FINAL REPORT
OF THE
ENTERPRISE ZONE STUDY COMMISSION

Indiana Legislative Services Agency
200 W. Washington St., Suite 301
Indianapolis, Indiana 46204-2789

November, 2004

INDIANA LEGISLATIVE COUNCIL
2004

Speaker B. Patrick Bauer
Chairman
South Bend

Representative Brian Bosma
Indianapolis

Representative Russell Stilwell
Boonville

Representative Dale Grubb
Covington

Representative Charlie Brown
Gary

Representative Scott Pelath
Michigan City

Representative Kathy Richardson
Noblesville

Representative Richard Mangus
Lakeville

Senator Robert Garton
Vice-Chairman
Columbus

Senator Richard Young
Milltown

Senator Becky Skillman
Bedford

Senator Joseph Harrison
Attica

Senator Patricia Miller
Indianapolis

Senator Thomas Wyss
Fort Wayne

Senator James Lewis
Charlestown

Senator Earline Rogers
Gary

Philip J. Sachtleben
Executive Director
Legislative Services Agency

Enterprise Zone Study Commission

Membership Roster

Representatives

Sheila Klinker, Chair
Lafayette

Phil Hinkle
Indianapolis

Senators

Ron Alting
Lafayette

Frank Mrvan
Hammond

Lay Members

Alan Jones
Evansville

Pam Meyer
South Bend

Deanna Oware
Indianapolis

Patrick Reardon
Schererville

Edwin Rousseau
Ft. Wayne

Kostas Poulakidis
Indianapolis

Legislative Services Agency Staff

Jim Landers, Fiscal Analyst
Sarah Freeman, Attorney
Ross Hooten, Attorney

November 1, 2004

A copy of this report is available on the Internet. Reports, minutes, and notices are organized by committee. This report and other documents for this Commission can be accessed from the General Assembly Homepage at http://www.state.in.us/legislative/.

FINAL REPORT

Enterprise Zone Study Commission

I. STATUTORY DIRECTIVE

The Indiana General Assembly enacted legislation (P. L. 63-2004) establishing the Enterprise Zone Study Commission and directing it to study the following:

1. Means of assisting Enterprise Zones in attracting businesses to downtown areas and to disadvantaged areas.

2. Ways to replace sources of funding for Urban Enterprise Associations that were the responsibility of the owners of inventory property located in an Enterprise Zone before the enactment of tax deductions that eliminate most property taxes on inventory.

3. Ways to mitigate the shift to homeowners and other property taxpayers of the property tax levies that were the responsibility of the owners of inventory property before the enactment of tax deductions that eliminate most property taxes on inventory.

II. INTRODUCTION AND REASONS FOR STUDY

The Commission is studying potential new Enterprise Zone (EZ) incentives and funding sources for the Urban Enterprise Associations (UEAs). In particular, this study is motivated by the ongoing elimination of the Inventory Tax Credit under the 2002 *Tax Restructuring* Law (P. L. 192-2002(ss)). The Inventory Tax Credit serves as the primary development incentive and funding source for the UEAs.

The Indiana Enterprise Zone Program was established by legislation enacted in 1983. EZs may be located in municipalities and on closed or inactive military bases. The 20-member State Enterprise Zone Board reviews and approves proposed EZs, renews existing EZs, and monitors EZ operations and incentive use. EZs are designated by the EZ Board based on demographic, socioeconomic, and geographic size criteria. The initial designation period for an EZ is 10 years, with EZs being eligible for two 5-year renewals upon review by the EZ Board. In addition, EZs which have operated for a full 20-year period may be re-designated for an additional 20-year term by the EZ Board. The EZ Board is authorized to designate two new municipal EZs each year until December 31, 2015. Currently, there are 25 municipal EZs and 3 EZs located on closed military bases.

A municipality establishing an EZ must appoint a 12-member Urban Enterprise Association to coordinate the development activities within the EZ. Until recently, the EZ program has offered five business tax incentives:

1. The Inventory Tax Credit which is a property tax credit for taxes imposed on inventory of a business located in an EZ.

2. The Gross Income Tax Exemption for income earned by a business in an EZ.

3. The Investment Cost Credit which is a state income tax credit for equity investment in an EZ business.

4. The Employment Cost Credit which is a state income tax credit for wages paid to EZ residents working in a business located in an EZ.

5. The Loan Interest Credit which is a state income tax credit on interest income earned by a taxpayer from loans to EZ businesses.

