MINNESOTA · REVENUE

VARIOUS TAXES
Job Opportunity Building Zones

	Yes	No
Separate Official Fiscal Note Requested		
Fiscal Impact		
DOR Administrative Costs/Savings		

April 23, 2003

Department of Revenue
Analysis of S.F. 496 (Bakk) 1st Engrossment

	Revenue Gain or (Loss)			
	F.Y. 2004	**F.Y. 2005**	**F.Y. 2006**	**F.Y. 2007**
		(000's)		
Corporate Franchise Tax Exemption	0	($85)	($210)	($280)
General Sales & Use Tax Exemption	($1,250)	($2,590)	($2,370)	($2,760)
Property Tax Refund	0	0	0	($10)
Job Credit	0	0	($990)	($1,640)
Job Opportunity Building Zone Aid	0	0	0	0
Appropriation to the Dept. of Trade and Economic Development	($100)	($30)	($30)	($30)
Appropriation to the Dept. of Revenue	($53)	($29)	($29)	($29)
General Fund Total	($1,403)	($2,734)	($3,629)	($4,749)

Job opportunity building zone definitions and development plans effective the day after enactment.
Sales tax exemption effective for sales made on or after the day after enactment.
Job credit effective the day after enactment.
Motor vehicle sales tax exemption effective for sales made after December 31, 2003.
Corporate franchise tax exemption effective beginning with tax year 2004.
Property tax exemption effective beginning with property taxes payable in 2005.
Job opportunity building zone aid effective beginning with aid based on property taxes payable in 2005.

EXPLANATION OF THE BILL

Current Law: There are no provisions for job opportunity building zones in Minnesota. Some tax exemptions and credits are available in border city zones.

Proposed Law: The Commissioner of Trade and Economic Development would designate up to ten job opportunity building zones, five agricultural processing facility zones, and, **as amended**, five mineral processing facility zones. A zone may not exceed 5,000 acres and must be located outside the seven-county metropolitan area. The designation of zones would take effect January 1, 2004. The maximum duration of a zone is 24 years, although tax incentives for a business cannot be granted for more than 12 years.

EXPLANATION OF THE BILL (cont.)

A job opportunity building zone must be located within the boundaries of the local unit(s) of government that request the zone. Each zone may consist of one or more noncontiguous subzones. Areas in an existing border city zone do not qualify, but property may be removed from the border city zone and become part of a job opportunity building zone.

As amended, an applicant for a zone, as part of its development plan, may reserve for later inclusion in the zone up to 1,000 acres, which must be within the boundaries of the applicants. The original maximum duration of a zone is not changed by later including the additional area to the zone. Subject to the maximum 5,000 acres of a zone, there is no limit to the number of times an applicant may propose to include additional area within a zone from the reserved area proposed in the development plan.

The bill defines "qualified business" as a person carrying on a trade or business at a place of business located within a job opportunity building zone. **As amended**, a retail business is not a qualified business. A business that relocates to a job opportunity building zone can qualify if it increases full-time employment by at least 20% in the first full year of operation in the zone or if it makes a capital investment equivalent to 10% of the gross revenues for the year immediately preceding the taxable year.

As amended, five "mineral processing facility zones" may be designated as Job Opportunity Building Zones. The mineral zones must include mineral processing facilities that produce either:

- Value added iron products, including direct reduced iron, hot briquetted iron, iron carbide, pig iron, iron nuggets, steel slabs, billets, bloom, steel, or steel fabricators located adjacent to steel making facilities, excluding taconite iron ore pellet production, or
- Nonferrous mineral mining or processing, including base metals, precious metals, or high-value industrial minerals such as diamonds, dimension stone, decorative rock, or pigments or facilities for producing more than 1 million yards per year of taconite mining wastes for aggregate.

