HOUSE RESEARCH

Bill Summary

FILE NUMBER: H.F. 946 **DATE:** April 7, 2005

Version: As introduced

Authors: Abrams and others

Subject: International Air Freight Zone

Analyst: Joel Michael, 651-296-5057

Overview

This bill authorizes designation of an international economic development zone within 60 miles and 90 minutes driving time of the Minneapolis-St. Paul International Airport. This zone is intended to stimulate development of a regional distribution center that will increase the capacity and capability to handle international air freight. Qualifying businesses operating in the zones are exempt from sales, income, and property taxes and a refundable jobs credit is available for the portion of increased payroll that exceeds $30,000 per FTE. Individuals who invested in zone businesses would be exempt on their business income attributable to activity in the zone, as well as capital gain taxes on zone investments. The zone designation and the tax incentives would have a maximum duration of 12 years. The tax incentives are patterned after the JOBZ program, although with some differences.

Section

1 **International economic development zone property.** Provides that commercial and industrial property (both real and personal) in an international economic development zone is exempt from property taxation it if either:

- Is part of an regional distribution center (defined in section) or
- Is primarily used by qualified business that is a freight forwarder.

Section

The exemption does not apply to land.

The exemption applies to the first assessment year after designation of the zone by the commissioner of trade and economic development.

2 **Individual income tax exemption.** Provides that income derived from investing in or operating a qualified business in an international economic development zone is exempt from individual income taxation. The qualifying rules for these exemptions are described in section 0.

3 **Corporation franchise tax exemption.** Provides income from operating a qualified business in an international economic development zone is deductible in calculating taxable income under the corporate franchise tax. The details of this exemption are described in the summary of section 0.

4 **Individual income tax exemption, nonresidents.** Provides that in calculating the Minnesota tax for a non-resident, international economic development zone income is excluded from both the numerator and denominator of the ratio. Nonresidents calculate their Minnesota tax by determining the Minnesota tax on their total income (both Minnesota and non-Minnesota). The Minnesota liability is, then, determined by multiplying this amount by a fraction, the numerator of which is Minnesota source income and the denominator of which is total income.

5 **Jobs credit.** Provides that the jobs credit applies against chapter 290 taxes (regular and alternative minimum tax under both the individual income and corporate franchise taxes). A summary of the rules for this credit is found in section 0.

6 **Dependent care credit.** Clarifies that tax-exempt international economic development zone income reduces the amount of the dependent care credit that is allowed. For example, if one-quarter of the taxpayer's income were tax-exempt international economic development income, the otherwise applicable dependent care credit would be reduced by 25 percent. This is same treatment that applies to tax-exempt reservation income of American Indians and to part year residents.

7 **Working family credit.** Clarifies that tax-exempt international economic development zone income reduces the amount of the working family credit that is allowed. This is the same treatment described in section 0for the dependent care credit and is consistent with the treatment of other forms of tax-exempt income.

8 **Individual AMT exemption.** Extends the individual income tax exemption to the alternative minimum tax or AMT.

9 **Corporate AMT exemption.** Exempts income from operating a business in an international economic development zone from the corporate AMT.

10 **Minimum fee, complete exemption.** Exempts a business from the minimum fee if all of its property and payroll is located in an international economic development zone.

11 **Corporate minimum fee.** Excludes property and payroll located in an international economic development zone from use in calculation of the minimum fee under the corporate franchise tax. This exemption applies to a business that has property and payroll outside of the zone.

12 **Sales tax exemption.** Provides a sales tax exemptions for businesses located in an international economic development zone. To qualify for this exemption, the goods or taxable services must be primarily used in the zone and purchased during the duration of the zone. The exemption extends to contractor purchases (if the final use of the property is in

Section

the zone) and to local sales taxes.

13 **Definitions.** Defines terms for purposes of the international economic development zone statute.

- **Foreign trade zone** means a foreign trade zone designated under federal law or an authorized subzone.

- **Foreign trade zone authority** is Greater Metropolitan Foreign Trade Zone Commission number 119. This is a joint powers organization formed by Hennepin County, Bloomington, Minneapolis, and the Metropolitan Airports Commission. The definition permits other local governments to join the agreement later.

- **International economic development zone** means a zone designated designed under section 0.

- **Person** includes individual, corporations, partnerships, limited liability companies, and any other entity.

