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October 19, 2005

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Assembly Bill 223/Senate Bill 136: Airport Development Zones and Loan Program

Assembly Bill 223 and Senate Bill 136 would create an airport development zone (ADZ) and an airport development zone loan program. The bills are identical except for specific provisions related to review and comment by, and notification to, the Department of Transportation (DOT).

AB 223 was introduced on March 16, 2005, and referred to the Assembly Committee on Urban and Local Affairs. Assembly Amendments 2 and 3 were adopted, and AB 223, as amended, was recommended for passage on July 14 by the Committee on Urban and Local Affairs by a vote of 8 to 0. The bill was then referred to the Joint Committee on Finance.

SB 136 was introduced on March 23, 2005, and referred to the Senate Committee on Job Creation, Economic Development and Consumer Affairs. Senate Amendment 2 to SB 136 was adopted by a vote of 5 to 0 on June 28, 2005, and the bill was recommended for passage as amended by a vote of 3 to 2. The bill was referred to the Joint Committee on Finance on July 25, 2005.

CURRENT LAW

Economic Development Tax Credit Programs

Wisconsin has five programs that provide tax credits to businesses as incentives to expand or locate operations, increase employees, or increase investment in different areas of the state. These programs include:

a. Development Zones. The program includes 22 zones, including zones that encompass 17 entire counties and two American Indian reservations. A total of $38.155 million in tax credits can be claimed under the program, and $34.9 million has been allocated to businesses in the zones. Eligible businesses in the zones can claim the consolidated development zones jobs and environmental remediation tax credit.

b. Enterprise Development Zones. The program is authorized 98 zones (as a result of a veto of 2005 Wisconsin Act 25), including 10 zones for environmental remediation projects, to be designated in municipalities and counties. Sixty-four zones have been created, and a total of $124.1 million has been allocated to businesses in the zones. Businesses in the zones can claim the consolidated development zones jobs and environmental remediation tax credit.

c. Development Opportunity Zones. Three development opportunity zones have been designated in the Cities of Kenosha, Milwaukee, and Beloit. A total of $4.7 million in tax credits have been allocated for businesses in both the Milwaukee and Beloit zones, while $7.0 million has been allocated to the Kenosha zone. Businesses in the zones can claim the consolidated development zones jobs and environmental remediation tax credit, and development zones capital investment tax credits. Three other zones in Beloit, Eau Claire, and West Allis have lapsed.

d. Technology Zones. A total of eight technology zones have been designated encompassing 54 counties. The maximum amount of tax credits that can be claimed in each zone is $5.0 million. A total of $12.2 million in tax credits have been allocated to businesses in the zones. Eligible businesses can claim technology zone tax credits for jobs created, capital investments, and property taxes paid.

e. Agricultural Development Zone. Eighteen counties (not designated as technology zones) have been designated as an agricultural development zone. A total of $2.7 million in tax credits have been allocated to businesses in the zone. Businesses in the zone can claim capital development zones investment tax credits and the consolidated jobs and environmental remediation tax credit.

WHEDA Loan Programs

Currently, WHEDA is authorized to issue bonds to fund loans for the housing rehabilitation loan program, the home ownership mortgage loan program, residential facilities for the elderly and chronically disabled, the property tax deferral loan program, economic development, and the beginning farmer loan program. Total bonding authority for these programs is in excess of $800 million. In addition to bonding for these programs, WHEDA also operates several programs to guarantee loans made by private lenders to qualified businesses. These loan guarantees are backed by the Authority's Wisconsin Development Reserve Fund (WDRF), which primarily consists of monies that were originally appropriated by the Legislature and subsequent returns and revenues from the fund's assets. Under the WDRF, the Authority may have up to $49.5 million in outstanding loan guarantees and generally must maintain WDRF reserves of $1 for every $4.50 in guarantee authority. Programs currently administered under the WDRF consist of the credit relief outreach program (CROP), the farm assets reinvestment management loan program (FARM), the agribusiness loan guarantee program and the small business development loan guarantee program.

SUMMARY OF BILLS

AB 223/SB 136 would create both an airport development zone program administered by the Department of Commerce and an airport development zone loan program administered by the Wisconsin Housing and Economic Development Authority.

Airport Development Zone Program

AB 223/SB 136 would create an airport development zone program that would provide tax credits to businesses that locate or expand operations, increase employees, or increase investment in an ADZ.

