the system which exists today and which has proved unsatisfactory.

Since these extreme approaches to the training program appear to be impractical, the solution may lie in a mixed approach combining state aid with private training programs. An examination of the available alternatives involves, as it did with programs for the exclusive purpose of attracting industry, a consideration of direct payments and tax incentives. Many valid reasons support the conclusion that reimbursement for training expenses is the most effective method. A system of direct payments enables the state to control the amount and the direction of the funds which it chooses to spend for training. An annual appropriation would embody the sum which a state chooses to devote to such training. An annual budgetary review would assure efficient and effective expenditures. Also, the determination of the amount of money to which each company is entitled would be ascertainable from its expenses in the training area.

Balanced against these attractive aspects of direct payments are some possible practical difficulties. These reimbursements flow primarily through a contractual agreement between a company and the government. The contract introduces two potential drawbacks. First, it may bind the company to a very specific arrangement. Second, in light of experience under federal programs, it may involve the company in considerable and unwanted administrative red tape.[19] Finally, the very real question arises whether a state government could receive more training for its money under some sort of tax incentive plan.

The use of tax credits is a fourth means to establish training programs. This approach, however, raises a possible constitutional question. It may be argued that this kind of governmental action would violate the equal protection clause of the fourteenth amendment insofar as it differentiates between industries. But it is clear that the equal protection clause does not require the states to tax all industrial entities by exactly the same criteria.[20] Thus, as long as a state could designate a reasonable basis for granting a tax credit, it should overcome any constitutional arguments against tax credits.

Constitutional arguments aside, tax credits have been criticized on other grounds. From a fiscal point of view, it is difficult for a state to calculate in advance the amount of tax revenue to be lost by a tax credit. The incalcula-

[19] Task Force at 84.

[20] In Ohio Oil Co. v. Conway, 281 U.S. 146, 159 (1930), the Court said,

> In levying such taxes, the State is not required to resort to close distinctions or to maintain a precise, scientific uniformity with reference to composition, use or value. To hold otherwise would be to subject the essential taxing power of the State to an intolerable supervision, hostile to the basic principles of our Government and wholly beyond the protection which the general clause of the Fourteenth Amendment was intended to assure.

bility of such loss will persist, since legislatures tend to concentrate review on direct expenditures rather than on reform of existing law.[21] Therefore, once a tax credit bill becomes law, it is likely to remain on the books even if it is not as successful as had been hoped. And, conceptually, many critics have great difficulty with the application of the tax structure to the cure of social ills. They look to the tax system exclusively as a means of raising revenue and fear its use as traditional regulatory legislation.[22]

Those in favor of the use of tax credits to encourage industry to establish training programs in urban areas feel that it is the most efficient and economic means to accomplish the desired objectives.[23] Philosophically, it may be thought that a tax credit is more consistent with a system of free enterprise because private industry itself will design, operate and maintain the programs. Furthermore, a tax credit may be contrasted with a contractual arrangement between government and industry, where government, the entity disbursing the funds, has unilateral power to determine the character of programs to be established. Proponents of a tax credit also argue that this device avoids unnecessary delays in contract negotiation with the government.[24] Finally, a tax credit approach guarantees that qualifying industries will be able to receive a financial benefit, whereas a system of direct payments is limited by the amount of funds which have been appropriated.[25]

## IV. New York State Urban Job Incentive Program

Against this entire background, the New York legislature enacted a bill establishing the New York State Urban Job Incentive Program.[26] The purpose of the Act is twofold. By the use of tax credits, it attempts to encourage private enterprise to locate in depressed urban areas and to expand facilities already in those urban areas. Secondly, the Act gives tax credits to those businesses in the urban area which establish acceptable training programs.[27] Thus, this one piece of legislation tries to solve two interrelated problems heretofore treated separately at both the federal and state level.

The entire program is administered by the New York State Urban Job Incentive Board. The board consists of the Commissioner of Commerce, who serves as chairman, the Commissioner of Taxation and Finance, the Industrial Commissioner, the Commissioner for Local Government, and the Commissioner of Housing and Community Renewal.[28] Each member's term on the board runs concurrently with his term of office as commissioner. The prime responsibility of the board is to certify those businesses which qualify for credits against state taxes on corporations and on unincorporated busi-

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21 Kurtz, Tax Incentives: Their Use and Misuse, U. So. Cal. 1968 Tax Inst. 1, 7.

