

Tax incentives for Illinois manufacturers

Illinois manufacturers who plan to make a substantial capital investment or create new jobs should carefully review tax incentive options early in the planning process. The reason is simple — this early planning and analysis can result in substantial savings for the company in the short-term and over time. These incentive options are typically embedded in State and local tax codes but can also be found in the development, financing or real estate sections of the codes. Some tax incentives are entitlements, meaning that so long as a company meets the applicable legal criteria, a company is “entitled” to receive the tax benefit. Other tax incentives are discretionary which means the administering government agency can decide whether to award the incentive even if all criteria are met. This article is not meant to be an exhaustive review of all codes and programs. Rather, it provides an overview of common, and sometimes overlooked, incentives that are available to Illinois manufacturers. Consideration of all of these options can significantly improve the bottom line for investments in new facilities, equipment and facility expansion projects.

Entitlement tax credits

The Illinois Income Tax Act includes several income tax credits that are geared to manufacturers and that may be used so long as the applicable legal criteria are met. In addition, the Illinois Retailer’s Occupation Tax, or the Sales Tax Act, and other pieces of legislation include sales tax exemptions and credits for equipment, parts and building materials used in the manufacturing process.

For example, the Income Tax Act was recently amended to renew the tax credit against Illinois income tax liability to promote increased research and development on new

or improved manufacturing products, processes, or other technical business components. Businesses can qualify for a credit of up to 6.5 percent on “qualifying research expenditures” if the research activities are designed to (1) develop a new or improved business component; (2) eliminate uncertainty concerning the development or improvement of the business component; (3) develop information that is technical in nature; and (4) evaluate one or more alternatives through the experimentation process. In addition, to qualify to the credit, qualifying research expenditures must be increased over the average qualifying expenditures of the preceding three years. The most typical qualifying research expenditure is wages of employees directly involved in the research and development activities. Qualifying expenditures also include supplies such as prototypes and testing materials and contract payments to third parties for conducting research. The Illinois

credit is in fact modeled after the federal credit which can be a credit of up to 20 percent of the amount of qualifying expenditures.

Another valuable entitlement is the sales tax exemption for machinery and equipment. In Illinois, a sales tax is not imposed on sales of machinery and equipment used primarily in the manufacturing process. The exemption also extends to repair and replacement parts as long as the parts are incorporated into machinery and equipment that is exempt under the Sales Tax Act. A buyer of manufacturing machinery or equipment must certify to the seller (on a Department of Revenue form) that the buyer will use the equipment in connection with a manufacturing process. The seller then keeps that certificate and delivers it to the Department of Revenue to evidence the transaction’s exemption from sales tax.

One challenge in taking advantage of this exemption is determin-

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years, there was strong resistance in the United States to changing its first-to-invent system. However, with the passage of the AIA, the United States finally implemented the first-to-file system with the amendments to 35 USC §102. Thus, for original applications filed after March 15, 2013, a patent will now be awarded to the first inventor to file a patent application for a claimed invention.

What does the new first-to-file provision mean in practical terms? The filing date of a patent application becomes of paramount importance since a patent will now be awarded to the inventor who first files an application with the U.S. Patent and Trademark Office. Thus, it is in the best interest of companies to get their patent applications prepared and on file with the Office as soon as possible. For many companies, this will likely require a change in the existing procedures for collecting and evaluating invention disclosures and for preparing, reviewing, and filing of applications. Now more than ever, time is of the essence. Invention disclosures will need to be harvested and evaluated more quickly than before.

Applications will need to be prepared, reviewed and filed with greater speed. The filing of provisional applications may gain popularity as a cost-effective means of getting a disclosure on file rapidly. Companies cannot continue business as usual. To do so could potentially risk a patent grant to a more diligent-to-file inventor.

Revised conditions for patentability

In addition to implementing the first-to-file system, the amendments to 35 USC § 102 change the type of activities that qualify for the one-year grace period. Prior to the enactment of the AIA, inventors had a year within which to file a U.S. patent application after using, disclosing or attempting to commercialize an invention in the United States. While the AIA does include a grace period that protects an inventor's public disclosure or publication of an invention, the grace period may not encompass public use or any on-sale activity. It is likely that the courts will ultimately become involved in order to determine the scope of qualifying activities that trigger the grace period. Until then, it would be prudent for inventors to file applications before a disclosure of any kind.

Derivation proceedings

The change to the first-to-file system brings to mind the following scenario: what happens in the situation where the first-to-file "inventor" derived the invention from the true inventor who happened to file an application on a later date? To address this situation, the AIA has introduced a derivation proceeding, which can be used to establish that the "inventor" of an earlier application derived the invention from the inventor that initiates the derivation proceeding, thereby providing a procedure for correcting inventorship. The petition to initiate the proceeding must be filed within one year of publication of a claim to an invention that is the same or substantially the same as the claim in the earlier application.

Conclusion

Whether the AIA will benefit large and small businesses (including manufacturers) and universities alike can be debated at length. Ultimately, this will be determined as the AIA provisions are implemented and, in some cases, litigated in the courts. There can be no disagreement, however, that the AIA has brought substantial reform to U.S. patent law, the ramifications of which will only truly be appreciated with the passage of time. ■

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ing where the manufacturing process begins and ends. There will always be gray areas of the exemption which require a more detailed analysis. However, manufacturers should keep in mind that the purchase of core manufacturing machinery and equipment is exempt from Illinois sales taxes.

