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Milwaukee Development Opportunity Zone and Capital Investment Credit (General Fund Taxes -- Individual and Corporate Income and Franchise Taxes)

[LFB 2001-03 Budget Summary: Page 29, #12]

CURRENT LAW

Wisconsin has two programs that provide tax credits to businesses as incentives to expand and locate in designated economically distressed areas: development zones and enterprise development zones. The programs are designed to promote economic growth through job creation and investment in the distressed areas. Designation criteria target areas with high unemployment, low incomes and decreasing property values. Businesses which locate or expand in the different zones are eligible to claim the development zone jobs and environmental remediation tax credits. The Department of Commerce has designated 20 development zones and certified 40 enterprise development zones. Commerce has authority to designate a total of 22 development zones and 79 enterprise development zones. In addition, an area in the City of Kenosha has been designated as a development opportunity zone.

GOVERNOR

Designate an area in the City of Milwaukee as a development opportunity zone. The Milwaukee development opportunity zone would exist for seven years, beginning with the effective date of the bill. Any corporation that conducted economic activity in the zone and that, in conjunction with the Common Council of the City of Milwaukee, submitted a project plan would be eligible to claim the development zone tax credit, the development zone investment credit and a development zone capital investment credit that would be created in the bill. The maximum amount of tax credits that could be claimed by businesses in the zone would be $4.7 million. (This provision is designed to provide assistance to Saks Fifth Avenue for the Grand Avenue Boston Store location in Milwaukee.)

DISCUSSION POINTS

1. Under the bill, in order to claim tax credits, a corporation that conducts or intends to conduct economic activity in the Milwaukee development opportunity zone would have to submit a project plan to Commerce, in conjunction with the Common Council. The project plan would have to include: (a) the name and address of the corporation's business for which tax benefits will be claimed; (b) the federal tax identification number of the business; (c) the names and addresses of other locations outside the development opportunity zone where the corporation conducts business and a description of the business activities at those locations; (d) the amount the corporation proposes to invest in a business, or spend on the construction, rehabilitation, repair or remodeling of a building located in the development opportunity zone; (e) the estimated total investment of the corporation in the development opportunity zone; (f) the number of full-time jobs that would be created, retained or substantially upgraded as a result of the corporation's economic activity in relation to the amount of tax benefits estimated for the corporation; (g) the corporation's plan to make reasonable attempts to hire employees from the targeted population [public assistance recipients and other economically disadvantaged individuals]; (h) a description of the commitment of the Milwaukee Common Council to the corporation's project; (i) any other information required by Commerce or the Department of Revenue (DOR).

2. The bill would create a development zone capital investment tax credit that would only be available to a business in the Milwaukee development opportunity zone. The credit would equal 3% of the following:

a. *The purchase price of depreciable, tangible personal property*. To be eligible for the credit, the property would have to be purchased after the claimant was certified as eligible for tax benefits and the personal property would have to have at least 50% of its use in the claimant's business at a location in the development opportunity zone. If the property was mobile, the base of operations for at least 50% its use would have to be in the development opportunity zone.

b. *The amount expended to acquire, construct, rehabilitate, remodel, or repair real property in the development opportunity zone*. Expenses would be eligible for the 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 development opportunity zone. Expenses could be claimed for the credit if the completed project was placed in service after the claimant was certified as eligible for tax benefits. A credit could not be claimed for expenses for preliminary activities such as planning, designing, securing financing, researching, developing specifications, or stabilizing the property to prevent deterioration.

A claimant could also claim a tax credit for 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 development opportunity zone or if the completed project was placed in service after the claimant was certified as eligible for tax benefits. Property would be considered previously owned if the claimant or a related party owned the property during the two years prior to Commerce designating the place where the property was located as a development opportunity zone. In addition, the property would have to be subject to the federal prohibition on the deductibility of losses on the sale or exchange of such property to related parties. However, the federal 50% ownership interest threshold for determining a related party would be eliminated so that any interest in another entity would make it a related party.

In calculating the capital investment credit for purchases of real property, a claimant would be required to reduce the amount expended to acquire the property by a percentage equal to the percentage of the area of the real property that is not used for the purposes for which the claimant is certified for tax benefits. Similarly, the amount expended for other purposes would be reduced by the amount expended on the part of the property not used for purposes for which the claimant is certified.

Credits that were not entirely used to offset income or franchise taxes in the current year could be carried forward up to 15 years to offset future tax liabilities. Internal Revenue Code (IRC) provisions would govern the carry-forward of unused credits in cases where there was a change of ownership.