22 Id. at 8-9.

23 Task Force at 77.

24 Id. at 78.

25 Cf. id. at 83-84.

26 Ch. 1054, Laws of New York (1968) (McKinney Session Law News 2076 (1968)).

27 N.Y. Comm. Law § 118(d) (McKinney Supp. 1968).

28 Id. § 116(a).

nesses; and for exemptions from real property taxes at the option of local cities or counties.[29]

### A. *Eligibility*

In order for a business to become eligible for these tax concessions, it must be located within a city having a population of at least 125,000.[30] Also, the business must be situated in an area consisting of a census tract where the median family income is in the lowest quartile of all census tracts in all eligible cities in New York State.[31] At the discretion of the board, an "eligible area" may include a census tract contiguous to another tract in such a lowest quartile.[32] The business facility must also serve an area larger than the eligible area in which it is located. A facility meets this requirement if it is engaged primarily in wholesaling or manufacturing, but it does not qualify if its primary activity consists of retail sales of goods or services for which customers visit the facility, or if its primary function is to furnish accommodations to people.[33]

Aside from these physical characteristics, the facility must create or retain at least five jobs and provide a training program which will prepare inhabitants of the eligible area for these jobs.[34] Also, the facility must "assure such residents opportunities for job upgrading and for entry into supervisory positions . . . ."[35] If the board finds that a business meets these criteria, it "shall" issue a certificate of eligibility.[36] The maximum number of years for which this certificate may be granted is ten. However, the certificate automatically expires at the end of each tax year unless it is renewed by the board after a reexamination of the requirements for eligibility.[37] A certificate may be revoked by the board at any time if it finds that a business no longer qualifies for eligibility.[38]

### B. *Computation of Tax Credit*

Once a business is certified as an eligible business facility, it is automatically entitled to a tax credit against state franchise and unincorporated business taxes.[39] The amount of the credit is determined by multiplication of the tax due by the average of the following two percentages: the percentage that eligible property values in the qualifying facility bear to the value of the real and tangible personal property of the company in New York State; and the percentage that the total wages, except for general executive salaries, of employees serving in jobs created or retained in the

29 Id. § 117(b).
30 Id. § 115(c).
31 Id.
32 Id.
33 Id. § 118(b).
34 Id. §§ 118(c), (d).
35 Id. § 118(d).
36 Id. § 120(a).
37 Id. §§ 120(b), (d), (e).
38 Id. § 120(f).
39 N.Y. Tax Law §§ 210(11)(a); 219-q(11)(a); 701(c)(1) (McKinney Supp. 1968).

qualifying installation bear to the total wages of all the taxpayer's employees in the state, except for general executive officers.[40]

The franchise taxes cannot be reduced below minimum figures,[41] and the amount of all credits cannot exceed the total amount of the eligible property values in the eligible facility.[42] In the computation of the first percentage, the term "eligible property values" includes the value of depreciable real and tangible personal property in an eligible facility as a result of one of the following expenditures *after July 1, 1968:* (1) capital improvements consisting of the construction, reconstruction, erection or improvement of real property in the facility; (2) if the taxpayer rents real property, eight times the portion of the annual rent attributable to expenses defined in (1) by the lessor; (3) tangible personal property, other than vehicles, used in the eligible facility; (4) if the taxpayer rents tangible personal property, other than vehicles, for use in the business facility, eight times the annual rent if the rental period commenced after July 1, 1968.[43]

By requiring that the expenditures be made after July 1, 1968, the Act was designed to measure the credit by the relative value of the expenditures motivated by the Act. Similarly, the use of the percentage of the wages earned by those in the training program to the total wages of the taxpayer's employees in the state was an attempt to compute the credit with regard to the training accomplishments attributable to the legislation.

In addition to tax credits against state taxes, the Act also allows a city where such a facility is located to amend its real property tax laws in order to grant an exemption from taxes for city and school purposes.[44] This amendment of local law may be adopted by the whole county in order to grant an exemption from taxes and special ad valorem levies.[45] These exemptions apply only to those increases in taxes caused by eligible expenditures certified by the New York State Urban Job Incentive Board to have been paid after July 1, 1968. This provision also measures the tax concession by expenditures motivated by the Act. The exemptions from additional real property taxes, like the tax credits, may be granted for a maximum of ten years and are automatically revoked when a certificate of eligibility is canceled by the board.

### C. *Comparison With Other Plans*

This rather unique tax credit plan has many of the characteristics favored by advocates of direct payments. By limiting the types and locations of businesses eligible for the tax credits, the New York statute is able to focus attention upon particular areas not susceptible to concentrated treatment by a general tax credit. While the New York plan, unlike a system of direct payments, does not provide for an annual appropriation, the yearly reexamination of the eligibility of the facility serves a similar function. By

40 Id. §§ 210(11)(b), 219-q(11)(b), 701(c)(2).
41 Id. §§ 210(1)(a)(4), 219-q(3), 701(b).
42 Id. §§ 210(11)(e), 219-q(11)(e), 701(c)(4).
43 Id. §§ 210(11)(d), 219-q(11)(d), 701(c)(3).
44 N.Y. Real Prop. Tax Law § 485(2) (McKinney Supp. 1968).
45 Id.

close supervision, the board will at least be able to attest to the fact that the businesses receiving the tax credits are those which the Act was meant to benefit. The board is also well situated to give authoritative advice to the legislature regarding the program, since the board will be the body approving all certificates and witnessing the results. Finally, while the possibility exists that an unqualified company will infiltrate the statutory scheme, the ten-year limitation to the certificate of eligibility establishes a definite time beyond which no misuse may occur.

