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TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Assembly Bill 208: Rural Enterprise Development Zones

Assembly Bill 208 would authorize the Department of Commerce (Commerce) to designate rural enterprise development zones (REDZs) and provide tax benefits to businesses that operate within the zones. The bill was introduced on March 15, 2005, and referred to the Assembly Committee on Rural Development. That committee recommended the bill for passage by of vote of 5 to 0 on March 30, 2005, and the bill was then referred to the Joint Committee on Finance

CURRENT LAW

Wisconsin has five programs that provide tax credits to businesses as incentives to expand or locate operations, increase employees, or increase investment in different areas of the state. These programs include:

a. Development Zones. The program includes 22 zones, including zones that encompass 17 entire counties and two American Indian reservations. A total of $38.155 million in tax credits can be claimed under the program, and $33.8 million has been allocated to businesses in the zones. Eligible businesses in the zones can claim jobs and environmental remediation tax credits.

b. Enterprise Development Zones. The program is authorized 81 zones, including 10 zones for environmental remediation projects, to be designated in municipalities and counties. A total of $3.0 million in tax credits can be claimed by businesses in each zone. Sixty-five zones have been created, and a total of $122.8 million has been allocated to businesses in the zones. Businesses in the zones can claim jobs and environmental remediation tax credits.

c. Development Opportunity Zones. Three development opportunity zones have been designated in the Cities of Kenosha, Milwaukee, and Beloit. A total of $4.7 million in tax credits have been allocated to businesses in both the Milwaukee and Beloit zones, while $7.0 million has been allocated to the Kenosha zone. Businesses in the zones can claim jobs, environmental remediation, and capital investment tax credits. Three other zones in Beloit, Eau Claire, and West Allis have lapsed.

d. Technology Zones. A total of eight technology zones have been designated encompassing 54 counties. The maximum amount of tax credits that can be claimed in each zone is $5.0 million. A total of $10.6 million in tax credits have been allocated to businesses in the zones. Eligible businesses can claim tax credits for jobs created, capital investments, and property taxes paid.

e. Agricultural Development Zone Eighteen counties (not designated as technology zones) have been designated as an agricultural development zone. A total of $5.0 million in tax credits can be claimed in the zone. A total of $2.5 million in credits have been allocated to businesses in the zone. Businesses in the zone can claim jobs, environmental remediation, and capital investment tax credits.

Commerce is generally responsible for administering these zone programs.

SUMMARY OF BILL

Designation of Rural Enterprise Development Zones

Under the bill, the local governing bodies of one or more political subdivisions could apply to Commerce for designation of an area as an REDZ, if the proposed zone includes land within the boundaries of the political subdivisions. An application would have to include a development plan that includes all of the following:

a. A map of the proposed zone that shows its physical boundaries and size in acres and the present uses and condition of land and structures in the proposed zone.

b. Evidence of support in the proposed zone for the designation, including support from local government, the public, and business groups.

c. A description of the applicant's goals for, and proposed methods for achieving, increased economic opportunity and expansion, infrastructure improvements, reduced regulatory burdens, and increased job training opportunities in the proposed zone.

d. A description of current social, economic, and demographic characteristics of the proposed zone and of the anticipated improvements in health, human services, and employment that would result from designation as a rural enterprise development zone.

e. A description of anticipated economic and other activity in the proposed zone, including industrial uses, commercial or retail uses, and residential uses.

f. A proposal as to the time period in which the designation would remain in effect.

Commerce could designate up to 10 REDZs. The Department could designate an area as an REDZ if the area does not exceed 5,000 acres (approximately 7.8 square miles) and does not include any part of a city of the first class or a city with a population greater than 200,000 (currently only Milwaukee and Madison).

"Local governing body" would mean the governing body of one or more cities, villages, towns, or counties or the elected governing body of a federally recognized American Indian tribe or band in this state. "Political subdivision" would mean a city, village, town, or county.

In determining whether to grant an application to designate an area as an REDZ, Commerce would have to consider indicators of the area's economic need, which could include data regarding household income, average wages, the condition of property, housing values, population decline, job losses, infrastructure and energy support, and the rate of business development.

