HOUSE RESEARCH

Bill Summary

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Overview

The delete everything amendment authorizes the commissioner of the department of trade and economic development (DTED) to designate up to 10 job opportunity building zones in economically distressed rural areas. These zones could be divided up into separate noncontiguous subzones, located in one or more local government units. Qualifying businesses operating in the zones are exempt from sales, income, and property taxes and a refundable jobs credit is available for the portion of increased payroll that exceeds $30,000 per FTE. Individuals who invested in zone businesses would be exempt on their business income attributable to activity in the zone, as well as capital gain taxes on zone investments. The zones would have a maximum duration of 12 years. Designations would occur in 2003 and the tax reductions would be effective in 2004.

In addition, the bill authorizes designation of up to 5 agricultural processing facility zones. These zones would be limited to the sites of the agricultural processing facilities themselves.

<u>**Section**</u>

1 **Job opportunity building zone property.** Provides that commercial and industrial property (both real and personal) in a job opportunity building zone or an agricultural processing zone is exempt from property taxation. This exemption does not apply, however, to the following:

- Land
- Commercial-industrial property where the neither the owner nor the lessee is a qualified business (See the summary below for section 0for the definition of a qualified business.)
- Debt service levies, if the bonds were issued before designation of the zone
- School operating referenda, if the voters approved the levy before designation of the zone.

The exemption applies to the first assessment year after designation of the zone by the commissioner of trade and economic development.

2 **Wind energy production tax exemption.** Provides that electricity generated in a job opportunity building zone is not subject to the wind energy production tax. This tax is imposed in lieu of the property tax.

3 **Individual income tax exemption.** Provides that income derived from investing in or operating a qualified business in a job opportunity building zone is exempt from individual income taxation. The qualifying rules for these exemptions are found in section 0.

4 **Corporation franchise tax exemption.** Provides income from operating a qualified business in a job opportunity building zone is deductible in calculating taxable income under the corporate franchise tax. The details of this exemption are described in the summary of section 0.

5 **Individual income tax exemption, nonresidents.** Provides that in calculating the Minnesota tax for a non-resident, job opportunity building zone income is excluded from both the numerator and denominator of the ratio. Nonresidents calculate their Minnesota tax by determining the Minnesota tax on their total income (both Minnesota and non-Minnesota). The Minnesota liability is, then, determined by multiplying this amount by a fraction, the numerator of which is Minnesota source income and the denominator of which is total income.

6 **Jobs credit.** Provides that the jobs credit applies against chapter 290 taxes (regular and alternative minimum tax under both the individual income and corporate franchise taxes). A summary of the rules under this credit are found in section 0.

7 **Dependent care credit.** Clarifies that tax-exempt job opportunity building zone income reduces the amount of the dependent care credit that is allowed. For example, if one-quarter of the taxpayer's income were tax-exempt job opportunity building income, the otherwise applicable dependent care credit would be reduced by 25 percent. This is same treatment that applies to tax-exempt reservation income of American Indians and to part year residents.

8 **Working family credit.** Clarifies that tax-exempt job opportunity building zone income reduces the amount of the working family credit that is allowed. This is the same treatment described in section 0for the dependent care credit and is consistent with the treatment of other forms of tax-exempt income.

9 **Individual AMT exemption.** Extends the individual income tax exemption to the alternative minimum tax or AMT.

10 **Corporate AMT exemption.** Exempts income from operating a business in a job opportunity building zone from the corporate AMT.

11 **Corporate minimum fee.** Excludes property and payroll located in a job opportunity building zone from use in calculation of the minimum fee under the corporate franchise tax. This fee applies to partnerships and S corporations, as well as traditional C corporations that are subject to the franchise tax.

12 **Sales tax exemption.** Provides a sales tax exemptions for businesses located in a job opportunity building zone. To qualify for this exemption, the goods or taxable services must be primarily used in the zone and purchased during the duration of the zone. The exemption extends to contractor purchases (if the final use of the property is in the zone) and to local sales taxes.

13 **Motor vehicle sales tax exemption.** Provides an exemption from the motor vehicle sales tax for vehicles used by a business in a job opportunity building zone. The vehicle must be both garaged in the zone and primarily used in support of zone operations of the business (e.g., delivering products produced in the zone or delivering supplies used in the zone). The exemption also applies to local sales taxes.

