ISSUE ANALYSIS

South Carolina Policy Council
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Economic Development Bill Rewards Special Interests Over Independent Businesses

Issue Summary

One of the final pieces of legislation passed by the General Assembly this year (but still awaiting gubernatorial action) is an omnibus economic development bill that provides an array of targeted credits and subsidies aimed at stimulating South Carolina's ailing economy. Recipients of the credits range from alternative energy producers to start-ups to waste-grease biodiesel producers. In effect, new and unproven industries are getting the nod over established, independent businesses left to pick up the tab.

Analysis

The "Economic Development Competitiveness Act of 2010" (H 4478) was drafted by House Speaker Bobby Harrell and a team of consultants from Nelson Mullins, Nexsen Pruet, and the S.C. Association of Realtors, among others. According to Harrell's office, the bill represents a "proactive economic development strategy" that includes such recommendations as eliminating the corporate income tax and restoring the Closing Fund. The strategy, in other words, is to stimulate the economy both by enacting broad-based tax cuts and by doling out subsidies to special interests. Except there are no broad-based cuts.

> **H 4478 is purported to stimulate the economy both by enacting broad-based tax cuts and by doling out subsidies to special interests—except there are no broad-based cuts.**

Legislators reject fundamental tax reform

As we wrote earlier this year, plans to eliminate the corporate income tax were "clearly the sweetener being used to force down the bitter pill of more government-driven economic development." The Senate moved quickly to delete the corporate income tax cut, arguing that "it's too expensive right now." Never mind that the incremental tax cut would not have been implemented until FY13-2014 – at a cost of only $16.8 million. Or that no tax cut was ever envisioned for FY10-2011. Or that the full tax of 5.0 percent would not have been reduced to 0.0 percent until 2022. Currently, the tax brings in only a fraction of General Fund revenue, or an estimated $134.5 million for FY10-2011.

Of course, eliminating both the corporate income tax and the 5 percent flat tax on small businesses would have been an even better idea. Ninety-seven percent of South Carolina's employers run small businesses, accounting for 50 percent of private sector jobs.

Special interests benefit most

Not a few lawmakers have wondered about which special interests are benefitting from H 4478. "The bill's key sponsors 'are trying to please somebody' probably from out of state," commented Sen. Glenn Reese (D-Spartanburg) to *The State*. "I think there are many, many rabbits throughout this whole bill." This impression was seconded by a statement in the Senate journal by Senators Glenn McConnell (R-Charleston) and Lee Bright (R-Spartanburg) calling H 4478 a "Christmas tree."

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As if to confirm these suspicions, House Ways & Means Committee Chairman Dan Cooper (R-Anderson) acknowledged that a new renewable energy tax incentive program inserted into H 4478 was "designed for a significant business prospect" looking at investing $500 million in Greenville. Possible candidates would seem to be BMW or GE. (BMW has been experimenting with hydrogen vehicles for some time, whereas GE's Greenville plant is a major producer of wind turbine generators.)

The top beneficiaries of H 4478 include:

Renewable energy companies

- As dictated by the "South Carolina Renewable Energy Tax Incentive Program," firms in the renewable energy industry will receive a five-year, 10 percent tax credit. The threshold for the credit is low, requiring a minimum $500,000 investment that results in the creation of at least 1.5 full-time positions. The S.C. Board of Economic Advisors (BEA) anticipates only one company will be eligible for the credit at a cost of $40,000. This calculation, however, seems to have no basis in prior and anticipated investment patterns for the renewable energy industry in South Carolina, meaning the costs will likely be much higher.

- Under the newly titled, "S.C. Life Sciences and Renewable Energy Manufacturing Act," manufacturers of solar and wind turbine products, as well as manufacturers of lithium ion and other batteries used in alternative energy vehicles, will receive job development credits and other subsidies as authorized by the Enterprise Zone Act of 1995. Such companies are likewise eligible for various income tax breaks and a 20 percent depreciation allowance on manufacturing property taxes. As highlighted in *The Nerve*, Proterra of Greenville, S.C., may be one of the beneficiaries of this credit.

