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FISCAL IMPACT STATEMENT

LS 7376 | **NOTE PREPARED:** Jan 18, 2004
BILL NUMBER: HB 1438 | **BILL AMENDED:**

SUBJECT: Enterprise Zones.

FIRST AUTHOR: Rep. Klinker | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** | **IMPACT:** State & Local
X **DEDICATED**
FEDERAL

Summary of Legislation: The bill provides that a taxpayer is entitled to a credit against property tax liability on personal property other than inventory. It also provides that the state Enterprise Zone Board shall allocate the tax credits to each qualified Urban Enterprise Zone Association (QUEZA) based on the amount of business personal property in each qualified Enterprise Zone. The bill allows a QUEZA to allocate its share of the statewide credits to Zone businesses that enter into an allocation agreement with the QUEZA. The bill provides that the total amount of credits allowed statewide each year may not exceed $60,000,000, as adjusted each year after 2005. It also provides that the Enterprise Zone Investment Cost Credit is assignable. The bill allows the Enterprise Zone Board to designate contiguous property in two municipalities as an Enterprise Zone. The bill establishes criteria for designation as a multijurisdictional Enterprise Zone and allows the Board to designate up to 29 Enterprise Zones.

Effective Date: Upon passage; January 1, 2002 (retroactive); July 1, 2004.

Explanation of State Expenditures: *Multi-jurisdictional Enterprise Zones (EZs):* The Indiana Department of Commerce (IDOC) would incur additional administrative expenses relating to: (1) EZ boundary modifications for multi-jurisdictional EZs; and (2) annual allocation of business personal property tax credits to the EZs. Under current statute, the IDOC is required to provide administrative assistance to the Indiana Enterprise Zone (EZ) Board. Under the bill, the EZ Board would have to review applications for multi-jurisdictional boundary modifications of existing EZs, and designate multi-jurisdictional EZs. In addition, the EZ Board is required to allocate business personal property tax credits (established under this bill) to the EZs. These additional administrative demands presumably could be absorbed given the IDOC's existing budget and resources. The December 3, 2003, state Staffing Table indicates that there were 32 vacant full-time positions in IDOC, including regional office positions.

The EZ Board could experience an increase in annual business registration fees due to the: (1) expansion of existing single jurisdiction EZs to multi-jurisdictional EZs; and (2) additional tax incentive benefits relating to the business personal property tax credit established by the bill. The EZ Board receives an annual registration fee from each business that receives in excess of $1,000 in benefits from tax incentives provided through an EZ. The registration fee is equal to 1% of the benefits obtained exceeding $1,000. The potentially impact of multi-jurisdictional EZs on registration fees is indeterminable. However, the impact of the business personal property tax credit on registration fees could potentially total $600,000 in FY 2006, with annual growth in subsequent years equal to 5%.

Business Personal Property Tax Credit: The bill requires the Department of Local Government Finance (DLGF) to annually certify to the EZ Board the net AV of business personal property located in each EZ as of the most recent assessment date. The certification must be completed before July 1 each year. The net AV totals for each EZ are to be certified to the DLGF by county auditors before June 1 each year. It is important to note that a non-code provision of the bill requires the initial allocation of business personal property tax credits to be based on 2002 net AV totals for the EZs. Thus, the initial certification by the DLGF to the EZ Board will have to include 2002 net AV totals for business personal property in EZs.

Explanation of State Revenues: *Multi-jurisdictional Enterprise Zones:* The bill allows the Enterprise Zone (EZ) Board to designate a new EZ or modify an existing EZ such that the EZ contains a contiguous area located in two municipalities. The bill also limits to 29 the total number of municipal EZs that the EZ Board may designate. There are currently 26 municipal EZs. (Note: Under a separate provision of current law, EZs also may be designated on former-military bases. These EZs are not included in the limit specified by the bill.) Thus, the bill could potentially lead to the establishment of up to three new multi-jurisdictional municipal EZs and the modification of existing 26 single jurisdiction EZs into multi-jurisdictional EZs. This could potentially lead to new EZs in municipalities that individually are unable to meet the threshold criteria for an EZ. Also, this could potentially lead to an increase in the territory of existing EZs. Both of these outcomes could increase the total EZ incentives provided in the state. However, the fiscal impact of these potential changes is indeterminable.

Background: The bill requires that the executives of both municipalities must submit a joint application for designation or modification of an EZ as a multi-jurisdictional EZ. Under the bill, a multi-jurisdictional EZ generally must meet the same threshold criteria that a single jurisdiction EZ must meet. As with a single jurisdiction EZ, a multi-jurisdictional EZ must contain property that is suitable for development of a mix of commercial, industrial, and residential activities. However, for a multi-jurisdictional EZ, this property must be in both municipalities. In addition, two other threshold criteria are altered for purposes of a multi-jurisdictional EZ.

(1) A multi-jurisdictional EZ must have a population of more than 4,000 but less than 21,000 (current law requires a population of 2,000 to 10,500 for single jurisdiction EZs).

(2) A multi-jurisdictional EZ is limited in size to eight square miles (current law limits a single jurisdiction EZ to four square miles).

