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MEMORANDUM

January 17, 2007

TO: Interested Persons
FROM: Economics Staff, 303-866-3521
SUBJECT: Colorado's Enterprise Zone Program

This memorandum provides information on Colorado's Enterprise Zone Program along with the tax credits and other incentives that are provided to taxpayers who engage in economic activities in enterprise zones.

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. Statewide, the number of enterprise zones is statutorily limited to 16. Within these enterprise zones, there are 32 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.

There are several tax credits and incentives available to taxpayers for economic activities in enterprise zones. For FY 2005-06, the total state income tax credits claimed by taxpayers in enterprise zones was \$33.9 million of which the bulk of the credits claimed were through the 3-percent investment tax credit. Businesses in enterprise zones invested \$880 million in new equipment in FY 2004-05 and created 5,222 new jobs. It is unknown whether the net job increase would have occurred if the enterprise zone program was not in place.

State Enterprise Zones

Enterprise zones were established 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 (Section 39-30-103 (4) (a), C.R.S). Within these enterprise zones, there are 32 counties designated as enhanced rural enterprise zones. Maps showing enterprise zones in the state and in the Denver Metro Area are provided as Attachments A and B.

Enterprise Zone Program. The Colorado Urban and Rural Enterprise Zone Act of 1986 established the enterprise zone program and sets forth the criteria for determining whether an urban or rural area can be designated as an enterprise zone. The total population residing within an enterprise zone boundary cannot exceed 80,000 people in urban areas and 100,000 in rural areas. In addition, an area has to meet at least one of the following three criteria to be designated as an enterprise zone (Section 39-30-103 (1), C.R.S.):

- an unemployment rate greater than 25 percent above the state average;
- per capita income less than 75 percent of the state average; or
- population growth less than 25 percent of the state average.

The Colorado Economic Development Commission in the Office of Economic Development and International Trade has the authority to designate and terminate enterprise zone areas (Section 39-30-103 (4) (e), C.R.S.).

Enhanced rural enterprise zones. Enhanced rural enterprise zones offer increased financial incentives for businesses that create new jobs in certain areas of the state. Enhanced rural enterprise zones are located in a portion of any county already in an enterprise zone that meets at least two of the following criteria (Section 39-30-103.2 (1), C.R.S.):

- a county unemployment rate greater than 50 percent above the state average;
- a county per capita income less than 75 percent of the state average;
- a county population growth rate less than 25 percent of the state average;
- total non-residential assessed value ranking in the lower half of all counties; or
- a county population of less than 5,000.

The state is required to review whether each county meets the criteria to be designated as an enhanced rural enterprise zone every two years (Section 39-30-103.2 (2), C.R.S.). The next review and designation of enhanced rural enterprise zones must be conducted by December 2008. Within the 16 statewide enterprise zones, there are 32 counties designated as enhanced rural enterprise zones for FY 2006-07 and FY 2007-08. Table 1 lists these counties.

Table 1: Counties Designated As Enhanced Rural Enterprise Zones
(FY 2006-07 and FY 2007-08)

Alamosa	Conejos	Hinsdale	Lincoln	Phillips
Archuleta	Costilla	Huerfano	Logan	Prowers
Baca	Crowley	Jackson	Mineral	Rio Grande
Bent	Custer	Kiowa	Moffat	Saguache
Chaffee	Delta	Kit Carson	Otero	San Juan
Cheyenne	Delores	Lake	Ouray	Sedgwick
Clear Creek				Washington

Source: Office of Economic Development and International Trade

Tax Incentives

There are seven state income tax credits available to taxpayers who operate or own a business in an enterprise zone. Table 2 lists these tax credits.

Table 2: State Enterprise Zone Income Tax Credits

Statutory Section	State Enterprise Zone Income Tax Credits
39-30-104 (1)	Investment - 3 percent of investment.
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.
39-30-105 (1)	New Business Facility Employees - \$500 for each new employee hired plus \$200 for each employee who is insured under a health insurance plan provided by the employer.
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.
39-30-104 (4)	Job Training - 10 percent of training costs.
39-30-105 (3)	New Business Agricultural Processing Facility - \$1,000 for each new employee hired.
39-30-105.5	Research and Development - 3 percent of increased research and development costs.

Enhanced rural enterprise zone tax credits. Taxpayers in enhanced rural enterprise zones are eligible for any of the regular enterprise zone credits. In addition, they are eligible for a larger tax credit amount for two of the regular enterprise zone credits – the new business facility employees credit and the new business agricultural processing facility credit. These credits can be carried forward for seven years if the credit is in excess of a taxpayer's income tax liability. Table 3 explains these credits.

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 plus the regular enterprise zone credit of \$500 per new employee.)
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, 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.

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, for FY 2004-05, the total amount of enterprise zone credits claimed by taxpayers was \$25.7 million — \$13.7 million from corporate taxpayers and \$12.0 million from non-corporate and fiduciary claims (individual contribution credits, sole proprietor, partnership, and other business credits). The total amount of credits certified was \$41.3 million.