On the other hand, the New York plan has some of the drawbacks implicit in a direct payments plan. While no formal contract runs between the state and the firms, a formal application must be made to the board, and any expenses of investigating and processing the application must be borne by the applicants. If the board makes stringent demands upon a company and makes the application process a difficult or expensive one, businesses might tend to disregard the program and devote their resources to less burdensome projects.

While the New York legislation resembles a system of direct payments, it also shows many of the characteristics of a general tax credit approach. The state cannot control the amount of tax revenue which will be lost since the wording of the statute provides:

> If the board finds that a business facility described in an application for a certificate of eligibility meets the requirements of section one hundred eighteen, it *shall* issue such certificate.[46] (Emphasis added).

Every eligible facility qualifies for the full complement of tax credits. As is characteristic of all indirect expenditures through tax concessions, the state legislature is likely to give little consideration to the legislation in future years.[47] Legislators are more concerned with measures which involve the direct disbursement of government funds. Also, those critics reluctant to accept the tax structure as a vehicle for the solution of urban problems will not be assuaged by the New York statute. However, while training programs still must be acceptable to the board, industry will still exercise certain discretion over the nature of the programs since no formal contract binds it to a fixed program.

## V. Criticism of the New York Plan

Like much new legislation, the New York State Urban Job Incentive Program is vulnerable to criticism directed at its specific provisions. The New York law favors firms which had no facilities within the state before July 1, 1968. For example, if X Corporation had a facility in the state before July 1, 1968, and after that date made a million dollar capital investment in an eligible area, its tax would be reduced by the average of the percentages (1) that the one million dollars bears to the total value of its property within the state; and (2) by the percentage that the wages for jobs created in the new facility bears to total wages in the state. However, if Y Corporation made

[46] N.Y. Comm. Law § 120(a) (McKinney Supp. 1968).
[47] Kurtz, Tax Incentives: Their Use and Misuse, U. So. Cal. 1968 Tax Inst. 1, 7.

the same million dollar investment in an eligible area and had no other facility in the state, it would receive the maximum credit allowed. This discrepancy affords different treatment to two companies making the same investment in an eligible area and certainly makes the program less attractive to those companies already located in New York State. Although X Corporation might make the necessary expenditures, it is still receiving a smaller credit for the same investment.

Also, the program would not be especially appealing to a company located in an eligible area before July 1, 1968, which could establish a training program with a modest amount of capital. The tax credit would be based upon the small amount of money spent and would not consider expenditures before July 1, 1968, which also might have been made for equipment used in the training program. However, this discrepancy does not appear to be unreasonable when one considers that the program carries a twofold objective—business expansion and training.

Another problem under the Act regards a subsequent sale of an eligible facility after the ten-year period has expired. While the legislation does not address itself to this problem, the implication is that once the certificate expires, the facility can no longer be eligible under the program.[48] But what treatment is accorded the subsequent buyer whose purchase price includes the cost of capital improvements? If he makes more improvements and continues to operate an acceptable training program, he too should be entitled to tax credits. Yet nowhere does the Act make a provision for such a contingency.

Another undesirable result under the Act could occur for a new company whose taxes happen to be low during its ten-year period of eligibility. Even if such a company had a very large capital investment after July 1, 1968, it could still receive a smaller credit than a company with high taxes and a smaller investment. This anomaly thwarts the desired aim to give a greater reward to a company incurring greater expense.

## VI. Conclusion

Overshadowing the entire New York plan is the policy question whether any kind of state tax credit can be sufficiently attractive to induce industries to make the necessary expenditures. A state tax credit does not save the taxpaying company the full amount of the credit, because a smaller state tax means a smaller deduction for purposes of the federal income tax and thus a larger federal tax.[49] However, the Urban Job Incentive Board reports that the program has generated a great deal of interest on the part of businessmen in New York State. At the present time, several firms are considering applications for a certificate of eligibility.[50]

The New York State Urban Job Incentive Program is a unique and tightly drafted piece of legislation attempting to work partial solutions for

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[48] See N.Y. Comm. Law § 120(c) (McKinney Supp. 1968).

[49] See Int. Rev. Code of 1954, § 164(a).

[50] Letter from Michael P. Vadala, Executive Secretary, New York State Urban Job Incentive Board, to B.C. Ind. & Com. L. Rev., March 24, 1969.

difficult and complex problems. Of course, it would be preferable for a state to know beforehand how much revenue it would be losing. But it is more attractive for industry to know that if it qualifies it will gain an automatic tax concession. While certain characteristics of the law could lead to unequal treatment, the program deserves adequate time to prove itself. It is easy to offer critical analysis of such legislation; but often expected difficulties invite their own correction once a program is set in motion.

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