Commerce would also have to consider indicators of the likelihood of success in achieving the goals for increased economic opportunity and expansion, infrastructure improvements, reduced regulatory burdens, and increased job training opportunities, which could include: (a) the strength and viability of the development plan; (b) the level of creativity and innovation reflected in the plan; (c) the strength of support for the proposal in the proposed zone; (d) the existing resources available to the area; (e) the effect of designation on other initiatives and programs to promote economic and community development in the area, including regional initiatives and programs; (f) the extent to which designation will ease regulatory burdens; (g) the extent to which the development plan links job creation and job training; and (h) the extent to which the development plan focuses on creating high-paying jobs.

To the extent possible, Commerce would have to give preference to applications in which the areas proposed for designation have the lowest population densities and have the greatest economic need according to the indicators listed above.

A designation of an area as an REDZ could remain in effect for no more than 12 years.

If Commerce designates an area as an REDZ, the governing body of each political subdivision that applied for designation would have to, during the time that the designation is in effect, annually submit a report to Commerce, in a form and at a time prescribed by the Department, describing the political subdivision's progress in meeting the goals contained in the development plan regarding increased economic opportunity and expansion, infrastructure improvements, reduced regulatory burdens, and increased job training opportunities. The report would also have to include any additional information required by Commerce.

Certification of Businesses for REDZ Tax Benefits

Commerce could certify for tax benefits a business that begins operations in an REDZ or that relocates to an REDZ from outside this state.

Commerce could also certify a business that relocates to an REDZ from another location in this state if:

a. The business will increase the number of full-time employees employed in the zone by at least 10%, and the business enters into an agreement with Commerce to claim tax benefits only for years during which the business maintains the increased level of employment; or

b. The business makes a capital investment in property located in the zone and the value of the capital investment is equal to at least 10% of the business's gross revenues in the preceding tax year, and the business enters into an agreement with Commerce to claim tax benefits only for years during which the business maintains the increased level of capital investment.

"Tax benefits" would mean the individual and corporate income and franchise tax credits outlined below.

Commerce would have to revoke a firm's certification if the business does any of the following:

a. Supplies false or misleading information to obtain tax benefits.

b. Leaves the REDZ to conduct substantially the same business outside the zone.

c. Ceases operations in the zone and does not renew operation of the business or a similar business in the zone within 12 months.

Commerce would be required to notify the Department of Revenue (DOR) when it certifies a business to receive tax benefits and within 30 days of a revocation of the certification.

Commerce could require a business to repay any tax benefits the business claims for a year in which the business failed to maintain employment or capital investment levels required by the certification agreement.

Commerce would also have to annually verify information submitted to it under the new tax credit provisions.

Rural Enterprise Development Income Credit

The bill would create a refundable individual income tax credit equal to a portion of the income that an individual who owns or operates a trade or business in an REDZ derives from the operation of his or her trade or business in the zone. The credit would equal 20% of the individual's income derived from operations in the zone multiplied by 6.5%. The net result of this calculation is that the credit would equal 1.3% (6.5% of 20%) of income derived in the zone.

As noted, the credit would be refundable. Therefore, if the amount of credit exceeded the claimant's individual income tax liability, the state would issue a check to the claimant for the excess amount. The credit would be paid from a new sum-sufficient, GPR appropriation.

Claims for the credit would have to be made within four years of the unextended due date for the claimant's income tax return. For nonresidents and part-year residents, the credit would be pro-rated based on the ratio of the claimant's Wisconsin adjusted gross income (AGI) to the claimant's federal AGI.

DOR would be authorized to enforce the credit and to take any action, conduct any proceeding, and proceed as it is authorized in respect to income and franchise taxes. The income tax provisions relating to assessments, refunds, appeals, collection, interest, and penalties would apply to the new credit. Claimants of this credit would not have to be certified by Commerce.

Rural Enterprise Development Capital Gains Credit

The bill would create a refundable individual income tax credit equal to 6.5% multiplied by the amount of capital gains that are not excluded from tax under current law, if the gains were derived from the sale or exchange of property that is used by a business that has been certified to receive REDZ tax benefits. In order for a gain on real property to qualify for the credit, the property would have to be located within the zone.

If the property was held by the individual during a period when the zone was not designated, the gain would have to be multiplied by a fraction, the numerator of which is the number of days that the property was held by the individual during the period the zone designation was in effect and the denominator of which is the total number of days that the property was held by the individual.

Claims for the credit would have to be made within four years of the unextended due date for the claimant's income tax return. For nonresidents and part-year residents, the credit would be pro-rated based on the ratio of the claimant's Wisconsin AGI to federal AGI. The credit would be paid from a new sum-sufficient, GPR appropriation.