The EZ tax incentives have served both as a recruitment tool for the EZs and a funding source for the UEAs. Each EZ business that receives tax incentives is required to assist the UEA in an amount determined by the municipality's legislative body. If the EZ business does not assist the UEA, it can be disqualified from eligibility for incentives by the municipal legislative body. In practice, this policy has been implemented with *participation fees* imposed by UEAs. The participation fees imposed by the UEAs are equal to a percentage of the tax savings the business obtains from the incentives. Currently, the UEA participation fees range from 20% to 49% of the tax savings. In 2002, savings from tax incentives reported by EZ businesses totaled approximately $39.2 M. Approximately $34.8 M of the incentive savings (about 89% of the total) was attributable to the Inventory Tax Credit; and approximately $1.9 M (about 5% of the total) was attributable to the Gross Income Tax Exemption. Participation fees paid to UEAs during 2002 totaled about $9.1 M.[1]

Under *Tax Restructuring* (P. L. 192-2002(ss)), the Corporate Gross Income Tax was repealed in 2003, thus, eliminating the Gross Income Tax Exemption for EZ businesses. P. L. 192-2002(ss) also has affected the Inventory Tax Credit. Currently, the Inventory Tax (and, as a result, the Inventory Tax Credit) is scheduled to be eliminated statewide in 2007 when the statewide 100% inventory deduction takes effect. However, some Inventory Tax reduction (and, as a result, diminishment of the Inventory Tax Credit) has already occurred, as work in process and raw materials incorporated in finished goods to be shipped out of state were exempted from Property Tax beginning in 2004. In addition, the local option 100% inventory deduction authorized under P. L. 192-2002(ss) commenced in 2004 in 5 counties containing EZs - Fayette, Floyd, Grant, Miami, and Washington. The local option inventory deduction also is scheduled to commence in 2005 in two counties containing EZs - Allen and Clark. Thus, the changes resulting from *Tax Restructuring* have implications both for the recruitment tools available to the EZs and the funding source the incentives provide for the UEAs.

III. SUMMARY OF WORK PROGRAM

The Commission met three times: August 3, 2004, September 1, 2004, and October 12, 2004.

---

[1] Incentive information was obtained from annual EZ business registration reports received by the Indiana Department of Commerce.

At its first meeting, the Commission received a report from the Legislative Services Agency regarding its project to generate a census of EZ businesses and various data relating to these businesses. The Commission also received testimony about the benefits of EZs to Indiana communities and various incentive options for the EZ Program.

At its second meeting, the Commission received testimony about the impacts of EZs on local communities and considered draft legislation establishing new EZ incentives.

At its third meeting, the Commission recommended 5 preliminary drafts of legislation to the General Assembly amending existing EZ incentives or creating new EZ incentives.

IV. SUMMARY OF TESTIMONY

The following is a general summary of the public testimony received by the Commission. The Commission minutes are available on the Internet at http://www.in.gov/legislative/interim/committee/ezsc.html.

Enterprise Zone Benefits

The Commission heard testimony from interested parties regarding the local benefits of EZs. The testimony outlined the importance of the EZs to the economies of their host cities. This testimony highlighted the following:

- Community development activities carried out by UEAs and EZ businesses to the benefit of local community members. These activities included: (1) repair and renovation of the Lafayette Theater with assistance from the Lafayette UEA; (2) financial assistance to local youth groups and associations and educational programs in Marion by Marion Glass Company; and (3) development of a park by the Bedford UEA on land owned by Bedford Machine and Tool Company.

- Economic development activities by UEAs which preserved existing employment in EZs and encouraged new investment and employment opportunities in EZs. The incentive impacts discussed included: (1) blast furnace relining by Ispat, East Chicago, which preserved approximately 1,200 jobs; (2) expansion of Marion Glass, Marion, since 1987 from 13 to 84 employees and training of 30 employees through their 8000-hour apprenticeship program; (3) expansion of Mulhaupt's, Inc., Lafayette, from 36 to 70 employees since 1993 and $1.0 M in investment in new plant and equipment; and (4) construction of the Lafayette Holiday Inn Select comprising $15.0 M in investment and generating 65 new jobs.

Incentive Utilization and UEA Participation Fees

The Commission received annual data from the Indiana Department of Commerce that describes EZ incentive utilization, job creation and new business investment in the EZs, increased wages paid to EZ residents, jobs filled by EZ residents, annual registration

fees paid by incentive recipients to the state EZ Board, and participation fees paid by such businesses to UEAs. This data indicated that in 2002, participation fees totaled about $9.1 M statewide, with registration fees to the EZ Board totaling about $488,000. The data also indicated that almost 89% of incentive savings to businesses and participation fees to the UEAs in 2002 were attributable to the Inventory Tax Credit.