14 **Definitions.** Defines terms for purposes of the job opportunity building zone statute.

- **Agricultural processing facility** means a facility that transforms, packages, sorts, or grades agricultural, livestock, or plant products into goods for intermediate or final consumption.

- **Applicant** is a local government or governments applying for designation of a job opportunity building zone. A joint powers board, acting on behalf of two or more local government units, may be an applicant.

- **Commissioner** is the commissioner of trade and economic development.

- **Development plan** is a development plan adopted by the local government as part of its application for designation of a job opportunity building zone.

- **Local government unit** is a city (either home rule charter or statutory), county, town, or school district.

- **Job opportunity building zone** is a zone designated under the statute's procedure and includes an agricultural processing zone.

- **Job opportunity building zone percentage** is a fraction used to apportion income to zone for business operating both within and outside of the zone. The percentage is the average of the zone payrolls and property over total Minnesota payrolls and property.

- **Job opportunity building zone payroll factor** is the wage and salaries paid to employees for services performed in the zone or to employees working from offices in a zone, if the work outside the zone is incidental to that in the zone.

- **Person** means individual or any type of legal entity (corporation, partnership, etc.).

- **Qualified business** means a trade or business operating within a job opportunity building zone. If a business relocates operations into a zone, to be a qualified business it must both:

o Meet an expansion test by either:

• Increasing employment by 20% in its first full year of zone operations; or

• Making a capital investment in the zone equal to 10% of its gross revenues in the prior year from the portion of the business it relocated to the zone; and

- **Agree in writing to repay the tax benefits, if it does not meet the expansion test.**
    - **Relocates** means moving a Minnesota business operation from outside a zone into a zone or by locating an operation in a zone that supplants employment at an existing Minnesota business operation outside the zone. It does not include an expansion that does not replace or supplant another Minnesota operation.

15 **Development plan.** Requires applicants for zone designation to adopt a written development plan containing at least:

- A map of the zone with details on present uses and conditions in the area
- Evidence of community support and commitments to the zone
- Description of the plans and methods that will be used to stimulate development of the zone
- Description of the characteristics of the zone (e.g., social, economic, and demographic conditions)
- Description of the anticipated activity in the zone
- Any other information the commissioner requires.

16 **Limitations.** Establishes various rules governing job opportunity building zones:

- **Maximum size** is limited to 5,000 acres. For an agricultural processing facility zone, the maximum size is limited to the site of the facility, including space for ancillary facilities and expansion in the "reasonably foreseeable future."
- A zone may be divided into noncontiguous subzones.
- Zones must be located **outside of the Twin Cities (7 county) metropolitan area**.
- No person or entity may own over half the property in the zone. This rule does not apply to an agricultural processing facility zone.
- A zone cannot overlap with a **border city development zone**. A border city can, however, chose to seek designation of the area of a border city development zone as a job opportunity building zone by providing for removal of property from the border city zone. If property owners in the existing zone are receiving incentives under it, they must consent to the removal. The removal can be contingent upon designation of the zone as a job opportunity building zone. Border city development zone incentives cannot be provided to businesses for operations in a job opportunity building zone
- The **maximum duration** of a zone is 12 years. A shorter duration can be requested by the applicant or specified by DTED in its designation of the zone.

17 **Application for designation of zones.** Provides rules governing applications for zone designations.

Who may apply. One or more local governments (city or town, county, and school district) may apply for designation of a zone. The zone must be located, at least partially, in each of the applicant governmental units. A local government can apply for only one zone designation.

Contents of application. The application must include:

- A development plan for the zone

- The proposed duration of the zone

- Resolutions approving the application by all of the cities, towns, and counties that include the zone (This is essentially an agreement to provide the local tax reductions-i.e., property tax or local sales tax exemptions.)

- Consents to removals, if the proposed zone includes a border city development zone

- Supporting evidence to help the commissioner of DTED evaluate the merits of the application

18 **Designation of job opportunity building zones.** Directs the commissioner of DTED to designate no more than 10 job opportunity building zones. These designations are to be made based on need and likelihood of success in revitalizing economically distressed rural areas in Minnesota. The commissioner may also designate up to 5 agricultural processing facility zones. In designating the zones, the commissioner may modify the development plans, including the boundaries of the zones. Notice and a statement of reasons must be provided to the applicant for any modifications.