3. Partnerships, LLCs and S corporations could not claim the credit as an entity, but eligibility for, and the amount of credit, would be based on the entity's economic activity. Partners, members of LLCs, and shareholders of S corporations could claim the capital investment tax credit based on the entity's activities in proportion to their ownership interest. The corporation, partnership or limited liability company would be required to compute the amount of credit that could be claimed by each of the entity's shareholders, partners and members, respectively, and provide this information to them. The shareholders, partners and LLC members could use the credit to offset the tax attributable to their income from the partnership's, company's or corporation's business operations in the development zone or their income from the entity's directly related business operations.

4. Under current law, eligible businesses which conduct economic activity in development or enterprise development zones may claim the development zone tax credit. A business in the Milwaukee development opportunity zone would be eligible for the tax credit. The credit is based on amounts spent on environmental remediation and the number of full-time jobs created or retained.

a. *Environmental Remediation Component.* A credit against income taxes due can be claimed for 50% of the amount expended for environmental remediation in a development, or enterprise development zone.

b. *Full-Time Jobs Component.* A credit of up to $8,000 against income and franchise taxes can be claimed for: (a) each full-time job created in a development or enterprise development zone and filled by a member of a targeted group; and (b) 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 credit of up to $6,000 can be claimed for each full-time job created or retained in a development or enterprise development zone that is filled by a Wisconsin resident who is not a member of a targeted group.

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.

5. An eligible corporation in the Milwaukee development opportunity zone could claim a credit against income taxes due for 2.5% of the purchase price of depreciable tangible personal property or 1.75% of the purchase price of depreciable tangible personal property that was expensed under section 179 of the IRC. Only taxes due on income generated by or directly related to business activities in the development opportunity zone could be offset by the credit. Unused credit amounts could be carried forward to offset future tax liabilities generated by activities in the development opportunity zone. However, if the business ceased operations in the zone, unused credit amounts could not be carried forward.

6. Commerce would be required to revoke the entitlement for tax credits of a corporation that: (a) supplied false or misleading information to obtain the tax benefits; (b) left the zone to conduct substantially the same business outside the development opportunity zone; or (c) ceased operations in the zone and did not renew the same or similar operations within 12 months. Annually, Commerce would be required to estimate the amount of revenue that would be forgone due to tax credits claimed by businesses in the development opportunity zone. The zone would expire 90 days after the day on which Commerce determined that the amount of forgone revenue equaled or exceeded the $4.7 million tax credit limit.

7. Commerce would be authorized to certify a person that was conducting economic activity in the development opportunity zone as eligible for claiming the available tax credits based on the economic activity of another person. (This is intended to address cases where a person developed a business location for lease to another business and the lessee business created jobs but could not claim the jobs component of the development zones credit.) In order for Commerce to certify a person as eligible for credits based on the economic activity of another person, the following would have to apply: (a) the person's [to be certified] economic activity was instrumental in enabling another person to conduct economic activity in the development opportunity zone; (b) Commerce determined that the economic activity of the other person would not occur without the involvement of the person to be certified; (c) the person to be certified for tax benefits would pass the tax benefits through to the other person conducting economic activity in the development opportunity zone; and (d) the other person conducting economic activity in the zone would not claim tax benefits.

A person that intended to claim tax benefits based on the economic activity of another would be required to submit an application to Commerce, in the form prescribed by the Department, with information required by Commerce and by DOR. Commerce would be required to verify information submitted for tax credits and to notify DOR of all persons that were certified to claim tax credits.

Commerce would be required to revoke the certification for tax credits under this provision if it determined that the person: (a) supplied false or misleading information; (b) ceased operations in the development opportunity zone; or (c) did not pass tax benefits through to the other person conducting economic activity in the zone, as determined by Commerce. The Department would be required to notify DOR within 30 days of the revocation.

8. As noted, Commerce currently administers the development and enterprise development zone programs that provide tax credits to businesses that locate in the zones. Under the development zones program, Commerce designates an area within one or more city, village, town or Native American reservation as a zone. In order to be designated, the areas are subject to maximum property value and population limits. Areas comprised of entire counties may be designated a development zone if the population of the area is 75,000 or less. Designation as a development zone is effective for 20 years. The local governing body can apply to Commerce for one five-year extension of the designation. Commerce has designated 20 of the 22 authorized development zones. The designated zones are located in: Beloit; Eau Claire; Fond du Lac; Green Bay; Janesville; Manitowoc; Milwaukee; Racine; Richland Center; Sturgeon Bay; Superior; Two Rivers; Ashland, Bayfield and Price Counties; Iron County; Florence, Forest, Lincoln and Langlade Counties (North Four); Juneau, Adams and Marquette Counties; Grant and LaFayette Counties; Marinette and Oconto Counties; and the Lac du Flambeau and Stockbridge-Munsee Indian Reservations. Commerce allocates the total statewide authorization of development zones credits ($38.155 million) to each of the 22 development zones. Businesses which conduct economic activity in the zones can claim the development zone jobs and environmental remediation credit. Commerce has allocated $27.3 million in tax credits to the 20 designated zones. Individual businesses have been allocated $26.7 million of those credits.