DOR would be authorized to enforce the credit and to take any action, conduct any proceeding, and proceed as it is authorized in respect to income and franchise taxes. The income tax provisions relating to assessments, refunds, appeals, collection, interest, and penalties would apply to the new credit.

Current law provides an exclusion for 60% of the capital gain on assets held more than one year. Gains on assets held one year or less are fully taxed. Full exclusions are provided for certain gains on small business stock and for business assets sold to family members. The new credit would equal 6.5% of the portion of gains that are not exempt from tax under the current 60% exclusion.

Rural Enterprise Development Zone Jobs Credit

The bill would create a refundable REDZ jobs credit under the individual income tax and the corporate income and franchise tax. The credits would be paid from a GPR, sum-sufficient appropriation.

The following definitions would apply to the new credit:

a. "Base year" would mean the taxable year beginning during the calendar year prior to the calendar year in which the REDZ in which the claimant is located takes effect.

b. "Claimant" would mean a person who is certified by Commerce to claim REDZ tax benefits and who files a claim for the new jobs credit.

c. "Full-time employee" would mean an individual who is employed in a regular, nonseasonal job and who, as a condition of employment, is required to work at least 2,080 hours per year, including paid leave and holidays.

d. "State payroll" would mean the amount of payroll apportioned to this state under the income and franchise tax apportionment rules for multi-state businesses.

e. "Zone payroll" would mean the amount of state payroll that is attributable to compensation paid to individuals for services that are performed in an REDZ or who are working from an office located in a zone if the work is incidental to any work that the individual performs within the zone. "Zone payroll" would not include the amount of compensation paid to any individual that exceeds $100,000.

The credit would consist of five components, which are described below:

Jobs Component. Subject to the limitations described below, a claimant could claim as a credit against the state individual income tax and the state corporate income and franchise tax an amount calculated as follows:

a. Determine the lesser of: (1) the claimant's zone payroll in the taxable year, minus the claimant's zone payroll in the base year; or (2) the claimant's state payroll in the taxable year, minus the claimant's state payroll in the base year.

b. Subtract the number of full-time employees that the claimant employed in the area that comprises the REDZ in the base year from the number of full-time employees that the claimant employed in the zone in the taxable year.

c. Multiply the amount determined under "b", if greater than zero, by $30,000.

d. Subtract the amount determined under "c" from the amount determined under "a".

e. Multiply the amount determined under "d" by 7%.

Under these provisions, a business that opens in an REDZ or relocates to an REDZ from outside of Wisconsin would be eligible for a credit equal to 7% of its zone payroll in excess of $30,000 per employee. For example, a business that relocated to an REDZ with 20 employees and a total payroll of $800,000 (average of $40,000 per employee) would receive a credit of $14,000. The $14,000 amount is $700 per employee, which is 7% of the $10,000 difference between the $40,000 average wage paid by the business and the $30,000 threshold in the bill. The credit would be smaller if the firm paid lower wages or larger if the firm paid higher wages. No credit would be provided if the average wage was below $30,000. Businesses that move to a zone from elsewhere in Wisconsin could receive a credit under this provision if they add staff and/or increase wages after moving to the zone.

Personal Property Tax Component. The claimant could claim a credit equal to the amount of property taxes that the claimant paid in the taxable year for personal property that is located in an REDZ.

Sales Tax Component. The claimant could claim a credit equal to the amount of state sales and use taxes that the claimant paid in the taxable year on the purchase of property and services that are used or consumed primarily in an REDZ.

Payroll and Property Component. If all of the claimant's payroll is zone payroll and all of the claimant's business-related property is located in an REDZ, the claimant could receive a credit based on the claimant's payroll and the value of the claimant's property in the zone. The credit would equal 20% of the sum of the claimant's zone payroll in the taxable year and the adjusted basis of the claimant's property at the time the property was first placed in service in the zone multiplied by: (a) 6.5% for businesses that file under the individual income tax; or (b) 7.9% for businesses that file under the corporate income and franchise tax.

Training Component. The claimant could claim a credit equal to the amount paid in the taxable year to upgrade or improve the skills of any of the claimant's full-time employees, to train any of the claimant's full-time employees on the use of new technologies, or to train any full-time employee whose employment with the claimant represents the employee's first full-time job.

