LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

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FISCAL IMPACT STATEMENT

LS 7128
BILL NUMBER: HB 1341

DATE PREPARED: Mar 4, 1999
BILL AMENDED: Mar 3, 1999

SUBJECT: Enterprise Zones.

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FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: (Amended) *Expansion of Enterprise Zones (EZs):* This bill increases the maximum permissible population of an EZ from 8,000 to 10,500 and increases the maximum permissible area of an EZ from three square miles to four square miles. It also provides that the EZ Board may not approve the enlargement of an EZ's geographic boundaries unless the area to be enlarged meets certain criteria of economic distress. In addition, the bill permits the EZ Board to review the success of an EZ and to expand the boundaries of the zone after the zone's final phase-out period. (Current law permits such reviews only during specified phase-out periods.)

Annual EZ report: This bill requires the Indiana Department of Commerce (IDOC) to publish an annual report identifying taxpayers that receive tax credits, deductions, or exemptions for operations in EZs.

Relocation requirements: This bill also establishes additional criteria for eligibility for EZ benefits and incentives which must be met by a business relocating its operations from a non-zone location in Indiana in order to relocate to an EZ.

Effective Date: (Amended) January 1, 1997 [retroactive]; Upon passage; July 1, 1999.

Explanation of State Expenditures: (Revised) *Expansion of EZs:* The IDOC was appropriated $181,125 to oversee the EZ program in FY 1998. In addition to 1.5 full-time equivalent positions dedicated for this program, additional staff support is currently required. Under this proposal, a significant number of additional taxpayers could be included in existing EZs, which would likely increase administrative costs for the Department.

The funds and resources required above could be supplied through a variety of sources, including the following: (1) Existing staff and resources not currently being used to capacity; (2) Existing staff and resources currently being used in another program; (3) Authorized, but vacant, staff positions, including those positions that would need to be reclassified; (4) Funds that, otherwise, would be reverted; or (5) New appropriations. Ultimately, the source of funds and resources required to satisfy the requirements of this bill will depend upon legislative and administrative actions.

Annual EZ report: This provision would require the IDOC to publish an annual summary of EZ tax incentives and the businesses receiving these credits, deductions, and exemptions. The Department would be able to absorb any additional expense related to development of this report given its existing budget.

Explanation of State Revenues: (Revised) *Expansion of EZs:* This bill expands the maximum permissible size of EZs. These zones may be established in economically distressed areas where 25% of the households have incomes below the poverty level or where unemployment is 150% higher than the state average. Under current law, the EZ must have a population greater than 2,000 but less than 8,000, and must also be larger than 3/4 square miles but smaller than 3 square miles. This bill would increase the maximum population to 10,500 and the maximum area to four square miles.

Existing zones would not be immediately affected. The EZ Board would be permitted to review the success of zones that have been renewed beyond the initial ten year allowance. The Board must first consider the recommendations of the local Urban Enterprise Association, and may then increase the boundaries of the zone. The area to be included in the enlarged zone must be considered an economically distressed area as defined in the paragraph above. There are currently 21 zones which include approximately 1,701 businesses. Businesses located within EZs are eligible for the following economic benefits:

Gross income tax exemption: The increase in gross income received by an EZ business after the designation of the zone is exempt from the gross income tax. According to forms filed with IDOC, the total amount exempted in FY 1998 was $1,040,726.

Employment expense tax credit: A credit against the gross income tax, adjusted gross income (AGI) tax, insurance premiums tax, or financial institutions tax (FIT) liability may be taken by an employer that increases wages after inclusion in the zone. The amount of the credit is equal to 10% of the increase in employment expenditures (although the credit may not exceed $1,500 per employee). According to IDOC, employment expense tax credits taken in FY 1998 totaled $814,030.

Loan interest credit: Any person, corporation, limited liability company, partnership, or other entity making a loan for the purposes of repair or improvement of an EZ business or residence is eligible for credits. The credit may be used against the gross income tax, AGI tax, insurance premium tax, supplement net income tax (SNIT), bank tax, or savings and loan association tax liability. The total loan interest credits awarded in FY 1998 were $1,081,355.

Investment cost credit: A taxpayer that purchasing an ownership interest in an EZ business may be eligible for a tax credit. Up to 30% of the investment may be taken as a credit against AGI tax liability. The IDOC determines the actual amount using a formula based on the amount invested, financial need of the EZ entity, and the number of jobs created.

Neighborhood Assistance tax credits: Neighborhood Assistance tax credits are awarded via non-profit organizations to taxpayers contributing to various community projects in economically disadvantaged areas. Businesses investing in these projects can receive a credit against their state tax liability equal to 50% of their contribution, although a single taxpayer cannot receive more than $25,000 in credits each taxable year. The credit can be applied to the gross income tax, the AGI tax, or the SNIT. IDOC is directed by statute to give priority to applicants whose efforts benefit EZs. These credits are currently capped at $2,500,000 each fiscal year.

In addition to these incentives awarded to businesses, residents of EZs may benefit from the employee AGI tax deduction. Residents employed within the zone may deduct the lesser of half of their AGI or $7,500 from their state income tax liability. The resident must be employed by a regular corporation or a sole proprietorship to be eligible for this deduction.

This bill could decrease state revenues as more credits, deduction, and exemptions are granted. However, if expanded EZs create jobs and economic development that would not have otherwise occurred, the state should experience some indirect positive impacts. Additional jobs would increase income tax collections and revenues generated by employees' purchases. These incentives may also help relieve the state's unemployment and welfare burdens.

Relocation requirements: Under current law, a business that reduces business activity or ceases operation at a site outside of an EZ in order to relocate within a zone is disqualified from EZ incentives (upon a panel review). However, there are certain conditions under which a business may relocate and remain eligible for EZ benefits.

This bill establishes several new conditions for businesses moving operations to an EZ site to retain EZ incentive eligibility. It requires that all conditions, including those in current law, must be met to prevent disqualification. These additional requirements may increase the number of businesses that could be disqualified in the future from receiving EZ benefits. Due to the January 1, 1997 (retroactive) effective date of this bill, some businesses currently receiving benefits could also be disqualified, possibly increasing state tax revenues. Although the exact impact cannot currently be determined, it is expected that few businesses would be affected.

<u>Explanation of Local Expenditures:</u>

<u>Explanation of Local Revenues:</u> (Revised) *Expansion of EZs:* This bill would have a direct impact on local government revenues in communities where already existing EZs are expanded. As inventory held within an EZ is exempt from property taxes, there would be a shift in the local tax burden to other taxpayers. The amount of this shift would vary in each zone, but $37,287,868 in total inventory tax credits was taken statewide in CY 1997. EZ expansion could also have positive secondary effects (see Explanation of State Revenues).

Relocation requirements: Requiring businesses who cease or reduce operations at a non-EZ site (in order to relocate within an EZ) to meet the conditions of this bill could increase the number of future EZ incentive disqualifications. Due to the January 1, 1997 (retroactive) effective date of this bill, some businesses currently receiving benefits could also be disqualified, possibly increasing inventory taxes paid by businesses that lose eligibility for this exemption.

<u>State Agencies Affected:</u> EZ Board, IDOC, Department of Revenue, State Board of Tax Commissioners.

<u>Local Agencies Affected:</u> Urban Enterprise Associations.

<u>Information Sources:</u> Leslie Richardson, Director, Division of Research, IDOC, (317) 232-8962.