- **Qualified business** means a person that has signed a business subsidy agreement and is doing business in the zone as either

- **A freight forwarder that the authority has certified furthers international distribution capacity and capability or**

- **Owner or operator of a regional distribution center.**

- **Regional distribution center** is a distribution center developed within a foreign trade zone. The center's primary purpose must be to centralize functions necessary to ship freight in international commerce, such as custom and security functions.

- **International economic development zone percentage** is a fraction used to apportion income to zone for business operating both within and outside of the zone. The percentage is the average of the zone payrolls and property used as part of the qualified business over total Minnesota payrolls and property.

- **International economic development zone payroll factor** is the wage and salaries paid to employees for services performed in the zone or to employees working from offices in a zone, if the work outside the zone is incidental to that in the zone. The work must be done for the freight forwarding or regional distribution business.

- **Freight forwarder** is a business that transports goods made by another business.

14 **Application for designation.** Authorizes local governments units to apply for designation of an area within their corporate boundaries as an international development zone. The application must include:

- Resolutions for each of the city/towns and counties in which the zone is located, agreeing to provide all of the local tax incentives

Section

- An agreement by the applicant to treat zone incentives as business subsidies
- Supporting evidence for the application.

Applications are due by December 31, 2005.

15 **Designation of international economic development zone.** Authorizes the foreign trade zone authority to designate a foreign trade zone that contains a regional distribution center as an international economic development zone. The zone must be between 500 and 1,000 acres in size. The zone can be no more than 60 miles from the Minneapolis-St. Paul International Airport. In designating the zone, the authority is to consider site, transportation, infrastructure, and financial factors.

The border of the zone must be no more than 60 miles and 90 minutes driving time from the Minneapolis-St. Paul International Airport. Before designating the zone, the authority must conduct a transportation impact study to assess the zone's impact on the transportation system. For sites in the metropolitan area, the study must evaluate the effect on the Metropolitan Transportation System plan. The applicant must pay for the cost of the study.

Final zone designation is to be made by June 30, 2006. The duration of the zone is for 12 years.

16 **Foreign trade zone authority powers.** Directs the authority to develop a plan for development of the regional distribution center with a goal of expanding international distribution capacity for the region. The authority must consult with municipalities that are interested in being the site for the zone and with businesses and federal and state agencies.

Before designation of the zone, the authority is to prepare a business plan setting performance goals for the zone. These goals must include, at least, the amount of investment, number of jobs, and amount of freight expected to be handled at the end of 3-, 5-, and 10-year periods. The plan must include feasibility analyses for the profitability of the distribution center. If the analysis concludes the project is not economically feasible, the distribution center does not meet the requirements and the zone cannot be designated.

The foreign trade zone authority may establish a port authority and may exercise any city powers. This implies that the authority will have property taxing authority, but presumably only within the area of the zone.

Tax incentives are subject to the business subsidy law.

17 **Available tax incentives.** The following tax incentives are available in international economic development zones:

- Business owners are exempt from the individual income tax on income from business operations and investments in an international economic development zone

- The corporate franchise tax does not apply to corporate income generated by zone operations

- State and local sales taxes do not apply to purchases used by businesses in an

Section

international economic development zone

- Property taxes do not apply to improvements in the zone
- A refundable jobs credit is available for higher paying jobs

18 **Individual income tax exemption.** Provides income tax exemptions for individuals, trusts, and estates operating businesses in zones or investing in zones. These exemptions only apply if the income would otherwise be taxable.

Rents. Rents received for both real and tangible personal property located in the zone are exempt. Rents from personal property that is used both within and outside of the zone must be apportioned based on the number of days the property was used in the zone.

Business income. Income from operating a business in an international economic development zone is exempt. If the business operates both within and outside of the zone, the income must be apportioned using the share of property and payroll located in the zone to the total property and payroll of the taxpayer. The exemption is limited so that the exempt income (determined by using the apportionment mechanism) cannot exceed 20 percent of the sum of the zone payroll and original adjusted basis of the investment in the zone.