Need indicators. The commissioner must consider the following measures of need (generally measured relative to the averages for the state as a whole):

- Percentage of the population below 200% of the poverty rate

- Average weekly wage

- Deteriorating or underutilized property

- Median sale price of housing units

- Median household income

- Population loss in the last two decades

- Closing of businesses or major employers

- Physical characteristics of property that it make it difficult to develop

- Presence of existing public and private infrastructure to support expanded development

- Low business startup and expansion rates

In applying these indicators, the best available data is to be used. If data that is specific to the zone is not available, the commissioner may use data for the next smallest area that is available.

Success indicators. The commissioner may use the following as measures of likely success of a proposed zone:

- Viability of the development plan

- How creative and innovative the plan is

- Local public and private commitment to the effort

- Existing resources available in the zone

- Relationship of the designation to other projects and programs

- How regulatory burdens will be eased in the zone

- Job training efforts that will be linked to the designation

- The extent to which the plan is directed at and the designation of the zone will result in high paying jobs

Schedule. The designations are to be made during calendar year 2003 and will take effect beginning January 1, 2004. The bill contains blank dates for (1) DTED specifying the rules for applications, (2) the application deadline, and (3) designation of zones by DTED.

19 **Available tax incentives.** The following tax incentives are available in job opportunity building zones:

- Business owners are exempt from the individual income tax on income from business operations and investments in a job opportunity building zone

- The corporate franchise tax does not apply to corporate income generated by zone operations

- State and local sales taxes (both general and on motor vehicles) do not apply to purchases used by businesses in a job opportunity building zone

- Property taxes do not apply to improvements in the zone

- The wind energy production tax does not apply to wind energy conversion systems in a zone

- A refundable jobs credit is available for higher paying jobs.

20 **Individual income tax exemption.** Provides income tax exemptions for individuals operating businesses in zones or investing in zones. These exemptions only apply if the income would otherwise be taxable.

Rents. Rents received for both real and tangible personal property located in the zone are exempt. Rents from personal property that is used both within and outside of the zone must be apportioned based on the number of days the property was used in the zone.

Business income. Income from operating a business in a job opportunity building zone is exempt. If the business operates both within and outside of the zone, the income must be apportioned using the share of property and payroll located in the zone to the total property and payroll of the taxpayer. The exemption is limited so that the exempt income (determined by using the apportionment mechanism) cannot exceed 20 percent of the sum of the zone payroll and original adjusted basis of the investment in the zone.

Capital gains. Capital gains on real and tangible personal property located in a job opportunity building zone or sale of a business operated in the zone are exempt from taxation. Different rules apply to determine the amount of the exemption:

- **Real property.** Capital gains on real property located in a job opportunity building zone are exempt from taxation based on the share of the holding period that took place while the area was designated a job opportunity building zone. To illustrate, assume A purchased a piece of real property for $1,000 and held the property for10 years. A, then, sold the property for $5,000. For 6 years of the 10-year holding period, the property was located in a job opportunity building zone. Of A's $4,000 capital gain ($5,000 sale price - $1,000 purchase price = $4,000), 60 percent or $2,400 would be exempt from taxation ($4,000 * 60% = $2,400), since 6 years out of the 10-year holding period occurred while the zone was designated a job opportunity building zone.

- **Tangible personal property.** Capital gains on tangible personal property located in a job opportunity building zone are exempt from taxation based on the share of the holding period that took place while the zone was designated a job opportunity building zone and the usage of the property in the zone. This calculation is essentially the same as that for real property. However, if the personal property was used both within and without the zone, the exemption amount must also be multiplied by a fraction. The numerator of the fraction is the number of days the property was used in the zone while it was designated as a job opportunity building zone and the denominator is the total number of days the taxpayer held the property.

- **Ownership in qualified business.** Capital gain on an ownership interest (e.g., stock or a partnership interest) in a qualified business is exempt from taxation. This exemption equals the job opportunity building zone percentage for the business multiplied by the capital gain. The zone percentage is calculated using as its denominator the total property and payroll (not just the Minnesota payroll and property). This exemption does not apply if the zone percentage is less than 25 percent. The business entity is responsible for notifying the owner of its qualification for the capital gain exemption.