Partnerships, limited liability companies (LLCs), and tax-option corporations could not claim the credit, but the eligibility for, and the amount of, the credit would be based on their payment of the amounts described above. A partnership, LLC, or tax-option corporation would have to compute the amount of credit that each of its partners, members, or shareholders could claim and provide that information to each of them. Partners, members of LLCs, and shareholders of tax-option corporations could claim the credit in proportion to their ownership interests.

No credit would be allowed unless the claimant includes with the tax return a copy of the claimant's certification for tax benefits.

Current provisions regarding administration and timely claims of the research credit would apply to the new REDZ jobs credit.

As noted, the credit would be refundable. Therefore, if the amount of credit exceeded the claimant's income or franchise tax liability, the state would issue a check to the claimant for the difference.

Effective Dates

The new tax credits would first apply to taxable years beginning on January 1 of the year in which the bill takes effect, except that if the bill takes effect after July 31, the credits would first apply to taxable years beginning on January 1 of the following year. The bill would take effect on the day after publication. The provisions regarding the Department of Commerce would take effect on that date.

FISCAL EFFECT

As described above, AB 208 would create a number of income and franchise tax credits for businesses that operate within rural enterprise development zones established by the Department of Commerce. The tax credits would be based on: income earned in the zone, capital gains realized on property used by the business in the zone, the amount of sales taxes and personal property taxes paid by certified businesses, the amount of payroll and investment of the businesses, and training expenses incurred by the businesses.

The number of zones would be limited to 10 and the size of each zone would be limited to 5,000 acres. The zones could not be located in the City of Milwaukee or the City of Madison. Under these provisions, the ten zones could cover a total area of 78.1 square miles. It appears that the territory of each zone would not have to be contiguous. Therefore, a zone could be comprised of many relatively small, separate parcels of land to assist individual business projects. Unlike the current development zone programs, the REDZ proposal would not limit the total amount of tax benefits for each zone or for individual businesses that are operating in the zones. Also, unlike the current development zone tax credits, the REDZ credits would all be refundable. This provision would allow a business that does not have an income or franchise tax liability to receive the tax benefits immediately and would result in higher program costs.

The proposal is patterned after the Minnesota job opportunity building zone (JOBZ) program, which took effect for the 2004 tax year. According to officials in the Minnesota Department of Employment and Economic Development (DEED), there were 134 business projects that were certified for tax benefits under the JOBZ program as of March 3, 2005. Minnesota also has estimates regarding the number of individuals who will be employed by these firms and the amount of capital investments that will be made in the zones. However, actual data on jobs and investment is not available and the amount of tax benefits that will be claimed by these businesses is unknown at this time. More information will be available after the 2004 tax returns are received and processed this spring. According to the Minnesota Department of Revenue, the JOBZ program was estimated to cost $1.6 million in fiscal year 2004, $3.1 million in FY 2005, $4.1 million in FY 2006, and $5.3 million in FY 2007. Most of these fiscal effects are due to a sales tax exemption for purchases by businesses that operate within the zones. The DEED data indicates that nearly all of the 134 completed JOBZ deals involve businesses that intend to locate or expand within a JOBZ zone or move to a zone from elsewhere in Minnesota. A small number involve relocations of existing businesses from other states.

AB 208 does not specify where the proposed rural enterprise development zones would be located, the number and types of businesses that would be certified for tax benefits, or the total amount of tax credits that could be claimed within each zone or by individual businesses. Because the amount of tax benefits claimed could vary dramatically depending upon the number and types of businesses that participate, along with their specific expenditure patterns and profitability, it is not possible to prepare a precise fiscal estimate for this proposal. Based on the estimates used in Minnesota, it is likely that the proposal would cost at least several million dollars during the initial years of implementation, and it is possible that the cost could be much higher if the zones were established and located in a way that makes it possible for a large number of businesses to participate.

In order to provide more certainty regarding the cost of the REDZ program, the proposal could be modified to adopt specific limits on the amount of tax benefits that could be certified for each zone. This would be similar to the current development zones, development opportunity zones, enterprise development zones, technology zones, and agricultural development zone programs. Statutory limits on the amount of available tax benefits were also included for the angel investment tax credit and early stage seed investment credit, which were created in 2003 Act 255.

As noted, the Department of Commerce would administer the REDZ program. AB 208 would not provide additional funding or positions to the Department. However, Commerce has submitted a fiscal note that indicates the Department would require $129,200 GPR and 2.0 GPR positions annually for administering the program.

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