9. The 1995-97 budget created the enterprise development zone program. A business that conducts or that intends to conduct economic activity in an area of the state can apply to Commerce to have the area designated as an enterprise development zone by submitting an application and a project plan. The Department can designate the area as an enterprise development zone if the area meets certain criteria and the Department approves the project plan. Commerce is authorized to establish the length of time an enterprise development zone can be designated, but the zone cannot be designated for more than seven years (84 months). The total number of enterprise development zones that can be created is 79. Ten of these zones are required to be for environmental remediation projects. Employers in the zones do not have to claim jobs credits. A business which conducts economic activity in an enterprise development zone and is certified by Commerce can claim the development zones tax credits. Only one person is eligible for tax benefits in an enterprise development zone. The maximum amount of credits that can be claimed by an eligible business in an enterprise development zone is established by Commerce, but cannot exceed $3 million. A total of 40 enterprise development zones have been certified in 41 municipalities. A total of $67.8 million in tax credits have been allocated to businesses in enterprise development zones.

10. In order for Commerce to designate an area as a development or enterprise development zone it must meet certain criteria that measure economic distress. Specifically, to be designated as a development or enterprise development zone at least three of the following criteria must apply: (a) the unemployment rate in the area is higher than the state average for the 18 months immediately preceding the date on which the application for creating the zone was filed; (b) the percentage of persons residing in the area who are members of households with household income levels at or below 80% of the statewide median household income is higher than the state average; (c) the percentage of households in the area receiving unemployment compensation or participating in the Wisconsin Works program is higher than the state average; (d) in the 36 months immediately preceding the date on which a application for creating a zone was submitted to the Department of Commerce, a number of workers in the area were permanently laid off by their employer or became unemployed as a result of a business action subject to the state business closing law; (e) an employer in the vicinity of the area has given public notice under state law of either a business closing or reduction of the greater of 25 employees or 25% of the employees of a business that will result in a number of workers being laid off permanently; (f) property values in the area have been declining; or (g) there has been a decline in population in the area.

11. Since 1994, four development opportunity zones have been created in the state. Under the provisions of 1993 Wisconsin Act 232, an area in the City of Beloit and an area in the City of West Allis were designated as development opportunity zones. The West Allis zone was created to make Quad/Graphics eligible for tax credits for a business expansion in the zone and $3.0 million in tax credits was authorized for the zone. The Beloit zone was created as an incentive to attract Motorola to locate in Wisconsin and $10.0 million in tax credits was allocated to the zone. However, Motorola expanded in Illinois and the Reynolds Wheels company located in the Beloit zone. A total of $2.8 million in tax credits was allocated to the zone. Under the provisions of 1995 Act 2, an area in the City of Eau Claire was designated a development opportunity zone for Hutchinson Technology, Inc. and $3.0 million in tax credits was reallocated from the Beloit zone. The businesses in these zones could claim development zones credits. Prior to 1997 Wisconsin Act 27 (the 1997-99 biennial budget), businesses could claim any of seven development zone tax credits including a jobs credit, investment credit, location credit, sales tax credit, research credit, day care credit and environmental remediation credit. The jobs and sales tax credits were refundable.

12. The 1999-01 biennial budget (1999 Wisconsin Act 9) designated an area in the City of Kenosha as a development opportunity zone that exists for seven years. A business that conducts economic activity in the zone is eligible to claim the development zone jobs and environmental remediation tax credit and the former development zone investment credit. The credit equals 2.5% of the purchase price of depreciable tangible personal property or 1.75% of the price of depreciable tangible personal property that is expensed under section 179 of the federal internal Revenue Code. DaimlerChrysler AG is planning a $600 million expansion of its Kenosha engine plant in the zone, and the tax credits are part of a package of state and federal aid to help finance the cost of the expansion. The expansion will be used to start a new engine line at the plant.

13. The Milwaukee development opportunity zone would provide financial assistance for a $32 million renovation of the Boston Store building at the Grand Avenue Mall in downtown

Milwaukee. Wisconsin Energy Corporation purchased the building from Boston Store last year, has leased the building back to Boston Store and is funding the renovations. The remodeled building would have a smaller Boston Store, renovated corporate offices for Carson Pirie Scott (a division of Saks Inc., that runs Boston Store), and 60 apartments. State financial assistance for the renovation project will be provided by $4.7 million in development opportunity zone tax credits, a $1.0 million forgivable loan from the Wisconsin Development Fund and a $250,000 brownfields grant.

