

Reinstate Contributions in Aid of Construction (Sec. 118)



A Critical Tool for Local Economic and Infrastructure Development

Overview

State and local governments frequently provide incentives to encourage private economic development in underserved communities. For example, a city might contribute an abandoned property, or provide environmental remediation, demolition or a grant to a development project with the expectation that these enhancements will benefit the general public by providing additional jobs or greater local tax revenues for the community.

Another widely used incentive is for a city to provide Tax Increment Financing (TIF). With a TIF, the local government issues bonds that will be paid by any increase in tax receipts generated by the new development. The money raised by the bonds is used by private developers who agree to improve the area for the local community.

Problem

Prior to passage of the Tax Cuts and Jobs Act (TCJA), these types of economic incentives were generally not considered taxable income to the developer (IRC sec. 118). Rather, the developer would forego depreciation and other tax benefits, ultimately paying a larger tax bill when the project was sold. Thus, the federal and state taxes on these incentives were deferred but not eliminated.

The TCJA made these common incentives subject to the federal income tax. The rationale for this change provided in the House Conference Report was to remove a federal tax subsidy for certain state and local incentives used to encourage businesses to relocate operations.

However, this change hijacks local investments intended for underserved areas and sends a portion to the federal government instead. This change in the TCJA represents an inappropriate transfer of state and local government funds to the federal government. It is particularly troubling considering that the federal government has reduced its financial support of state and local economic development initiatives. Further, it runs counter to Congressional efforts to encourage public-private partnerships.

S. 2942, would restore section 118 and ensure that economic development projects and local grants are not unfairly penalized by the federal tax code.

Our position

ICSC supports S. 2942, which would restore section 118 and ensure that economic development projects and local grants are not unfairly penalized by the federal tax code.



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