- The bill also extends fee-in-lieu of property tax (FILOT) benefits to nuclear plant facilities – an industry not even billions in federal aid has been able to sustain.

- H 4478 provides a 10 percent income tax credit for waste-grease biodiesel producers (see also H 3997). BEA analysis of this credit indicated that the "industry is in its infancy and the technology is unproven." In other words, it's a risky investment for taxpayers.

Firms planning on hiring anyway

- As amended by the Senate, H 4478 includes an unemployment tax credit. The credit is not likely to encourage new job growth, as it's too narrow and too temporary. But it will pad the pockets of businesses looking to expand anyway. Analysis by the BEA indicates the two-year credit would reduce revenue by $132.2 million in the first year (FY10-2011) and $175.8 million in the second year (FY11-2012). But it's unclear whether this provision will survive in conference committee.

Start-ups

- H 4778 extends license tax liability credits to entities developing "incubator buildings" for use by small start-up firms. Oddly enough, BEA analysis of this provision presumes only one company will take advantage of the new credit. In any case, contenders for the credit ($300,000 per company) would seem to be the South Carolina Research Authority "Innovation Centers" and a proposed "wet-lab incubation facility" at the near-empty Innovista complex.

Agribusiness companies

- Agribusiness operations are being added to the list of activities (manufacturing, tourism, processing, warehousing, distribution, research and development, corporate office, qualifying service-related facilities, extraordinary retail establishment, and qualifying technology intensive facilities, and banks) eligible for annual job tax credits.

Cargo carriers/distributors

- An existing $8 million tax credit for state port users is being expanded to include a credit against employee withholdings – up to $4 million maximum for all taxpayers. A $1 million cap on the amount of credits claimed by each recipient is also being eliminated (to the benefit of Boeing, BMW and other large manufacturers, it would seem). Finally, the credit is being amended to permit the Coordinating Council for Economic Development to give a $1 million credit to "a new warehouse or distribution facility which commits to expending at least forty million dollars at a single site and creating one hundred new full-time jobs."

Military employers

- Previous versions of H 4478 repealed job tax credits (5 percent of individual income tax withholding) allocated to redevelopment authorities located at Charleston Naval Complex, the Savannah River Site, and Myrtle Beach Air Force

Base. The Senate not only retained the credit, at a cost of $4.3 million annually, but extended it to 2017.

The tourism industry

- Sections 35 and 36 authorize the use of up to 50 percent of accommodations and hospitality tax revenue on the construction of "tourism-related buildings including, but not limited to, civic centers, coliseums, and aquariums." Developers, architects and a host of others will benefit from this change as well.

Small manufacturers

- Instead of lowering taxes for everyone, lawmakers are continuing to pursue a strategy of offering incentives and subsidies to select companies. Toward this end, H 4778 creates the Small Manufacturer's Retention and Growth Fund, which will be administered by the S.C. Manufacturing Partnership Extension. The fund will be used to subsidize various activities of manufacturers that employ less than 250 persons. H 4778 offers several tax credits to taxpayers who contribute to the fund. See also S 1066, which would grant a 100 percent (instead of 50 percent) credit.

Other beneficiaries of H 4478 include: manufacturers and others that tend to rely on FILOT agreements, with one change (§ 2) lowering the threshold from $10 million to $5 million (see also § 7, 10, 11); firms eligible for State Rural Infrastructure Fund grants (§ 14); and businesses that pay taxes on manufacturing and productive equipment property (§ 21). Especially as regards the latter credit, it is worth noting that, at 3.73 percent, South Carolina has the highest effective manufacturing property tax in the country. But instead of slashing the tax, lawmakers are continuing to pick winners and losers by offering targeted tax credits.

Instead of reducing the tax burden on all South Carolina businesses, lawmakers are continuing to pick winners and losers by offering targeted tax credits.

Nothing in the foregoing should be construed as an attempt to aid or hinder passage of any legislation.

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