Property Tax Exemption: Class 3 commercial, industrial, and utility property in a zone would be exempt from the local property tax and the state general levy if the occupant of the property is a qualified business. This exemption would apply to improvements to real property and to personal property; it would not include land. The exemption does not apply to debt service levies or similar levies to pay general obligation bonds. It also does not apply to a school referendum levy that was approved by the voters before the zone is designated. If applicable, the property would be exempt from the wind energy production tax.

Individual Income Tax Exemption: A subtraction from federal taxable income would be allowed to an individual who operated or invested in a trade or business located in a zone. The subtraction would apply to net income from operating a business in a zone, net rental income derived from real or personal property in a zone, and net capital gains related to zone investment. A similar subtraction would be allowed in computing alternative minimum taxable income.

EXPLANATION OF THE BILL (cont.)

Corporate Franchise Tax Exemption: A subtraction from taxable income would be allowed for income derived from the operation of a business in the job opportunity building zone. A subtraction would also be allowed in computing alternative minimum taxable income and the property and payroll factors for the minimum fee.

Sales Tax Exemption: Purchases of tangible personal property and taxable services by a qualified business are exempt from the sales and use tax if the property and services are primarily used or consumed in a job opportunity building zone. An exemption would also be allowed for construction materials and supplies for the improvement to real property in a zone used in the conduct of a qualified business, regardless of whether purchased by the business or a contractor. These transactions would also be exempt from local sales and use taxes.

Motor Vehicle Sales Tax Exemption: An exemption from motor vehicle sales tax would be allowed for the purchase of a vehicle by a person engaged in a trade or business located in the zone if the vehicle is garaged in the zone and used primarily for the business operation in the zone. These vehicles would also be exempt from local sales and use taxes.

Job Credit: A refundable job credit against the corporate and individual income taxes would be available for businesses based on the increase in payroll compared to the zone designation year payroll. The credit would be 7% of: the zone payroll for the taxable year minus the result of $30,000 times the increase in the number of full-time equivalent positions in the zone since the year of designation. Starting in tax year 2005, the $30,000 would be indexed annually for inflation.

Repayment: Section 23 provides for the repayment of tax reductions if a business relocates into a job opportunity building zone and then ceases to operate the facility within the zone. A business must repay the amount of tax reduction or local contribution received during the two years immediately before it ceased to operate in the zone.

Job Opportunity Building Zone Aid: For zone property exempt from the local property tax, each city and county is eligible for aid equal to one half of the amount by which exempt net tax capacity exceeds 3% of the city's total taxable net tax capacity for taxes payable for 2003, multiplied by the city's or county's average local tax rate for taxes payable in 2003. An amount sufficient to pay this aid is appropriated from the general fund.

Direct Appropriations: Section 26 appropriates $100,000 in fiscal year 2004 and $30,000 in fiscal year 2005 to the Department of Trade and Economic Development for the cost of designating the zones. It also appropriates $53,000 in fiscal year 2004 and $29,000 in fiscal year 2005 to the Department of Revenue for the costs of administering the tax provisions in the bill. Because they are not designated as one-time appropriations, they would continue at the FY 2005 level for the subsequent years of the program.

REVENUE ANALYSIS DETAIL

- The state revenue forecast is based on a projection of all economic activity in the state, including that which may occur in job opportunity building zones. Therefore, projected state revenues would be reduced if one or more state tax exemptions were enacted for the zones.

- This analysis assumes that fifteen job opportunity building zones would be utilized the first four years (ten job opportunity building zones plus five agricultural processing facilities zones). The zones will consist of vacant land when they are designated. There is no indication of any potential mineral processing facility zones being developed during the forecast period.

- Because the property tax exemption applies only to class 3 property, it is assumed that all property in a zone would be commercial or industrial property.

- Data from the Michigan Renaissance Zone program is used to estimate the first four years of investment and employment in the job opportunity zones. This analysis assumes the four-year investment total to be $24.5 million per zone. This investment per zone is characterized by type, with $20.4 million for industrial development and $4.1 million towards commercial non-retail.

