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Enterprise Zones Jobs Tax Credit Modifications
(General Fund Taxes -- Individual and Corporate Income Taxes)

Bill Agency

[LFB 2007-09 Budget Summary: Page 159, #13]

CURRENT LAW

The enterprise zone program was created by 2005 Wisconsin Act 361. Under the enterprise zone program, The Department of Commerce is authorized to designate up to 10 areas in the state of not more than 50 acres as enterprise zones. A zone designation cannot last more than 12 years. Eligible businesses that conduct operations in an enterprise zone and are certified by Commerce can claim the refundable enterprise zones jobs tax credit. The credit is paid from a sum-sufficient GPR appropriation, and is estimated to cost $1,625,000 in 2007-08 and $6,500,000 in 2008-09.

GOVERNOR

Modify a number of provisions related to the enterprise zones jobs tax credit under the individual income and corporate income and franchise taxes including changing the method of calculating the jobs tax credit, eliminating the supplemental payroll and property credit, and altering definitional and administrative provisions. The provisions would first apply to tax years beginning on or after July 1, 2007, and would reduce GPR expenditures by an unknown amount.

DISCUSSION POINTS

1. Wisconsin has numerous programs that provide tax credits to businesses for various types of economic activity in designated areas of the state. These programs include: (a) development

zones; (b) enterprise development zones; (c) development opportunity zones; (d) technology zones; (e) agricultural development zone; (f) airport development zones; and (g) enterprise zones. Commerce is generally responsible for administering these programs. The Department reviews and approves applications (where necessary), designates zones, allocates and certifies tax credits, and provides technical assistance to municipalities and businesses that participate in the programs. The Department of Revenue (DOR) administers the tax credits.

2. To designate an area as an enterprise zone, Commerce is required to consider all of the following:

a. Indicators of the area's economic need, including data regarding household income, average wages, the condition of property, housing values, population decline, job losses, infrastructure and energy support, the rate of business development, and the existing resources available to the area.

b. The effect of designation on other initiatives and programs to promote economic and community development in the area, including job creation and job training, and creating high-paying jobs. To the extent possible, Commerce must give preference in designating areas to those with the greatest economic need.

3. A business that conducts a project in an enterprise zone is eligible for the refundable enterprise zones jobs tax credit under the state individual income and corporate income and franchise taxes. The enterprise zones jobs tax credit has three components: (a) a payroll component based on changes in the claimant's payroll over a base year; (b) a credit for claimants whose entire property and payroll is in the enterprise zone, based on the sum of the claimant's payroll and basis of property; and (c) a component based on the amount a claimant pays for training to upgrade the skills of full-time employees who work in the enterprise zone.

4. A business must be certified by Commerce in order to claim the enterprise zones jobs tax credit. Commerce may certify for tax benefits any of the following:

a. A business that begins operations in an enterprise zone.

b. A business that relocates to an enterprise zone from outside the state, if the business offers compensation and benefits to its employees working in the zone for the same type of work that are at least as favorable as those offered outside the zone.

c. A business that expands its operations in an enterprise zone and increases its personnel by at least 10%, and enters into an agreement with Commerce to claim tax benefits only for years during which the business maintains the increased level of personnel. The business must offer compensation and benefits for the same type of work to its employers working in the enterprise zone that are at least as favorable as those offered to its employees working in Wisconsin but outside the zone.

d. A business that expands its operations in an enterprise zone and that makes a capital investment in property located in the enterprise zone if the following apply: (1) the value of capital investment is equal to at least 10% of the business' gross revenues in the state in the preceding tax year; (2) the business enters into an agreement with Commerce to claim tax benefits only for years during which the business maintains the capital investment; and (3) the business offers compensation and benefits for the same type of work to its employees in the zone that are at least as favorable as those offered to employees working in Wisconsin but outside the zone (as determined by Commerce).

5. SB 40 would make the following changes to the enterprise zones jobs tax credit: (a) change the method of calculating the jobs tax credit; (b) eliminate the supplemental tax credit for having all of the claimant's payroll and property in the zone; (c) clarify eligible training expenses; and (d) clarify Commerce verification responsibilities.

Jobs Tax Credit Formula

6. Under current law, the enterprise zones jobs tax credit is computed as follows:

a. Determine the lesser of: (1) the claimant's zone payroll in the tax year, minus the claimant's zone payroll in the base year; or (2) the claimant's state payroll in the tax year, minus the claimant's state payroll in the base year.

b. Subtract the number of full-time employees that the claimant employed in the area that comprises the enterprise zone in the base year from the number of full-time employees that the claimant employed in the zone in the tax year.

c. Multiply the amount determined under "b", if greater than zero, by $30,000.

d. Subtract the amount determined under "c" from the amount determined under "a."

e. Multiply the amount determined under "d" by 7%.

"Zone payroll" means the amount of state payroll that is attributable to compensation paid to individuals for services that are performed in an enterprise zone or who are working from an office located in a zone if the work is incidental to any work that the individual performs within the zone. "Zone payroll" does not include the amount of compensation paid to any individual that exceeds $100,000.