Program Procedures and Criteria. Under the provisions of AB 223/SB 136, the Department of Commerce could designate an area as an ADZ if it determined all of the following:

a. The governing body of each city, village, and town in which the ADZ, or a portion of the ADZ, would be located adopted a resolution indicting that an airport development project was desired for the area. (An "airport development project" would mean the construction or expansion of an airport in Wisconsin.)

b. The airport development project served a public purpose.

c. The airport development project would likely retain or increase employment in the state.

d. The airport development project would not likely occur or continue without the area being designated as an ADZ by Commerce.

e. The airport development project would likely positively affect the area.

In making these determinations, Commerce would be required to consider all of the following:

a. The extent of poverty, unemployment, or other factors contributing to general economic hardship in the area.

b. The prospects for new investment and economic development in the area.

c. The amount of investment that is likely to result from the airport development project.

d. The number of full-time jobs that are likely to be created as a result of the airport development project.

e. The number of full-time jobs that are likely to be available to the target population (as defined below) as a result of the project.

f. The competitive effect of designating the area as an airport development zone on other businesses in the area.

g. The needs of other areas of the state.

h. Any other factors that Commerce considers relevant.

Commerce would be authorized to designate an area as an airport development zone, and could specify the length of time the designation was effective, up to a maximum time period of seven years. Under AB 223 (but not SB 136), Commerce would be required to give DOT the opportunity to review and comment on any proposed designation of an ADZ. Commerce would be required to notify of the designation, expiration date, and change of expiration date of an ADZ, each person certified for tax benefits in the ADZ, the Department of Revenue (DOR), the Wisconsin Housing and Economic Development Authority (WHEDA), DOT (under AB 223), and the governing body of each city, village, town, and federally recognized American Indian tribe or band in which territory the ADZ was located. Commerce could not designate an area as an ADZ, if the area was located within the boundaries of a development zone, enterprise development zone, or a development opportunity zone. The Department would be annually required to estimate the amount of forgone tax revenues due to tax benefits claimed by businesses in the zones. A zone would expire 90 days after the limit on tax benefits was equaled or exceeded.

<u>Tax Benefits</u>. A business that conducted economic activity in an airport development zone and that was certified by Commerce could claim the consolidated development zones jobs and environmental remediation tax credit and the development zones capital investment tax credit. (A technical amendment would be necessary to clarify that claimants in ADZs could claim the capital investment tax credit.) The maximum amount of tax credits that could be claimed in an ADZ would be established by Commerce, but could not exceed $3.0 million. The tax credits could be claimed under the state individual and corporate income and franchise taxes. Tax credits could first be claimed under the ADZ program for tax years beginning on or after January 1, 2005.

Development Zones Environmental Remediation and Jobs Tax Credit. The consolidated development zones tax credit is based on amounts spent on environmental remediation and the number of full-time jobs created or retained as follows:

a. *Environmental Remediation Component.* A credit against income and franchise taxes due can be claimed for 50% of the amount expended for environmental remediation in a zone. "Environmental remediation" is defined as removal or containment of environmental pollution, and restoration of soil or groundwater that is affected by environmental pollution in a brownfield if removal, containment, or restoration began after the area that contains the site where the work was done was designated a zone. Investigation costs are eligible unless the investigation determines that remediation is required and remediation is not undertaken. "Environmental pollution" means the contaminating or rendering unclean or impure the air, land, or waters of the state, or making the same injurious to public health, harmful for commercial or recreational use, or deleterious to fish, bird, animal, or plant life. "Brownfield" is defined as an industrial or commercial facility the expansion or redevelopment of which is complicated by environmental contamination.

b. *Full-Time Jobs Component.* A tax credit of up to $8,000 against income and franchise taxes can be claimed for: (1) each full-time job created in a zone and filled by a member of a targeted group; and (2) retaining a full-time job in an enterprise development zone if Commerce determines that a significant capital investment was made to retain the full-time job. In addition, a tax credit of up to $6,000 can be claimed for each full-time job created or retained in a zone that is filled by a Wisconsin resident who is not a member of a targeted group. At least one-third of jobs credits claimed must be based on jobs created and filled by targeted group members. In addition, except for businesses that only claim credits for environmental remediation, 25% of all tax credits claimed must be based on creating or retaining full-time jobs.

"Full-time job" is defined as a regular, nonseasonal full-time position in which an individual, as a condition of employment, is required to work at least 2,080 hours per year, including leave and paid holidays, and for which the individual receives pay equal to at least 150% of the federal minimum wage and also receives benefits that are not required by federal or state law. A full-time job does not include initial training before an employment position began. Targeted groups include the following: (1) dislocated workers; (2) economically disadvantaged youths; (3) economically disadvantaged ex-convicts; (4) vocational rehabilitation referrals; (5) economically disadvantaged veterans; (6) general assistance recipients; (7) supplemental security income (SSI) recipients; (8) qualified summer youth employees; (9) Wisconsin Works (W-2) participants; (10) residents of federally designated enterprise communities; and (11) food stamp recipients.

