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M E M O R A N D U M

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TO: Interested Persons

FROM: Ron Kirk, Economist, (303) 866-4785

SUBJECT: Tax Incentives for Enterprise Zone Business Activities

Summary

The Colorado Urban and Rural Enterprise Zone Act of 1986 established an enterprise zone program to provide incentives and tax credits for private enterprise to expand and for new businesses to locate in economically distressed areas of the state. Certain economic and population criteria must be met in order for an area to be designated as an enterprise zone.

Tax credits and incentives are available to taxpayers for economic activities in enterprise zones. In FY 2008-09, taxpayers claimed $62.7 million in tax credits. In the following two years, the amount of the credits claimed decreased to $48.8 million and $43.9 million. As the economy recovered in FY 2011-12, taxpayers claimed $72.1 million in tax credits for economic activities in enterprise zones, a 64.3 percent increase over the prior year's amount. The bulk of the credits claimed were through the 3 percent investment tax credit. During the past five years, about two-thirds of all credits claimed can be attributed to the 3 percent investment tax credit.

The certification process and use of state income tax credits is tied to the business cycle and the level of economic development in enterprise zones. In 2010, after the recent recession, about 45 percent of state income tax credits that were certified by enterprise zone administrators were claimed by taxpayers who had a large enough tax liability to use the credits. Based on data for tax years 2003 through 2010, taxpayers have not used $305.1 million in state income tax credits that were certified by zone administrators. As the economy grows and more profits are realized by businesses, the utilization rate of credits will likely increase.

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This memorandum provides information on tax incentives available to individuals and businesses that conduct economic activities in Colorado's Enterprise Zone Program. Most of these incentives are administered by the Office of Economic Development and International Trade (OEDIT). These tax incentives are generally certified by local enterprise zone administrators and reduce state income taxes owed by taxpayers who participate in the program. The Colorado Department of Revenue administers the state income tax system that includes tax credits and other incentives that are captured under the program. Since income tax revenue is credited to the state's General Fund, the program's tax credits reduce the amount of revenue that would otherwise be used to fund other state programs and services.

Tax Incentives for Colorado's Enterprise Zone Program

Background. The Colorado Urban and Rural Enterprise Zone Act of 1986 established an enterprise zone program to provide incentives and tax credits for private enterprise to expand and for new businesses to locate in economically distressed areas of the state. Statewide, the number of enterprise zones is statutorily limited to 16. Within these enterprise zones for 2011 and 2012, there are 30 counties designated as enhanced rural enterprise zones. Certain economic and population criteria must be met in order for an area to be designated as an enterprise zone. Enhanced rural enterprise zones must meet more stringent economic and population criteria than standard enterprise zones to be designated as such.

Tax incentives in enterprise zones. State law authorizes income tax credits and sales and use tax exemptions for purposes of economic development in the Enterprise Zone Program. The tax credits available to taxpayers for economic activities in enterprise zones are listed in Table 1. The respective General Fund revenue impacts for these credits are listed in Appendix A and Appendix B.

Table 1: State Enterprise Zone Income Tax Credits

Statutory Section	State Enterprise Zone Income Tax Credits
39-30-103.5	***Contributions to Enterprise Zone Administrators to Implement Economic Development Plans*** - 25 percent of the contribution up to $100,000 for economic development, including assistance for homeless persons or a non-profit or government-funded community development project (5-year carry forward for unused credits)
39-30-105 (1)	***New Business Facility Employees*** - $500 for each new employee hired plus $200 for each employee paid with a health insurance policy (5-year carry forward for unused credits)
39-30-104 (1)	***Investment*** - 3 percent of investment (up to a 12-year carry forward and 3-year carry back period for unused credits)
39-30-104 (4)	***Job Training*** - 10 percent of training costs (12-year carry forward for unused credits)
39-30-105 (3)	***New Business Agricultural Processing Facility*** - $1,000 for each new employee hired (5-year carry forward for unused credits)
39-30-105.5	***Research and Development*** - 3 percent of increased research and development costs (no limit on carry forward for unused credits)
39-30-105.6	***Rehabilitation of Vacant Buildings*** - 25 percent of the cost up to $50,000 per building at least 20 years old and vacant for two years (5-year carry forward for unused credits)

Additional enterprise zone incentives. A sales and use tax exemption is available for purchases of certain machinery, such as machine tools valued at over $500 used in mining or oil and gas operations in an enterprise zone (Section 39-30-106, C.R.S.).

A municipality or county may also negotiate a property tax and/or sales tax incentive payment with any taxpayer who establishes a new business facility or expands an existing new business facility within an enterprise zone (Sections 39-30-107.5 (1) and (2), C.R.S.). The property tax incentive payment is capped at the lesser of: the taxes owed on real and personal property; or the difference between the current property taxes owed and the taxes owed for the same property one year before the enterprise zone was approved. The sales tax incentive payment is capped at the sales taxes levied by the taxing authority for the purchase of equipment, machinery, machine tools, or supplies used in the taxpayer's business in the enterprise zone.