Tracking credits. The Colorado Department of Revenue separately tracks three of the seven enterprise zone tax credits claimed by corporations — enterprise zone tax credits for individual and fiduciary claims *are not tracked* by the department. Tracking policies are determined by a number of factors. But generally, a tax credit is tracked whenever the legislature *appropriates the funds* to absorb the computer and administration costs tied to a tax policy change. Other factors that have determined whether a tax credit gets tracked is the cost of the credit, space limitations on the corporate or individual tax return, computer resources (keys), and whether the tax credit affects TABOR refunds. In the past, the department has generally tracked tax credits that have a significant cost to the state. Although is no set policy, threshold, or statute that defines a significant cost.

Corporate and individual credits claimed. The three percent investment tax credit has traditionally made up the bulk of the enterprise zone credits claimed. For FY 2005-06, the 3-percent investment tax credit made up \$13.9 million of \$19.7 million (71 percent) of total corporate enterprise zone tax credits claimed. This credit applies to any qualified investment in

tangible personal property used in a taxpayer's trade or business such as machinery, furniture, appliances, law books or vehicles.¹ The credit is allowed on the first \$5,000 of tax liability plus 50 percent of the liability in excess of \$5,000.

The new business facility employee jobs credit was the second largest credit claimed by corporations and totaled \$1.8 million for FY 2005-06. According to the Office of Economic Development and International Trade's Annual Report for 2005, businesses certifying tax credits reported an increase in employment of 5,222 jobs in FY 2004-05 for an increase of 11 percent over the prior year. These companies retained 116,000 jobs during the same time period. (Jobs retained is defined as the total number of jobs at the beginning of the year for businesses with job growth plus the number of jobs for those companies without job growth.)

State law allows a tax credit for contributions to projects "implementing the economic development plan for the enterprise zone." These projects must be related to job creation, preservation, assistance for homeless shelters that provide employment-related services, or to promote community development projects. The amount of corporate contribution tax credits to zone administrators amounted to about \$0.5 million in FY 2005-06. Table 4 summarizes the enterprise zone tax credits claimed by corporations, and individual and fiduciary claims.

Table 4: Enterprise Zone Tax Credits Claimed
(in millions)

Credit	Corporate Credits Claimed		Individual and Fiduciary Credits Claimed	
	FY 2004-05	FY 2005-06	FY 2004-05	FY 2005-06
3- Percent Investment	\$8.3	\$13.9	(Credits are not tracked separately by the Colorado Department of Revenue)	
New Business Facility Employees(NBF)	\$3.2	\$1.8		
Contributions To Zone Administrators	\$0.6	\$0.5		
Other Enterprise Zone Credits	\$1.6	\$3.5		
Totals	\$13.7	\$19.7	\$12.0	\$14.1
FY 2004-05 Total Credits Claimed	\$25.7			
FY 2005-06 Total Credits Claimed	\$33.9			

Sources: Colorado Department of Revenue; and Colorado Enterprise Zones Annual Report, February 2006, Governor's Office of Economic Development and International Trade.

¹ Tangible personal property is commonly referred to as "Section 38 Property" and is defined in Section 48 of the Internal Revenue Code as that section existed prior to 1990. This property is either federal recovery property or other depreciable or amortized property having a useful life of three years or more.

Additional enterprise zone incentives. In addition to the previously noted tax credits, a state sales and use tax exemption is available for certain machinery. The exemption applies to purchases of machinery and machine tools and materials for the construction or repair of machinery, and machine tools valued at over \$500 used in manufacturing tangible personal property 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.

Statistics For Businesses Claiming Credits

Companies claiming enterprise zone credits must provide information required by enterprise zone administrators to allow each zone administrator to evaluate the effectiveness of each zone (Section 39-30-103 (4) (c.5), C.R.S.). Enterprise zone administrators are required to compile annual documentation on the following statistics:

- the number of jobs created and retained in enterprise zones;
- the average annual compensation, categorized by employee status;
- the number of employees from areas outside of enterprise zones who work in a facility;
- an analysis of capital investment in the zone;
- the number of employees trained and the amount of investment in job training programs;
- the number of employees employed in new or expanded business facilities;
- the amount of investment tax credits claimed and the amount of credits claimed for new business facility employees; and
- any other information reasonably required to evaluate the effectiveness of each zone.

Table 5 summarizes some of the above statistics for FY 2003-04 and FY 2004-05 for businesses with certified credits. In FY 2004-05, 4,815 businesses were certified for potential enterprise zone tax credits, down 0.6 percent from the number of businesses certified in the prior year. Businesses certifying enterprise zone tax credits saw a net increase in employment of 5,222 jobs in FY 2004-05, compared to a net job increase of 4,700 for FY 2003-04.

It is important to note that these net employment changes do not necessarily result from the benefits employers receive from the enterprise zone program. It is unknown whether these net job changes would have occurred if the enterprise zone program was not in place. Finally,

businesses with certified zone tax credits invested \$880 million in new equipment used by businesses in enterprise zones during FY 2004-05. This level of investment reflects a 45 percent decline from the higher level of investment of \$1.6 billion in the prior year.

Table 5: Statistics For Businesses Claiming Credits

Businesses With Certified, Potential Tax Credits			
Fiscal Year	FY 2003-04	FY 2004-05	% Change
Total Certifications	4,845	4,815	(0.6 %)
Net Employment Change for Businesses Certifying Zone Tax Credits	4,700	5,222	11%
Investment In New Equipment	\$1.6 Billion	\$0.9 Billion	(45%)

Source: Colorado Enterprise Zones Annual Report, February 2006, Governor's Office of Economic Development and international Trade.