Tax credits that are not entirely used to offset income or franchise taxes in the current year can be carried forward up to 15 years to offset future tax liabilities.

Development Zones Capital Investment Tax Credit. The development zones capital investment tax credit equals 3% of the following:

a. *Personal Property.* The purchase price of depreciable, tangible personal property. The property must have been purchased after the claimant was certified as eligible for tax benefits, and the personal property has to have at least 50% of its use in the claimant's business location in the zone. If the property is mobile, the base of operations for at least 50% of its use must be in the zone.

b. *Real Property.* The amount expended to acquire, rehabilitate, remodel, or repair real property in a zone. Such expenses are eligible for the tax credit if the claimant began the physical work of construction, rehabilitation, remodeling, or repair, or any demolition or destruction in preparation for the physical work, after the place where the property is located was designated a zone, or if the completed project is placed in service after the claimant is certified for tax benefits. A credit cannot be claimed for expenses for preliminary activities such as planning, designing, securing financing, research, developing specifications, or stabilizing the property to prevent deterioration. A claimant can also claim a tax credit for the amounts expended to acquire real property, if the property was not previously owned and the claimant acquired the property after the place where the property was located was designated a zone, or if the completed project was placed in service after the claimant was certified as eligible for tax benefits.

Tax credits that are not entirely used to offset income and franchise taxes in the current year can be carried forward up to 15 years to offset future tax liabilities.

There are certain statutory provisions that apply to both tax credits. Specifically, if a certification of eligibility for tax benefits is revoked, credits cannot be claimed for the tax year in which the certification was revoked or for successive tax years, and unused credits cannot be carried forward to offset tax liabilities for the year in which the certification was revoked and succeeding years. In addition, credits cannot be claimed for the year in which a person that was certified for tax benefits ceases operations in the zone, and unused credit amounts cannot be carried forward from that year or from previous years.

Partnerships, limited liability companies (LLCs), and tax-option corporations (S corporations) cannot claim either of these credits, but eligibility for, and the amount of, the credits are based on each entity's economic activity, and not that of their partners, members, or shareholders. A partnership, LLC, or tax-option corporation is required to compute the amount of credit that each of its partners, members, or shareholders can claim and provide that information to each of them. Partners, members of LLCs, and shareholders of tax-option corporations claim the credits in proportion to their ownership interest.

The Department of Revenue administers credit claims and can take any action, conduct any proceeding, and act as authorized under income and franchise tax provisions relating to timely claims, assessments, refunds, appeals, collection, interest, and penalties.

<u>Certification for Tax Benefits</u>. A person that intends to operate a place of business in an airport development zone would have to submit an application and a business plan to Commerce. The business plan would be required to include all of the following:

a. The name and address of the person's business for which tax benefits will be claimed.

b. The appropriate Wisconsin tax identification number of the person.

c. The names and addresses of other locations outside of the airport development zone where the person conducts business and a description of the business activities conducted at those locations.

d. The amount that the person proposes to invest in the place of business or to spend on the construction, rehabilitation, repair, or remodeling of a building in an ADZ.

e. The estimated total investment of the person in the ADZ.

f. The estimated number of full-time jobs that would be created, retained, or substantially upgraded as a result of the person's place of business in the airport development zone in relation to the amount of tax benefits that the person would receive.

g. The person's plans to make reasonable attempts to hire employees from the target population, and the estimated number of full-time jobs that would be filled by such individuals.

h. Any other information required by Commerce or DOR.

If the business plan submitted to Commerce was approved, the Department would have to certify the applicant as eligible for tax benefits. Within 30 days of certification, Commerce would be required to notify DOR of the certification. Commerce would be required to revoke a person's certification when the designation of the applicable airport development zone expired. In addition, Commerce would have to revoke certification if the person did any of the following:

a. Supplied false or misleading information to obtain tax benefits.

b. Left the ADZ to conduct substantially the same business outside the ADZ.

c. Ceased operations in the ADZ, and did not renew operation of the business or a similar business in the ADZ within 12 months.

Commerce would be required to notify DOR of a revocation within 30 days after it occurred. Tax benefits would not be transferable to another person, business, or location, except to the extent permitted under Internal Revenue Code (IRC) provisions governing change of ownership. Commerce would be required to verify tax credit information submitted related to airport development zones.