14. State financial assistance for the Boston Store renovation project is supported because it would preserve Boston Store as an anchor for the Grand Avenue Mall, retain 200 current Boston Store jobs for at least 10 years, and retain Carson Pirie Scott's corporate headquarters and 650 jobs for at least 15 years. Economic activity at the Grand Avenue Mall would increase. The remodeling project has also generated construction jobs. Finally, the historic character of a landmark building would be significantly improved.

15. Some have criticized the proposed Milwaukee development opportunity zone because it would provide a direct government subsidy to a private business. Although the development and enterprise development zones programs also benefit businesses, the zones must be located in areas that meet certain economic distress criteria. In addition, many of the jobs retained by the renovation project are in the retail business, whereas most development and enterprise development zones allocate tax credits to manufacturing businesses where jobs are generally higher paying. Of the 40 enterprise development zones currently designated, about 90% were created for manufacturers. Finally, providing financial assistance to the Boston Store renovation could lead to requests for similar assistance for other businesses in the state. A recent economic study of economic development incentives in the Detroit metropolitan area found that the likelihood of communities offering tax incentives just because other communities in the metropolitan area were offering them increased over time (Anderson and Wassmer, 2000).

16. Since renovation has already begun on the building, a question arises as to whether or not the financial assistance provided through the development opportunity zone tax credits would be necessary for the project to be undertaken. Note that the credits could be claimed based on investment that occurred before the area is designated as a zone if the completed project is placed in service after designation. Presumably, the project was initiated in anticipation of legislative approval of the proposed zone. Economic research on the effectiveness of tax incentives on economic development has provided data to support the positions of both proponents and opponents of the use of tax incentives as an economic development strategy. State governments have an appropriate interest in the creation of local incentive programs if such incentives are effective at retaining and directing economic activity to places where there is a public benefit to the state arising from the creation or retention of jobs in that area. Studies have identified a public benefit when jobs are created in persistently high unemployment, economically declining areas and fiscal benefits have been identified when job creation puts existing but underutilized public infrastructure and services to use (Bartik, 1994). Studies of the Indiana enterprise zone program found that the value of inventories increased while the value of manufacturing and equipment decreased, indicating a shift in the type of capital investment. In addition, unemployment claims in the zones dropped significantly (Papke, 1994, 2001). On the other hand, research on the sensitivity of investment to tax

differentials indicates that such differences do not induce substantial investment (Wasylenko, 1997). Other studies have indicated that the benefits of tax incentives are generally less than their costs to governments (Fisher and Peters, 2001, Anderson and Wassmer, 2000). A study on enterprise zones (Fisher and Peters, 2001) concludes that there will be net revenue gains only if the zone incentives succeed in attracting sufficient jobs from outside the state. To the extent that there are additional effects in the form of a redirection of investment into zones from elsewhere within the state, there will be a redistribution of economic activity that will favor zone cities, which may be considered desirable.

17. Although up to $4.7 million in tax credits could be claimed for investment, remediation and jobs created or retained, the bill does not include a fiscal effect for creating the Milwaukee development opportunity zone and providing the tax credits. As noted, Wisconsin Electric Corporation owns the building and is conducting the renovation. Since renovation has already begun, the development zone capital investment credit could be claimed based on the purchase of the building and the construction and remodeling costs. In addition, the provision allowing credits to be claimed based on the economic activity of another would allow Wisconsin Electric to claim the jobs credit based on jobs retained or created by Boston Store and Carson Pirie Scott, as long as the benefits are passed on to those businesses. The tax credits would be available for tax year 2001 if the bill is effective before July 31; however, if the bill is effective after that date the tax credits could not be claimed until tax year 2002. Corporate taxpayers' final returns are due on the fifteenth day of the third month after the end of their fiscal year but corporations can also take an automatic six-month extension. If the bill is not effective before July 31, the first year for which tax credits could be claimed would be 2002. If the automatic extension of the filing date for corporate returns was used, the credits would not be claimed until September 2003. As a result, unless the bill is effective before July 31, it is not likely that the tax credits would be claimed by Wisconsin Electric Corporation during the 2001-03 biennium.

ALTERNATIVES TO BILL

1. Approve the Governor's recommendation to designate an area in the City of Milwaukee as a development opportunity zone that would exist for seven years, beginning with the effective date of the bill. Authorize any corporation that conducts economic activity in the zone and that, in conjunction with the Common Council of the City of Milwaukee, submits a project plan to claim the development zone tax credit, the development zone investment credit and a development zone capital investment credit that would be created in the bill. Limit the maximum amount of tax credits that could be claimed by businesses in the zone to $4.7 million.

2. Maintain current law.

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