Enhanced rural enterprise zones. Enhanced rural EZs offer increased financial incentives for businesses that create new jobs in certain areas of the state that meet certain economic characteristics. Table 2 lists the counties that are designated as enhanced rural EZs for calendar years 2011 and 2012. The state is required to review whether each county meets the required criteria to be designated as an enhanced rural enterprise zone every two years.

Table 2: Counties Designated as Enhanced Rural Enterprise Zones for 2011-2012

Alamos	Custer	Lake	Plowers
Archuleta	Delta	Lincoln	Rio Grande
Baca	Dolores	Logan	Saguache
Bent	Fremont	Mineral	San Juan
Cheyenne	Morgan	Sedgwick	Hinsdale
Conejos	Otero	Washington	Huerfano
Costilla	Jackson	Ouray	
Crowley	Kiowa	Phillips	

Enhanced rural enterprise zone tax credits. Taxpayers in enhanced rural EZs are eligible for any of the regular EZ credits. However, they are also eligible for a larger tax credit amount for two of the regular EZ credits: the new business facility employees credit and the new business agricultural processing facility credit. These credits are listed in Table 3.

Table 3: State Enhanced Rural Enterprise Zone Income Tax Credits

Statutory Section	State Enterprise Zone Income Tax Credits
39-30-105 (1) (a) (III)	***New Business Facility Employees*** - $2,500 total for each new employee hired (This is the combined enhanced credit of $2,000 in the enhanced rural enterprise zone (7-year carry forward for unused credits) plus the regular enterprise zone credit of $500 per new employee (5-year carry forward for unused credits).)
39-30-105 (3)	***New Business Agricultural Processing Facility*** - $3,500 total for each new employee hired ($500 per new business agricultural processing facility employee in the enhanced rural enterprise zone (7-year carry forward for unused credits), plus the regular enterprise zone credit of $500 per new business agricultural processing facility employee, plus the base $2,500 new business facility employee credit, each having a 5-year carry forward period for unused credits)

Certification process. Prior to 2012, taxpayers who made investments in enterprise zones were not required to have zone administrators certify investments prior to making the investment. Beginning January 1, 2012, before taxpayers make a qualifying investment or engage in any activity for which the taxpayer intends to claim a tax credit under the Enterprise Zone Program, the taxpayer must submit a pre-certification form to the respective enterprise zone administrator. The form must be submitted prior to making an investment in an enterprise zone for the taxpayer to be eligible to claim a state income tax credit under the program. If the certification requirement is not met, state income tax credits will not be authorized for the taxpayer claiming the credits. The pre-certification process can be completed on-line at the following link:

https://www.colorado.gov/apps/oedit/enterpriseCert/home.jsf

The process for certification used by OEDIT verifies that the taxpayer is conducting a business activity in an enterprise zone and that the activities qualify for tax incentives under the program. In addition, the taxpayer is asked to agree to certify the following:

- the claimant is aware of the Enterprise Zone Program;
- that tax incentives (credits) are a contributing factor to the startup, expansion, or relocation of the business in the enterprise zone; and
- that any activity by the claimant begin after the date that pre-certification is granted by a local enterprise zone administrator.

Credit utilization. The total state income tax credits *claimed* by taxpayers in enterprise zones are limited by a taxpayer's income tax liability each year. If a certified credit exceeds the income tax liability of a taxpayer, it can be carried forward for a certain number of tax years. In contrast to credits claimed, the amount of tax credits "certified" by zone administrators is typically higher than the amount actually "claimed" and reported by the Department of Revenue. The amount "certified" represents *potential* credits for which taxpayers qualify. As an example, in FY 2009-10, the total amount of credits certified was $108.7 million. During this time period, the total amount of enterprise zone credits claimed by taxpayers was $48.8 million — $31.7 million from corporate taxpayers and $17.1 million from non-corporate and fiduciary claims (individual contribution credits, sole proprietor, partnership, and other business credits).

General Fund revenue impacts. As mentioned above, only a portion of certified tax credits are used by taxpayers to offset state income tax liability. For most tax credits, the carry forward period that a taxpayer can take unused credits varies and is up to 12 years for some incentives. This means that these "unused" credits will be utilized when the economy recovers to a point that corporate (and individual) tax liabilities are sufficient enough to use the credits. For example, from tax years 2003 through 2010, taxpayers did not use $305.1 million in state income tax credits that were certified by zone administrators. Thus, if taxpayers in a future year were to claim all of the unused credits over one year, General Fund revenue would be reduced by $305.1 million in a given year. However, it is more likely that the $305.1 million will be spread over several years and have a much lesser impact on state revenue.

Carry-forward schedules. For tax years 2012 and afterwards, taxpayers who claim one or more income tax credits under the program are also required to file, along with their state income tax return, a carry-forward schedule for each income tax credit claimed. As an example, the schedule would list the credits that are used in the current tax year for which the return is filed and list the remaining credits that would be carried forward to the following tax year. Staff was informed by the department that this process will be limited in terms of determining a cumulative carry forward amount of credits in future years.