7. Although the current formula for determining the enterprise zones tax credit is designed to provide credits for new jobs that pay at least $30,000, in certain cases, the current formula can provide tax credits for increasing wages, rather than creating new jobs. In addition, credits can be claimed for creating jobs that do not pay high wages. Attachment 1, prepared by the Department of Revenue, provides examples of such cases. As a result, the Governor has recommended that the method of determining the enterprise zones jobs tax credit be changed and that the definition of zone payroll be modified to explicitly limit it to full-time employees.

8. The new formula for calculating the enterprise zones jobs tax credit would provide tax credits only for the creation of full-time jobs with wages, as defined under the federal Internal

Revenue Code, that exceed $30,000. Under the bill the new formula for determining the enterprise zones jobs tax credit would be as follows:

a. Determine the lesser of: (1) the number of full-time employees that are employed in an enterprise zone whose annual wages are greater than $30,000 in the tax year minus the number of full-time employees that are employed in the enterprise zone in the base year whose annual wages are greater than $30,000 in the base year; or (2) the number of full-time employees in the state whose annual wages are greater than $30,000 in the tax year minus the number of full-time employees in the state whose annual wages are greater than $30,000 in the base year.

b. Determine the claimant's average zone payroll by dividing total wages for full-time employees in the zone whose annual wages are greater than $30,000 for the tax year by the number of those employees.

c. Subtract $30,000 from the average wage determined under " b."

d. Multiply the amount determined under "c" (average wage in excess of $30,000 a year) by the number determined under "a" (net number of new employees hired in the zone).

e. Multiply the amount determined under "d" by 7%.

9. The new formula for calculating the tax credit is designed to ensure that a credit is only provided for the creation of additional jobs and that the jobs created have high wages. Attachment 2, also prepared by DOR, provides a comparison of tax credits that could be claimed under current law, with credits that could be claimed under the formula included in SB 40. Attachment 3 provides a side-by-side comparison of the current and proposed formulas for calculating the enterprise zones jobs tax credit.

Payroll and Property Tax Credit

10. Under current law, if all of the claimant's payroll is zone payroll and all of the claimant's business-related property is located in an enterprise zone, the claimant may receive a credit based on the claimant's payroll and the value of property in the zone. The credit equals 20% of the sum of the claimant's zone payroll in the tax year and the adjusted basis of the claimant's property at the time the property was first placed in service in the zone multiplied by: (a) 6.5% for businesses that file under the individual income tax; or (b) 7.9% for businesses that file under the corporate income and franchise tax.

11. State economic development activities have evolved so that businesses that are relocating or starting new operations regularly receive incentive packages consisting of combinations of state and local subsidies. In this environment, economic development incentives are justified as necessary to attract new investment and jobs to the state. The investment and related jobs and spending are viewed as benefiting state residents through employment and higher wages, while expanding the government's revenue base. As a result, the ability to provide residents with services will be enhanced, or the per capita cost reduced. The economic growth stimulated by the investment activity will increase the incomes of residents.

12. The payroll and property component of the tax credit provides an incentive for businesses to conduct all of their activities in the enterprise zone. It is also an incentive for the firm to limit any expansion to the zone. The credit benefits firms that can conduct all of their business activities at one site. However, from the perspective of the state, limiting the firm's business activity to one 50-acre area is not necessarily beneficial. It is very possible that the best location for a business expansion would be outside the zone, either in the same municipality, or elsewhere in the state. In either case, the increased jobs and economic growth associated with a business expansion would benefit the state economy. Conversely, any firm that creates new jobs and new investments in an enterprise zone will also benefit the state economy, regardless of whether that business has multiple locations or not. Moreover, a firm is not required to create jobs to claim the payroll and property credit. As a result, there is little rationale for the state to provide a subsidy for limiting business activities to an enterprise zone.

Training Tax Credit

13. Under the training component, the claimant may claim a credit equal to the amount paid in the tax year to upgrade or improve the skills of any of the claimant's full-time employees, to train any of the claimant's full-time employees on the use of new technologies, or to train any full-time employee whose employment with the claimant represents the employee's first full-time job.

14. Current law provides no definition of the type of employee training for which the tax credit can be claimed. The bill would specify that amounts on which the credit is based be for improving or upgrading job-related skills, for training employees on job-related new technologies, or for providing job-related training.

Administration

15. Under current law, Commerce is authorized to designate enterprise zones, certify businesses for tax benefits, notify DOR when it certifies a business to receive tax benefits, and revoke a certification under certain circumstances.

16. The bill would require Commerce to determine the maximum amount of tax credits that a certified business could claim and notify DOR of the amount. Commerce would also be required to verify information submitted to it that was related to the enterprise zone jobs tax credit. Claimants would be required to include, with their tax returns, a copy of the certification for tax benefits and verification of expenses from Commerce. These provisions are comparable to those governing other economic activity zone programs.