Capital gains. Capital gains on real and tangible personal property located in an international economic development zone or sale of a business operated in the zone are exempt from taxation. Different rules apply to determine the amount of the exemption:

- **Real property.** Capital gains on real property located in an international economic development zone are exempt from taxation based on the share of the holding period that took place while the area was designated an international economic development zone. To illustrate, assume A purchased a piece of real property for $1,000 and held the property for10 years. A, then, sold the property for $5,000. For 6 years of the 10-year holding period, the property was located in an international economic development zone. Of A's $4,000 capital gain ($5,000 sale price - $1,000 purchase price = $4,000), 60 percent or $2,400 would be exempt from taxation ($4,000 * 60 percent = $2,400), since 6 years out of the 10-year holding period occurred while the zone was designated an international economic development zone.

- **Tangible personal property.** Capital gains on tangible personal property located in an international economic development zone are exempt from taxation based on the share of the holding period that took place while the zone was designated an international economic development zone and the usage of the property in the zone. This calculation is essentially the same as that for real property. However, if the personal property was used both within and without the zone, the exemption amount must also be multiplied by a fraction. The numerator of the fraction is the number of days the property was used in the zone while it was designated as an international economic development zone and the denominator is the total number of days the

Section

taxpayer held the property.

- **Ownership in qualified business.** Capital gain on an ownership interest (e.g., stock or a partnership interest) in a qualified business is exempt from taxation. This exemption equals the international economic development zone percentage for the business multiplied by the capital gain. The zone percentage is calculated using as its denominator the total property and payroll (not just the Minnesota payroll and property). This exemption does not apply if the zone percentage is less than 25 percent. The business entity is responsible for notifying the owner of its qualification for the capital gain exemption.

19 **Corporate franchise tax exemption.** Provides that a corporation operating in an international economic development zone is exempt from the corporate franchise tax, if it is a qualified business. If the entire business operates in the zone, the corporation is fully exempt from taxation under the corporate franchise tax and would not be required to file a return. If the corporation does business both within and outside of the zone, the following rules apply:

- **Regular tax.** The corporation's taxable net income is multiplied by its zone percentage (average property and payroll in the zone divided by total Minnesota property and payroll) and subtracted from its taxable income.

- **AMT**. The corporation's alternative minimum taxable income is multiplied by the zone percentage and this amount is subtracted from the taxable income.

- **Minimum fee**. Its zone property and payroll are excluded from calculating the minimum fee.

The exemption is limited so that the exempt income (determined by using the apportionment mechanism) cannot exceed 20 percent of the sum of the zone payroll and original adjusted basis of the investment in the zone.

The exemption applies to tax years that begin during the zone's duration.

20 **Jobs Credit.** Provides a job credit to a qualified business operating in a zone equal to 7 percent of:

- The lesser of either:
- The increase in the business payroll (but excluding amounts paid to an employee in excess of $100,000 per year) in the zone since the year of designation or
- The increases in total Minnesota payroll since the year of designation; minus
- The increase in the number of FTEs in the zone since designation multiplied by $30,000

Inflation adjustment. Starting for tax year 2005, the $30,000 amount will adjusted for inflation. Thus, this inflation adjustment would increase the $30,000 threshold before the

Section

zone is designated and any credits are claimed.

Refundable. The credit is refundable.

21 **Repayment of tax benefits.** Requires a business to repay tax benefits, if the business ceases to operate in the zone, to be a qualified business, or to be in compliance with the business subsidy agreement.

The provision requires repayment of the last two years of benefits received before the business ceased its zone operations or failed to meet its agreed goals.

Disposition or repayments. Repayments of state tax reductions are paid to the state and deposited in the general fund. Repayments of property taxes are distributed to local governments in the same manner as delinquent property taxes. Repayments of local sales taxes are made to the unit imposing the tax.

Authority to collect. The commissioner of revenue is given authority to collect repayments in the same manner as unpaid taxes and the same interest and penalty rules apply. For individual income and corporate franchise taxes and state and local sales taxes, the taxpayer files an amended return and must repay within 30 days after the triggering event. For property taxes, the county auditor is to prepare a tax statement using the otherwise applicable tax rates. If the amounts are not paid, they become liens against the property in the same way as any other unpaid property tax.

Waiver authority. The commissioner of revenue, after consulting with the foreign trade zone authority and the local units of government, may waive all or part of a repayment if it is deemed to be in the best interest of the state and the business ceased operations for reasons beyond its control, such as a natural disaster, unforeseen industry trends, or loss of a major supplier or customer.

22 **Reporting requirements.** Requires the successful applicant for a zone designation to annually report to the commissioner of employment and economic development on its progress in meeting zone performance goals under the business plan and its compliance with the business subsidy law.