The Urban Enterprise Association (UEA) for a mulitijurisdictional EZ consists of 22 members instead of 12 members as required for a single jurisdiction EZ. Under current law, a UEA consists of two members appointed by the Governor and ten members appointed by the municipal executive. Under the bill, each municipal executive appoints ten members to the UEA. Current law does not provide for UEA members to be paid a salary per diem or reimbursed for incurred expenses.

Assignment of EZ Investment Cost Credit: The bill allows a taxpayer entitled to claim the EZ Investment Cost Credit (ICC) to assign any portion of the ICC to another taxpayer. Under current statute, the ICC is equal to a maximum of 30% of the cost of purchasing an ownership interest in an EZ business. The credit is non-refundable. However, a taxpayer may carry over excess credits to subsequent taxable years. Assuming unused credit amounts would eventually be utilized, the bill has no long run fiscal impact. Rather, the bill likely would provide for more timely use of credits obtained by taxpayers whose tax liabilities are not sufficient to exhaust the credits in one year. Credits approved over the years has totaled $2.9 M. However, data is unavailable indicating the amount of the approved credit total that has been claimed against tax liability.

Explanation of Local Expenditures: The bill requires county auditors to annually certify to the DLGF the net AV of business personal property located in EZs as of the most recent assessment date. The net AV totals must be certified by the DLGF before June 1 each year. A non-code provision of the bill requires the initial allocation of business personal property tax credits to be based on 2002 net AV totals for the EZs. Thus, county auditors presumably will have to certify the 2002 net AV totals to the DLGF.

Explanation of Local Revenues: The bill establishes a credit against the net property tax liability for business personal property of qualified EZ businesses beginning with 2004 Pay 2005 taxes. Since the credit is not replaced with another revenue source, this credit would reduce property tax revenue to the civil taxing units and school corporations that serve the local taxing districts containing EZs by **$60.0 M** in 2005. This revenue loss would increase by 5% annually in subsequent years. The revenue loss also could potentially be increased by as much as $3.0 M annually with the addition of three new EZs.

The bill establishes a property tax credit for business personal property, other than inventory, of "qualified EZ businesses. Under the bill, a qualified business must meet all the following conditions:

(1) at least 50% of the total gross receipts of the business is derived from sources within an EZ;
(2) at least 50% of the value of real property and tangible personal property used in the business of the business is located within an EZ;
(3) at least 50% of the wages, salaries, commissions, and other compensation of employees of the business are paid to individuals employed at a location in an EZ;
(4) at least 50% of the employees of the business are Indiana residents; and
(5) if the entity is a pass through entity, at least 50% of the taxable income for the taxable year is allocated to the owners of the pass through entity who are residents of Indiana.

In addition to meeting these conditions, the business must enter into an allocation agreement with the Urban Enterprise Association (UEA) governing the EZ. The allocation agreement must:

(1) conform to the UEA's allocation plan;
(2) be entered into by the UEA and the taxpayer before October 1 of the year preceding the year in which the credit will be claimed; and
(3) include at least the: (a) the calendar years in which the credit may be claimed by the taxpayer; (b) the amount of the credit that may be claimed by the taxpayer in a particular calendar year; and (c) any other conditions adopted by the UEA that the taxpayer must satisfy before the taxpayer may claim the credit.

The bill prohibits an allocation agreement from allocating the property tax credit for more than 5 years. However, the bill allows a UEA to enter into a new allocation agreement with the same business when an allocation agreement expires.

The bill limits the total credits granted in all EZs to $60.0 M in 2005. The bill increases the aggregate credit limit by: (1) 5% per year after 2005; and (2) $1.0 M for each additional EZ approved by the EZ Board after December 31, 2004. The latter adjustment could potentially add $3.0 M to the aggregate credit limit. The bill requires the EZ Board to annually allocate the aggregate allowable credit amount among the EZs based on each EZ's proportionate share of EZ business personal property AV.

Current EZ Incentives: Under current statute, businesses operating in EZs are eligible for the following tax incentives:

(1) Inventory Tax Credit: A credit against property taxes for inventory of a business located in an EZ.
(2) Investment Cost Credit: A state income tax credit for equity investment in an EZ business.
(3) Employment Expense Credit: A state income tax credit for wages paid to an EZ resident working in a business located in an EZ.
(4) Loan Interest Credit: A state income tax credit on interest income earned by a taxpayer from loans to EZ businesses.

Under tax restructuring enacted in P. L. 192-2002ss, the inventory tax will be eliminated by 2007 when the 100% inventory deduction begins. As a result, the inventory tax credit will be eliminated as in incentive in 2007. However, the inventory tax credit has already been diminished. Some inventory tax reduction has already occurred as work in process and raw materials incorporated in finished goods to be shipped out of state is exempt from property tax beginning in 2004. In addition, the local option 100% inventory deduction is scheduled to commence in 14 counties in 2004.

State Agencies Affected: Department of Local Government Finance; Department of State Revenue; Indiana Department of Commerce; Indiana Enterprise Zone Board.

Local Agencies Affected: County Auditors.

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