ALTERNATIVES TO BILL

1. Adopt the Governor's recommendation to: (a) change the formula for determining the enterprise zones jobs tax credit; (b) eliminate the payroll and property component of the enterprise zones jobs credit; (c) specify that training on which the training component tax credit is based be job-related; and (d) require Commerce to determine tax credit amounts, verify information,

and notify DOR, and taxpayers to include certifications and verifications with tax returns.

2. Delete any of the following from the bill:

a. The change in the formula for determining the enterprise zones jobs tax credit.

b. Elimination of the payroll and property component of the enterprise zones tax credit.

c. The provision specifying that training on which the training component tax credit is based be job-related.

d. The requirement for Commerce to determine tax credit amounts, verify information, and notify DOR, and taxpayers to include certifications and verifications with tax returns.

3. Delete provision.

Prepared by: Ron Shanovich
Attachments

ATTACHMENT 1

Examples of Unintended Credit Effects for Similar Business Behavior

As shown below, two businesses that increase their payroll by approximately the same amount would receive very different credits under the current formula, with the business that creates no new jobs receiving the larger credit. Business A increases its payroll by $70,886 to employ two additional workers with a payroll cost of $35,443 each, and receives a credit of $762. Business B creates no new jobs but increases its payroll by $70,720 to give raises to existing employees, and receives a credit of $4,950, seven times larger than the credit given to Business A.

Business A:

	Number of Full-time Employees	Average Wages	Total Payroll
Base Year	100	$31,200.00	$3,120,000
Taxable Year	102	31,283.30	3,190,886
Difference	2		70,886
Multiply jobs created x 30,000			60,000
Subtract payroll difference			10,886
Credit			$762

Business B:

	Number of Full-time Employees	Average Wages	Total Payroll
Base Year	100	$31,200.00	$3,120,000
Taxable Year	100	31,283.30	3,190,720
Difference	0		70,720
Multiply jobs x 30,000			0
Subtract payroll difference			70,720
Credit			$4,950

The credit is also not limited to companies that pay high wages to their workers. For example, as shown below a company with 100 full-time employees could conceivably receive a credit of $4,914 if it creates no new jobs, its base wage is the minimum wage, and it increases that wage only slightly.

	Number of Full-time Employees	**Average Wages***	**Total Payroll**
Base Year	100	$16,006	$1,600,560
Taxable Year	100	16,708	1,670,760
Difference	0		70,200
Multiply jobs by 30,000			0
Subtract payroll difference			70,200
Credit			$4,914

Note: Wages in the base year are minimum wage ($5.70 an hour) plus benefits of 35 percent, times 2080 hours. In the taxable year, the hourly wage is increased to $5.95 while the other factors stay the same.

Source: Department of Revenue.

ATTACHMENT 2

Example of Fiscal Effects Under Current Law and Proposal

Only claimants that create high-paying jobs would be eligible to claim the credit:

Base Year		Taxable Year		Credit Available	
Jobs	Average Wage	Jobs	Average Wage	Current Law	Proposal
100	$31,200	102	$31,283	$762	$180
100	31,200	100	31,907	4,950	0
100	11,856	100	12,376	3,640	0
0	0	15	31,200	1,260	1,260
10	24,960	25	31,200	5,628	1,260

In the first two cases, a credit is provided only for the creation of additional jobs; no credit is provided for increasing the average payroll of existing jobs. In the third case, no credit is provided unless new jobs pay at least $14.43 per hour (including benefits) equal to $30,000 annually. In the final two cases, the same credit is provided for the creation of 15 new jobs irrespective of the number of jobs existing in the base year.

Source: Department of Revenue.

ATTACHMENT 3

Enterprise Zones Jobs Tax Credit
Alternative Formula Comparison

Current Law	SB 40
Zone payroll -- compensation to individuals	***Zone payroll -- federal definition of wages paid to a full-time employee***
1. Determine the lesser of: a. Zone payroll in tax year minus zone payroll in base year. b. State payroll in tax year minus state payroll in base year.	1. Determine the lesser of: a. Number of full-time employees with annual wages greater than $30,000 in zone in tax year minus the number of full-time employees with wages greater than $30,000 in zone in base year. b. Number of full-time employees with wages greater than $30,000 in state in tax year minus the number of full-time employees with wages greater than $30,000 in state in base year.
2. Number of full-time employees in zone in tax year minus number of full-time employees in zone in base year.	2. Divide the total <u>wages</u> of full-time employees with annual wages greater than $30,000 in zone in tax year by the <u>number</u> of full-time employees with wages greater than $30,000 in zone in tax year.
3. Multiply #2 amount by $30,000.	3. Subtract $30,000 from the #2 amount.
4. Subtract #3 amount from #1 amount.	4. Multiply the #3 amount by #1 amount.
5. Multiply #4 amount by .07 (7%).	5. Multiply #4 amount by .07 (7%).

Base Year = Tax year prior to the year in which the zone is designated.