Airport Development Zone Loan Program

The bills would create an airport development zone loan program in the Wisconsin Housing and Economic Development Authority (WHEDA). WHEDA is a public body corporate and politic that sells taxable and tax-exempt mortgage revenue bonds and uses the proceeds to fund loans to eligible homebuyers, housing developers and businesses at below market interest rates. WHEDA was created for this purpose because the state is constitutionally prohibited from incurring this type of debt.

The Authority is not a state agency. Its operating budget is not included in the state budget and is not subject to legislative control. Revenues to finance its operating budget come from interest earnings on loans it makes, investments of its assets and administrative fees it assesses.

Under the airport development zone loan program, WHEDA would be allowed to award loans to businesses for the purpose of financing the construction or expansion of an airport in an airport development zone as established under the bills. In addition to airport construction, loan proceeds would be allowed to finance activities to increase the number of flights to and from the airport or to encourage airlines that do not offer flights to and from the airport to offer such flights. The Authority would be required to charge a rate of interest for each airport development zone loan that would approximate the cost of issuing the portion of the bonds (along with its principal and interest) that funded the loan.

WHEDA would be authorized to issue bonds of up to $200 million in aggregate principal to fund airport development zone loans, with the state building commission serving as financial consultant to assist and coordinate the issuance of these bonds. The bonds would be special obligations of the Authority, would be payable solely out of revenues received in connection with the program, and interest income received by bondholders would not be exempt from state income taxes. All assets and liabilities created through the issuance of bonds under this program would be separate from all other assets and liabilities of WHEDA.

ASSEMBLY AMENDMENT 2/SENATE AMENDMENT 2

AA 2 to AB 223 and SA 2 to SB 136 would make the following modifications to the bills:

a. "Airport development project" would be redefined to mean a business that locates or expands in an area designated as an ADZ.

b. Counties would be authorized to pass resolutions indicating the need for ADZs and to receive notification of expiration and change of expiration dates.

c. Commerce could only designate an area as an ADZ if the airport had at least two runways at the time of designation, and the airport's primary runway was at least 5,000 feet in length and its secondary runway was 3,000 feet in length.

d. The total aggregate amount of tax benefits that could be claimed by businesses through the ADZ program would be limited to $9.0 million. In addition, after four years from the month of designation, Commerce could evaluate an area designated as an ADZ and reallocate the amount of available tax benefits.

e. Tax credits could be claimed under the ADZ program for tax years beginning on and after January 1, 2006.

ASSEMBLY AMENDMENT 3

AA 3 to AB 223 would clarify that the consolidated development zones jobs and environmental remediation tax credit, and the capital investment tax could be claimed under the ADZ program.

FISCAL EFFECT

Assembly Bill 223

Airport Development Zone Tax Credits. AB 223/SB 136 would create an airport development zone program administered by the Department of Commerce. Certified businesses that operated in ADZs could claim the consolidated jobs and environmental remediation development zone tax credit and the development zones capital investment tax credit. The tax credits could be claimed beginning with tax year 2005.

According to the DOT 2003-04 airport directory, there are 132 airports in the state. Based on a study conducted by DOT staff, about 20 different airports begin construction and expansion projects in a year. Assuming that only one airport development zone could be created for each airport, potentially 20 ADZs could be designated in each of the first six years of the program, followed by 12 in the 7th year.

Under the enterprise development zone program administered by Commerce, a total of $3 million in consolidated development zone tax credits can be allocated to each individual zone. Through September, 2004, the average amount of tax credits allocated to individual businesses in enterprise development zones was $1.8 million per zone. When Commerce allocates tax credits to a zone, it requires the business to claim the credits over a three- or five-year period. Credits claimed over the three-year period are back-loaded, with 25% of the total credit allocation being claimed in each the first two years, and 50% of the total allocation claimed in the third year. Commerce staff have indicated that, although the tax credits could be claimed beginning with tax year 2005, the program would probably not be fully implemented until the 2006 tax year. Thus, tax credit claims would likely first be made in fiscal year 2006-07.

The fiscal effect for ADZs assumes: (a) that the program would be fully implemented in 2006, for taxes paid in 2007; (b) 20 ADZs would be designated each year for six years, followed by the final 12 in the seventh year; (c) a total of $1.8 million in tax credits would be allocated to each zone to be claimed over three years, beginning in 2006-07; and (d) credits not fully used to offset taxes during the first three years would be carried forward and used to offset taxes equally during the next two years. Based on these assumptions, it is estimated that enactment of AB 223/SB 136 would reduce state individual and corporate income and franchise tax revenues by $7.38 million in 2006-07. The table below shows the estimated fiscal effect over time.