21 **Corporate franchise tax exemption.** Provides that a corporation operating in the zone is exempt from the corporate franchise tax, if it is a qualified business. If the entire business operates in the zone, the corporation is fully exempt taxation under the corporate franchise tax and would not be required to file a return. If the corporation does business both within and outside of the zone, the following rules apply:

- **Regular tax.** The corporation's taxable net income is multiplied by its zone percentage (average property and payroll in the zone divided by total Minnesota property and payroll) and subtracted from its taxable income.

- **AMT**. The corporation's alternative minimum taxable income is multiplied by the zone percentage and this amount is subtracted from the taxable income.

- **Minimum fee**. Its zone property and payroll are excluded from calculating the minimum fee.

22 **Jobs Credit.** Provides a job credit to a qualified business operating in a zone equal to 7 percent of:

- The lesser of either:

o The increase in the business payroll in the zone since the year of designation or

- o The increases in total Minnesota payrolls since the year of designation; minus
- The increase in the number of FTEs in the zone since designation multiplied by $30,000

Inflation adjustment. Starting for tax year 2005, the $30,000 amount will adjusted for inflation.

Refundable. The credit is refundable.

23 **Repayment of tax benefits.** Requires a business to repay tax benefits or any non-tax amounts provided by the local governments, if the business:

- Relocated into the zone after its designation and

- Ceased to operate in the zone or was not a qualified business.

The provision requires repayment of the last two years of benefits received before the business ceased its zone operations.

Disposition or repayments. Repayments of state tax reductions are paid to the state and deposited in the general fund. Repayments of property taxes are distributed to local governments in the same manner as delinquent property taxes. Repayments of local sales taxes are made to the unit imposing the tax.

Authority to collect. The commissioner of revenue is given authority to collect repayments in the same manner as unpaid taxes and the same interest and penalty rules apply. For individual income and corporate franchise taxes, the taxpayer files an amended return and must repay within 30 days after the triggering event. For property taxes, the county auditor is to prepare a tax statement using the otherwise applicable tax rates. If the amounts are not paid, they become liens against the property in the same way as any other unpaid property tax. Motor vehicle sales taxes are repaid to the motor vehicle registrar.

Waiver authority. The commissioner of revenue, after consulting with the commissioner of DTED and the affected local units of government, may waive all or part of a repayment if it is deemed to be in the best interest of the state and the business ceased operations for reasons beyond its control, such as a natural disaster, unforeseen industry trends, or loss of a major supplier or customer.

24 **Zone performance; remedies.** Successful applicants for zone designation must annually report to the commissioner on zone performance. Based on these reports and other information, the commissioner may take action the commissioner considers appropriate, such as removing property from the zone or terminating the zone or a subzone. Before doing so, the commissioner must consult with the local governments and provide notice of the proposed action. The commissioner's action may be appealed as a contested case under the administrative procedures act. Income and property tax incentives provided in area removed from a zone or terminated zone continue for existing businesses. Sales tax exemptions continue for purchases made before the beginning the first calendar month beginning 30 days after termination of the zone or removal of the property.

25 **Job opportunity building zone aid.** Provides for the payment of state aid to partially reimburse cities and counties with job opportunity building zones for a proportionately large loss of tax base as a result of the zones. To qualify for this aid, a city or county must experience at least a 3% drop in tax capacity (as compared with a base year of 2001) as a result of the property tax exemption provided through the job opportunity building zone. The amount of aid is calculated using the following formula:

> 0.5 * local unit's rate in 2003 * [job opportunity building zone exempt tax capacity - (0.03 * 2003 tax capacity)]

Certification by assessor. The county assessor is to certify entitlements to this aid to the commissioner of revenue. The commissioner notifies the each city and county of its entitlement to aid by August 20 of the assessment year. The aid is paid by July 20 of the payable year. An appropriation is made to the commissioner of revenue for the aid.

26 **Appropriations.** Appropriates an unspecified amount to the commissioners of DTED and revenue to cover the cost of administering the act.