A related, and widely underutilized, credit is the Manufacturer's Purchase Credit, or MPC. The MPC is a valuable sales tax credit available to manufacturers that purchase qualifying, exempt manufacturing machinery and equipment, including qualifying repair and replacement parts. Purchasers of qualifying exempt machinery, equipment and parts are entitled to a credit equal to 50 percent of what the state sales

taxes would have been (i.e., 6.25 percent) if the transaction were taxable. The purchaser will receive a certificate of the amount of credit earned from the seller. The MPC referenced in that certificate can be then applied against State (not municipal) sales taxes only on future purchases of "production related tangible personal property" which include, for example, research and development materials and building materials physically incorporated into a manufacturing facility. Users of the MPC must also report credits used on an annual basis to the Department of Revenue.

Enterprise zones also provide an opportunity for sales tax savings in connection with a new facility or facility expansion. An enterprise zone is a specific area designated by the State to stimulate economic activity. Like the sales tax exemption on manufacturing machinery and equipment, purchases of building

materials physically incorporated into a manufacturing facility are exempt from state sales taxes, and typically municipal and county taxes as well. Manufacturing companies can take advantage of this exemption by securing a certificate of exemption from the enterprise zoning administrator. The certificate is then presented to the seller in connection with the purchase of any exempt materials in order to secure the exemption.

Companies should also be aware that the purchase and sale of real estate located within an enterprise zone is exempt from State transfer taxes. Some units of local government, such as the City of Chicago and Cook County, also exempt conveyances of real estate within an enterprise zone from their respective transfer taxes.

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Discretionary tax credits

While many entitlement tax credits and exemptions exist for Illinois manufacturers, there are an equal number of discretionary programs. All are designed to encourage and enhance Illinois' manufacturing base.

The most common discretionary tax credit program on the state level is the Economic Development for a Growing Economy program, or EDGE. The EDGE tax credit is a non-refundable tax credit against corporate income tax liability over a period generally not to exceed 10 years. Projects where EDGE credits are awarded generally involve the expansion of an existing facility, establishment of a new facility or a decision to keep jobs within the state (compared with moving them out of state). In all cases, a company must demonstrate that it has considered out of state options and, but for the grant of EDGE credits, the project likely would not have occurred in Illinois. To qualify for the EDGE credit, a company must make a capital investment of at least \$5 million and create a minimum of 25 new jobs. Waivers of this minimum standard are available but only in limited circumstances.

The EDGE credit can equal up to 100 percent of the personal income tax collected on salaries paid to company employees in newly created. Retained jobs typically only gar-

ner a credit equal to 50 percent or the personal income tax collected from the retained employees. Each annual tax credit amount may not exceed the company's state income tax liability, but the credit may be carried forward for five years. To keep these tax benefits, a company must maintain the project and jobs outlined in the tax credit agreement in Illinois during the agreement term. By way of example, if a company invested \$5 million in a new facility that created 25 new jobs with a payroll of \$1 million, the company could receive a tax credit of about \$40,000 per year for 10 years. An important point to keep in mind, however, when considering EDGE credits is to be certain the company has, or expect to have, Illinois corporate liability. Otherwise, the credits have no value.

Tax increment financing

The primary discretionary economic development tool utilized on the local level is real estate tax increment financing, or TIF. Under the state's TIF statutes, a municipality is allowed to capture real estate taxes over a certain base level in a particular area that has been determined to be in need of economic development. That area is referred to as the TIF District. The municipality can then use such captured, or incremental, amounts of real estate taxes to pay for or reimburse a company for certain costs incurred in connection with developing the TIF District.

A municipality can only pay for or reimburse a company for "redevelopment project costs" in the area. Costs that qualify include the following:

costs of acquiring property; demolition of buildings, site clearing and grading of land; public works and improvements; costs of job training and retraining; relocation costs; rehabilitation, reconstruction or repair of existing buildings; and certain financing costs of the company. A municipality will generally make reimbursement payments once a year as incremental real estate taxes are paid but will, on occasion, issue bonds backed by the incremental taxes. The proceeds of those bonds are then used to reimburse the company for redevelopment project costs they may have incurred. For example, if a company sites a new facility in a TIF district, it could be reimbursed for land acquisition and site preparation costs, new access roads or other necessary public improvements and even job training for new workers. Even if a site is not in a TIF District, a company can request that the site be designated as a TIF District and thus may be able to take advantage the benefits of TIF.

Even if TIF is not available, manufacturers should consider possible real estate property tax abatements for their new or expansion projects. Units of local government (e.g., municipalities, counties, park districts and school districts) are permitted to abate their share of property taxes. Property tax abatement typically involves a written agreement between a taxpayer and unit of local government whereby the company commits to a certain level of investment and job creation and the unit of government agrees to refund real estate taxes paid each year. This incentive option is not common but does offer an opportunity for real estate tax savings where a TIF District or other incentives are not feasible.

Conclusion

In sum, whenever a company plans an expansion, a new facility or capital investment, it should carefully review its tax incentive options. The state of Illinois and other governmental entities have a number of programs in place to encourage and promote manufacturing and related activities within the state. A small amount of due diligence on a project or investment can result in big savings with the proper planning and analysis. ■

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2013 Annual Luncheon
Friday, December 6, 2013

IMA

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