UEA Budgetary Impact of Reassessment and Tax Restructuring Changes

The Commission received budgetary data from the UEAs for the period 2002 to 2004. A total of 25 UEAs reported budgetary data for both 2002 and 2003, with 14 UEAs reporting a decline in budgeted expenditures averaging about 24.6%. Budgetary data for both 2003 and 2004 was reported by 25 UEAs, with 18 reporting a decline in budgeted expenditures averaging about 54%. Eleven of the UEAs reporting a budgetary decline in 2004 also reported a reduction in 2003.

Potential New Enterprise Zone Incentives

The Commission heard testimony and considered draft legislation to alter current EZ incentives and to create new sales, income, and property tax incentives for the EZs. Potential incentive changes or new incentives considered by the Commission included:

1. Converting the existing Inventory Tax Credit into a personal property tax credit.

2. Establishing a job creation (income tax) credit equal to $2,000 per new employee hired.

3. Providing an additional 1% sales tax allowance to retail merchants located in an EZ.

4. Increasing the Loan Interest Credit from 5% to 15% of the interest received by financial institutions from qualified loans.

5. Changing the structure of the existing Investment Cost Credit, allowing a taxpayer to assign the credit to another person, corporation, or pass through entity, and capping the credit at $50.0 M beginning in 2006.

6. Establishing an assessed valuation deduction for real property located in an EZ that is capped at $25.0 M beginning in 2006.

7. Establishing a tax credit of up to 3.4% of the payroll expense of an EZ employer.

8. Providing an additional research expense credit for research expenses incurred by a business in an EZ.

V. COMMISSION FINDINGS AND RECOMMENDATIONS

The Commission made the following findings of fact:

- *Tax Restructuring* has eliminated the Gross Income Tax exemption that UEAs

have used as an incentive to encourage business investment and employment in the EZs. The Gross Income Tax Exemption accounted for about $1.9 M in savings to EZ businesses in 2002. This represented about 4% of the incentive savings obtained by EZ businesses in 2002.

- The ongoing elimination of the Inventory Tax under *Tax Restructuring* has significantly diminished the Inventory Tax Credit as an incentive to encourage business investment and employment in the EZs. This impact is the result of the "work in process" exemption effective in 2004 and the local option 100% inventory deduction affecting 5 EZs in 2004 and 7 in 2005. The Inventory Tax Credit will be eliminated in 2007 when the 100% inventory deduction goes into effect statewide. The Inventory Tax Credit accounted for about $34.8 M in savings to EZ businesses in 2002. This represented almost 89% of the incentive savings obtained by EZ businesses in 2002.

- The incentive eliminations described above in (1) and (2) have severely affected the operating budgets of UEAs due to corresponding reductions in participation fees. The Commission has found that 18 UEAs have experienced an average reduction in funding of about 54% from 2003 to 2004.

The Commission recommended the following preliminary drafts (PDs) of legislation to the General Assembly. Each of the PDs as well as this Final Report was approved unanimously by the Commission.

1. PD 3057 allowing EZ retail merchants to claim an additional 1% sales tax allowance.

2. PD 3058 increasing the amount of the EZ Loan Interest Credit from 5% to 15% of the interest received from qualified loans.

3. PD 3137 providing that a taxpayer is entitled to a 30% credit for research expenses incurred in an EZ that exceed the taxpayer's research expenses incurred in the EZ in 2005.

4. PD 3402 establishing the EZ Job Creation Tax Credit of $2,000 for each new employee employed by a taxpayer.

5. PD 3559 allowing a taxpayer to assign the EZ Investment Cost Credit, and providing that trusts, estates, corporations, and pass through entities that make qualified investments in EZ businesses may claim the Investment Cost Credit.

The PDs listed above are on file in the Legislative Information Center, Room 230 of State House, Indianapolis, Indiana 46204. The telephone number of the Legislative Information Center is (317) 232-9856, and the mailing address is 200 W. Washington Street, Suite 301, Indianapolis, Indiana 46204-2789.

W I T N E S S L I S T

Becky Bonham, South Bend
Joe Brisley, Marion Glass/GETCO, Marion
Bill Brown, Summit City Electric/Fort Wayne Urban Enterprise Association
Dennis Carson, Lafayette Urban Enterprise Association
Mick Clark, Marion Glass/GETCO, Marion
Mike Gibson, Mulhaupts, Inc./Lafayette Urban Enterprise Association
Jenny Hutch, Fort Wayne
Pam King, Indianapolis Urban Enterprise Association
Greg Leatherman, Ft. Wayne
Dave Mazanowski, Mainscape, Inc., Indianapolis
John Nielsen, Ispat Steel, East Chicago
Todd Rash, BAE System Controls, Fort Wayne
Brent Steele, Bedford
Marcia Varda, AJ Wright, South Bend
Bill Watson, Building Commissioner, Mitchell