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New tax-free zones offer great promise for our area

TAXING MATTERS
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Can the START-UP NY Act transform Rochester?

The new law, which authorizes tax-free zones surrounding colleges and universities, clearly presents an extraordinary opportunity for Rochester, but its idiosyncrasies could make it difficult to exploit. My goal in this column is to present some key points from a tax perspective to help our city get the most out of the new program.

First, the basics: The new law allows colleges and universities to create tax-free zones for businesses on campus or, in some cases, elsewhere. Public institutions upstate are entitled to create tax-free zones, and private institutions must apply to a newly created approval board for an allocation of available square footage.

Qualifying businesses that align with the academic mission of the campus and create and maintain jobs are allowed to locate in the zones. These businesses are entitled to relief from business income taxes and sales taxes. Up to 10,000 business employees per year statewide are entitled to exemption from state income taxes. The benefits last for a period of 10 years and are subject to complex technical rules.

Is it worth it? For businesses, the continuing qualification requirements generate unpredictability and the reporting requirements are voluminous. The tax savings, however, are material: New York corporate income tax rates are about 7.5 percent, and sales tax in Monroe County is 8 percent. Together the savings can be substantial for the right business.

For universities, participating provides opportunities for commercialization of university-developed technologies, experiential learning opportunities for students and jobs for graduates. It also provides an opportunity to make a profit or at least offset costs: Space in a tax-free zone is valuable, and companies will be willing to pay well for it.

From a volume perspective, the biggest potential contributors to the program in the greater Rochester area are our public institutions. Public colleges and universities can designate an unlimited amount of space to the program and can also designate up to 200,000 square feet—four football fields—off campus for the program.

This off-campus space presents an extraordinary opportunity for downtown Rochester. Virtually all of downtown is within a mile of a public campus, and if there's anything that downtown has, it's a lot of vacant space. Importantly, the institution does not need to own the building where the zone is; leased space is eligible.

Private colleges and universities may have their tax-free zones anywhere—on or near campus or elsewhere. While these institutions are required to apply for an allocation out of the 3 million square feet available statewide—an amount roughly equal to the square footage in the Empire State Building—Rochester's private universities and colleges could not be better qualified for an allocation. Using existing space downtown or vacant industrial space in facilities such as the Eastman Business Park would add a compelling element to an application, given the law's stated preference for underutilized properties.

Fundamental to filling this space is finding businesses that can benefit from the tax breaks. Though the focus in the press has been on high-tech businesses, this is not an eligibility requirement outside the New York City metro area. Manufacturing businesses, for example, are eligible. Because the benefits include exemption from sales tax, businesses that make large taxable equipment purchases or use large amounts of utilities would be particularly well-positioned to benefit. Certain types of businesses, such as retail, financial services and (sadly) law firms, are not eligible for the program.

Much of the focus in the press has been on startups, but it takes time for a startup to make money, and taxes aren't usually the most important consideration at first.

However, businesses don't really need to be new, as long as they are expanding or new to New York. Existing, profitable businesses willing to relocate to New York would get the most from the incentives, but absent other compelling reasons, businesses may be unwilling to move to a high-tax jurisdiction like New York just to get a temporary tax break. The key to attracting such businesses, if it's possible, is likely the synergy with an academic institution's research and teaching activities and co-location with other businesses in allied fields. Areas of local expertise, like optics and imaging, could prove attractive in this regard.

At the end of the day, expanding businesses already in the region are probably most likely to want to relocate to the zones. To be eligible for benefits, an expanding company must show that it really is bringing new jobs to the tax-free area, rather than merely transferring existing jobs. For existing New York companies in a growth mode that need to move to larger facilities anyway, locating in one of the zones is a no-brainer.

The key for institutions is finding a way to connect with such businesses. Making efforts public, from the beginning, is critical here. Government and economic development non-profit agencies could add tremendous value by helping to match eligible businesses with appropriate projects and coordinating the efforts of different academic institutions.

By adopting this program, the state has essentially deputized colleges and universities to offer extraordinary tax breaks to for-profit businesses under a set of strange but somewhat logical rules. The key to making the program work is identifying the right tenants and finding a way to live with the program's idiosyncrasies. At the outset, it may not be easy, but with perseverance and focus, the right team can make this program transformative for Rochester.

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