- Data from the Department of Trade and Economic Development regarding investment per job for rural Minnesota is used to calculate the number of jobs in job opportunity building zones, assuming just over $96,000 of investment per job for industrial and commercial non-retail jobs. Employment during the first four years is assumed to be 252 jobs per zone. This employment per zone is characterized by type, with industrial accounting for 204 jobs and commercial non-retail accounting for 48 jobs.

- Based on recent projects, it was assumed that the average investment per agricultural processing facility zone would equal $2.5 million, and each facility would employ an average of 30 individuals.

- These investment and employment totals are apportioned based on the annual experience similar to the Michigan zones during the first four years of its Renaissance Zone program, with 40% of total investment occurring the first calendar year and 20% annually thereafter.

Corporate Franchise Tax

- Based on state revenue forecast data for corporate franchise tax collections and statewide employment, a per-job tax collection amount was calculated.
- This amount was adjusted based on a rural-to-metro wage ratio to compensate for the rural locations of the job opportunity building zones. The per-job corporate franchise tax collection figure is $159 in FY 2005, $155 in FY 2006, and $150 in FY 2007.
- This per-job corporate franchise tax collection number was aggregated based on job opportunity building zone employment estimates.
- All business and investment income is accounted for in the corporate franchise tax estimates.
- This analysis assumes a one-half year impact in FY 2005 and full impact thereafter.

REVENUE ANALYSIS DETAIL (cont.)

General Sales Tax

- The revenue impact from sales tax exemptions is calculated for two categories, initial construction and ongoing purchases.
- Construction materials and initial furnishings were calculated as 45% of total project investment.
- An estimate for ongoing purchases, such as office furnishings, utilities, and supplies, was based on state revenue forecast data for sales tax collections and statewide employment to calculate a per-job tax collection number.
- The per-job sales tax figure equals $624 in FY 2005, $649 in FY 2006, and $671 in FY 2007.
- Combined with projected annual employment in the zones, an estimate for sales tax exemptions for ongoing purchases was calculated.

Property Tax

- The local property tax exemption would result in a shift to other properties. The increased tax on homeowners would increase the state cost for homeowner property tax refunds.
- Investment data for industrial and commercial property was apportioned to calculate the total property tax exemption for real property building costs.
- The total property tax shift equaled $185,000, and 2.6% of this total tax shift results in the expected increase in property tax refunds.
- For taxes payable in 2006, the increase in property tax refunds would have a revenue impact beginning in FY 2007.
- The exemption from the state general levy would have no impact on state revenues. The tax rate would be adjusted to yield the amount of revenue required by statute.

Job Credit

- Average wages by sector were calculated from 1999 industry wage data from the Minnesota Department of Economic Security. Data excludes the seven-county metro area and the cities of Rochester, Duluth, Mankato, and St. Cloud to reflect average wages in greater Minnesota outside the large cities.
- Annual increases in average wages were based on wage growth rates from the February 2003 forecast by the Department of Finance
- It was assumed that all jobs in the zones were new (not relocated) jobs and were full time.
- The $30,000 threshold was indexed for inflation based on the February 2003 forecast of the Consumer Price Index.
- The credit could first be claimed for tax year 2005. The tax year impact was allocated to the following fiscal year.

REVENUE ANALYSIS DETAIL (cont.)

Job Opportunity Building Zone Aid

- For taxes payable in 2003, an average for the 25 rural cities with the largest taxable net tax capacity was calculated.
- Based on investment and taxable net tax capacity of the job opportunity zones, the 3% threshold would not be reached, and there is no revenue impact from job opportunity building zone aid during the forecast period.

Number of Taxpayers Affected: By FY 2007, 118 businesses would be directly affected by the job opportunity building zones.

Source: Minnesota Department of Revenue
Tax Research Division
http://www.taxes.state.mn.us/polic.html#analyses

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