TABLE 1

Estimated Revenue Losses Under the Airport Development Zone Proposal ($ in Millions)

	Total Zones	Total Credits	Year 1 2006-07	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
Totals	132	$237.60	$7.38	$14.76	$29.52	$32.76	$36.00	$36.00	$33.05	$25.67	$15.34	$5.18	$1.94

Wisconsin Housing and Economic Development Authority. The bills do not appropriate WHEDA any funding for the program. WHEDA employees are not state employees and WHEDA has control over its personnel and staffing decisions. The Authority's balance sheet shows that on July 31, 2005, WHEDA had total assets of almost $2.7 billion, with liabilities of $2.3 billion. The Authority had fund equity of approximately $397 million including $5 million in unrestricted equity that is being used for the WHEDA "Dividends for Wisconsin" program in fiscal year 2005-06.

In an April 8, 2005, fiscal note, WHEDA officials estimated that were $200,000,000 in bonds issued to fund the airport development zone loan program, the Authority would face capitalization costs of approximately $4,000,000 (2% of the total issuance). These costs are related to the new bond issuance to fund the start-up of the program, and demonstrate to bond rating agencies WHEDA's vested interest in the program. To fund these costs, WHEDA could be required to make other expenditure reductions, including the amount of funding available for other programs and purposes, or the amount of surplus general reserve funding available, which is used to fund the Authority's "Dividends for Wisconsin" plan. However, Authority officials are uncertain what programs could be targeted for reductions at this time. Authority officials also estimate annual costs of $100,000 related to one new position and related costs that would be needed to administer the airport development zone loan program.

Proponents of the bills have argued that the program could provide a favorable source of financing for construction related to airport development zones. However, others have expressed some reservations about WHEDA administering a program in an area where the Authority currently has limited experience.

The bills do not specify certain operations of the program, including the structure of any bonds that would be issued by WHEDA to fund the program. WHEDA officials are uncertain what type of bonds would be used, and the process under which they would be issued. However, revenues tied to the airport construction (such as landing fees at a newly-constructed portion of the airport) would likely be used to support the bonds. The ability of any dedicated revenues to support bonds issued under the bills and to provide for the necessary reserves is uncertain at this time.

In addition, under federal law, interest income earned on debt issued for certain municipal airport construction could potentially be federally tax-exempt, while interest income from debt issued for construction or improvements issued for an airline would be taxable to the bondholder. In 2005, the state has a volume cap of federally tax-exempt bonding of $440.7 million. Administrative rule Comm 113 specifies that $10 million of the volume cap annually be allocated to the state Building Commission, with the remainder divided evenly between the Department of Commerce and WHEDA. Comm 113 specifies that in the year the cap is provided, the amount of the cap that is assigned to the Department of Commerce be used for economic development bonding, while the amount of the cap that is provided to WHEDA be used for single- and multi-family housing and beginning farmer bonding. Beginning in the year after the year in which the volume cap is provided, all federally tax-exempt bonding must be used by WHEDA for low-income housing. As a result, unless arrangements were made with Commerce to allow for the use of a portion of the economic development bonding volume cap, or Comm 113 is changed, interest earned from bonds issued for airport development zone loans would likely be federally taxable.

Department of Commerce Administration. AB 223/SB 136 does not provide any additional funding to the Department of Commerce for administering the ADZ program. The Department indicates that it would require 2.0 GPR positions and annual funding of $129,200 to administer the ADZ program.

Assembly Amendment 2/Senate Amendment 2

The amendments would limit ADZs to airports with primary runways of at least 5,000 feet in length and secondary runways of at least 3,000 feet in length, cap total aggregate tax benefits for the ADZ program at $9.0 million, and first provide tax credits for tax years beginning on January 1, 2006. These provisions could have the effect of limiting the fiscal effect of the bills.

Restricting ADZs to airports of a certain size would reduce the number of eligible airports for which an ADZ could be designated. Although the tax credits could not be claimed until tax year 2006, the ADZ program could be implemented before then. Consequently, tax credits could be claimed in fiscal year 2006-07. Once the aggregate limit of $9.0 million in tax credits was allocated, no further credits could be claimed under the ADZ program.

Using the same methodology described above, assuming two projects a year and a total of six, it is estimated that the fiscal effect of AB 223/SB 136 as amended by AA 2/SA 2 would be a reduction in state individual and corporate income and franchise taxes of $740,000 in 2006-07. The table below shows the estimated total fiscal effect of AB 223/SB 136 over time.

TABLE 2

Estimated Revenue Losses Under AB 223/SB 136 as Amended by AA 2/SB 2
($ in Millions)

	Total Zones	Total Credits	Year 1 2006-07	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Totals	8	$9.0	$0.74	$1.48	$2.58	$2.17	$1.39	$0.49	$0.16

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